MONETARY, CREDIT, AND FISCAL POLICIES

HEARINGS

BEFORE THE

SUBCOMMITTEE ON MONETARY, CREDIT, AND FISCAL POLICIES OF THE

JOINT COMMITTEE ON THE ECONOMIC REPORT

CONGRESS OF THE UNITED STATES

EIGHTY-FIRST CONGRESS

FIRST SESSION

PURSUANT TO

SEC. 5 (A) OF PUBLIC LAW 304, 79TH CONGRESS

SEPTEMBER 23, NOVEMBER 16, 17, 18, 22, 23, AND DECEMBER 1, 2, 3, 5, 7, 1949

Printed for the use of the Joint Committee on the Economic Report

UNITED STATES
GOVERNMENT PRINTING OFFICE
99076 WASHINGTON : 1950

JOINT COMMITTEE ON THE ECONOMIC REPORT

(Created pursuant to sec. 5 (a) of Public Law 304, 79th Cong.)

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MONETARY, CREDIT, AND FISCAL POLICIES

FRIDAY, SEPTEMBER 23, 1949

UNITED STATES SENATE,
SUBCOMMITTEE ON MONETARY, CREDIT, AND FISCAL POLICIES
OF THE JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The subcommittee met, pursuant to call, at 10:35 a. m., in the caucus room, Senate Office Building, Senator Paul H. Douglas (chairman of the subcommittee) presiding.

Present: Senators Douglas (presiding), and Flanders; Representatives Patman and Buchanan.

Also present: Senators John J. Sparkman and Arthur V. Watkins and Dr. Grover W. Ensley, associate staff director; Mr. John Lehman, clerk; and Dr. Lester V. Chandler, economist to the subcommittee.

Senator DOUGLAS. Gentlemen, I wonder if we might come to order. Mr. Sonne, Mr. Leland and Mr. Smithies, please come forward.

Among the functions of the Joint Committee on the Economic Report, which was created under the Employment Act of 1946, are those of making a continuing study of matters relating to the Economic Report, and of studying means of coordinating programs in order to further the policy of the act.

In line with these responsibilities of the committee, the Congress, in May of this year, passed Senate Concurrent Resolution 26, authorizing and directing the joint committee to make full and complete studies of four very important subjects: First, the problem of investment; second, the problem of the effectiveness and coordination of monetary, credit, and fiscal policies in dealing with general economic policy; third, the problem of low-income families in relation to economic instability; fourth, the problem of unemployment trends and their significance in current economic analysis.

Senator O'Mahoney, the chairman of the joint committee, has appointed four subcommittees to make these studies.

This subcommittee, dealing with the second subject, namely, monetary, credit and fiscal policies, includes, in addition to its chairman, Senator Flanders and Representatives Wright Patman, Frank Buchanan, and Jesse P. Wolcott.

We have, of course, invited all members of the full Committee on the Economic Report to attend the hearings, and we are very pleased to have Senator Sparkman and Senator Watkins with us this morning

I think it would be difficult to overestimate the importance of these closely related policies. We have very little chance of achieving the purposes of the Employment Act, namely to achieve maximum production, maximum employment, and maximum purchasing power, if we cannot maintain an appropriate and relatively stable flow of money and credit, and if our taxing, spending, and debt-management policies do not make for stability rather than instability.

It is our duty, therefore, to find out what types of monetary, credit, and fiscal policies are capable of contributing most to the purposes of the Employment Act, to appraise their effectiveness for these purposes, to see whether or not they have in the past been appropriately coordinated with each other and with other economic policies, and to discover what changes, if any, would be both feasible and desirable.

One of the major problems that we face is that of the Government's revenue, expenditure, and debt-management policies. Fifty years ago, when the annual Federal budget was only half a billion, and the national debt was less than a billion, the Government's fiscal policy had little effect on the over-all behavior of the economy.

Now, with the Federal budget at about $40,000,000,000, and the national debt at more than $250,000,000,000, our policies relative to taxes, Government spendings, and debt management are a powerful force, capable of promoting either stability or instability.

It is for this reason that we are glad to receive today two reports on fiscal policy which have been drawn up and unanimously approved by a group of 14 of the Nation's leading economists.

I am very happy to find such a degree of unanimity among the economic brethren, because we are all aware of the wisecrack that was once uttered, that if you laid all the economists in the country end to end they would not reach a conclusion.

There is another variant of that wisecrack, that if you were to lay all the economists in the country end to end, it would be a good thing. [Laughter.]

But we are very happy indeed to welcome this group which is presenting these reports.

The conference which produced these two reports was sponsored by the National Planning Association, at the request of Senator Flanders and myself; and I understand that the reports are to be formally transmitted to the subcommittee by Mr. H. Christian Sonne, chairman of the board of trustees of the National Planning Association.

STATEMENT OF DR. SIMEON E. LELAND, PROFESSOR OF ECONOMICS, AND DEAN OF THE COLLEGE OF LIBERAL ARTS, NORTHWESTERN UNIVERSITY; ACCOMPANIED BY H. CHRISTIAN SONNE, CHAIRMAN OF THE BOARD OF TRUSTEES, NATIONAL PLANNING ASSOCIATION, AND DR. ARTHUR SMITHIES, PROFESSOR OF ECONOMICS, HARVARD UNIVERSITY

Mr. SONNE. I am H. Christian Sonne, chairman of the board of trustees of the National Planning Association, 800 Twenty-first Street NW., Washington, D. C.

Senator Douglas, and members of the committee, the National Planning Association has for several years been interested in fiscal and monetary policy, because we realize it is an important part of the problem of stabilizing our economy, and of achieving full employment.

We were, therefore, very glad to comply with the request of Senator Douglas and Senator Flanders to arrange for a meeting of prominent economists, with a view toward seeing whether there was an area of agreement on fiscal policy.

We made a condition that when it came to the invitations to the Conference of Economists, the responsibility should rest with the National Planning Association. We had special reasons for doing so. Just as Senator Douglas explained, citizens are a little skeptical about all these differences of opinion among economists, and sometimes they wonder whether there is really such a thing as economic science.

The answer is, in part, that the economic profession has a difficulty in that it is a social science, and economists have to gage human behavior, which very often can upset the best calculations.

Another difficulty is that the social sciences are faced with problems very similar to those which were faced by the medical profession some generations ago. I refer to "quack" doctors. Many people, today, call themselves economists who are not qualified to so so, but we know that it takes much longer for the economic health of a strong country to show visible signs of mistreatment by inexperienced doctors than it does for the human body to collapse. Consequently, I am afraid that the economic profession will still work for some time under a handicap. This was our reason for carefully picking the participants invited to the conference.

We invited economists from the point of view of their geographic distribution. We selected economists from the point of view of their economic and human philosophy, representing all shades of economic opinion. We invited economists who are recognized for their ability and their standing in the community.

We did not succeed in getting together all the economists whom we invited. But we so nearly succeeded that I think it is fair to say that even if the additional three or four who were invited had been able to attend, the final result would be practically the same as that which we now present to you.

We decided to confine ourselves in this conference to fiscal policy, because we felt that if we were going to take in monetary and credit policy, the problems would become too complicated for one meeting of only 3 days.

Now, since I am about to transmit these statements on fiscal policy to you, I should like, without going into detail, to make it clear that the members of the conference unanimously approve of the so-called anticycle budget. That means that we recognize that there are certain phases in bad times when a deficit in the budget is not only permissible, but helpful.

I think the economists would approve my saying that they do not mean that a deficit is justified at all times and in all countries. For instance, if the permission to have a deficit in any one year should result in reckless spending, or in squandering the Nation's fortune, it might be a lesser evil to demand an annual yearly budget.

You may compare this condition to that of a doctor who knows that he can shorten the pain and the illness of his patient by giving him certain drugs. But, if the patient's character is too weak, the doctor may fear that even if the patient is cured he may go on taking drugs and become a dope fiend. It may be a lesser evil for the doctor to insist on the patient's recovering in a slower and more painful way.

So, an economist may well favor deficits occasionally in a well-managed democracy but not necessarily favor the same policy in a country that is run by an administration, let us say, of the type of a Chiang Kai-Shek.

It follows that there is no inconsistency whatsoever in citizens being in favor of an occasional unbalanced budget today in the United States, even though a decade or two ago they believed in a balanced budget. There is no change of position in agreeing today that occasionally we may have an unbalanced budget. It is a recognition of the fact that the United States has so developed in the last few decades that now occasionally an unbalanced budget is justified.

Just one word, in conclusion, on fiscal policy in general: No measures under this heading can have their full effect on the economy unless they are understood by the citizens as a whole. If leaders of agriculture, business, and labor do not understand the measures of government and do not cooperate with them, they can, through lack of confidence, undo many times what these measures try to accomplish. Hence, it is important that the country, as a whole, understand this. That is why we in the National Planning Association appreciate that the Congress, through the Joint Economic Committee, has taken up the subject of fiscal policy for very serious study.

The committee will, unquestionably, as the hearings go on, apprise the country of the details of fiscal policy.

We in the National Planning Association have for years tried in an educational way to carry such knowledge to the people, and we shall continue to do so. When requested, we are at all times ready to cooperate to the fullest extent with the Congress.

Dr. Simeon E. Leland was chairman of the Princeton conference when the two statements were drafted and unanimously adopted. Both are signed by university economists and myself. It is my pleasure to transmit these reports to the subcommittee, and to ask Dr. Leland to present them to you.

Senator DOUGLAS. Thank you very much, Mr. Sonne.

You speak of the conference being held under the auspices of the National Planning Association. I wonder if you would state briefly for the record what the National Planning Association is, who its principal officers are, and so forth.

Mr. SONNE. The National Planning Association is a nonprofit, nonpolitical organization, which was formed some 15 years ago—in 1934—for the purpose of planning for democracy.

Those were the days when planning was not quite understood. Some thought it directed toward "totalitarian, planned economies." We have tried to emphasize that American citizens must plan to avoid a planned economy.

We came to the conclusion that we should always try to find the main area of agreement, and that no measures could, in the long run, be recommended unless they were approved by agriculture, business, labor, and the professions. We therefore have operated through standing committees—agriculture, business, labor, and international policy committees—on which outstanding leaders serve. Whenever the National Planning Association comes out with a joint statement, there is a guaranty to the Nation that the recommendations do not favor one selfish interest or special group, because it is underwritten and approved by agriculture, business, and labor.

Senator DOUGLAS. I wonder if you would give the names of some of the principal officers and members of the board of trustees of your association.

Mr. SONNE. I should have given that. From labor we have people like Marion H. Hedges and Clinton S. Golden; from agriculture we have Donald R. Murphy, Prof. Theodore W. Schultz, and Allan B. Kline.

Senator DOUGLAS. Mr. Kline is president of the American Farm Bureau Federation?

Mr. SONNE. That is right.

Senator DOUGLAS. You may continue, Mr. Sonne.

Mr. SONNE. We have among businessmen people like William L. Batt of SKF, Beardsley Ruml, and Fowler McCormick.

Senator DOUGLAS. Mr. McCormick—the president of the International Harvester?

Mr. SONNE. That is right. Then you have a few who represent agriculture, business, and labor. I can go over the list. There is Laird Bell of Chicago——

Senator DOUGLAS. Member of one of the leading Chicago law firms, chairman of the board of directors of the Weyerhauser Co.

Mr. SONNE. And there is Harry Bullis, chairman of the board, of General Mills.

Then, we have Robert Heller, whose report on Strengthening the Congress, you may remember, had effect on the reorganization of Congress.

Then there is Luther Gulick, who is an authority on Government organization.

Then, we have Philip Murray, of the CIO.

Among our agricultural people is James G. Patton.

Senator DOUGLAS. President of the National Farmers' Union.

Mr. SONNE. Then we have Clarence Pickett of the American Friends Service Committee and Wayne Taylor, who now happens to be with Paul Hoffman in ECA.

I think I have given you a list representing all shades of opinion.

Senator DOUGLAS. Thank you very much.

Dr. Leland, we are very happy to welcome you. You are going to present both of these reports?

Dr. LELAND. Yes.

Senator DOUGLAS. I would suggest that Dr. Leland be permitted to complete both reports before we start questioning him, so that we may get the recommendations as a whole into the record before we start on piecemeal questioning.

Dr. LELAND. On behalf of the group of economists who prepared these reports, I should like to say that we were greatly appreciative of the invitation that came to us from Senator Douglas and Senator Flanders. We were glad to attempt to work up statements on economic policy that would make some contribution to economic stability and that would be of service to the committee and to the Congress generally. The reports deal only with fiscal policy; they do not cover everything that Congress might do to contribute to economic stability.

The reports are as follows:

FEDERAL EXPENDITURE AND REVENUE POLICY FOR ECONOMIC STABILITY

INTRODUCTION

Although our economic system accords a dominant role to private enterprise, Government expenditures and receipts have now reached a scale that make them crucially important factors in our national welfare. In 1949, with a gross national production of $250,000,000,000, the Federal Government is spending more than

$40,000,000,000, while Federal, State, and local governments together are spending around $60,000,000,000.

Government programs of this size make it more than ever desirable that every dollar of Government expenditures be used as efficiently as possible. We are not rich enough to afford waste of resources by government any more than by anyone else.

It is equally important that the expenditure and revenue programs of government, in their formulation and execution, be consistent with the progress and stability of the private economy. The fiscal policy of the Government must make useful positive contributions to the maintenance of high levels of employment and income—the goals declared in the Employment Act of 1946 to be a national objective.

Government affects business through both sides of its budget. Payments to Government employees, bondholders, veterans, the aged, and the needy all constitute income that can be used to buy consumption goods from business; Government procurement affords a direct market for business. On the other side of the budget, taxes capture funds that consumers might have spent or that business firms might have invested in improved facilities. Taken by themselves, tax collections tend to shrink the market of private business, contract employment, and lower prices; just as, taken by themselves, Government expenditures tend to expand the market for business, increase employment, or raise prices.

It is not only the size of revenue and expenditure that counts; their composition must also be considered in any appraisal of the effects of Government policy. The economic effects of a billion dollars collected in the form of income taxes will be different from those of a billion dollars collected in excise taxes. Spending to build roads may stimulate private investment in automobiles, trucks, and garages; there are other forms of expenditure that may have adverse effects on private investment. Rationally or irrationally, Government spending and taxing may greatly affect the climate within which families and businesses make their decisions.

THE PRINCIPLE OF AN ANNUALLY BALANCED BUDGET

The traditional goal of fiscal policy was to secure a balanced budget in every single year. But that objective has now proved impracticable and, besides, has serious disadvantages in principle. There is not even a clear or unique concept of "budget" to which the requirement of balance could be applied. For instance, in the regular budget, bookkeeping transfers to the social security trust account are classified as expenditures. As a result of this, that budget may show a deficit at a time when the cash budget shows an excess of receipts over outgo. But even the cash budget may not be adequate to portray the effects of fiscal policy; taxes may have their impact when tax liabilities are incurred rather than when payment is made; purchases may have their impact when contracts are entered into rather than when disbursements are made. However, where a single budget concept is used in economic analysis bearing on stabilization policy we prefer the cash budget to any available alternative.

Compared to the full span of the business cycle, a year is a short period of time. To insist upon a balance in every single year is certainly undesirable and to attain it is probably impossible. To attempt to raise tax rates every time there is a decrease in national income will only result in discouraging private consumption and investment at a time when these are most in need of expansion; on the other hand, to try to eliminate a tax surplus by cutting tax rates or expanding Government activities would serve to increase inflationary pressures at a time when they are already acute.

If the budget were balanced in good years as well as bad, there would have to be either big fluctuations in expenditure programs or severe and perverse changes in tax rates. To vary expenditures in this manner would disrupt the essential services provided by government. Applied to military expenditures, it would mean a large defense program in boom years and a small defense program in depression years. This is both ineffective and wasteful. Government would be increasing its employment of resources when they were scarce and cutting down on their use when they were abundant. This, of course, would aggravate the fluctuations in private business.

THE PROBLEM OF CONTROLLING GOVERNMENT EXPENDITURES

Annual budget balancing is, thus, both difficult in practice and unsound in principle. But one great merit it does have: It provides a yardstick by which legislators and the people can scrutinize each activity of government, testing it both for efficiency of operation and for its worthwhileness in terms of cost. Every Government program undertaken has to be paid for in a clear and unequivocal sense. The legislature and the Executive are required to justify additional taxes equal to the cost of any new program. This is a principle every citizen can understand. If dropping the principle of annual budget-balancing were to mean dropping all restraints to unwise and inefficient expenditure, grave damage would be done to our economic and political system.

Were expenditures divorced entirely from the need for taxation, political opposition to extension of the Government's expenditure programs would largely disappear. The scale on which the public sector absorbs resources would grow beyond what was really desired by the people as a whole; sooner or later the country would find itself in a state of chronic inflation. Such inflation is a sign of weak government and comes from eagerness to spend without a willingness to tax. Accordingly, other general principles, other habits of thought and of action must be set forward to insure the standards of judgment and the self-discipline of Government's activities and to do better what the principle of annual budget policy attempted—though imperfectly—to accomplish.

Experience shows that business activity has its ups and downs. There is thus a strong case for countercyclical fiscal action—surpluses in good times and deficits in bad. If we do not adopt such a policy deliberately we are likely to be forced into an imperfect version of it through the pressure of events. One of the major questions for the future is how such a policy can be administered with the restraint and efficiency that is supposed to be achieved through the balanced budget rule. If a flexible policy is to win acceptance, it must not be used as an excuse to introduce expenditure or tax programs that cannot be justified on their merits. Boondoggling should have no place in a rational fiscal program.

We doubt whether it would be possible, or even desirable, to rely exclusively on fiscal action to offset fluctuations in private business. That course could easily involve changes of impractical magnitudes in taxes and expenditures; it would mean placing excessive reliance on one measure for achieving economic stability and growth; it would involve problems in forecasting beyond the reach of present knowledge and techniques.

We can, however, reasonably expect that the budget be formulated in the light of economic judgment available that takes full acount of the actual course of events and should contribute to economic stability rather than aggravate instability. In view of uncertainties, part of the planning process should be preparation for quick adaptation of fiscal operation to changing circumstances. Certain automatic devices for bringing remedial forces quickly into play are in a stage where they deserve consideration.

GUIDES TO FISCAL POLICY IN NORMAL TIMES

When the economy is prosperous and stable and there is no clear-cut reason to expect a change in any particular direction, the objective of policy should be to adapt the budget to changes in the Government's requirements but to leave its economic impact on total employment and purchasing power unchanged. This could be approximately achieved if newly planned increases or decreases in expenditures were to be matched with corresponding changes in planned tax receipts. The net expansionary or contractionary effect of the budget would then remain roughly the same. Thus, in conditions of continued prosperity, a modified version of the balanced-budget rule could be used as a guide: Taxes should grow or shrink corresponding to desired changes in expenditures. Thus, proposed increases in expenditures would be exposed to the traditional test of whether they are worth their cost in terms of taxes.

However, if recent events and the outlook for the near future pointed, on balance, toward unemployment and deflation in the private sector of the economy, then budgetary changes should be made in the direction of producing a moderately expansionary effect. New Government expenditure programs should still be considered on their merits, but the additional taxation that in prosperous times would accompany them should now be deferred. Taxes that are deferred in these circumstances should be put into effect as soon as that can be done without impeding recovery. There should be no delay in making the tax reductions warranted by any reductions in Government expenditures; and if expenditure requirements are expected to decline in the future, anticipatory tax reductions could be enacted.

On the other hand, if the weight of the evidence appeared to be on the inflationary side, the opposite policy should be followed. The rule that increased expenditures should be accompanied by increased tax yields should be rigidly followed. Tax reductions that would normally be in order should be deferred; and tax increases should anticipate expected increases in expenditures.

GUIDING PRINCIPLES IN TIME OF ACUTE RECESSION OR BOOM

Where there is a definite expectation, justified by events, of serious recession or inflation, more strenuous fiscal measures would be called for, and the policies described above should be supplemented by emergency fiscal action.

In the event of severe recession, it is not only politically necessary, but economically desirable to provide additional employment projects that can be started and ended quickly. Temporary tax relief should be given in order to stimulate private spending and employment. Other incentives for private investment, such as guaranties, should be considered. There can be no social or economic justification for allowing mass unemployment to persist for extended periods at a time when there is abundant need for roads, schools, hospitals, and other useful objects of public expenditures. However, we recognize that there are difficult questions of extent and timing connected with any such program. An overambitious Government program may impede the course of recovery in the private sectors of the economy by dislocating resources and delaying needed price adjustments. On the other hand, a program that was overcautious could needlessly fail to advance recovery by not stimulating the demand for the products of private industry. Much skill and judgment are required to move from depression to stable prosperity. We must not rely on the private economy, unaided by Government action, to perform that task. The Government must not shirk the responsibility placed on it by the Employment Act, and fiscal policy is one of the most promising instruments it possesses.

On any occasion when serious inflation is in prospect, emergency measures would be needed to curtail expenditures and increase taxation. Wartime and postwar experience provides convincing evidence that the political obstacles to a fiscal policy adequate to combat inflation are so great that there is little practical danger of going too far. The survival of a relatively free and stable price system depends heavily on our willingness to fight inflation by fiscal methods.

A policy that helps to maintain stable prosperity will be no more likely in practice to result in an upward trend in the national debt than one that does not. The course of events may in fact be such that stabilization requires steady reduction in the debt. Budgeting surpluses to fight inflation will provide for the reduction of the public debt in a helpful rather than a painful fashion. Surpluses are not feasible in times of depression. They are desirable where the private economy is strong enough for the Government to tax more than it spends without causing unemployment. The private economy is not likely to possess this strength if Government policies aggravate rather than offset business fluctuations.

ADDITIONAL POSSIBILITIES FOR A FLEXIBLE FISCAL POLICY

While we consider these guides for budget policy essential to a stabilization program, the annual budget cannot, in the nature of things, be based on precise forecasts; nor can it be expected to compensate for sudden and short-run fluctuations in business that occur within the period of its operation. Even though the budget can and should be amended in the light of changing circumstances, the legislative process is necessarily too cumbersome to make delicately timed adjustments in fiscal policy. Therefore, we consider whether further flexibility can be achieved by two devices which may be called "automatic flexibility" and "formula flexibility."

"Automatic flexibility" means a tax system such that revenue under a given set of tax rates will fall sharply if unemployment develops, and rise sharply in the opposite case of inflation; and expenditure programs under which increased outlays arise from increased unemployment.

"Formula flexibility" means a system under which preannounced tax cuts and upward revisions of spending programs will come into force if unemployment exceeds a certain figure or production falls below a certain level, and preannounced changes in the opposite direction if price indexes rise at more than a certain speed.

AUTOMATIC FLEXIBILITY

Automatic flexibility is exemplified by the unemployment compensation system. If unemployment increases, employers' contributions at once decline, while the unemployed begin almost immediately to draw more in benefits. Thus the Government finds itself automatically taking less money out of the public's pockets and putting more in.

There are now many such flexible elements in Federal taxes and revenues, and they have greatly increased in importance with the growth of the budget. Besides the unemployment compensation system, there is, for example, substantial automatic flexibility in personal- and corporate-income taxes.

Automatic flexibility can slow down and perhaps halt a decline of activity or a rise of prices; it can give time for restorative forces to come into play, but it will not, by itself, pull activity back to a full-employment level or restore prices to a pre-inflation level.

We feel strongly that the existing automatic flexibility makes an important contribution to economic stability, which should not be frittered away, as it would be, for instance, by rigid application of the annual-balanced-budget rule. But we do not believe it prudent for policy to regard automatic flexibility as more than a first line of defense; more must be done to cope with serious economic fluctuations.

FORMULA FLEXIBILITY

The enactment by Congress of rules under which tax rates, and perhaps of rules under which expenditure programs, will shift in certain contingencies specified in advance is a possibility that deserves further exploration. For example, the period during which unemployed workers can draw unemployment compensation might be extended according to a flexible schedule based on the volume of unemployment. The withholding rate under the personal-income tax for any calendar quarter might rise by a stated amount above a standard rate whenever, say, the index of retail prices has increased by over a certain amount in the preceding 6 months. The withholding rate might be lowered whenever standard indexes of production and employment drop below stated levels or trends.

The question of formula flexibility shades off into the question of granting to the Executive wider discretionary authority than it now possesses to initiate changes in the timing or extent of the fiscal program. This raises difficult issues of political principle and administration responsibility. We can here do no more than call attention to them.

CONCLUSION

In this statement we have confined ourselves to fiscal policy of the Federal Government. But, while essential, that is only one element in a stabilization policy. The policies of State and local governments can make useful contributions within their more limited spheres. Monetary and credit policies including debt management must play an active role in their own right and must be properly coordinated with fiscal policy. All necessary measures must be taken to preserve and stimulate competition. Supported by such measures, Federal fiscal policy offers the best prospect of achieving sustained prosperity within the framework of our existing economic system.

Senator DOUGLAS. Mr. Leland, perhaps I should ask one question before you go on.

Is this statement approved by a group of economists who represent a rather wide range of opinion?

Dr. LELAND. That is correct. As a matter of fact, when the conference first started, I had no hope that the assembled group would be more likely to reach a unanimous conclusion than all the economists you mentioned in your opening wisecrack about economists. The shades of opinion were really quite variant.

This second statement is an attempt to apply the principles which we first formulated to the economic situation now prevailing or which is on the horizon.

This statement, too, was unanimously agreed upon by the entire group:

FISCAL POLICY IN THE NEAR FUTURE

At present, September 1949, the economy exhibits no clearly discernible swing—either toward a resumption of inflation or toward increasing unemployment—which would call for a major change in tax rates or expenditures. If any substantial change were made, it might accentuate an inflationary or deflationary movement in 1950 instead of countering it.

Past decisions on taxes and commitments on expenditures have resulted in a current deficit in the cash budget. We regard those decisions as unfortunate, in particular the decision in 1948 to reduce taxes; it would have been the course of sound policy to have revenues exceeding or, at the least, equaling expenditures at the present level of business activity. The latter, if lower than levels of a year ago, is still high and a modest cash surplus at the present time would probably be consistent with stability. But it is one thing to deplore past mistakes and another to correct them on short notice. It would be unwise to increase taxes at this time. Such action might in itself be unduly deflationary. There is a possibility that the step might soon have to be reversed to counter a business downturn. While we do not doubt that there are expenditures that can and should be reduced—and we do not regard those of any agency or department as sacred—this reduction must be part of a constant and continuing effort. Economy efforts cannot be turned on and off at will.

Although no major change in fiscal program is indicated for the immediate future, the country should have positive assurance that the Government will be prepared to act promptly either if prices should display a sharp and continuous upward swing, or if unemployment should increase substantially. Congress should plan ahead and announce the actions to be taken in either contingency. It should enact preliminary legislation to be effective when needed.

Congress should act in case of a decline in activity involving a genuine increase in unemployment of more than 1,500,000 persons above present levels. This would mean total unemployment of about 5,000,000 according to present methods of computation. The extent, combination, and sequence of its actions should depend upon the severity of the recession.

The appropriate steps include, first, the repeal of the special wartime excise taxes. These taxes were enacted for various special reasons during the war and are not appropriate to peacetime. A second step is the temporary abatement of the lower-bracket rates or a temporary increase in the exemptions of the personal income tax. This should be done according to prearranged legislation to become effective when economic activity declines to a specific level. The revenues from other taxes would be allowed to decline, without a change in rates, as business activity fell off. If these actions were insufficient, additional measures should be taken.

The period of unemployment benefits might be temporarily lengthened, with appropriate provisions for Federal reinsurance of the emergency risks. The plan to do this should be arranged and announced in advance so that workers could count on this protection. By this measure, the system of unemployment compensation would be made adaptable to its differing role in times of prosperity and in times of depression.

Public works might be expanded. The Congress should already have arranged for a stand-by shelf of planned and ready-to-start projects, including Federal assistance for State and municipal projects. We approve the principle, expressed in pending legislation, of a shelf of public works. We recommend the prompt enactment of legislation to this end. On the shelf would be only projects that are economically desirable, and that can be started promptly when the need for additional governmental spending arises, and completed or stopped promptly when this is no longer needed. Examples of projects of this nature are: Road construction, residential housing, and construction and rehabilitation of public buildings.

Should there be a resumption of inflation, marked by a persistent upward surge of prices in general, Congress should be prepared to take effective counteraction. In this case increase of lower-bracket rates or lowering of exemptions in the personal income tax would be in order. Repeal of the wartime excise taxes might appropriately be postponed. If these taxes were already repealed, or their repeal were deemed necessary for reasons of equity, they should be replaced by equivalent sources of revenue. Finally, such inflation would be an occasion for strong measures to reduce public expenditures. To cite specific examples, the starts of civil public works of all categories should be held to the practical minimum. The test should be whether there is serious economic loss from delay. Military construction should also be closely measured against the urgent present needs of the armed forces. Large farm benefits, either through support prices or in the guise of soil conservation payments, should not be tolerated at a time when, in any case, farm income is likely to be high.

TAX REFORM

A time like the present when no emergency exists should not be allowed to go by without consideration of fundamental tax reform. This has two sorts of relation to stabilization policy: (1) Adjustment of the tax structure so as to make private business more nearly self-stabilizing—for instance, by providing more complete averaging of losses and gains. (2) Planning tax measures whose impact will be stimulating or depressing so that they can go into effect at times when short-term policy calls for additional stimulants or depressants. For example, if we are to move toward integration of corporate and individual income taxes in a way which would reduce revenue, the effective date would appropriately come in depression.

It is now, and doubtless always will be, impossible to forecast more than a year in advance the revenue-expenditure policies best suited to varying economic conditions. It is our final recommendation that Congress be prepared both now and in the future to make prompt alterations in the policies adopted for any fiscal year. It must be recognized that this will involve important changes in the organization and procedures of Congress for fiscal management.[1]

Senator DOUGLAS. Thank you very much, Dr. Leland.

Dr. LELAND. Thank you, Senator Douglas.

Senator DOUGLAS. I wonder if for the sake of completeness, you would put into the record the names of the economists who have signed these reports.

Dr. LELAND. I will be glad to do that.

Dr. Howard R. Bowen, dean of the college of commerce, University of Illinois.

Dr. Howard S. Ellis, professor of economics of the University of California, and now president of the American Economic Association.

Dr. J. Kenneth Galbraith, department of economics, Harvard University.

Dr. James K. Hall, professor of economics, University of Washington, Seattle.

Dr. Albert G. Hart, professor of economics, faculty of political science of Columbia University.

Dr. Clarence Heer, professor of economics, University of North Carolina.

Dr. E. A. Kincaid, professor of finance, University of Virginia.

Dr. Simeon E. Leland, professor of economics and dean of the college of liberal arts, Northwestern University.

Dr. Paul A. Samuelson, professor of economics, Massachusetts Institute of Technology.

Dr. Lawrence H. Seltzer, professor of economics and sociology, Wayne University, Detroit.

Dr. Arthur Smithies, professor of economics, Harvard University.

Dr. Tipton R. Snavely, professor of economics, University of Virginia.

Mr. H. Christian Sonne, chairman of the board of trustees, National Planning Association.

Dr. Jacob Viner, professor of economics, Princeton University, and the past president of the American Economic Association.

Dr. Donald H. Wallace, professor of economics, school of public and international affairs, Princeton University.

I might say that the document was sent to both Professor Ellis and Prof. Sumner Slichter, Thomas Lamont professor of Harvard University—the president and a past president of the American

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[1] Since the original release of these two reports they have been submitted to the National Planning Association labor and agriculture committees, which unanimously approved them "in principle, but not necessarily in detail."

Economic Association. The document on policy was signed by both Ellis and Slichter. Slichter did not sign the document on advice with respect to the near future, but Ellis did.

Senator DOUGLAS. Mr. Leland, do you mind if I address a few questions to you and I understand Dr. Smithies is here with you, so that you can parcel out the questions between you as you wish. I wonder if you would state for the sake of the record why you approve of the deficit financing in periods of depression.

Dr. LELAND. We have tried to make those statements in the document, and I think that any statement that we might make in words or phrases that are not those of the document had better be taken as our own personal opinions——

Senator DOUGLAS. I understand that.

Dr. LELAND (continuing). And not standing for the opinions of our colleagues, who are not here to speak for themselves. So much of the statement is a matter of personal wording that I would hate to speak for any of them.

My own position is that whether we will it or not, every dollar of money taken in taxes, or every dollar of money spent, or dollar borrowed, has some effect upon the economy, so that irrespective of whether we intend to have a surplus or intend to have a deficit in any particular period, the action of the Government will have an important effect in determining, or helping determine, the volume of income flow and the volume of production; that unless the policies are conceived in advance, and are determined so as to direct those flows in proper directions, results which are neither desired nor anticipated may occur.

If, then, you are interested in a government that has volumes of expenditures of the size that we now have, where they represent something like 20 to 25 percent of the total spending or the total of the purchasing power flows in the economy, it is desirable that the effects of those operations be the kind that are needed to help maximize human well-being and economic welfare, so that when private business is unable to provide all the employment, or produce on its own all the goods that are desired, and there remains substantial numbers of unemployed, it is desirable to have the Government, through its taxing and spending policies, influence the total volume of production and employment.

You cannot let the task fall completely to the private sector of the economy at a time when unemployment is growing, and the result is that a deficit which will finance that employment is desirable in the interest of maximizing economic welfare.

Mr. Smithies can undoubtedly give you a shorter statement as to why we would prefer that very policy.

Dr. SMITHIES. I can give a shorter statement, but I do not think it will be a better one, Mr. Chairman.

I would like to say two things: First, it seems to me that experience in the past has demonstrated that it is impractical to avoid a deficit in times of depression. Both the Hoover administration in the 1930's, and the Roosevelt administration in its early months, made strenuous efforts to balance the budget, and found that it was quite impractical.

The second point is that it is desirable not to have a balanced budget in times of depression because it is important that the Government generate more purchasing power by spending money than it contracts purchasing power by taking money away in the form of taxes. At a time when economic resources are unused, we do not see any justification for leaving them unused for extended periods of time when the Government could put them to work.

Dr. LELAND. Mr. Sonne might have a statement of his own on that.

Senator DOUGLAS. Mr. Sonne, would you like to comment?

Mr. SONNE. I would say that there is, first, the question of why this problem arises. Why can we not have a stable economy all the time?

It is interesting to contemplate that if you had a country with ideal laws, antitrust laws, stable prices, and so forth, for a certain period, it could not remain like that because of increased productivity.

Man, by using his ingenuity, learns to do things better and better in a shorter time as each year goes by. So there would invariably come a period when prices would begin to fall, and then human nature would dictate that citizens abstain from buying because they think prices would fall further. Then you would find that they would save, would not spend; the result is unemployment. There would be a further drop in prices until the developments rectified themselves.

Now, what should we do in such circumstances? It seems to me clear that when a large group of citizens withhold their savings for a period of years, and then suddenly, when they think it is all over and begin to buy, let us say, motorcars, that you cannot expect the motorcar factory to keep pace with this sudden demand. After 5 years of no business the manufacturer would not be able to produce suddenly all the cars the public wants.

Consequently, it seems that the Government ought, during such a period, to see to it that enough purchasing power is distributed amongst those who will consume to keep the economy going—in this case a motorcar factory. There is nothing unsound in it as long as the Government pumps into the economy no more than what private individuals have saved. The Government would be able to get back its expenditures when people again were willing to spend their past savings.

I can put it in another way, as a farmer—which I happen to be originally. A farmer will hire 100 men to work pretty hard when he sows and when he harvests. Then in the old days when the winter came there was a period where there was little to do. He would not throw the workers out. He would say, "Boys, I will feed you and will use the winter months to paint the barn and get our machinery in shape, but instead of working 50 or 60 hours a week, like we did in the summer, we can all work less."

Now, he can afford to spend the money to keep the barn in shape and keep those boys employed even if, perhaps, they are not fully employed, because he knows that very soon there will be another spring and another crop.

Now, this can be compared to the cycles in depressions and booms. If we have a depression, it is equivalent to the winter. We should fix the barn, and that means we should build roads and Government buildings.

The farmer can do this normally because he knows exactly when the crop is coming, but the unfortunate thing with private industry is that when it comes to booms and depressions, businessmen do not know with the same certainty when the depression will be over. Hence, the Government, in some form, must take a hand in it.

Senator DOUGLAS. I noticed that in dealing with depressions, you favor a double-barreled program. On the one hand, you favor decreasing tax rates or eliminating certain taxes, and also, on the other hand, expanding governmental expenditures.

Did you reach any rough agreement as to the relative emphasis to be given to each of these?

Dr. LELAND. I do not think we had any agreement, or even attempted to get an agreement, as to the magnitudes of one or the other.

Senator DOUGLAS. There are certain groups who feel that the sole method of dealing with a depression is an expansion in governmental expenditures, while on the other hand, there are others who say that the sole way of dealing with a depression is by a curtailment of taxes. You apparently advocate both, and I wonder if you could give advice to hard-pressed legislators as to the relative importance to be given to each of these.

Dr. Smithies, do you have anything to say on this topic?

Dr. SMITHIES. I do not think any formula would meet the needs of the case, Mr. Chairman. I think decisions must rest on a broad economic judgment of what is required.

Reductions of taxes will leave more money in the hands of the taxpayers, and will stimulate spending by them on the goods produced for private consumption or investment; whereas Government expenditures, for instance, on public works and projects, will benefit the community through the results of the projects. I think the correct policy depends very heavily on the economic judgment as to what the community really needs.

If it needs more dams and roads, then it may be appropriate to stress expenditures.

If it is the judgment, say, of your committee that we are relatively well supplied with public works, it would be more appropriate, I think, to lay stress on tax reduction, and allowing private consumers to get the benefits of the recovery policy.

Senator DOUGLAS. It is sometimes said, however, that while a reduction of tax rates, particularly in the upper income brackets, would release purchasing power to potential consumers, this purchasing power would not be fully utilized because of the fact of hoarding, and that therefore reductions, let us say, of 5 billions in taxes would not reflect themselves in 5 billions of expansion in private purchasing power; whereas, in public expenditures, each dollar that is spent, in the main, going to lower-income groups, would result in a higher rate of expenditure by those receiving the amounts.

Dr. SMITHIES. I think this is a difficult question which must be the subject of further statistical research. I know it used to be the commonly held belief that reductions in high-bracket income taxes would not stimulate more spending; I think more recent research into consumer expenditures has thrown some doubt on that conclusion and has more or less tended toward a conclusion that reductions of all taxes might help. This, I might emphasize, certainly was not discussed in our committee, and it is a highly controversial matter.

Senator DOUGLAS. All the budgetary studies that I have seen seem to indicate that as income increases the increase in the rate of savings is greater than the rate of increase in income; so that the income elasticity of savings is greater than unity. If the savings are not translated into investments, as is frequently the case during a depression, then would not that mean that the reductions in taxes would not be as effective as an increase in expenditures?

Dr. SMITHIES. I think you would have to draw a distinction between what people do on the average out of their incomes and what they do when their incomes increase or decrease. Undoubtedly high-income people save more than low-income people. That is an unquestioned fact, but from that it does not necessarily follow that a high-income person would spend less of an addition to his income than a low-income person. A high-income receiver might save, on the average, 50 percent of his income because of, say, life insurance commitments and other savings commitments, but if he got an additional thousand dollars, he might spend almost 100 percent of that addition.

A low-income person might be spending a hundred percent of what he already had and might spend a hundred percent of any addition to his income. But, as I say, I do not want to commit myself on that point; I want to keep an open mind on it.

Senator DOUGLAS. The advocates of deficit spending are sometimes accused of proposing policies that lead to a secular rise of Government taxes and spendings. It is said that they favor an increase of spendings during depression, but when prosperity and boom come around they favor a rise of taxes and no decrease of expenditures. The result is therefore said to be a continuous expansion in Federal expenditures, with the compensatory device of added expenditures being used in periods of depression, but with no tapering off of expenditures in periods of prosperity, and instead merely added taxes at that period. Then, when the next depression comes, that is sometimes used as a jumping-off place for added expenditures, so that in the long run you get a tremendously accelerated secular trend in expenditures which eats into the private economy.

I wondered if any of you wanted to make statements on that question.

Dr. LELAND. I certainly do. I want to call your attention to the fact that the entire group of economists was agreed that a cyclical fiscal policy requires attention to both sides of the Federal taxing and spending program in each phase of the cycle. But when it came to a depression, we not only advocated increases of expenditure where necessary to increase employment and production, but likewise decreases in tax rates.

And conversely, in periods of prosperity, we advocated not merely increased taxation, but decreased expenditures, with some hard words in here, as hard as we could get in, to the effect that we did not think that the ideals in this respect had yet been achieved.

Senator DOUGLAS. Well, I am delighted to have that statement, because I think that point has not been sufficiently stressed by the advocates of a compensatory fiscal policy in the past.

Dr. LELAND. And I think one other thing ought to be added to that: If you are going to have a compensatory fiscal policy, all of the other policies of the Government should, if they are to have the greatest impact upon the economy, be consistent with it, and that means that you have a countercyclical policy not merely with respect to taxes and expenditures but also with respect to money and credit policies, with respect to administration, with respect also, let us say, to regulation of certain other activities.

Senator FLANDERS. Mr. Chairman, may I ask a question just at this point?

Senator DOUGLAS. Yes.

Senator FLANDERS. Would you say that it would be good policy for the Treasury to start or continue a heavy E bond campaign during a period of depression?

Dr. LELAND. I do not think the E bond campaign in a period of depression makes any sense whatever. I would say likewise I am not too much sold on it in a period of prosperity.

I would much prefer compulsory saving at that time to a voluntary effort—I would prefer compulsory saving to voluntary saving. But whatever the policy is, it ought to be consistent. To try to increase savings in a depression when the desideratum is increased spending, is wholly inconsistent, Senator.

Mr. SONNE. May I add, Senator Flanders, that this is more in the area of monetary policy.

Senator FLANDERS. That was not within the framework of reference which would——

Mr. SONNE. I believe all economists would entirely agree with Mr. Leland.

Senator FLANDERS (continuing). Be under which you worked. I realize that.

Mr. SONNE. I would just like to say that although economists did not put down any particular rule about the order in which events or these measures should be taken, there was one very definite thing on which they all agreed—automatic flexibility. If you do not increase the tax rates as things get worse, you get automatically a deficit. As they say in the report, they regard that as "more than a first line of defense," meaning that knowing that this automatic thing was working, there should be a breathing spell within which Congress could decide which of all these other steps ought to be taken, with due regard, as Dr. Smithies said, to what the country needs. There was unanimous agreement on that.

Senator DOUGLAS. Now, we have briefly gone over the recommendations for cases of depression and for cases of boom.

What would you advocate in the intermediate periods which can, I suppose, be designated as recessions or mild prosperity?

Dr. LELAND. Well, at that point, the group tried to formulate a statement that no major changes should take place They did say two things: On the taxation side, that such a period was an ideal time in which things that ought to be done that did not have material fiscal impact ought to be undertaken. It is an appropriate period for improving the tax system for its own sake.

Similarly, it is also a period when efficiency and improvements in efficiency might well be emphasized, although the committee was agreed that any time, irrespective of the cycle, was an appropriate time for such activities. But when there was no perceptible trend, then the action should be such as would not make any material impact upon the economy, either in the direction of producing conditions which might tend to have an expansionary effect or, conversely, those which would tend to have a deflationary effect

Senator DOUGLAS. It is very difficult to pick out the dividing lines, but we have to make decisions here in the midst of circumstances, and I think what puzzles a great many of us is this: When does a recession become a depression? When does mild prosperity become a boom? It is all well and good to lay down these general rules, but are there any specific guides that you can set up as to that?

Dr. SMITHIES. Could I touch on that, Mr. Chairman?

Senator DOUGLAS. Yes.

Dr. SMITHIES. That, of course, is the essential and difficult problem from the point of view of the Congress and we struggled with that in our statement, and we have three possible cases.

The first one is:

When the economy is prosperous and stable and there is no clear-cut reason to expect a change in any particular direction, the objective of policy should be to adapt the budget to changes in the Government's requirements but to leave its economic impact on total employment and purchasing power unchanged. This could be approximately achieved—

and we underline the word "approximately"—

if newly planned increases or decreases in expenditures were to be matched with corresponding changes in planned tax receipts.

Our group did not go into the question of procedures in the Congress, but if I might give a personal view on that, it seems to me that the practical way in which such a rule could be implemented would be essentially through the operation of your committee.

I imagine your committee, in its hearings, would make a judgment on the economic situation. If it found that there was no clear-cut reason to expect a change we would recommend that you suggest to the financial committees of the Congress that if they increase expenditures they should enact corresponding increases in taxation.

Senator DOUGLAS. Well, we held such hearings in February, and certain very reputable economists appeared before us and testified that the danger was acute inflation, and that we should take steps to reduce inflation by a high-tax policy, and various other methods.

Now, within a period of 2 months, those prophecies were clearly not borne out by facts, and exactly the opposite happened.

Mr. SONNE. I think you will find, Senator Douglas, that in the second document we give a certain guidance there. We, first of all, say, "At present"—which was last week end—"the economy exhibits no clearly discernible swing." And then we say that Congress should act in case of a declining activity involving a genuine increase in unemployment of more than a million and a half.

Senator DOUGLAS. A total of 5 million.

Mr. SONNE. Meaning, as a guide, 5 million.

Senator DOUGLAS. I was very much interested in that figure of 5 million, because it so happens that it was the rough benchmark which I have used in my mind. It comes to about 10 percent of the nonagricultural working force, or about 8 percent of the total agricultural and nonagricultural working force.

Mr. PATMAN. Mr. Chairman, may I ask a question here?

Senator DOUGLAS. Please do, and do not let me monopolize the questioning.

Mr. PATMAN. That is all right.

Early in your statement on Fiscal Policy in the Near Future you say, "The country should have positive assurance that the Government will be prepared to act promptly either if prices should display a sharp and continuous upward swing, or if unemployment should increase substantially."

Now, you place No. 1 there, the upward swing, and the No. 2, unemployment. Do you consider that there is danger of inflation at this time more than unemployment?

Dr. LELAND. You are asking me my personal opinion?

Mr. PATMAN. Well, you explained a moment ago that any opinion you expressed would be a personal opinion.

Dr. LELAND. Yes.

Well, I do not see any marked signs that prices are likely to move sharply upward or that we are in danger of much in the way of inflation at this juncture, or that it is to be a likely event in the months immediately ahead of us. You understand that is my own personal opinion.

Mr. PATMAN. But, do you believe that there is more danger of an inflationary condition than there is a deflationary condition?

Dr. LELAND. Well, that depends, I think, in part upon the general effect of the demands for increased wages, and the continued high cost, high unit cost levels, with respect to labor. My own general feeling is that if conditions are not much different than they are now, the general drift is down, with some pick-up in the volume of business activity this fall.

Mr. PATMAN. I would like to know if these other two gentlemen would like to express their views on that subject, too.

Mr. SONNE. I would like to just answer your question here. You mentioned that we said first, upswing, and then, unemployment.

Mr. PATMAN. Yes.

Mr. SONNE. I would like to confine myself to the document. Where we stated that there was no clearly discernible swing I think we felt that Congress should be ready to act, in the case of either alternative, either an upward swing or downward swing. We suggested that a downward swing be judged by the number of unemployed people, whereas with regard to the upward swing, we suggested using price indices as a guide for.

Mr. PATMAN. Now, the second question, would you mind commenting on it? Are we more in danger of deflation or inflation?

Mr. SONNE. There you ask for a personal opinion, and I may say that we were careful to put in the statement, "September 1949." I would have preferred having the date fixed as that of the last week end, because no sooner was this statement made, than sterling went down to $2.80, and it is difficult to know what the repercussion would be.

Mr. PATMAN. You are not expecting any repercussions in this country to amount to that, bad repercussions?

Mr. SONNE. Repercussions about sterling?

Mr. PATMAN. Yes.

Mr. SONNE. That remains to be seen. You see, the answer is that when it comes to prices we, in this country, may well know that this had to be, but the people who determine the price of a number of commodities, such as burlap, coffee, cocoa, are not the Americans, but the people who sit in Africa, India, and South America. The question is, What repercussions will the drop of the pound sterling have on these business decisions and outlook? Whether we wanted it or not, commodity prices in certain instances have dropped materially.

It is very likely that there will be only a short period until we will know the outcome, but I would have said, with more confidence last week than this week, that there is no discernible trend.

Mr. PATMAN. No discernible trend?

Mr. SONNE. Either up or down, we said last week.

Mr. PATMAN. Either way?

Mr. SONNE. Either way.

Today, if I sat in Congress, I would say "Let us be a little more prepared on the downward side than the upward side because the chances are that if there is a change, it will be downward."

Mr. PATMAN. You think that is more likely than upward?

Mr. SONNE. Yes; but I say both are within the realm of possibility.

Mr. PATMAN. I would like to have this gentleman's opinion with respect to that.

Dr. SMITHIES. I would agree with that possibility. I agree there is a possibility of further inflation, and there are further possibilities of recession. I believe that the possibilities of recession rather outweigh the possibilities of further inflation.

Incidentally, I do not happen to agree with Mr. Sonne on the effects of the depreciation of the pound, but to go into that would lead us too far afield today.

However, I do feel that the possibilities of depression do not sufficiently outweigh the possibilities of expansion and prosperity to warrant any emergency action or any change in policy at the present time. But I fully agree with this report that advance preparation should be made.

Could I just revert for a moment to your initial question, because I think this illustrates the basic difficulty?

We have gone at great pains in this document to stress the inability of people to forecast, and we know that some of us, as economists, have frequently been wrong. Nevertheless, someone has the task of preparing a budget at this time of the year to take effect over the following fiscal year. All we can say here is that it has to be prepared on the basis of the best economic judgment available, and I imagine it is one of the functions of your committee to take what economists say to you with the necessary grains of salt. Something has to be done, and we cannot hope that those forecasts or that judgment will always be correct. That is why we say that the judgment that is applied to the annual budget this time of the year to take effect the following fiscal year has to be supplemented by preparations for these emergency and extraordinary measures that may have to be taken during the year.

Mr. PATMAN. Just one other suggestion that I want to make here, to be more practical and to be more specific: Do you not think this $2,800,000,000 paid to veterans the early part of the year, commencing in December, will have a tremendous effect on our economy?

Dr. SMITHIES. I believe it will have a strong stimulating effect.

Mr. PATMAN. Concerning the payments being made to World War I veterans, I have not seen any mention of it in the newspapers.

Dr. SMITHIES. The veterans' bonus in 1936 did have a powerful stimulus.

Mr. PATMAN. And that was only less than one-half, about 40 percent.

Dr. SMITHIES. Payment of the dividend enters into our judgment on this matter. That is one of the expansionary factors that offset the possible deflationary factors.

Mr. PATMAN. There is another factor that I have never seen discussed in the newspapers or the radio. There are between four and five hundred thousand veterans of World War I who kept their policies, and who have been receiving an enormous increase in their spending power. One veteran had two $5,000 policies, and he received $225 on one and $120 on the other, $345 on those two policies, and that has gone on all over the country recently. I have not seen that in the newspapers. That is bound to be an enormous amount of money, and the $2,800,000,000 is bound to have an influence on our economy. I believe you agree with that?

Dr. SMITHIES. Yes.

Mr. BUCHANAN. Mr. Chairman, relative to military expenditures in the budget for fiscal '50, was there any agreement or climate of opinion so far as that subject is concerned as to present Government policy?

Dr. LELAND. We did not discuss what you do with the present military budget or what you should do with it, but everyone was certainly agreed that military expenditures are no more sacred than any other expenditures, and one of the places to look for economy at all times is in the military budget.

There is an adage, you know, that if you want either to cut expenditures or to operate upon revenues, you have to look where the money is. You do not find money either where it is not possessed or it is not being spent, and there was agreement that those budgets and those requests should be looked at in the light of the policies indicated with the necessary qualification, of course, that the defense and the international position of the country has to be considered.

Senator FLANDERS. Mr. Chairman, I would like to ask Dr. Leland whether the net result of this document would indicate, perhaps, a long-term reduction in the national debt rather than a long-term increase in it or a long-term balance.

Dr. LELAND. Well, I think—and this is purely a personal opinion—that the document itself would indicate over the long run some decrease in the public debt. It implies, of course, that there will be expansion in the public debt during periods of depression, and at times when there are budgetary deficits. But, conversely, it implies although it does not say so definitely and specifically, that this is a part of the field of fiscal policy that needs to be more comprehensively covered by a specific inquiry into the money and credit policy, but I think that the implication of the recommendation for a surplus is to the effect that those surpluses would in the end be used to finance reductions in the national debt.

Senator FLANDERS. Perhaps, it is outside the task to which you set yourself to answer this question, but I will ask this also: Do you feel that there is anything in the secular decrease in the debt that is a worthy objective in itself?

Dr. LELAND. To state now whether or not I think that debt payment, irrespective of the cycle is worth doing?

Senator FLANDERS. No; I am talking about a secular decrease. Is that a worthy objective, and does it have a determining effect on these policies?

Dr. LELAND. If that means a reduction of the debt in good times, and its expansion in poor times, I think you will find that there is some disagreement of opinion among the economists as to the way it ought to be handled.

The general statement is to the effect that you run deficits in depressions, and you retire the deficits during booms.

My private opinion is that if you take that as the policy, the payment of the debt in the boom contributes to the boom, and adds to the inflation.

My feeling is that prosperous periods are the times to impose taxes for the purpose of debt retirement, and that the money collected for that purpose should be sterilized and kept out of the monetary system, and that during the depression and the beginning of the depression, is the time to pay the debt, and that this policy will lessen the total amount that necessarily must be borrowed. So that it really means the imposition of high taxes in boom times, the sterilization of the funds collected during the boom, and then the initial repayment of the funds, and the payment of the debts to the holders of the debt during the depression.

Senator FLANDERS. Is this sterilization which you are talking about to be accomplished by preference retiring of bank indebtedness rather than privately held indebtedness, or are there other means?

Dr. LELAND. That is one way. The other way, of course, would simply be to sterilize the fund and put it in an independent treasury, which is not connected with the banking system. You could ship that down to Fort Knox, along with the gold.

Senator FLANDERS. You could ship paper as well as gold.

Dr. LELAND. You might, yes, that is right. [Laughter.]

You asked for another possibility—understand, I am not recommending that; I just added that to the sum total of things that might be done—but the action on the bank-held debt is the most hopeful way of meeting that situation.

Senator FLANDERS. You regard the principles of your report as following the Keynesian theory of economics?

Dr. SMITHIES. I would like to add a word about what Dr. Leland has said about the national debt. I think there we are entirely in the field of personal opinion. Our group certainly did not consider what the course of the national debt would be in the future, and I would not like to give the impression that we are trying to provide anyone with an easy way to reduce the national debt.

It seems to me that the future course of the national debt will be determined by events. It will not be determined by the budgetary policies followed by the Government. If we have more depressions in the future than we have booms, I think we will inevitably have an increase in the national debt. If we have more periods of inflation in the private economy than periods of depression, we shall have retirement of the national debt. But it seems to me it is quite impossible to forecast what the course of the national debt will be in the future.

We do feel, as we say in this document, that we feel reasonably confident that the policy we recommend here will not result in any greater increase in the national debt than any other policy that might be adopted.

We believe that if you adopt a prosperity policy, you may in fact have periods of prosperity in which you can retire the debt, whereas, if you do not do it, you may have periods of chronic depression where you will inevitably have large deficits.

Senator FLANDERS. What you are saying is if the purposes set up in the statute by which the joint committee was set up are successfully effected, then the national debt will be reduced.

Dr. LELAND. Over a period of time.

Senator FLANDERS. Over the long time. In other words, if we are successful, on the whole, in maintaining high employment and production, then probably the national debt might conceivably diminish cyclically—not cyclically, I mean secularly.

Dr. SMITHIES. I think it has to be put rather carefully. It seems to me that you can say that, if the inherent strength of the private part of the economy is sufficiently great, the Government may be able to afford to tax more than it spends without impeding prosperity. But that is a different thing from saying that the policies of the Employment Act, if they are carried out, will result in debt retirement, because you may, in fact, need deficits to attain the objectives of the act.

Senator FLANDERS. Yes.

Dr. LELAND. I want to add to that point. I want it to be perfectly clear to all those present that in replying to that question I was replying for myself alone, and, secondly, I would reply to part of the question that was asked with respect to the cyclical aspect and not to the secular aspect that you put to Mr. Smithies, because there I happen to believe in the necessity for the secular long-term reduction in debt, and Mr. Sonne——

Senator FLANDERS. I was going to say that Mr. Sonne looks to me, Mr. Chairman, as if he might have an idea in his mind, and I would like to ask him to make an observation.

Mr. SONNE. I felt that I would like to report what I think was the consensus—although not necessarily a hundred percent. I think it is fair to say that the majority of economists at the meeting do not like debt for debt's sake.

Dr. SMITHIES. I do not think any economist likes it for its own sake.

Mr. SONNE. If for no other reason than that interest charges would come back in taxes.

Now, they say it is impossible, as Dr. Smithies says, to engage over the years in a discussion as to whether there are going to be long periods of recession or good times, but it is conceivable that at the end of, let us say, a 30-year period, under this policy our debt will be reduced. It is also conceivable that it will be larger. If it is enlarged, it will be regarded as a lesser evil than to have unemployment and bad times.

They also go so far as to say that if it is enlarged through the exercise of this policy, it would also have been enlarged as a result of the old-fashioned idea of balancing the budget, because we simply would not be able to do it.

I think that is a pretty fair statement, as I say, but I think most of them expressed the hope that over the years it will be reduced, although they do not necessarily think that it will happen.

Dr. SMITHIES. Yes.

Senator FLANDERS. I started to ask another question, and that was as to whether the ideas in the report followed the, what we have come to consider as, Keynesian philosophy in economics.

Dr. LELAND. I would like to say on that score that I do not think that Mr. Keynes is entitled to credit for the belief that the budgets of governments ought to be cyclically unbalanced. I think he is entitled to considerable credit, along with other people, for having argued that way, and seen the consequences of it, but most of Mr. Keynes' contributions to economics fall in the field of monetary, banking, and employment policy rather than particularly with respect to the fiscal operations of the Government.

It happens that in this particular case they coincide, and the reasons are harmonious, but the general belief in unbalancing budgets, I think, was prevalent before Mr. Keynes wrote his first book upon this topic, and many others have pointed to the intimate connection between the public and the private economy and the role that the Government plays in influencing the effect of business activity. So, it is both in the tradition of the Keynes' doctrine, and it is completely apart and outside of it.

Senator FLANDERS. Dr. Smithies, I have had the general impression that Keynesian ideas were rampant in the institution of which you are a part. Do you want to give your comments on that? [Laughter.]

Dr. SMITHIES. We are inhabited by all shades of opinion. I would like to say that I deplore the practice of labeling people as Keynesians or anti-Keynesians. However, certain fiscal ideas have been labeled "Keynesian," and I think this document is undoubtedly indebted to those ideas, but it does stress an aspect of the matter that has been insufficiently stressed in the literature—the necessity of keeping adequate control over the size of Government expenditures. That leads me back to one of the questions that Senator Douglas put before, whether the kind of a policy we suggest leads to high expenditures in depression times and high taxes in boom times.

For all that has been said in this so-called Keynesian literature, that problem, so far as I know, has never been adequately dealt with. We believe the essential budgetary principles must be maintained if we are ever going to get rational consideration of fiscal policy. I think, therefore, our report differs from what is usually labeled—perhaps wrongly, as Mr. Leland says—as Keynesian, by stressing that point.

Senator FLANDERS. Of course, that leads up to the practical question of how we are going to put the principles mentioned into operation here in a politically minded Congress. Have you any suggestions to make on that?

Dr. SMITHIES. It seems to me, as I said earlier, that it depends very heavily on the success of your committee. I do not think there is any magic, from what I know of the Congress, in reorganizing the Congress because, whatever the organization adopted, most Members of Congress are chiefly concerned with particular programs of government. In my opinion, it is necessary to get an economic point of view superimposed on the consideration of the particular programs, and I think every economist who feels the way we do welcomes very heartily the Employment Act, the establishment of this committee and the establishment of the legislative budget under the Legislative Reorganization Act. I feel that the ideas we express here can only be brought into play by a sort of educational process which, I am very happy to see, your committee is making strenuous efforts to carry out.

Senator FLANDERS. You also spoke of examples of projects which could be started and stopped, increased or diminished, and you mentioned residential housing. I think one of our achievements has been in introducing the idea of flexibility into the public housing plan.

Dr. LELAND. That is right.

Senator FLANDERS. And that is a definite step in the direction of your report.

I note in the report, before the subheading of "Tax reform," your statement with regard to large farm benefits. There, of course, you strike a field in which there is intense political thinking at the present time, and it is an example of the difficulty that Congress has in coming to an economic conclusion in the face of strong political forces.

I do not think it would be proper for me to ask you how we are going to handle that political problem, but I think we will have to recognize that it is there.

Dr. LELAND. I think it would be equally inappropriate, Senator, if we gave you advice. We faced that problem squarely. We recognize that this is a document on economic policy, prepared for a branch of the Government that is our most important political instrumentality.

We are familiar with the difficulties that face Congress at any phase of the cycle.

For instance, in the depression, I think there is ample evidence to indicate that during the last depression Congress did not spend enough; just as during the period of prosperity recently passed, they did not tax sufficiently, and we are familiar with the difficulties which face the Congressmen in increasing taxes, which are notoriously unpopular at any time; and similarly decreasing a spending program which may equally be unpopular at another time, so there is no counsel of perfection to be given here at all.

We are mindful of the problem, but unless the consequences are clearly realized, we will never get to a point where we can get movements, at least in the right direction.

Senator FLANDERS. Mr. Chairman, I have finished the questions I wanted to ask. I just want to comment that it seems to me that these two documents are extremely valuable. I do not know when we have had anything since the committee has been in active service that is more simple or more clear or more useful than these documents that have been presented to us this morning.

Senator DOUGLAS. Congressman Buchanan?

Mr. BUCHANAN. Mr. Chairman, I believe that since the document is so warm at the present time, it should be brought to the attention of the entire membership of the Congress, and I would like to request that you, as the chairman of the subcommittee, see to it that it is incorporated in the record, if you will, and if it meets with the wishes and comments of the other members of the subcommittee.

Senator DOUGLAS. Do you have questions?

Mr. BUCHANAN. No questions.

Senator DOUGLAS. I must apologize to both Congressmen Buchanan and Patman for taking up so much of the time.

Mr. PATMAN. That is expected of the chairman.

You mentioned blocking off of a part of the national debt a while ago and you suggested that we could just put it down in Kentucky where we have gold, and it might be a good thing and get it out of the way. Could you not do the same thing by having the Federal Reserve banks buy up a part of the national debt, especially that which is owned by the different local banks, that is so inflationary, and freeze it, not put it in circulation?

Dr. LELAND. Certainly, if other measures were taken to prevent the Federal Reserve funds from adding to excess bank reserves.

Mr. PATMAN. That would be the same thing.

Dr. LELAND. Yes.

Mr. SONNE. And save some interest, by the way.

Dr. LELAND. Oh, yes. Those are possibilities that a group considering money and credit policies ought to consider.

Mr. PATMAN. This gentleman here, being a farmer himself and having given a great deal of thought and study to the different farm plans, I wonder if he has come to any conclusion on the Brannan plan?

Mr. SONNE. I would be happy to discuss that question with you unofficially, because it is slightly outside the sphere of this hearing.

Mr. PATMAN. I will not insist on it.

That is all, Mr. Chairman.

Mr. SONNE. I am very much interested.

Senator DOUGLAS. I was puzzled by Congressman Patman's question and your reply. Suppose the Federal Reserve, with a surplus, were to buy Government bonds held by member banks in the open market. Would that not give to the member banks a credit deposit with the Federal Reserve System which could also operate as an inflationary device, and that, therefore, it would not be deflationary?

Mr. PATMAN. Which could be easily corrected by raising the reserve of the banks.

Senator DOUGLAS. Dr. Leland, do you want to make any comments?

Dr. LELAND. I think the question of whether it is deflationary or inflationary is determined by the sources of funds that are used to retire the debts. It is the taxes that are imposed that get the money that are deflationary, whereas, the very fact of retirement, as you point out, may put money into the hands of the banking system unless accompanied by changes in the reserve ratio and voluntary abstinence in the use of those funds. You cannot get a complete answer without tracing through all of the effects, first, from where the money comes; then, second, the effects of what it is used for, and how the purchasing power either is withheld or goes back into the total economy. The mere payment may simply restore the purchasing power at a different spot and may offset all the good that is accomplished by the taxes imposed.

Senator DOUGLAS. Well, as we move on into money and credit policy, I see that we will have some ticklish problems there.

Congressman Patman, do you have any questions?

Mr. PATMAN. No questions.

Senator DOUGLAS. Congressman Buchanan?

Mr. BUCHANAN. No questions.

Mr. PATMAN. Remember, I am not criticizing you for taking the time that you did. Your questions were very constructive.

Senator DOUGLAS. I have a guilty feeling of taking more time than I should have, and I want to apologize

Mr. PATMAN. No apology is needed.

Senator DOUGLAS. All right, gentlemen. Thank you very much.

(Whereupon, at 12:30 p. m., the subcommittee adjourned, subject to the call of the Chair.)

MONETARY, CREDIT, AND FISCAL POLICIES

WEDNESDAY, NOVEMBER 16, 1949

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON MONETARY, CREDIT, AND FISCAL POLICIES,
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The subcommittee met, pursuant to notice, at 10 a. m., in the caucus room, Senate Office Building, Senator Paul H. Douglas (chairman of the subcommittee) presiding.

Present: Senators Douglas (chairman of the subcommittee) and Flanders; Representatives Buchanan and Wolcott.

Also present: Dr. Grover W. Ensley, acting staff director, and Dr. Lester V. Chandler, economist to the subcommittee.

Senator DOUGLAS. Ladies and gentlemen, as the Subcommittee on Monetary, Credit, and Fiscal Policies reopens its hearings, we are happy to have as our first witness, Mr. Alfred H. Williams, president of the Federal Reserve Bank, Philadelphia.

Mr. Williams, I believe you have brought along an associate, who may assist you with certain technical questions. I wonder if you want to identify him at this time for the record.

Mr. WILLIAMS. He is Mr. Karl R. Bopp, vice president, Federal Reserve Bank, Philadelphia.

Senator DOUGLAS. I assume you will, yourself, want to answer questions relating to the fiscal policies of your bank and the Federal Reserve System as a whole, but I hope you will not hesitate to refer any questions to Mr. Bopp if you care to do so.

Senate Concurrent Resolution No. 26, which authorized the establishment of this subcommittee, directed us to make "a thorough and complete study and investigation of the effectiveness and the coordination of the monetary, credit, and fiscal policies in dealing with general economic policy."

This is obviously a very broad subject, and in your written statement to the subcommittee, which I have here, you have already dealt with many aspects of it. I think perhaps it would be best this morning if we started off with having your own judgment as to what are the most important and urgent problems in the field, so that we may narrow the range of consideration at the beginning of our hearings.

STATEMENT OF ALFRED H. WILLIAMS, PRESIDENT, ACCOMPANIED BY KARL R. BOPP, VICE PRESIDENT, FEDERAL RESERVE BANK, PHILADELPHIA, PA.

Mr. WILLIAMS. Mr. Chairman, perhaps I should at the outset make the point that I am speaking as president of the Federal Reserve Bank of Philadelphia and not as a representative of the President's Conference of the System or of the Board of Governors. You have the record of replies to your questionnaire which indicates the general point of view. That record was created by appointing a committee of economists from the 12 banks, who met and discussed the questions and formulated replies. Individual deviations from those replies, either in the way of supplement or disagreement, are in the record.

I think it might be helpful in this initial hearing to discuss the broad aspects of the problem of coordination and effectiveness of monetary and fiscal debt-management policies. I am glad to do this, because it seems to me that the area under consideration by the subcommittee is an extremely vital area, a very important one. It is especially important to the System, because we are under a legislative mandate to use the techniques attached to monetary policy to bring about improved economic stability in the public interest.

I would like to make the general point that in my judgment the problems of economic instability are becoming increasingly difficult, and that the basic ground swells may well be inflationary. As I reflect and digest developments, it seems to me that in considerable measure these stem from a zeal for social justice. There are many observers who think of this as arising only in the United States. In my judgment, it is world-wide.

Roughly, there are 65 sovereign powers on the planet, and I think a survey of these would indicate that the zeal is at work in almost every one of these groups. I suspect that at some future time, when a historian sits down to record the developments, he will think of this as the period in which the Zeitgeist, the spirit of the age, is one of getting a greater amount of what we may term social justice.

In the United States, that is taking the form of conscious efforts on the part of the state to achieve a larger measure of equity in every specific situation where trouble appears. It would be presumptuous for me to go into this in any detail. I take it that the experience of the members of the committee in specific provinces that fall within their assignments would furnish us all the material we need.

Senator DOUGLAS. May I interject for a moment?

Mr. WILLIAMS. Surely.

Senator DOUGLAS. Do I take it that you are somewhat afraid that the expenditures on so-called welfare purposes will result in unbalancing the budget and, therefore, exert a steady inflationary pressure on the economy?

Mr. WILLIAMS. I think that is a fair statement of my feeling.

Senator DOUGLAS. Of course, about 78 percent of the Federal budget goes for either preparation against a future war or payments incurred as a result of past wars or nearly 33 to 34 billion dollars of the total of 43 to 44 billion dollars that will be spent for the current fiscal year; and I wondered if you would not add to this feature that you have mentioned the fact that the world is in a state of uncertainty and that high military preparations are being made, and that these exert an even greater inflationary pressure than the so-called welfare measures.

The specific welfare measure appropriations by the Federal Government amount to only about 2.2 billion dollars out of the total of 44 to 45 billion dollars in the budget.

Mr. WILLIAMS. I quite agree, and these expenditures are highly inflationary because they are in essence wasteful, except as they produce real or fancied security.

Senator DOUGLAS. Will you proceed? I merely wanted to correct the record a bit so that the so-called welfare state would not be charged with responsibility for unbalancing the budget.

Mr. WILLIAMS. There are other aspects that will tend to produce economic instability, and I think, as I proceed, they will be brought out and result finally in a more balanced picture than I give when developing this first point, Chairman Douglas.

What we have is an attempt to give to each aggrieved part of the economy, to each claimant, a cure. We look at agriculture, at veterans' affairs, at housing, at local depressed areas. My native birthplace, a town in Pennsylvania, is added to the list as of this past week.

The danger is that we give to each and assume there shall be no losers. This, of course, is impossible unless we can expand output with each gift, and this in turn soon comes to an end because of the impossibility of indefinite expansion. The Germans have an adage that trees do not grow to the sky.

We tend to shore up the weak points as they appear rather than view the development of weakness as a process by which resources are redistributed.

I turn for a moment and contemplate the small-business scene. Without taking the position that more of these claimants deserve all possible aid, I think of the philosophizing of a Danish economist, who says, "Thank God for the bankruptcies." By that he was thinking of the bankruptcy as a process by which individual enterprises are sloughed off and resources are redistributed. This is not to say that we should not make every effort to see that, for example, a depressed area is given some aid; but we should raise the question as to whether we ought not to make an orderly transition from the type of economy that exists there to something that is more balanced and will not continue the difficulties that are occupying our current interest.

This zeal for social justice reflects itself also in the form of our efforts to obtain full employment with ever-rising wage rates. The postwar record is one of successive demands and pretty much of successive acquiescence.

A second force that is likely to make our economy more unstable is the changed character of economic action.

It seems to me that economic movements are more pronounced; they are more powerful; they are more unpredictable. Decisions are no longer made by large numbers of participants in the economic process where you get the operation of the law of large numbers.

I referred a moment ago to the 65 sovereign powers. All of them are now entering into the actions of the market place. One gets by reason of state action—and for other reasons, too, of course—gyrations in all forms of economic activity. For example, before us at the moment is the price of coffee.

Now, these are in some cases unpredictable because they grow out of political influences and not the give-and-take of the buyer and seller in an open market place. I am not saying we ought to return to the days of so-called free competition. I am discussing what seem to me to be realities at the moment in the light of achieving economic stability. This will bring us ultimately to the question of what we can do via fiscal policy, in the management of the public debt, and through the operations of the Federal Reserve System.

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I would cite as a second illustration of the changed character of economic action what is happening in the field of collective bargaining. At the outset I would make the point that I am not against collective bargaining and that what I am about to say ought not to be construed as antiunion.

We have had a development in the labor movement which is of the utmost significance from the standpoint of wage rates, pensions, et cetera. I enter this field, Mr. Chairman, with some diffidence because of your own professional interest and competence in the area; but, as I read it, we had up to 1934 a relatively slow growth of trade-unions. At that time there were 3,000,000 members. If one looks at the composition of the unions, we find for the most part they were the elite of the labor movement. The A. F. of L. and the brotherhoods dominated the situation. The general public was not conscious of the results of their collective-bargaining efforts.

But suddenly there came forth in 1934 and continued to grow a democratization of the labor movement. We brought in not only the craftsmen, the men with technical skills, but went down into the ranks of labor and organized those. Today we have not 3,000,000 members of trade-unions but 16,200,000.

Now, these new members differ from those that peopled these smaller unions. They have zeal for social justice. They set up demands; and, because they are unskilled for the most part, or have highly specialized skills, and for other reasons, we have the development of industry-wide bargaining. So, as a result of contractual negotiations, we have wage rates that cut right across an industry. If, as a result of strong bargaining, a leader in one industry achieves a wage increase, perforce the leader in every other industry must get it, too. He must bring the bacon home to his men. You have here a force that is very pervasive. One contract permeates until it soon influences an entire industry, and that industry influences the others. If a mistake is made in the initial contract, it is transmitted to others and becomes a major mistake for the whole economy.

There is a witticism concerning Nazi Germany to the effect that it was so well organized that it could make only major mistakes. In a sense, that conveys something of the thing I am trying to put across at the moment.

Another aspect of these major factors making for economic instability is the fact that this country has been catapulted into a position of world leadership by virtue of a long chain of events that need not be analyzed here.

It seems to me that this position of world leadership and responsibilities which are attached to it reinforce the drive to see that we shall not fail, because of the consequences of any untoward domestic action on us in the international scene. This tends to make us less flexible, less willing to suffer defeat on one front because we fear it may go to others.

I am leading to the conclusion, Mr. Chairman, that we must redouble our efforts to achieve stability and to achieve it under conditions of high levels of employment and production and at reasonably stable prices. This in the minds of able students is the only way in which in the long run, you are going to be able to achieve social justice.

The problems are not only complex; they are on the increase. The stakes are larger.

The question is, How do you achieve this stability? Broadly speaking, there are two ways in which it can be achieved. One is by a series of specific controls, and the other is by attempting to get some general influences that will be impartial, that will be impersonal, that will be pervasive.

To select the former route is to begin to go down a road where one control leads to another. I suspect that the British Labor Government finds itself in a position where it cannot very well go back and, therefore, is going on, perhaps very reluctantly.

I think we have to be very careful about that. I think the period that we are now in is one in which we are going to make some basic choices. I shall attempt to tie this in to the attitudes that exist now within the field of banking and within the field of bank administration. I refer again to the fact that the area you are exploring here is in my judgment a very important one.

I take it you are interested in our judgment as to the inherent effectiveness of work in this area of general controls. What is our judgment as to the way we are organized and some of the results that we are failing to achieve because of lack of organization? Are the tools that are at our disposal ones that needed to be added to or resharpened?

I stop to say at this point that my own choice is for general instruments of control and influence. They can be few in number if they are well chosen.

Senator Douglas. May I interject a question there?

Mr. Williams. Yes, of course.

Senator Douglas. I take it what you are saying that if we could have a sound monetary, credit, and fiscal policy, reasonable stability of prices, but with prevention of depressions, then if that can be effected through monetary, credit, and fiscal policies, you would prefer to use that; and that specific controls over given areas, such as an industry, and so forth, should be discarded or abated and that you would trust instead to the forces of competition in fixing individual prices within the framework of the general stabilized price system; is that right?

Mr. Williams. The question is an extremely difficult one to answer, Mr. Chairman. In agriculture the Government has a bull by the tail. In agriculture we have 6½ million business enterprises—I call the modern farm a business enterprise—subject to unusually unstabilizing factors. I would not go so far as to say we ought to begin now and by a process of orderly liquidation over a period of years get out of agriculture completely, but I think we ought to ask ourselves the questions: To what extent can we get out of agriculture? How rapidly can we accomplish this reduction in commitment? What are the ways in which we can bring this about? It ought not to be a separate approach to a problem which ramifies out in all directions and which has essential unity.

Senator Douglas. The presumption, however, should be in favor of a general solution rather than a series of specific measures?

Mr. Williams. Quite so, and the presumption should be that everyone who is affected by a general policy ought to be informed about that policy.

Senator Flanders. May I ask a question?

Senator Douglas. Yes.

Senator FLANDERS. Mr. Williams, does what you are saying also apply to credit control itself? Do you feel that credit control by the Government through the Federal Reserve System or by any other means should be general rather than applied to specific areas of business operation?

Mr. WILLIAMS. I would go into specific credit areas with the greatest reluctance. We will come to that question later.

Senator FLANDERS. Thank you.

Mr. WILLIAMS. This background focuses attention upon the role of the Congress, of the Treasury, and of the Federal Reserve System in this drama, if I may use the term, the social drama that I am attempting here to sketch.

I consider first the role of the Congress in the fiscal policy. Here again I may be presumptuous in bringing up the question. I do so only because it is such an essential part of it.

The role of fiscal policy in economic stability is one that in broad outline is easily handled by students of the subject under the general term of compensatory fiscal policy.

The Government achieves economic balance by putting funds in and taking them out of the spending stream. Question is raised as to how frequently you must be in balance. There are several schools of thought with respect to it. Do you attempt to achieve it annually? Do you attempt to achieve it over a longer period of time? Theoretically, the scholars say you achieve it over a longer period than a year. These economic recessions and swells do not occur according to the calendar.

When you turn to compensatory fiscal policy, in practice, you step out of the closet into the world of men who are sensitive to political values—and I do not use that invidiously. I mean Congressmen are locally elected, and I may say reelected or rejected; and that influences their actions.

In 1948 we had tax cuts, which increased the money available for spending by $5,000,000,000. There were probably many considerations which led to the action, but the chances are that not many of them centered around—let me put it this way: there were some that did not center around the question of achieving economic balance. I am not saying this critically, because there are a great many limitations to the effectiveness of the role that Congress can play in this question of achieving economic balance, and I hope if I am in error here that you will set me right.

To be successful, there must be some fairly accurate predictions, sometimes far in advance, because the economic effects of congressional action may be delayed for a considerable time. Fiscal policy as carried out by Congress is not a flexible tool. You cannot change tax and expenditure policies quickly.

Also, as important as anything, when the decisions are made, frequently the aggregates are not in view. By focusing attention on one aspect, particularly if a person is politically motivated, you get a total result which you would not accept if you knew in advance that it was coming. You do not get the discipline that frequently arises in other fields of action, notably business, where the penalties are pretty direct and pretty immediate and pretty close at hand.

I think that the most we can hope for in the consideration of what Congress can do in this whole area—that is, fiscal policy—is that it will not seriously aggravate the problem. That is a pretty mild statement.

At the same time, the effects of fiscal policies are large and growing. For example, during the twenties Federal and governmental expenditures were in the magnitude of $5,000,000,000, compared to a gross national product of $90,000,000,000. Today we have $40,000,000,000 of governmental expenditures and gross national product of $250,000,000,000.

Now, the Government can waste resources just as readily as can the individual citizen or the business enterprise. I think it would be helpful if we were constantly reminding ourselves that the responsibilities that are set forth broadly in the Employment Act of 1946 contain implied responsibilities for Congress as well as for the Treasury Department or the Federal Reserve System. It involves the art as well as the economics of government and, I think, deserves the fullest possible attention.

That brings me to a consideration of Treasury and the Federal Reserve System responsibilities and relations. The Treasury, of course, aside from advising the Congress in tax matters, has certain operating responsibilities that we can pass by—collecting tax revenues, making Government disbursements, managing the operating balance. The last of these, that is to say, building up or drawing down the operating balance for regular payments to meet maturing issues, and so forth, does gear in pretty closely to the work that we do.

The major field, however, is management of the public debt. This involves Treasury decisions as to refunding, as to maturities, as to marketable and nonmarketable issues, and importantly as to price.

These operations are closely geared into the Federal Reserve's responsibilities and opportunities.

We turn to the Federal Reserve System for a moment. Here the basic responsibility is one of adjusting the money supply to the flow of goods and services. The most important manner in which we influence this situation is the way we work in changing the amount, availability, and cost of actual reserves, and the level of reserve requirements. We have three tools in our kit. The first is discount rates. Initially, it was the most important instrument when banks were acquiring reserves by discounting. It is now less important because reserves are influenced through open-market operations, although I think we can underestimate the influence of the discount rate because of the psychological aspects of this tool.

Open-market operations are a tool of major importance at the present time in the matter under consideration, because through our purchases of securities we supply additional reserves, and by our sale of securities we reduce reserves.

Senator Douglas. Mr. Williams, I wonder if you would state for the record of what open-market operations consist.

Mr. Williams. I will ask Mr. Bopp to answer that question.

Mr. Bopp. They consist, Chairman Douglas, of the purchase by the Open-Market Committee of the Federal Reserve System for the account of the Federal Reserve banks' Government securities of such maturities and at such prices, and so on, as may be determined by the Open-Market Committee; and, correspondingly, sales of securities in the open market. An adjunct to sales involves the redemption of securities as they mature on the part of the Treasury.

Senator DOUGLAS. When the Federal Reserve System purchases the Government securities from banks, what are the banks given in return?

Mr. BOPP. The Open-Market Committee deals with a list of Government security dealers, so that typically a bank would operate through a dealer. The purchase would be made by payment of a check drawn on the Federal Reserve bank itself, which would be given to the seller of the Government securities.

This seller in turn would deposit that check in his bank, and his bank would send it up to the Federal Reserve bank and get credit for it on the books of the Federal Reserve bank in the form of an increase in its deposit account. The deposit account of a member bank is also its reserve account. The result of the purchase of the security by the Open-Market Committee is an increase in the private deposit account of the seller of the security at his local bank; and that bank in turn would have an increase not only in its deposits but a corresponding increase in its reserve account at the Federal Reserve bank. A sale would have the opposite effect.

Senator DOUGLAS. A Federal Reserve bank creates a credit with which it purchases Government bonds?

Mr. BOPP. That is correct, and that credit initially is in the form of a deposit in the Federal Reserve bank.

Senator DOUGLAS. What proportion of the earnings of the Federal Reserve System come from this type of credit operation?

Mr. BOPP. Virtually all. There are a few small types of other earnings, but virtually all come from ownership of Government securities.

Senator DOUGLAS. Is this a type of transaction which was not originally contemplated when the Federal Reserve System was set up?

Mr. BOPP. I think that is probably a fair statement of it, Chairman Douglas. Initially the Federal Reserve System was considered rather a more passive institution. It was assumed that with an increase in the general level of economic activity there would be an increase in what at the time was called and still is called eligible commercial paper arising out of the increased activity. If a businessman needed additional credit, he would take that paper to his bank for discount to secure a deposit for it. If the bank in turn needed funds, it would take that paper to the Federal Reserve bank for discount.

The Federal Reserve would pay for that paper by an increase in the deposit account of the bank. However, at the time it was also felt—and this is trying to recollect the history of the time or the reading of the history—that there might be times when the Federal Reserve System would have inadequate earnings, and when business might be depressed, and, therefore, the System should have some authority to put funds into the market of its own violition.

Therefore, it was given authority to deal in the open market in Government securities and certain specified other securities, but initially it was not considered a basic instrument of policy. It became so in the 1920's.

I think it is, therefore, a correct statement to say that the ultimate development of open-market policy was not contemplated by the framers of the Federal Reserve Act.

Mr. WILLIAMS. Would you comment on the matter of initiative on the part of the bank, on the one hand, and of the System on the other?

Mr. BOPP. In the case of open-market operations the System is enabled to take the intiative to put funds into the market or to take them out. In the case of discounting, the initiative is on the part of the prospective borrower. If, however, the System, as during the war and postwar periods, establishes a price in the market at which it will deal in Government securities, then the initiative may be taken by the market rather than by the Federal Reserve System so far as amount is concerned.

Senator FLANDERS. May I ask a question?

Senator DOUGLAS. Yes.

Senator FLANDERS. Mr. Bopp spoke of the open-market operations as affecting the available bank reserves. I would like to inquire whether in its actual operation the purpose of open-market operations is directed toward increasing or decreasing bank reserves, or is it directed toward maintaining the price level of the bonds themselves?

Mr. BOPP. During the war period and for a considerable period after the war, as I mentioned, the Federal Reserve System established the yield structure on Government securities and bought or sold securities so as to maintain that yield structure. The effect on reserves was incidental to that.

However, with the announcement by the Open Market Committee in June of this year, it was stated that in the future the Open Market Committee will be concerned with the general level of economic activity, which I would interpret to mean that it would be more concerned with the level of reserves than it had been hitherto.

Senator FLANDERS. Does that mean that as a result it will be paying less attention to the maintenance of an interest rate, which I presume means the maintenance of price because the earning rate is dependent on the price—that it would be less concerned with that in the future than it has been in the past?

Mr. BOPP. The exact interpretation is one I cannot personally give. It is a matter of the individuals who have prepared the statement. However, I think one can get some impression as to the meaning of it by following the Federal Reserve holdings of Government securities.

If one looks at the holdings of the United States Government bonds, for example—these are the long-term securities held by the Federal Reserve System—the volume remains unchanged week after week. There were a few very small changes and one large change which happened to come at the time of the maturity of a bond issue. That would mean, it seems to me, that the Federal Reserve open market committee was not in the market in the long-term issues. That is evidenced also by significant changes in the prices of long-term issues since the statement was issued.

Senator FLANDERS. Has the history of yields of Government securities and the market prices on which those yields are based actually shown more flexibility since that decision was arrived at than was the case before?

Mr. BOPP. With respect to long terms, I am quite sure that is the case. I will have to check with the chart book.

Senator FLANDERS. Specifically, are there any issues which have been allowed to go below par?

Mr. Bopp. No; with the release of reserves and this policy statement, the pressures all were in the other direction, and prices have gone up very significantly, which means that yields have gone down. When I express the judgment that the variations in yield on long terms have been significant since that time, I meant not an increase in yields, but a decrease in yields of a significant amount. My hunch would be a quarter of a percent in yields.

Senator Flanders. The effect of that policy has not been detrimental so far to the policy, if you want to call it policy, of maintaining the price of Government securities, but has been the reverse so far?

Mr. Bopp. Well, I should say that it is evidence that there is no ceiling at the present time.

Senator Flanders. But the floor is still there?

Mr. Bopp. As I say, that is a question that——

Mr. Williams. We are floating in the air and have not explored the floor yet.

Senator Flanders. What will happen when you hit the floor if reserve requirements should indicate that prices should go below the floor?

Mr. Williams. I think that question will come up again later, Mr. Flanders.

Senator Flanders. All right.

Senator Douglas. Now, you have mentioned two weapons that the System has—the rediscount rate and the open market operations.

Mr. Williams. Reserve requirements being the third.

Senator Douglas. Yes.

Mr. Williams. Just one more point to supplement what Mr. Bopp has said about the operations of the Open Market Committee. This is a force in the money market that has great leverage. By that I mean that if used with deftness, with psychological astuteness, it can work results that are far beyond the magnitudes here involved. One in effect sits there shooting with a rifle and not with a shotgun, and you have the entire market revealed before you. You come to know it, and the task of managing the account, which is one of great importance, is in my judgment one that has been superbly carried out, if one goes back especially to the postwar period.

Senator Douglas. I wonder if either of you would briefly sketch for the record the effect upon the general supply of credit when the System sells securities in the open market.

Mr. Williams. I think you have traced in more detail the effect of the System buying, Mr. Bopp.

Mr. Bopp. The sale of securities would require payment by the purchaser of the security to the Federal Reserve bank for that security. In making this payment, the Federal Reserve bank in turn would collect the check for payment from the bank whose customer had purchased the security, and that would result in a reduction in this bank's deposit account, which is its reserve account at the Federal Reserve bank, and also a reduction in this bank's deposit account with its customer; so that you would have initially a reduction in both reserves of all member banks of the Federal Reserve System and a corresponding reduction of the accounts of private customers in their commercial banks.

Senator DOUGLAS. And hence a reduction in the potential lending capacity of member banks?

Mr. BOPP. Yes, sir; unless offset by excess reserves. If it did not have excess reserves, it would be short of reserves and could force a retraction through the banking System.

Mr. WILLIAMS. This brings me back to the topic of relations between the Treasury and the Federal Reserve System. I think Mr. Bopp's explanation and the connotations of it indicate that the task of the Treasury in managing the public debt and its working balance and the task of the Federal Reserve System in using its monetary authority to achieve stability are very closely meshed.

Mr. WOLCOTT. May I ask a question?

Senator DOUGLAS. Yes, of course.

Mr. WOLCOTT. What Mr. Bopp said a moment ago just registered with me. You made a statement that if the bank sells out its reserves, in answer to a question asked by Senator Douglas, that it decreased the amount of money which was available for loaning by the bank.

Is it the practice to reduce reserves sometimes to make available more money for loaning—private loaning?

Mr. BOPP. To reduce reserve requirements?

Mr. WOLCOTT. Reserves. If thev are above the requirements, there is a tendency to liquidate their reserves?

Mr. BOPP. Provided they have excess reserves, they will use that for lending purposes. If, however, the Federal Reserve System has sold securities, that will initially reduce the reserves of the bank whose customer bought the securities. That bank will then have less reserves available for lending, purchasing securities, or whatever purpose it has.

Not only that, if it began the process without excess reserves it would then be short of reserves because the reduction in reserves is as great as the reduction in deposits. It is required by law to keep only a percentage of reserves against deposits, and it would then have to restore the deficiency of reserves by the sale of some assets.

Mr. WOLCOTT. When there is a movement on the part of a great many banks to liquidate a great many excess reserves, then is it the function of the Federal Reserve, if they have flexibility enough in their reserve requirements, to increase the reserve requirements to stop that practice?

Mr. BOPP. I should say it is contingent on whether, in the judgment of the Reserve authorities, an expansion should take place. If so, they would encourage it. I am thinking of the thirties, when banks had large volumes of excess reserves and when the Federal Reserve System was interested in having expansion. If banks had expanded, that would have been to the good.

On the other hand, if this process is going on at a time of inflationary pressure when the desire is to restrict, then you would have the question of whether to restrict by sales of securities or by changing requirements.

Mr. WOLCOTT. Previous to the Banking Act of 1935 the Open Market Committee functioned in more or less an advisory capacity. They were given power in the Banking Act of 1935; they did not have the power to initiate purchases and sales previous to that.

Mr. BOPP. I should say it was a voluntary arrangement prior to that, and any individual Reserve bank could refuse to participate in the open-market operations which the committee itself had recommended for the System as a whole.

If, however, the committee felt that a specified volume of securities should be bought or sold and a particular Reserve bank should have refused to participate, they might have distributed that amount among the other banks.

However, so far as I know, no bank refused, in fact, to participate in them. But your question concerned the power of the System itself. It had the power. However, by law it was lodged in the individual banks who collectively had an open market committee to advise with respect to and to engage in open-market operations subject to the rules and regulations of the Board of Governors, but the individual bank had the power not to go along if it desired.

Senator DOUGLAS. And now?

Mr. BOPP. And now it is a System operation and no individual Federal Reserve bank may refuse to go along.

Senator DOUGLAS. And the amounts which each bank must take or must sell are specified by the Open Market Committee?

Mr. BOPP. Actually it is a single account for the entire System, and the actual ownership of the securities by the individual Reserve bank is distributed from time to time.

As to the exact formula, I confess you have every right to expect me to know that. I have known it for as long as a half hour after reading it, but for the long run I have considered the burden on my memory to be greater than the value of the information. I can, however, supply you with it.

Senator DOUGLAS. We will ask someone to make it a matter of record.

(The formula referred to above is as follows:)

FORMULA FOR ALLOCATION OF SECURITIES IN THE SYSTEM OPEN MARKET ACCOUNT

Securities in the System open market account are allocated by the Federal Open Market Committee among the individual Federal Reserve banks on the basis of their expense and dividend requirements. The formula is based on estimates for the year of each Federal Reserve bank's expenses, dividends, and earnings from sources other than securities in the System open market account. Ratios of the estimates for each Federal Reserve bank to those for the 12 Federal Reserve banks combined are then computed and securities in the System open market accounts are allocated on the basis of these ratios.

Adjustments may be made in the allocations from time to time if the reserve position of a particular Federal Reserve bank indicates that an adjustment is desirable or if the allocations on the basis of the original estimates are no longer appropriate.

Mr. WOLCOTT. In that connection, perhaps affiliated with the subject with respect to rediscount rates, previous to the Banking Act of 1935 Federal Reserve banks could initiate increases in rediscount rates, but they would not become effective without approval of the Federal Reserve Board, and now the Federal Reserve Board may initiate increases or decreases in rediscount rates.

Mr. BOPP. That particular provision, Congressman Wolcott, has had an interesting history. As I gather it, the provisions in the initial draft of the Federal Reserve Act contained a provision that the Federal Reserve banks shall establish from time to time rates of rediscount, subject to review by the Federal Reserve Board.

At some time during the process of hearings and subsequent reports this wording was changed to read, "Subject to the review and determination by the Federal Reserve Board."

Now, it is a question as to what those words mean. In my own judgment, and I can be in error, I think the Congress intended to be somewhat vague, and time would tell. You would see how the thing worked out.

The Attorney General was asked, and it is my recollection it was in 1919, as to a judicial interpretation of these words. He said that going through the legislative history it is clear that the words "and determine" were added, and since they were added, attention was specifically called to them and they meant something. If they meant something, they meant something other than "review" and, therefore, it meant that the Board had the power to determine rates. He interpreted the words to mean that, if necessary, the Board could initiate a change in the rate, and it did prior to the Banking Act of 1935 in the case of the Federal Reserve Bank of Chicago. I think the year was 1927.

So the Board did, as a matter of fact, prior to the Banking Act of 1935 initiate and require the Federal Reserve bank to change a rate which the bank did not want to change. Senator Douglas may remember that Chicago incident.

Mr. WILLIAMS. I return now to the question of relationships between the Treasury and the System, starting with the war period. The prime consideration from the standpoint of the Treasury and the System was to win the war; and management of the debt and the changing policies with respect to reserve requirements and open market operations were in the light of this prime consideration of achieving military victory.

Looking at the economy as a whole, I take it that to the extent we were interested in stability we relied pretty much on direct controls.

The system's task during the war was to facilitate the operations of the Treasury. The Treasury had a number of important decisions to make. One of them had to do with the interest rate pattern, and there I would rather rely on Mr. Bopp's memory than my own as to what happened during the thirties to bring us up to the point of entrance into the war with a plethora of funds and low interest rates. The general point is that we froze the interest rate structure into a pattern beginning at three-eighths of 1 percent and ending at 2½ percent.

I think it may be interesting for the record to outline what had transpired during the thirties which had resulted in this situation.

Mr. BOPP. Although this is not the ultimate beginning of it, one may begin with the change in the price of gold on the part of the United States from $20.67 to $35 an ounce. At any rate, following that we had very large importations of gold into the United States, and a very great plethora of funds and the absence of a demand for funds to any considerable extent.

Banks having these large excess funds and no very great demand for credit desired to keep their funds in short-term assets; and as a consequence, one had a superabundance of funds, particularly short-term funds. At one time the United States Treasury was able to borrow 90-day money at a zero rate of interest, and for some peculiar tax provisions in the city of Chicago, on rare occasions, at a negative rate of interest.

However, in part because bankers and others felt that these rates were excessively low and that it was merely a matter of time until they would rise, investors were unwilling to commit themselves at the long-term rate then prevailing.

In a period in which anticipations are for a rise in interest rates, one gets a rate structure with short-term rates below long-term rates. Incidentally, we have had other periods in which people have anticipated declines in interest rates and when the short-term rate has been above the long-term rate.

Because of the plethora of funds and institutional habits with respect to investments and anticipation of ultimate increases in rates, we had a rate structure and a period of depression and lack of demand in which the short-term rates were very low relative to the long-term rates, with all rates being low relatively on a historical basis.

Those circumstances, however, are quite different from the circumstances into which we were going once the war broke out.

Mr. Williams. In an attempt to avoid the mistakes of World War I, when there was a reluctance on the part of some to participate in war loans in view of the fact that the next loan might carry a more favorable rate, we froze the structure, and it became known that we had frozen the structure.

There were, I think, relatively good results from the operation of the Treasury and Federal Reserve System during the war period.

Roughly, we raised 40 percent of the needed funds by taxation. This could have been higher, but I think Canada's record was 43 percent or thereabouts. It was slightly above. Great Britain, where the capacity to endure taxes, is, I think, pretty highly developed, did not do a much better job.

We got good results from our distribution of the 60 percent we borrowed; the distribution of that among the nonbank market was 35 percent of the total, roughly.

The position of the banks—I think they all understood it—was they were to be the residual buyers of anything and they were to provide the funds we could not obtain by taxation and borrowing from the rest of the economy. They came forward and took 25 percent, and it would be my judgment that that is a pretty good result. Karl, is that your opinion?

Mr. Bopp. Yes.

Senator Douglas. I wonder if you would describe the process by which the individual banks subscribed to this 25 percent, or I believe somewhere around $70,000,000,000.

Mr. Williams. Karl, will you do that?

Mr. Bopp. In order to facilitate the sale of securities banks were permitted to open what is technically called a war-loan account, which is a deposit account in the bank to the credit of the Treasury. There were some changes during the period, but the general process was that a bank could pay for its securities to the Treasury by simply giving it credit in the war-loan account, which meant that initially the bank picture would be an increase in its holdings of the Government securities and an increase in the Treasury's deposit at that bank.

Senator DOUGLAS. Then it was a private creation of purchasing power made available to the Government through the creation of deposits, and the Government drew checks upon these accounts?

Mr. BOPP. That is correct.

Senator DOUGLAS. And, therefore, the money supply, if you include checks as a portion of money, was inflated?

Mr. BOPP. Yes.

Senator DOUGLAS. This portion was not financed out of the current savings or current taxes.

Mr. BOPP. That is correct.

Senator DOUGLAS. But through a creation of monetary purchasing power, which had an inflationary effect.

Mr. BOPP. Yes.

Senator DOUGLAS. And which in turn you tried to restrain by specific controls.

Mr. BOPP. That is correct.

Mr. WILLIAMS. The next period was the postwar period.

Mr. WOLCOTT. Just a minute. In connection with those accounts, purchases by the banks—or sales, rather, by the banks—which the money got into that account, were deflationary. Is that right, and would that offset the inflationary tendencies incident to the creation of this account?

I mean by that that when a bond was sold by a bank, sold to an individual, that came out of that individual's earnings or savings, it was a bond which could not be monetized—payment of that bond into this account—and the Treasury would draft on that account for what the individual had put into the account.

We were told when the drives were on that to avoid inflation we should get as many as possible of the E bonds and other savings bonds out to the people and encourage them to hold them as an influence against inflation.

Mr. BOPP. That is quite correct. As individuals bought Government securities, they would pay for them with a draft on their own deposit accounts; and you then would have a shift from that purchaser's account to the war loan account of the Treasury. That resulted in neither an increase nor a decrease in the total money supply. The banks in these war loan drives were selling Government securities out of their own holdings, but they were selling fresh issues which the Treasury brought out.

Mr. WOLCOTT. Would it reduce the pressures which would otherwise be on prices?

Mr. BOPP. Quite right.

Mr. WOLCOTT. Which is a reflection of the depression of the value of the dollar by making that much less money available, creating a demand for consumer goods.

Mr. BOPP. Roughly 60 percent of the total cost of the war was met by borrowing. Of that 60 percent, roughly 60 percent again or 35 or 36 percent of the total was purchases of securities by nonbank investors, but the other 25 percent was purchases by banks, so that you had the two processes going on at the same time; and yet over the war period banks expanded their Government security holdings by the 25 percent of the total volume issued.

Senator DOUGLAS. Their deposits went up correspondingly, too.

Mr. BOPP. That is correct.

Senator FLANDERS. When you say individual purchasers, you include also corporate purchasers?

Mr. BOPP. All nonbank purchasers.

Senator FLANDERS. Insurance companies, business firms, and so on?

Mr. BOPP. Yes; all nonbank purchasers.

Mr. WILLIAMS. Every effort was made to induce nonbank buyers to acquire in order to thus channel off the purchasing power that otherwise would be reflected on a diminished supply of goods. We were seeking to curb these inflationary pressures in this manner and relying also on direct controls to help take the pressure off by means of allocation and rationing. We had a period here of 4 or 5 years when monetary and debt management considerations were focused on a military objective. Now, since then we have had a period of 4 years, and the question comes up as to what our objectives have been during this period. If I were asked to describe this in one phrase, I would say it was to make an orderly transition from war to peace.

Now, I call your attention to the fact that at the height of the war the Government was spending a billion dollars every 4 days, and for the most part was spending it for destruction.

If we may revert to the war period—as an incident to war finance, a great deal of purchasing power was built up. But the psychology of the situation after the war was such that we forgot about that purchasing power and focused our attention on what would happen when the Government ceased to spend $90,000,000,000 a year. This was the underlying psychology of it.

People said that the Federal Government, the principal buyer of the goods of manufacturing and mining, is going to step out of the market and we will get a collapse of Government spending to $30,000,000,000 a year, and that is going to bring on depression. There was a surprising amount of agreement among professional students of the situation that we were not going to be able to get through this transition without severe depression, and estimates of unemployment went from 8 to 10 to 12 million—I do not know if any got above that, Senator Douglas.

Senator DOUGLAS. I believe there was only one man who made a forecast that there would not be a depression.

Senator FLANDERS. Who was he?

Senator DOUGLAS. Mr. Woytinsky in the Social Security Board.

Senator FLANDERS. Also a group that goes under the name of the Committee for Economic Development.

Senator DOUGLAS. All right, there were two.

Mr. WILLIAMS. There certainly was the possibility of depression. It was in the picture.

Senator FLANDERS. It was entirely possible.

Mr. WILLIAMS. Yes, Well, it didn't materialize.

Senator FLANDERS. Will you tell us why it didn't?

Mr. WILLIAMS. Well, I will make an effort, Senator Flanders.

It didn't materialize primarily for two reasons, in my judgment. One was that we had, beginning with the home, empty linen closets, empty pantry shelves—someone said that we got guns and butter both during the war, but there wasn't much butter. There was a lot of soft goods which make it appear that total personal consumption didn't greatly diminish. But this is one of these deceptive totals. To make it significant you have to take it apart and see what composes it. When you take it apart you see there an unsatisfying craving for a lot of goods, durable consumer goods. And when you go back beyond that, to the department store, the storerooms had to be filled. When you go beyond that, back to the wholesaler, the storerooms had to be filled. And, beyond these, to the manufacturer, warehouses and storage yards had to be filled. Throughout the 4-year period as a whole, Senator Flanders, there were some unusual demands set up for filling the pipe lines and refurbishing the plant of our economic system.

Shortly after the cessation of hostilities we set about preparing for war. We were not only preparing but assisting some of our allies. In referring to preparing for war, I include all of the economic efforts of maintaining a front against the Russians in western Europe.

Senator DOUGLAS. It is an exercise in semantics but I would prefer to say that we were preparing against war rather than preparing for war.

Mr. WILLIAMS. Yes; I accept the amendment.

Senator FLANDERS. Didn't you also have a good money supply?

Mr. WILLIAMS. Well, yes. There existed the capacity to take the goods and the desire to take them.

Senator DOUGLAS. There was a tremendous accumulation of purchasing power, built up in the form of these bank reserves, credits, savings accounts of individuals, Government bonds, and so forth, so that there was a tremendous latent purchasing power, there; isn't that true?

Mr. WILLIAMS. That is right.

Senator DOUGLAS. And that, combined with the desire, created an effective demand?

Mr. WILLIAMS. Yes; I think your thumbnail description there contains the broad details. In addition, there was a psychological element that I think needs to be taken into consideration. I will refer to this later in a discussion of our policy with respect to use of the open-market instrument as a mechanism.

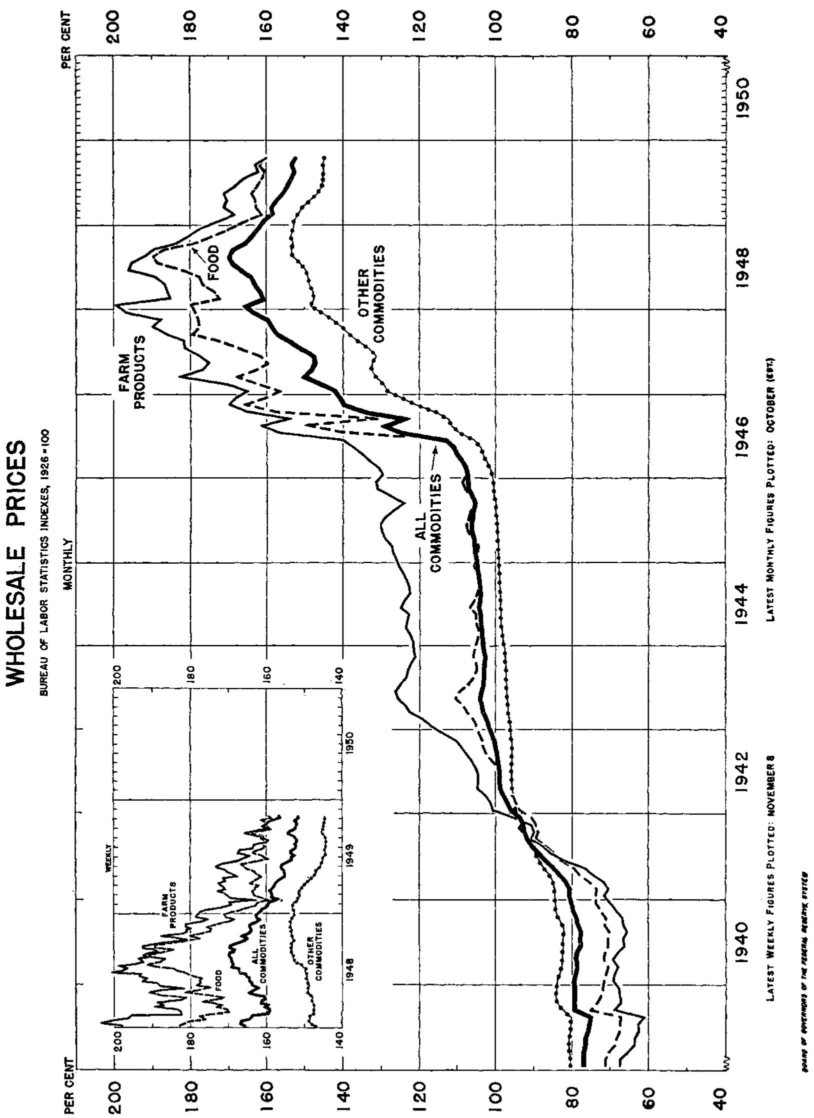
If you look back at the period, this expected depression—if I can use a John L. Lewis phrase—reared its ugly head every spring, almost. Karl, your memory is better than mine. Sketch this potential set-back, the series of set-backs that appear in this period.

Mr. BOPP. We had one in 1946, just after the war. We had another in the spring of 1947, in the spring of 1948, and in the spring of 1949. It seems to be an annual affair. It is a matter that I think merits some study. I must confess that I haven't studied it. It happens also that the Federal budget, even though balanced over a given calendar year, will have a very large surplus of cash receipts in the first half and then a deficit in the second half of the year. Whether this periodic spring recession which we have had is related to that or not I am not altogether sure. It merits inquiry, I should think.

I must confess I felt the inflationary forces would be much stronger. Unless, however, one is awfully dogmatic, and is sure he is right with respect to the future, he is influenced by such periodic recessions. Every spring there would be a gradual decline and one would say, perhaps we had better take another look. We did have this little uncertainty throughout.

Mr. WILLIAMS. That result, as you look back over the period, worked in our favor. What was potentially a situation which could have developed into runaway inflation, just as it could have developed a depression, turned out to be a period of action, where, by fits and starts, we have come through, in my judgment, with remarkably good results. There are others who disagree. But, Mr. Bopp and I would have you look at the chart on commodity prices.

It would be unfortunate if there would be lack of confidence because of a lack of understanding of what transpired during this period.



Mr. Bopp. During the war period, as President Williams has mentioned, we had inflation which was, in a sense, suppressed via direct controls. These controls were removed in the summer of 1946. Immediately you had a very strong upsurge in prices.

It seems to me that much, if not indeed all of that was merely bringing to the surface what had hitherto been held under the blanket of direct controls. Much of that initial post war rise in prices was, in a sense, bringing to the surface what you really had.

If one takes that initial upsurge in prices to the spring of 1947 as merely bringing out the hidden inflation, we find the wholesale price level, relative to 1926, at roughly 150. Subsequent to that the highest point reached was, roughly, 170. So you have 20 points, or 12 to 15 percent, which, it seems to me, is the general order of magnitude we are talking about at being subject to more restrictive credit action. Since then we have had the subsequent decline to roughly 154 at the present time.

Mr. Williams. I would say then, Senator Flanders, that we came through this period in a manner such as to avoid depression, avoid runaway inflation, avoid undue harm to international relations, and without undue disturbance to the internal economy, and with a public debt that was not dislodged, although it had the possibilities of dislodgment.

Now, there is a result, I think, to which the system contributed by means of its powers, and they were modest powers; remarkably good over-all results have been achieved.

We did it by a close intermeshing of the Treasury and the System. Some students will raise the question as to why the support, to the extent that it was given to the Government bond market, was not withdrawn and why we did not allow these forces to have free reign so as to determine, in the market, what the price of money should be.

Now, my friends ask me that question. Well, I serve only intermittently, as do the other presidents under the plan of rotation on the Open Market Committee. I say that as I look back at it, and realize what the responsibilities were, that I think if I were to relive that period, I wouldn't do anything substantially different, especially now that I have knowledge of what the results have been.

There were a great many debates on the part of all of us who were in the System as to what we should do and what we should not do; debates between each other and internal personal debates. I was conscious of the fact that we had a volume of public debt that had increased very greatly, that we had a tense international situation, that we had difficulties of labor adjustment in bringing into a wage structure the realities of power. Someone said that a labor arbitrator is one who unctuously gives to the lion the lion's share. Well, the lion here was demanding a lot. There is no question that we were closely intermeshed. I wouldn't want to debate the question as to who led the parade, but we were going down the road together here.

Let us now turn our backs on this wartime period and the four postwar years, and ask the $64 question: Where do we go from here? That is the question.

Mr. Wolcott. Mr. Williams, how much of the thinking, or has the thinking of the men in your position, been influenced by the fact that we are in a de facto war, and possibly because of our defense efforts—our economy being affected by it as much as it would be during a war—we must approach our problems with about the same spirit as we approached them during the war. How much has that influenced your thinking?

Have I made myself clear? In other words, we are spending a good many billions of dollars for defense, as we were spending a good many billions of dollars during the war for defense. How much has your thinking on economic matters been influenced by the fact that the Government has got to make these continuing expenditures over a period of years—to make these tremendously large expenditures for the defense effort?

Mr. WILLIAMS. I might answer the question in this manner, Congressman Wolcott, that two considerations weigh heavily in my own personal thinking. One is that this is a period of potential war, as you have just said. The other is that, undoubtedly, it is a period of great social struggle. There are at work within the American social fabric forces that will produce results that I think we are not in a position to predict. There is going on here a social struggle which can take a variety of forms. I think that is all right. That is what life is. We get about what we want. We are trying to work out what we want. It doesn't do to rail against the New Deal or the square deal. Our task is to find out what the problems are and to take an intelligent position and try to use our personal influence there.

Now, it is those two forces that are influencing my judgment with respect to what we ought to be doing. I am trying not to use any of my personal predilections in the decisions that I make with respect to the operation of the Federal Reserve System.

Have I answered you? What you have said is a very important factor.

Mr. WOLCOTT. It does have influence on your thinking?

Mr. WILLIAMS. Very definitely.

Mr. WOLCOTT. Apparently we are going to have the problems with us for some time to come.

Mr. WILLIAMS. Yes.

Mr. WOLCOTT. Would it be possible to divorce that from our money? For instance, previous to some date in the thirties, you had a certain amount of commercial paper. We amended the law to make that no longer necessary. So at the present time, with the exception of 25 percent of the gold which is put up, all of the rest of it can be put up in debt, Government bonds. That seems, to many people, to so wed debt to our money as to create instability in the value of the American dollar. Unfortunately as the debt increases and decreases there is such an affiliation between the national debt and the money that fluctuations in debt cause fluctuations in the value of the currency. Is there some way to offset that by, perhaps, segregating—or what term do you use—quarantining—a certain amount of debt, so that it could not be monetized, and by that remove the threat of these constant fluctuations, incident to fluctuations in debt?

Mr. WILLIAMS. Well, Congressman, there are many rational plans that can be devised and have been devised. The difficulty with them is that they are designed to affect adversely our private banking system, our commercial banking system, on the score that the banks reap where they haven't sown.

I have a great reluctance here to give any aid or comfort to consideration of these plans because of my conviction that American free enterprise owes a great deal of its strength to the presence in the structure of 14,000 banks; and, when I look at the return on invested capital in banking and compare it with the returns from other fields, I say the evidence that banks are reaping where they haven't sown doesn't appear in what is either distributed as dividends or added to capital accounts.

Now, if I may stop and digress for a moment. What I say later may be interpreted—improperly interpreted—as being critical of commercial banking. I want here to put in a plug for commercial banking because of the service that it renders. We have in American business a condition whereby there wells up from underneath every year a lot of Joe Dokeses who have unusual capacities to go into business and rub one dollar against another and produce a third. Now, we have got to preserve that. We all benefit by the presence of these people. A great many of them go by the boards. I don't know how many cousins have been put in the grocery business and their failure accepted philosophically by the family providing the funds. The family relatives say: "Well, we guess Joe isn't a good groceryman." But a lot of these fellows are good grocerymen and we need them. How does banking fit into this picture? It works in this way.

We have in these 14,000 institutions a group of loan officers who every day are making thousands of judgments as to whether they ought to put the bank's credit into business ventures. To the extent that these banks are close to the local scene and flexible in their policies, they are picking the people who have managerial talent and are backing them. So you have a screening process at work which brings to the fore these people with talent. There is a social service which banking contributes. I think it ought to be recognized. I mention it to get it in the record.

Senator DOUGLAS. Might I return to a line of questioning which Congressman Wolcott started. It is this: The banks have enormous quantities of Government bonds in their portfolios; and, as I understand it, if the banks present these bonds to the Federal Reserve System, the System must accept them and give them credit in the form of reserves?

Mr. WILLIAMS. That is right.

Senator DOUGLAS. Now, in view of these enormous amounts of bonds held by the banks, doesn't that take away from the Federal Reserve System the power of controlling inflation, because banks can present the bonds, have the accounts credited as reserves, and then can expand their loans to other sectors of business correspondingly; so that doesn't this weaken the amount of control which the System can exercise over the total loan funds of the country?

Mr. WILLIAMS. That is true. The extent or the effect will turn entirely on the price at which we are willing to accept the bonds, Senator Douglas, which is leading directly into the question of the support of the Government bond market, I take it.

I can answer it in this way—and this brings me, incidentally, to the next fundamental point that I want to present: I think that from here out, or at some reasonably near time, we, as a system, ought to be in a position to use fully any of the tools that are necessary on our part to stem the inflationary forces if they develop, and I said at the outset I expect them to develop. Therefore, I think that we are right up against the alternative of whether we are going to regain the use, the flexible use, of the tools at our disposal, which means essentially open-market operation in both directions, buying and selling, as contrasted with a policy of fixed interest rates, where we supply funds in boom times and withdraw them in depression times.

Now, I have indicated before the advantage of use of a general tool. I think that the sharpening of our tools, the regaining of their use, is important. I don't mean to imply that they haven't been used. Perhaps my phrasing is in error. The fuller use of the tools than we have made is entirely compatible with freedom, with the attainment of freedom.

One of the great instruments among the general instruments to which I refer is this device of open-market operations. That has implications for the commercial banks, implications for the Treasury, and implications for the System. If circumstances call for the use of reserve requirements, there must not be a feeling on the part of any bank that this is an improper control. We have weathered the four difficult years. If the circumstances call for a flexible interest-rate structure, there ought not to be any grave doubts about the stability of the credit of the United States Government.

This calls for an understanding of monetary policy on the part of commercial banks and a willingness to accept changes in policy. I think, if we are to obtain that willingness, it calls for a degree of skill in maintaining and creating good banking relations that will bring that acceptance.

Senator Douglas. Might I ask, Mr. Williams, what relationship these statements that you began with would have to the support program of the Reserve System and of the Treasury?

Mr. Williams. I think they are directly related, Mr. Chairman.

Senator Douglas. I wondered if you would itemize them and if you would state specifically what they are.

Mr. Williams. Well, for the Treasury the implications are that we ought to continue to work together closely. Here are two agencies that had a close degree of cooperation during the war period and the postwar period. I think relations were never more satisfactory than they are at the moment, but the mere size of the debt and the mere size of the fiscal operations of the Government are such as to call at all times for study of their implications for general economic stability. An overriding consideration ought not to be low cost of servicing the debt. Uncle Sam is spending $40,000,000,000 and the cost of servicing is about $6,000,000,000, roughly. In other words, we have $34,000,000,000 which is being paid for other things.

Both of these agencies, as indicated at the outset and in our reply to questionnaire, are really under the mandate of the Employment Act, and I think it would not be out of order to get specific reference to that fact in legislation.

Senator Flanders. May I inquire if what you are saying is that you can conceive of conditions in the not distant future in which you think the desirable action would be one which would raise the interest rate to the Government?

Mr. Williams. Yes.

Senator Douglas. How would you do that?

Mr. Williams. Well, one way would be via open-market operations. I am assuming now that conditions would arise which would indicate that we ought not to be supplying funds to the market at the initiative of the market so as to build up already developed inflationary tendencies.

Senator DOUGLAS. Would you describe in some detail the changes in open-market procedures which would be necessary if this policy were to be carried out?

Mr. WILLIAMS. That would depend entirely on the circumstances that arose. I take it that it would not be a step from support to non-support. I indicated at the outset that open-market operations are very subtle; they have to be handled very deftly. You use your leverage in ways that vary greatly according to specific circumstances. We have a large number of onlookers and participants in the Government-bond market who are seeking to understand.

Senator DOUGLAS. Suppose we were to get out of the recession and move into a period of full employment, and then prices started to move upward, so that we would be in danger of inflation. Have you thought about what changes, if any, you believe should be made in the open-market operation?

Mr. WILLIAMS. Well, I think we ought to be siphoning funds out of the market.

Senator DOUGLAS. And how would you do that, by selling Governments?

Mr. WILLIAMS. By selling.

Senator FLANDERS. That might reduce the price of Governments and thereby increase the yield and also increase the interest which the Treasury will be forced to pay on any new issues.

Mr. WILLIAMS. That is right. And I realize, of course, we are entering a period of refundings, in which the volume of refundings are very large, but it is a question of relative costs.

Discuss the matter of relative costs for a moment, Karl.

Mr. BOPP. You have the present interest charge on the Government debt——

Senator DOUGLAS. May I follow up this point?

Mr. BOPP. Yes.

Senator DOUGLAS. Suppose you do sell Governments to the banks and the banks have more Governments. Under your present provisions the banks can then come back and voluntarily present the Government bonds and you have to accept them. Are you proposing now that the Reserve System should not have to accept them?

Mr. WILLIAMS. From the standpoint of the commercial bank, it has a choice as to where it employs its funds. Is it going to invest its funds in Governments, or is it going to employ its funds in the extension of credit.? During the postwar period we exerted a considerable snubbing influence by the management of the short end of the maturity structure; namely, bills and certificates. It may well be that we can operate this account in such a way as to lure banks away from the extension of credit during the inflationary trends in business. We have, also, of course, the tool of reserve requirements.

Senator DOUGLAS. I know. That is always in the background.

Mr. WILLIAMS. Yes.

Senator DOUGLAS. But I was primarily interested in the movement in the open-market operations.

Mr. WILLIAMS. It is a case of alternative choices on the part of the banks.

Senator DOUGLAS. I want to follow up this line of questioning that Congressman Wolcott started some minutes ago, as to whether you think it should continue to be an obligation of the System upon the request of the banks to accept Government bonds and credit that to the reserve accounts of the member banks, thus creating a much greater potential loan capacity, and whether you can have an effective system of control, in your judgment a total system of control, if these powers still remain for the member banks?

Mr. WILLIAMS. Well, it is a question, of course, of using your tools in combination, and it is a question of the price you set on the Governments that are outstanding. We have been pegging the price thus far. A departure from a policy of a fixed price structure is going to bring about an adjustment of market values, and it may well be that banks would prefer to remain in Governments rather than to enter into the field of commercial credit extension.

Senator FLANDERS. May I ask a question? Supposing that it seemed desirable some time before long to allow bond prices to go down and interest rates to go up. That affects our responsibilities here in Congress in the way of searching for a balanced budget. I don't want to say that we are searching with full earnestness and determination. But it is always an ideal that is fluttering around us. Do you see anything in its effect on general business conditions, in which such a policy, appropriately applied at an appropriate time, might have the effect of increasing national income so that it wouldn't have a harmful effect in the long run on the Government income? In other words, that the increased cost of servicing the debt would, by any means, be counterbalanced by the increased return from taxation, or would it be a net loss?

Mr. BOPP. There is another aspect to the problem, because the Government is interested, so far as its budget is concerned, in total expenditures, one item of which is the interest cost on the debt. Suppose we take $5,000,000,000 as the interest cost at present. An increase of 20 percent in that is $1,000,000,000. If, through that increase in the interest charge of $1,000,000,000 you prevent prices from rising, the Government may profit because it is buying 35 or 40 billion dollars' worth of goods and services. A 3-percent increase in prices of the goods and services purchased by the Government would cost the Government as much as a 25-percent increase in the total interest cost to the Government. So far as the Government budget is concerned, it is the total that really interests Congress.

Senator FLANDERS. I am glad that point has been brought out. I would like to follow that up with one further question.

How direct is the influence of the money supply on prices? I raise that question because, as I remember, during the thirties, we increased the debt to some extent, the free money supply along toward $15,000,000,000, and its effect on prices was not very great.

I wondered if you feel that there is a direct and usable relationship between the money supply and the prices.

Mr. WILLIAMS. Mr. Bopp has handed me a page that I had copied out of Dr. Goldenweiser's book on Monetary Management——

Senator FLANDERS. May I just make an inquiry of the staff? I was told that when he was furnished with this questionnaire he sent in his book. I don't know whether that is significant or not.

Mr. Williams. It is a book that has some delicious gems in it, Senator Flanders. Here is one which Mr. Bopp, with a twinkle in his eye, passed along. He is discussing money. [Reading:]

In certain respects money, one of the most concrete of economic entities, is nothing but a state of mind. It means something entirely different to different people, depending on their state of mind. To the miser it is an end in itself. To the spendthrift it is a means of enjoying the process of spending, and to the thrifty, industrious citizen, it is a means of obtaining the necessaries of life and of providing for emergencies and old age. The same amount of money represents plenty for some and penury for others, peace of mind for one group and worry for others. Nor is this entirely a matter of living standards. It differs in its significance for persons with roughly identical standards and economic responsibilities.

There are people who always have enough money and some to spare, almost independently of the size of their income, provided it is not below an irreducible minimum necessary for the maintenance of decent standards. There are others who are always short of money regardless of the size of their income. The difference between the two is not entirely in the magnitude of their wants nor in the degree of their competitive vanity or of appreciation of finer and more costly things. It is in the whole gamut of almost imperceptible minutiae, in habits about gratuities, in preferences about diet, in responsiveness to others' needs, in sensitiveness about criticism, in aptitude for arithmetic, in willingness to take pains, in relative appraisals of the cost of effort, in relative knack for knowing the ropes, in relative degrees of affection for money itself—in a word, in differences more closely associated with the mind than with the pocketbook.

In discussing the economic role of money, the cardinal fact that the forces which affect its functions are not all concrete or easily definable, but are to a considerable degree intangible and psychological, needs to be recognized. It is a negation of the economic man and a recognition of men with different natures, habits, and states of mind. It is a caution signal for the rash generalizer.

Senator Flanders. Is there a general average statistical economic man?

Mr. Williams. Well, we find, Senator Flanders, that bankers who are professionals in the field of money, are motivated in many of the ways that are mentioned here, and that they are psychologically affected. It is difficult, Chairman Douglas, to point out the extent to which uncertainty with respect to the maintenance of par on Government bonds would influence the actions of commercial bankers in the extension of credit. We stand ready takers and sellers, and it may well be that a continuance of this—whereby in periods of business upsurges we are providing funds, and in periods of business recessions we are acting in an opposite way—will render ineffective this important tool that has been placed at the disposal of the System to use in this field to help to reduce economic instability.

So that my general philosophy here is that we are in this period of the rise of governmental action and we have to be careful because ambition will overleap itself and fall on the other side.

Senator Douglas. I don't want to push you too far, but I just want to follow out these questions that I have been attempting to ask.

To what degree are the open-market powers of the System in the period of inflation really effective as long as the banks can then take back to the System the bonds which the System has sold to them and get reserves?

Mr. Williams. That is a matter of their attitude toward disposing or holding the bonds and that in turn is geared into the price.

Senator Flanders. If you sold them to them low enough they might keep them?

Mr. BOPP. Yes. That is, I think the banks and others could be discouraged from selling by the price they will receive when they do sell. Hence they prefer to hold on rather than sell at the lower price; and hence the System is not asked to buy because of the low price which it offers for those securities.

(With the permission of the committee, Mr. Williams subsequently inserted the following amplification of the discussion of a flexible open-market policy:)

The purpose of a flexible open-market policy involving flexible, but not erratic, interest rates would be to promote economic stability by influencing the flow of expenditures through adjustments in the volume, availability, and cost of reserves. The relationship between reserves and the flow of expenditures is not rigid or invariable. For this reason it is not possible to give a precise blueprint for the day-to-day administration of a flexible open-market policy. It is possible, however, to give some implications of such a policy.

Fundamentally, it implies the possibility of movement of both directions—that is, more restrictive as well as less restrictive—as circumstances warrant. This means that there would not be inflexible support at any specified level of prices. It does not, however, mean that the Government securities market would be abandoned to its own fate. Indeed, unanimity does not exist as to the meaning of a "free" market in such securities under existing conditions. Of the $17,000,000,000 of Government securities owned by the Federal Reserve banks, $10,000,000,000 mature within a year; some mature every week. Does a free market mean that maturing issues will be replaced with other issues or that they will be redeemed? If they are to be replaced, with what other issues? If they are to be redeemed, what will happen to the money market from which $10,000,000,000 is withdrawn by the central bank in a year? And what is "natural" about having the rate of withdrawal determined by the particular maturities of issues acquired previously?

Consideration of the maturities of issues in the System account reveals also that the System need not, as is sometimes supposed, sell long-term bonds to withdraw funds from the market. It can do so by not replacing some of its maturing issues. It can reduce reserves also by sales of short-term issues.

The day-to-day operations of the open-market account are influenced not only by the securities in the portfolio but also by market forces whose strength varies a great deal. For example, if investors sell securities because of panic or fear, the appropriate action may be for the System to purchase in order to allay that fear. On the other hand, if owners are selling in order to invest or lend elsewhere, the appropriate action may be to permit yields—long term, short term, or both—to rise and correspondingly to allow prices of securities to fall.

The System is interested in the volume of reserves not as an end in itself but as a means of influencing the flow of expenditures to promote economic stability. In my judgment, the most important way in which the System can make its contribution to stability is through operations in an orderly and flexible but neither a rigid nor a completely free market for Government securities.

Mr. WOLCOTT. May I ask what might be a foolish question. When a member bank puts up its bonds as collateral for a Federal Reserve note, the title of the bond is not transferred to the Federal Reserve bank, is it?

Mr. BOPP. I am sorry. The Federal Reserve banks put up the collateral for Federal Reserve notes which are issued to them by the Federal Reserve agents. The bonds that are put up by the Federal Reserve banks may have been bought from banks or from individuals through open-market operations, namely, through Government securities dealers in the first instance.

Mr. WOLCOTT. Who gets the interest on the bonds which are pledged?

Mr. BOPP. They are owned by the Federal Reserve bank and the Federal Reserve bank gets the interest.

Mr. Wolcott. So the interest is theirs. I was wondering what influence a higher yield on Government bonds would have on their pledging the bonds for currency issues.

Mr. Bopp. I think the way the matter operates, Congressman Wolcott, is that the Federal Reserve bank takes its own Government securities, and if the commercial banks need Federal Reserve notes, they draw down part of their deposit account at the Federal Reserve bank, but they do not specifically send up Government securities to pay for the Federal Reserve notes which they want.

Mr. Wolcott. It is taken out of the reserves deposited with the Federal Reserve?

Mr. Bopp. That is correct. The commercial banks have nothing to do with this collateral reserve requirement. On the general relationship between debt and money, first, it has been historically true, ever since the goldsmiths became bankers, that debt has been related to money, although for a long period of time it was primarily private debt. What has happened is that now it is primarily public debt, but the intimate relationship between the debt and money is the essence of all banking.

Mr. Wolcott. That is the point I bring out. The old goldsmiths determined that there was a certain safe margin, the issuance of certificates against the gold which was in their keeping, and it kept increasing and increasing until the time that the Government came in and took over. We are confronted, apparently, with the same situation today, with respect to Government debt. It seems to me that we have got, somewhere along the line, to get better control, better control of the volume of public debt which can be monetized. Now, as I understand it, the objective of this committee is to find out the causes of our dips and booms, and then recommend to the legislative committees ways and means of preventing them. As I get it you have three weapons, which we will consider orthodox weapons: the manipulation of the rediscount rates, manipulation of reserve requirements, and the open-market operations.

Now, am I correct in the statement that when you increase the rediscount rate, and when the interest rate, or the yield rate on Government bonds is increased, there is a tendency on the part of the banks to pass that on to the commercial borrowers, and does not that influence the demand by commercial borrowers for credit?

Mr. Bopp. Yes, as well as——

Mr. Wolcott. Isn't that the orthodox way of controlling volume and velocity of credit?

Senator Douglas. I don't want to answer the question of my colleague, but is it not true that rediscounting has virtually ceased, and that the amount of paper which the member banks present to the Reserve banks and the System, is infinitesimal?

Mr. Bopp. Yes.

Mr. Williams. That is the psychological tool which I referred to before.

Mr. Bopp. On September 28 of this year the total amount of discounts and advances of all Federal Reserve banks combined was $300,000,000; at the same time the total United States Government securities held by the Federal Reserve System was $17,852,000,000. So that the order of magnitude is 3 out of 178.

Mr. WILLIAMS. I think, Congressman Wolcott, it is also difficult to generalize as to the effect of interest costs on the actions of businessmen, because a prospective profit may mean that the difference in the cost, with a rise of the interest rate, would not deter them from going ahead with their ventures.

Mr. WOLCOTT. Last spring we were told, when we had hearings on corporate profits and earnings, that there were very few stock and bond issues by corporations. How are the people getting their credit if they don't get it from banks?

Mr. WILLIAMS. I think the amount put out varies from time to time——

Mr. WOLCOTT. Put out by whom? The banks?

Mr. WILLIAMS. No, no; I am thinking of the amount of funds from the sale of stocks and bonds, that are issued, by investment bankers' fields, in anticipation——

Mr. WOLCOTT. Let me clarify my own thinking on this. I don't think I am clear on this matter now.

The banks, if they are not rediscounting, where are they getting the money to make the commercial loans, and other loans, anything that they are loaning on? Are they getting it out of earnings?

Mr. WILLIAMS. You have the figures there, Karl, of the increase.

Mr. BOPP. The loans of commercial banks, as a whole—just one moment, till I find the figures.

I have a chart of commercial loans at member banks in leading cities. I shall give you just three dates. Interpolating from the data here—at the beginning of 1948, they were of the general order of magnitude of $15,000,000,000. They fell by the middle of the year to, roughly, $14,000,000,000; and then rose to just under $16,000,000,000; and at the present time are about $13,500,000,000. So you have had a reduction of something like 2½ or 3 billion dollars in the total loans extended by member banks in leading cities, which roughly reflects what has been going on.

So there has not been an increase in bank loans in the last year.

Mr. WOLCOTT. The peak was $17,000,000,000?

Mr. BOPP. For member banks, in the leading cities, roughly $16,000,000,000.

Mr. WOLCOTT. That was due to industrial expansion, perhaps, which has leveled off somewhat?

Mr. BOPP. Yes.

Senator DOUGLAS. Mr. Bopp, the real answer that the banks have such large reserves in the Reserve banks is that they do not need to resort to the System for rediscounting of commercial paper, that they have built up these reserves by gold imports, which have gone through their hands into the System, and into the Treasury. Isn't that the answer?

Mr. BOPP. Yes.

Senator DOUGLAS. And also by the sale of securities?

Mr. BOPP. Yes.

Senator DOUGLAS. To the banks?

Mr. BOPP. Yes; quite right.

Mr. WOLCOTT. It is to be noted that I coupled the manipulation of rediscount notes with the increases in yields on Government bonds. Now, I assume that, because of the large holdings of Government bonds by the banks, if the new issues provided for a larger or higher interest rate, and we do not make provisions for retroactively taking care of the present holdings, that there would be a tendency on the part of the banks to liquidate their present holdings in favor of new issues?

Mr. Bopp. Yes.

Mr. Wolcott. Which brings me down to this point, the point which I started out to put forward: What is going to happen to all of this when we have to retire the savings bonds, the E bonds, and so forth, when we have to refund those, what is going to happen then to our bond market, and this situation generally, when we have to pay off?

Mr. Bopp. The first part, Congressman Wolcott, is technical, and I will take that, if you don't mind, and then the other is more a policy matter.

With respect to the willingness of anyone to hold onto currently outstanding issues, I think you are quite correct in saying they would like to dispose of them, except that for someone to dispose, someone else must acquire, and the other person will not offer a price on the old outstanding issue except one that is commensurate with the yield on the new issue.

Mr. Wolcott. But the Open Market Committee will peg it. Won't they maintain them in some manner?

Mr. Bopp. I misinterpreted the question. I thought you started out by saying, what if the Federal Reserve System, the Open Market Committee, permits an increase in yield on Government securities, which means they do not buy them at the former existing prices, but at lower prices.

Mr. Wolcott. That would be the way you would take care of the outstanding issues, by pegging at a price comparable to the price of the new bonds.

Mr. Bopp. If prices on outstanding issues were pegged at the old level, you would not have the increase in the interest rate or yield that you have mentioned.

Mr. Wolcott. You can increase the yield rate by pegging them at a lower price.

Mr. Bopp. Buying at a lower price, not necessarily pegging.

Mr. Williams. Increase the yield to the extent that it would be in line with the new issue.

Mr. Wolcott. That is right.

Mr. Williams. Of course we have a structure here that is——

Mr. Wolcott. All of which brings me to this point, that, apparently, where we are increasing constantly the reserves of the banks, so that the banks don't even have to rediscount to the Federal Reserve, to get enough credit with which to make their commercial loans, that being the case, as the banks increase the size of their Government portfolios, don't we increase the threat to the stability of our money proportionately as those bonds which are held by the banks might be monetized? What can we do to remove that influence, which I might say will be aggravated when we have to refund the E bonds that are outstanding?

Mr. Williams. We have a price mechanism here that has been in existence, and what I am inferring is that we now ought to get it out and use it.

Senator Douglas. Are you proposing that you would successively lower the support price on bonds, thus increasing the yields, and therefore making it more palatable for the banks to hold the Government bonds which will be sold to them?

Mr. WILLIAMS. No. I am proposing that we inject an element of uncertainty into the structure here, in such a way as to give rise to decisions, alternative choices.

Mr. WOLCOTT. You don't need any new congressional authority to manipulate rediscount rates, do you?

Mr. WILLIAMS. No.

Mr. WOLCOTT. You don't need any new authority in the Open Market Committee to peg the price of Governments. That is a practice among the System?

Mr. WILLIAMS. That is correct.

Senator FLANDERS. Or to unpeg them?

Mr. WILLIAMS. No.

Mr. WOLCOTT. Nor to unpeg them.

Now, we had some discussion this last year in respect to whether you had sufficient authority to manipulate reserve requirements in such manner as to reduce the demand for money or prevent the monetization. Have you any recommendations to make in that respect?

I might say that it has been the practice before congressional committees to make the first witness the "goat," so if you don't care to answer now, you don't have to.

Mr. WILLIAMS. Well, of course, I said at the outset that I do not speak for the System. I take it we will have no hesitancy in coming back if we think that additional authority is needed. The discussions which ensued last May when we asked for renewal of the supplemental grant of 4 percent are clearly in mind. Subsequent developments were such as to indicate they were not needed. It is a matter of judgment as to what is in prospect, and developments have been such as to bring about a decrease, a cession of upward pressures.

Mr. WOLCOTT. Do you think it would be helpful to the stability of our economy to give the Federal Reserve the authority to raise reserve requirements, we will say up to 10 percent, making them so flexible that the Federal Reserve Board could, within its discretion, use them up to that limit?

What I have in mind is this: Wouldn't the fact that the Federal Reserve has the authority to go up to 10 percent cause a great deal of uncertainty which would or might offset all stabilizing influences?

Mr. WILLIAMS. That raises the question of our relationships with the banks and the banking system, which is the last topic that I have to present, and which is an important one, and stems right back to this matter of understanding.

Senator DOUGLAS. Before you proceed to that—Mr. Buchanan.

Mr. BUCHANAN. Would you care to itemize the specific congressional directives to those responsible for policy in the coordination of fiscal-debt management and monetary policy?

Mr. WILLIAMS. I think it ought not to be in terms of specific directives. What I was proposing was a recognition on the part of Congress that management of the public debt is meshed into the operation of the Federal Reserve System, having to do with general credit and monetary policy, so that the two in combination might work with a view to achieving stability. I think it would be regrettable if we get into an attitude that we have a mechanical mechanism that can accomplish results, and then say, thank God, we are organized and can dismiss that question from mind. The situation would be even more regrettable if we have that feeling on the part of one group and a feeling on the part of another group—such as I fear is growing among bankers—that here is just another governmental regulatory body, and a plague on their house. When you get into that position you find too much being expected of the System on the one hand and a resentment for whatever is being done by the System on the other hand. It places you in an impossible position.

We have a thoroughgoing job of public relations on our hands with respect to the whole commercial banking structure. That is what I was referring to a while ago when I gave a plug for commercial banking, when I said that my later testimony might be construed as critical.

Senator FLANDERS. I don't know whether this is what Mr. Buchanan had in mind, but do you have any legislative, any restrictions of law on your rates of rediscount? You can set them what you please, can you?

Mr. WILLIAMS. Yes.

Senator FLANDERS. Do you have any legal restrictions on your open-market operations?

Mr. BOPP. There is one technical qualification with respect to rediscount rates. Section 10 (b) of the Federal Reserve Act, which authorizes the Reserve banks to extend credit to member banks on non-eligible assets, does require that the rate charged by the Federal Reserve bank for such advances be a half a percent higher than the highest discount rate. It is a curious circumstance in which the System has complete discretion with respect to the general level of rates, and with respect to the interrelations of rates, except for this particular rate which must be related to one other particular rate.

Senator DOUGLAS. But that is a minor thing?

Mr. BOPP. Yes.

Senator FLANDERS. So you have no legislative restrictions, practically speaking, on the rediscount rates, you have no legislative restrictions, practically speaking, on the open-market operation, but you do have legislative restrictions on the reserve?

Mr. BOPP. Yes.

Mr. WOLCOTT. May I ask one other question. I was leading up to this. I am trying to find out how much of the debt could be monetized under present authority. I guess perhaps the best way of determining that is to determine how much of the Government debt holdings by Federal Reserve banks is in a position where it could be pledged and that would be approximately three-quarters of the potential, of the possible volume, would it not?

Mr. BOPP. The restriction on Federal Reserve bank acquisition of assets is written in reverse, namely, it is a requirement that the liability on note and deposit accounts be backed by a minimum of 25 percent of gold holdings. So the total liability on these accounts may be equal to four times the gold holdings. Since the liabilities are offset by corresponding earning assets they could be roughly four times our gold holdings. If I remember correctly, our present gold holdings are about $25,000,000,000 which means we could have liabilities in the order of $100,000,000,000 and earning assets of $75,000,000,000.

Mr. WOLCOTT. That would be Federal Reserve notes. That is for the Federal Reserve banks.

Mr. BOPP. That is the Federal Reserve alone. However, if the commercial banks and the public, in their discretion as to the kind of liabilities they wanted, chose to have all of this increase in the form of deposits of Federal Reserve banks, the total for the entire banking system would be much larger. Deposits at the Federal Reserve banks are the reserves of member banks, which in turn enable them to increase their purchases of Government securities. The order of magnitude of the additional reserves would be: $75,000,000,000 of earning assets minus $17,000,000,000, which we now have, or $58,000,000,000. If the average member bank reserve requirement is 20 percent, we multiply that by five and get 240 to 250 billion dollars. So the total for the banking system, including the Federal Reserve, is about $300,000,000,000. In terms of legislative power it is, I should say, well adequate.

Mr. WOLCOTT. May we sum it up this way, and would this be a fair statement, that under existing authority it is theoretically possible to raise the volume of our money to—what would you say?

Mr. BOPP. 400 or 500 billion dollars.

Senator FLANDERS. May I ask a frivolous question at this point, and when I say "frivolous" I mean "frivolous": What would happen if every debt in the United States, private business and Government, were by some magic paid up, what would happen to money?

Mr. WILLIAMS. We would begin to acquire additional debt. The sharp pencil boys would get it from the rest of us.

I have discussed the relationship of the System, on the one hand, with the Treasury. I would like to turn now and consider relationships with the banking system as a whole.

Senator DOUGLAS. Will you discuss their reserve requirements, Mr. Williams, in this connection?

Mr. WILLIAMS. Yes.

Senator DOUGLAS. It is now 12:20 p. m. I wonder if you would return at 2 o'clock, and we will ask the witness who was to appear at 2 o'clock to postpone his appearance until later in the afternoon.

Mr. WILLIAMS. Yes.

Senator DOUGLAS. Thank you very much.

(Whereupon, at 12:20 p. m., a recess was taken until 2 p. m., of the same day.)

AFTERNOON SESSION

Senator DOUGLAS. Mr. Williams, you had not completed your statement this morning, and I take it you had about come to some definite recommendations. We would be very happy to have you proceed now, if you would.

STATEMENT OF ALFRED WILLIAMS, PRESIDENT, AND KARL BOPP, VICE PRESIDENT, FEDERAL RESERVE BANK, PHILADELPHIA—Resumed

Mr. WILLIAMS. I want to talk, if I may, about System relationships with banks. I include this in the presentation because it seems to me to be a problem of first-rate magnitude and affects the atmosphere in which we work. I find—and I think some of the other Federal Reserve Bank presidents do—that bankers are restive; they are skeptical; they are querulous; their morale is low. Some feel aggrieved; feel that they are singled out unduly for attention in this matter of regulation and control.

When one explores the question as to why this should be, the answer divides itself into the attitudes of member banks and of nonmember banks. I think to the extent that it exists among member banks it arises from the upping of reserve requirements last year under inflationary conditions.

Senator DOUGLAS. Would you state for the record the increase in the reserves which was put into effect last year and during this year?

Mr. BOPP. This is the record for 1948 and 1949: On February 27, 1948, reserve requirements of central reserve city banks were increased from 20 to 22 percent; on June 11 they were increased to 24 percent; then on September 16 the reserve requirements for county banks against net demand deposits were increased from 14 to 16 percent, and on time deposits for the same group of banks from 6 to 7½ percent. Effective September 24, the reserve requirements against demand deposits were increased from 24 to 26 percent for central reserve city banks and from 20 to 22 percent on reserve city banks, and at the same time the requirements against time deposits for both groups were increased from 6 to 7½ percent. On May 3, 1949, the reserve requirements for country banks were reduced by 1 percent on demand deposits and by ½ percent on time deposits. On May 5 there was a reduction from 26 to 24 percent against demand deposits for central reserve city banks and from 22 to 21 percent on reserve city banks, and a reduction of ½ percent against time deposits at those two classes of banks.

On June 30 there was a further reduction at reserve city banks from 21 to 20 percent against demand deposits and from 7 to 6 percent on time deposits.

On July 1 there was a reduction of 1 percent against both time and demand deposits of country banks; on August 1, a further decrease of 1 percent on country banks against net demand deposits only. Then a series of changes, a half percent at a time, followed through in August at these various banks.

We could insert the full table in the record, if you want.

Senator DOUGLAS. We would appreciate it if you would.

(The table referred to above is as follows:)

MEMBER BANK RESERVE REQUIREMENTS

[Percent of deposits]

Effective date of change	Net demand deposits [1]			Time deposits (all member banks)
	Central reserve city banks	Reserve city banks	Country banks	
1948—Feb. 27	22	20	14	6
June 11	24			
Sept. 16			16	[2] 7½
Sept. 24	26	22		[3] 7½
1949—May 1			15	[2] 7
May 5	24	21		[3] 7
June 30		20		[3] 6
July 1			14	[2] 6
Aug. 1			13	
Aug. 11	23½	19½		[3] 5
Aug. 16			12	[2] 5
Aug. 18	23	19		
Aug. 25	22½	18½		
Sept. 1	22	18		
In effect Oct. 1, 1949	22	18	12	5

[1] Demand deposits subject to reserve requirements, i. e., total demand deposits minus cash items in process of collection and demand balances due from domestic banks (also minus war loan and series E bond accounts during the period Apr. 13, 1943-June 30, 1947, and all U. S. Government demand accounts Apr. 24, 1917-Aug. 13, 1935).

[2] Requirement became effective at country banks.

[3] Requirement became effective at central reserve and reserve city banks.

Senator DOUGLAS. Do I understand, Mr. Williams, that member banks feel these reserve requirements are too high?

Mr. WILLIAMS. Resistance to the increase, I think, grew out of two reactions on the part of the member banks.

(1) A feeling that the timing was not good and not completely understanding what the conditions of business were that brought about the increases; and

(2) The problem of competitive relationship. Frequently we think of this in terms of the low percentage of deposits in nonmember banks and say that this is a relatively minor matter, and is a low price for the freedom that State banks enjoy for having the right to come in the System or stay out of the System and, therefore, we ought not to disturb it.

Senator DOUGLAS. I had some figures prepared on this by the members of the staff. They show that, as of June of this year, of the 14,149 commercial banks, 4,987 were national banks and a little less than 2,000 were State banks inside the System, or a total of around 6,900 banks inside the System, or about 49 percent.

But the deposits which these banks held amounted to 85 percent of the total deposits in the country. I wondered if there is not a sufficient body to the dog to be able to wag the tail.

Mr. WILLIAMS. Competitively, the placement of a nonmember bank in a local situation can be such as to work a disproportionate influence. Furthermore, quite apart from whatever advantages, real and fancied, there are to nonmembership, you have a psychological factor. If, when he is restive, the question of increase in requirements comes up, the member bank begins to raise——

Senator DOUGLAS. Are you saying this: That among the 2,000 State banks, which, by their own choice are members of the Federal Reserve System, but which may have the power, as I understand it, to withdraw from the System at any moment, that there are rumblings that some of them may get out of the System, at least?

Mr. WILLIAMS. There is talk. I think there is more talk than actual intention. In our own district two banks have raised the question, two banks of considerable size. In one instance the banker came down and went over in some detail the advantages in dollars and cents of getting out, and talked with us at some length about that.

Senator DOUGLAS. I wonder if you would be willing to make a considered statement on the relative advantages and disadvantages to a State bank as to whether or not it will voluntarily join or stay in the System.

Mr. WILLIAMS. May I have the privilege of working that out and inserting it in the record?

Senator DOUGLAS. I wonder if we could develop some of it by questions. What is the situation on clearance? Do nonmember banks have their checks cleared through the Federal Reserve System?

Mr. WILLIAMS. Generally speaking, the nonmember bank is operating via a correspondent city bank; there are some exceptions.

Senator DOUGLAS. Their checks are cleared through their correspondent, which is a member of the System, you mean, rather than directly?

Mr. WILLIAMS. That is right; and the correspondent in turn may be using our facilities, doing some of the work himself and not doing other portions of it.

Senator DOUGLAS. Will the State banks have the privilege of clearing directly through the System?

Mr. WILLIAMS. Only to a very limited extent.

Senator DOUGLAS. But, when they operate through a corresponding bank, is any service charge made to the State bank not a member of the System for having its checks cleared by the System?

Mr. WILLIAMS. No.

Senator DOUGLAS. So that service is given to them free, although it costs the Government naturally something to provide it. That is not an advantage, then, for their joining the System, since they can get the service without cost through a correspondent bank which is a member.

Mr. WILLIAMS. That is right. There is also a question as to relative efficiency of the two systems. Always we are attempting to improve our service and speed up delivery, but I would not want to imply that we always do a better job than correspondent banks, because that does not necessarily follow.

Senator DOUGLAS. But, if correspondent banks clear through the System, then they extend those privileges by that fact.

Mr. WILLIAMS. The clearances are direct on the part of the correspondent bank, where they have relationships with other correspondent banks, and one cannot generalize about that situation.

Senator DOUGLAS. Have you ever tabulated the laws and regulations which apply to national banks and to State banks that are members of the Federal Reserve System but which do not apply to State banks not members of the System?

Mr. WILLIAMS. Our vice president in charge of bank examinations has. I would not feel competent to testify offhand.

Senator DOUGLAS. I have had a list prepared, which comes to 30 items, which are restrictions upon members of the System which are not restrictions upon nonmembers of the System.

Mr. WILLIAMS. They exist; there is no question.

Senator DOUGLAS. They are limitations on total loans to one borrower, regulations governing purchase of investment securities, prohibition against purchasing stocks, prohibition against engaging in underwriting of investment securities and stocks, restrictions on loans to executive officers, restrictions on dealings with directors, restrictions on interlocking directorates or other interlocking relations with other banks and with securities companies, prohibition against banks having less than 5 or more than 25 directors, provision authorizing supervisory authority to remove officers and directors for continued violations of law or continued unsafe and unsound practices, prohibition against affiliation with securities companies, restriction on holding-company affiliates, restriction on bank stock representing stocks of other corporations, limitations on loans to affiliates, requirements of reports of affiliates and publication thereof, requirements for examination of affiliates, limitations on investment in bank premises, minimum capital requirements, minimum capital requirements for branches, prohibitions against loaning on or purchasing own stock, restrictions on withdrawal of capital and payment of unearned dividends.

If this list is correct, there are a large number of restrictions which are imposed upon members designed to safeguard the integrity of the deposits which are not imposed on nonmembers.

Mr. WILLIAMS. Yes.

Senator DOUGLAS. And, therefore, nonmembers in the absence of stringent State regulations are in general able to get many of the advantages of the Federal Reserve System but without subjecting themselves to these limitations; is that correct?

Mr. WILLIAMS. Yes.

Senator DOUGLAS. And would you develop the question of reserves, namely, comparative reserves?

Mr. WILLIAMS. These vary widely from State to State, but I think it undoubtedly is an accurate generalization to say that our requirements are higher than the State requirements. One can illustrate that in the statements that nonmember banks make to our field men when we approach them. I could have Mr. Bopp give you a few of those.

Senator DOUGLAS. I wish you would.

Mr. BOPP. These relate primarily, Mr. Chairman, to the objections which nonmembers had to the question of the increase in reserve requirements in the year 1948.

Senator DOUGLAS. Which nonmembers had?

Mr. BOPP. Excuse me—which members had because the higher requirements were not applicable to nonmembers.

First, "opposed to any increase unless applicable to all banks"; second, "feels the increase in reserves very unfair to member banks"; third, "if a member bank's reserves are increased further, this State bank member's board of directors will undoubtedly consider withdrawing from the System."

Those are comments which our field men get; whether the bank would actually withdraw, of course, is not demonstrated.

Continuing, "administration was wrong in not subjecting nonmembers to the same reserve requirements as members"; "unfair, should apply to nonmembers"; "opposed to giving Board more power in this direction"; "officer agrees with Federal Reserve policy curtailing credit but recommended withdrawal of their State bank from the Federal Reserve System because of the increased reserve requirements."

These are illustrative comments which we have received, which our field men have received from member banks with respect to the difference in requirements.

Senator DOUGLAS. In connection with another matter, Senator Flanders and I had a comparative study made on State reserve requirements, and I should like to have that put in the record at this time.

(The study referred to above is as follows:)

*State reserve requirements for commercial banks and trust companies, July 1, 1949**

SECTION A—REQUIREMENTS FOR SO-CALLED "COUNTRY BANKS," I. E., BANKS NOT DESIGNATED OR APPROVED AS RESERVE DEPOSITARIES, NOT LOCATED IN CENTRAL RESERVE OR RESERVE CITIES, ETC.

State	Required reserves			Composition of reserve required on demand deposits			Composition of reserve required on time deposits		
	Uniform requirements on demand and time deposits	Different requirements on— Demand deposits	Different requirements on— Time deposits [1]	Vault cash	Either balances with depositary banks or vault cash	Securities, balances with depositary banks, or vault cash [2]	Vault cash	Either balances with depositary banks or vault cash	Securities, balances with depositary banks, or vault cash [2]
	Percent of deposits specified			Percent of demand deposits			Percent of time deposits		
Alabama		15.0	4	0	15.0	0	0	4.0	0
Arizona		15.0	10	5.0	10.0	0	2.5	7.5	0
Arkansas	[3] 15.0			0	15.0	0	0	15.0	0
California		12.0	5	4.0	8.0	0	1.0	0	4.0
Colorado	15.0			[4] 3.0	12.0	(4)	[4] 3.0	12.0	(4)
Connecticut		15.0	0	4.0	9.0	2.0	0	0	0
Delaware		14.0	6	0	14.0	0	0	6.0	0
District of Columbia		20.0	6	0	[5] 20.0	0	0	[5] 6.0	0
Florida	20.0			0	0	20.0	0	0	20.0
Georgia		15.0	5	0	15.0	0	0	0	5.0
Idaho	15.0			0	10.0	5.0	0	10.0	5.0
Illinois (no statutory reserve requirements)									
Indiana		12.5	3	0	12.5	0	0	3.0	0
Iowa		7.0	3	1.05	5.95	0	.45	2.55	0
Kansas [6]		12.5	5	0	12.5	0	0	5.0	0
Kentucky		7.0	3	2.33	4.67	0	1.0	2.0	0
Louisiana		20.0	0	0	20.0	0	0	0	0
Maine		14.0	6	4.67	9.33	0	2.0	4.0	0
Maryland		15.0	6	0	15.0	0	0	0	6.0
Massachusetts		15.0	0	3.0	6.0	6.0	0	0	0
Michigan	12.0			0	12.0	0	0	0	12.0
Minnesota		12.0	5	0	12.0	0	0	5.0	0
Mississippi		15.0	7	0	15.0	0	0	7.0	0
Missouri		15.0	3	3.0	12.0	0	3.0	0	0
Montana	10.0			0	10.0	0	0	10.0	0
Nebraska		15.0	5	0	12.0	3.0	0	4.0	1
Nevada	15.0			0	15.0	0	0	15.0	0
New Hampshire		15.0	5	0	15.0	0	0	0	5.0
New Jersey		15.0	3	3.0	12.0	0	.6	2.4	0
New Mexico	12.0			0	12.0	0	0	12.0	0
New York		14.0	6	0	14.0	0	0	6.0	0
North Carolina		15.0	5	0	15.0	0	0	5.0	0
North Dakota		10.0	[7] 5	0	10.0	0	0	5.0	0
Ohio		15.0	10	0	15.0	0	0	4.0	6.0
Oklahoma		15.0	5	0	15.0	0	0	5.0	0

*In most cases the percentage requirements shown are prescribed in the State law itself. Where the law empowers banking authorities to change reserve requirements, the percentages shown are those which were actually in effect on July 1, 1949. The data in this table are based on Provisions of State Laws Relating to Bank Reserves as of December 31, 1944, published by the Board of Governors of the Federal Reserve System, and on changes in State reserve requirements reported to the Board since that time; the data have not been checked with the State banking authorities.

[1] The reserve requirements shown in the "Time deposits" column for Arizona, California, Connecticut, Massachusetts, Nebraska, Rhode Island, Utah and Wyoming apply only to deposits in the savings departments of commercial banks and trust companies. Other time deposits are subject to higher requirements, but inspection of State banking department annual reports indicates that such deposits in California' Connecticut, Massachusetts, and Rhode Island State commercial banks and trust companies are relatively small in comparison with deposits in their savings departments.

[2] Securities eligible as reserves are United States Government obligations and, in some instances, State and municipal obligations.

[3] There is a 50-percent requirement for banks in places with less than 1,500 population, with capital of $10,000 or more but less than $25,000.

[4] The required 3 percent vault cash reserve may be held "in cash and/or obligations of the United States."

[5] Vault cash may not be counted as part of the required reserve.

[6] For trust companies the reserve requirements are 25 percent of demand and 10 percent of time deposits, but there are only four trust companies (with little or no deposits) in the State.

[7] There is a 10-percent requirement on "secured savings deposits."

State reserve requirement for commercial banks and trust companies, July 1, 1949 (Section A)—Continued

State	Required reserves			Composition of reserve required on demand deposits			Composition of reserve required on time deposits		
	Uniform requirements on demand and time deposits	Different requirements on—Demand deposits	Different requirements on—Time deposits [1]	Vault cash	Either balances with depositary banks or vault cash	Securities, balances with depositary banks, or vault cash [2]	Vault cash	Either balances with depositary banks or vault cash	Securities, balances with depositary banks, or vault cash [2]
	Percent of deposits specified			Percent of demand deposits			Percent of time deposits		
Oregon		15.0	[8] 5	0	15.0	0	0	5.0	0
Pennsylvania		14.0	6	0	8.4	5.6	0	3.6	2.4
Rhode Island		15.0	0	6.0	9.0	0	0	0	0
South Carolina		7.0	3	0	7.0	0	0	3.0	0
South Dakota	17.5			0	7.0	10.5	0	7.0	10.5
Tennessee		10.0	3	0	10.0	0	0	3.0	0
Texas		[9] 15.0	5	0	15.0	0	0	5.0	0
Utah		15.0	5	1.88	13.12	0	1.25	3.75	0
Vermont		20.0	7	0	8.0	12.0	0	2.8	4.2
Virginia		10.0	3	0	10.0	0	0	3.0	0
Washington	15.0			0	15.0	0	0	15.0	0
West Virginia		10.0	5	2.0	8.0	0	1.0	4.0	0
Wisconsin	12.0			0	8.0	4.0	0	8.0	4.0
Wyoming		20.0	10	0	20.0	0	0	10.0	0

[1] The reserve requirements shown in the "Time deposits" column for Arizona, California, Connecticut, Massachusetts, Nebraska, Rhode Island, Utah, and Wyoming apply only to deposits in the savings departments of commercial banks and trust companies. Other time deposits are subject to higher requirements, but inspection of State banking department annual reports indicates that such deposits in California, Connecticut, Massachusetts, and Rhode Island State commercial banks and trust companies are relatively small in comparison with deposits in their savings departments.

[2] Securities eligible as reserves are United States Government obligations and, in some instanues, State and municipal obligations.

[8] There is a 10-percent requirement on time deposits in noninsured banks, but there was only one such bank on July 1, 1949, and it had no deposits.

[9] There is a 20-percent requirement for banks with capital stock of less than $25,000.

State reserve requirement for commercial banks and trust companies, July 1, 1949 (Section A)—Continued

SECTION B—REQUIREMENTS FOR BANKS DESIGNATED OR APPROVED AS RESERVE DEPOSITARIES, ETC.**

State	Required reserves			Composition of reserve required on demand deposits			Composition of reserve required on time deposits		
	Uniform requirements on demand and time deposits	Different requirements on—		Vault cash	Either balances with depositary banks or vault cash	Securities, balances with depositary banks, or vault cash [2]	Vault cash	Either balances with depositary banks or vault cash	Securities, balances with depositary banks, or vault cash [2]
		Demand deposits	Time deposits [1]						
	Percent of deposits specified			Percent of demand deposits			Percent of time deposits		
Arizona		20.0	10	6.67	13.33	0	2.5	7.5	0
Arkansas	20			8.0	12.0	0	8.0	12.0	0
California, banks in places with population of—									
100,000 or more		18.0	5	[3] 9.0	9.0	0	1.0	0	4.0
50,000 to 100,000		15.0	5	[3] 7.5	7.5	0	1.0	0	4.0
Colorado		20.0	6	[4] 4.0	16.0	(4)	[4] 1.2	4.8	(4)
Iowa		10.0	3	1.5	8.5	0	.45	2.55	0
Kansas		12.5	5	0	12.5	0	0	5.0	0
Kentucky		10.0	3	3.33	6.67	0	1.0	2.0	0
Massachusetts		20.0	0	4.0	8.0	8.0	0	0	0
Minnesota		15.0	5	0	15.0	0	0	5.0	0
Mississippi		25.0	10	0	25.0	0	0	10.0	0
Missouri		18.0	3	7.0	11.0	0	3.0	0	0
Montana	15			0	15.0	0	0	15.0	0
Nebraska		20.0	5	0	16.0	4.0	0	4.0	1.0
Nevada	15			0	15.0	0	0	15.0	0
New York:									
Manhattan Borough		24.0	7	0	24.0	0	0	7.0	0
Brooklyn, Bronx, and Buffalo		20.0	7	0	20.0	0	0	7.0	0
Oklahoma		18.0	5	0	18.0	0	0	5.0	0
Utah		20.0	5	2.5	17.5	0	1.25	3.75	0
Wisconsin	20			0	13.33	6.67	0	13.33	6.67

*In most cases the percentage requirements shown are prescribed in the State law itself. Where the law empowers banking authorities to change reserve requirements, the percentages shown are those which were actually in effect on July 1, 1949. The data in this table are based on Provisions of State Laws Relating to Bank Reserves as of December 31, 1944, published by the Board of Governors of the Federal Reserve System and on changes in State reserve requirements reported to the Board since that time; the data have not been checked with the State banking authorities.

**In States not listed in this section or in this footnote, the reserve requirements shown in section A are applicable to all State commercial banks and trust companies. The requirements shown in this section apply to banks designated or approved as Reserve depositaries, banks in central Reserve or Reserve cities, banks in specified cities, and banks in cities with specified population, as follows: Arizona—the requirement applies to banks in places with population of 50,000 or more. Arkansas—the 20-percent requirement applies to banks designated as Reserve agents. California—the requirements for banks in places with population of 50,000 to 100,000 apply also to Reserve depositaries in places with population under 50,000. Colorado—the requirements apply to banks designated as Reserve agents. Iowa—the requirements apply to banks in Reserve cities (designated as such under the Federal Reserve Act). Kansas—a 20-percent Reserve is required against demand deposits due to banks; the 12.5-percent requirement applies to other demand deposits. Kentucky—the 10-percent requirement on demand deposits applies to banks in Reserve cities. There is a 13-percent requirement against demand deposits for central Reserve city banks, but there is no central Reserve city in the State. Massachusetts—the requirement applies to trust companies doing business in Boston and less than 3 miles from the State House. Minnesota—the requirements apply to banks in Reserve cities (designated as such under the Federal Reserve Act). Mississippi—the requirements apply to banks in places with population over 50,000. Missouri—the requirements apply to banks in places with population of 200,000 or more. Montana—the requirement applies to banks approved as Reserve depositaries. Nebraska—the requirements apply to banks in cities with population of 25,000 or more. Nevada—a 25-percent Reserve is required against deposits due to banks; the 15-percent requirement applies to other demand deposits. Oklahoma—the requirements apply to approved depositaries. Utah—the requirements apply to banks in places with population of 50,000 or more. Wisconsin—the requirement applies to banks designated as Reserve depositaries.

[1] The reserve requirements shown in the "Time deposits" column for Arizona, California, Massachusetts, Nebraska, and Utah apply only to deposits in the savings departments of commercial banks and trust companies. Other time deposits are subject to higher requirements, but inspection of State banking department annual reports indicates that such deposits in California and Massachusetts State commercial banks and trust companies are relatively small in comparison with deposits in their savings departments.

[2] Securities eligible as reserves are United States Government obligations and, in some instances, State and municipal obligations.

[3] The "vault cash" requirements (9 percent for cities with population over 100,000 and 7.5 percent for cities with population of 50,000 to 100,000) apply only to reserve depositaries in such cities; for other banks in such cities the vault cash requirement is 6 percent, and the balance of the required reserve may be held with depositary banks.

[4] The required vault cash reserve may be held "in cash and/or obligations of the United States."

Basic statutory requirements, actual requirements on July 1, 1949, and minimum and maximum reserve requirements for State commercial banks and trust companies in States in which banking authorities are empowered to change reserve requirements

State	Percent of demand deposits				Percent of time deposits			
	Basic	Actual	Minimum	Maximum	Basic	Actual	Minimum	Maximum
Alabama [1]	-----	-----	-----	-----	1	4	1	5
Arkansas [2] [3]	15	15	15	FR	15	15	15	FR
Connecticut [4]	12	15	12	([5])	0	0	0	0
Delaware	7	14	FR	FR	3	6	FR	FR
District of Columbia	FR	20	FR	FR	FR	6	FR	FR
Kentucky:								
Reserve cities [6]	10	10	10	20	3	3	3	6
Elsewhere [6]	7	7	7	14	3	3	3	6
Maine	15	14	([5])	FR	0	6	0	FR
Maryland	15	15	15	FR 30	3	6	3	FR 6
Massachusetts: [4]								
Boston [7]	20	20	([5])	([5])	0	0	0	0
Elsewhere	15	15	([5])	([5])	0	0	0	0
Michigan [2]	12	12	12	24	12	12	12	24
New Hampshire	15	15	([5])	FR	5	5	[8] 5	[8] 5
New Jersey	15	15	15	30	3	3	3	6
New Mexico [2]	12	12	12	15	12	12	12	15
New York:								
Manhattan Borough	13	24	13	FR 26	0	6	0	([5])
Brooklyn, Bronx, and Buffalo	10	20	10	FR 20	0	6	0	([5])
Elsewhere	7	14	7	FR 14	0	6	0	([5])
North Dakota	10	10	10	20	5	5	5	10
Ohio	15	15	([5])	([5])	10	10	([5])	([5])
Oregon [9]	15	15	12	30	5	5	4	10
Pennsylvania	15	14	([5])	30	7.5	6	([5])	15
Utah:								
Large cities [10]	20	20	20	40	5	5	5	10
Elsewhere	15	15	15	30	5	5	5	10
Vermont	15	20	9	30	3	7	2	8

FR—This sumbol standing alone signifies that the State law provides that the basic, maximum, and/or minimum shall be the same as prescribed by Federal authorities for member banks; where the symbol appears with a percentage, the requirement prescribed by State authorities may not exceed either that percentage or the corresponding requirement applicable to member banks.

[1] The provision for changes in reserve requirements by the State banking board applies only to time deposits.

[2] In Arkansas, Michigan, and New Mexico, identical requirements apply to demand and time deposits. However, in Michigan the entire reserve on time deposits may consist of United States Government securities.

[3] Neither these percentages nor the authority to change requirements extends to banks designated as reserve agents.

[4] In Connecticut a 7 percent requirement is applicable to time deposits in the commercial department, and in Massachusetts the demand deposit requirement applies to certain time deposits in the commercial department. This table, however, shows zero requirements against time deposits, because the deposits in savings departments (of departmental banks) comprise all but a relatively small portion of their time deposits.

[5] None specified.

[6] The State law prescribes higher requirements for banks in central reserve cities, but there are no such cities in the State.

[7] Applies to banks in Boston and within 3 miles of the State House.

[8] The range of reserve requirements on time deposits in the commercial department is from zero (apparently) to the Federal Reserve maximum, but the reserve requirement on deposits in savings departments of commercial banks is the same as fixed for savings banks, namely, 5 percent.

[9] Neither these percentages nor the authority to change requirements extends to noninsured banks, but there was only 1 such bank on July 1, 1949, and it had no deposits.

[10] Banks in cities with a population of 50,000 or more.

Senator Douglas. In brief these tables show a general requirement somewhere around 15 percent, although in most cases this could be in the form of deposits in correspondent banks as well as vault cash, but there were certain States which fell even markedly below this standard. My own State of Illinois has no statutory reserve requirements. Kansas has 12½ percent, Kentucky has 7 percent, California has 12 percent, Minnesota has 12 percent, South Carolina has 7 percent, Tennessee has 10 percent, Washington has 10 percent, West Virginia has 10 percent.

So that you think the conclusion is that in general the reserve requirements are lower under the State system for State banks not members of the System than in banks which are members of the System?

Mr. WILLIAMS. That is right.

Senator DOUGLAS. And that a considerable portion of this can be in the form of mutual deposits—A in B and B in A?

Mr. WILLIAMS. I think it is fair to say that there are competitive disadvantages from the standpoint of reserve requirements in membership in the System. These are offset in other ways.

Senator DOUGLAS. Now, has this fact that the State banks can always get out of the Federal Reserve System ever operated to deter the System from raising reserve requirements? Is it a factor which is present in your considerations?

Mr. WILLIAMS. I confess the statement in the report submitted for the record, which said that the Board might be reluctant to take action because of the effect of the action on membership, escaped me. Personally, I doubt very much whether that is a factor in the determination of Board policy. I think that is an overstatement. That would be my judgment. We are living with the problem in other ways than attempting to solve it by not acting. Do I make myself clear?

Senator DOUGLAS. Yes.

Mr. WILLIAMS. I would doubt whether that was an important factor in the determination of Reserve policy, hesitancy to act because of the fear of withdrawals.

We have had one withdrawal—that is, not associated with consolidation or merger—in 10 years. I checked on the matter for the third district just before I left.

But that does not indicate that it does not have its effect through the generation of a state of mind, because there is undoubtedly a spirit of restiveness. I think it is apparent. I think you would share that feeling, Mr. Bopp.

Mr. BOPP. Yes, sir.

Mr. WILLIAMS. Both of us get into the field very frequently because of the policy of the bank of going out some 30 times a year to meet with bankers in our district in small groups. Each of these bankers brings a director with him. We have a round-table discussion for a period of 2 hours before dinner and a period of an hour after dinner in an attempt to bring to the bankers and their directors—and, incidentally, we bring nonmembers in on this discussion—in line with our general approach that one way to solve the problem is through education and the increase of understanding.

In the course of those discussions we get the feeling that the Federal Reserve is constantly in their minds. We get the feeling that there is activity on the part of State organizations. I think there is undoubtedly a wish to build a defense or to stem a tide that may at any time start legislation.

From the standpoint of public relations, it is an unhealthy situation. It raises a question as to how you solve it. I have pondered the question of legislation.

You have before you a proposal from the chairman. I admire the chairman's efforts in attempting to divorce this problem of monetary policy operating through reserve requirements from the question of the dual banking system, which always serves as a battle cry. He attempts to do that by stating that we are interested in having some influence on bank policy and on national policy via your bank through your reserve requirements, and he puts forward a plan which, as you know, would compel all to come in, but I am firmly——

Senator DOUGLAS. Just a minute. I do not think Mr. McCabe's proposal is to have all banks come into the Federal Reserve System, but to rather require a uniform reserve requirement.

Mr. WILLIAMS. I was using the term "banking system" in a different sense; and, of course, he gives an alternative.

Senator DOUGLAS. His proposal is for uniform reserve requirements for commercial banks the country over, whether or not members of the System.

Mr. WILLIAMS. That is right; I did not make my statement clear. I do not think that an approach of that sort would be an acceptable one to the nonmember banks. From my contact with bankers, I conclude that they are thoroughly aroused, Mr. Chairman, on this question of the long arm of the Central Government reaching out and coming in to the State banking system; and I think there is little likelihood that one would be able to get Mr. McCabe's proposal into action.

I took the same position before the Senate Banking and Currency Committee last May, where, as you will recall, there was attached to the application for renewal of the supplementary reserve requirement this condition of applying it to nonmember banks.

The president of a State bankers association told me within 3 months that in his judgment the dual banking system in the United States was not a classification which separated national banks from banks that received their charters from States, but it was a classification of banks into member banks and nonmember banks.

Senator DOUGLAS. But the State banks always have the option of withdrawing.

Mr. WILLIAMS. Surely.

Senator DOUGLAS. So that makes the differentiation applicable, and also the rules concerning the types of loans which can be made are different, so that there are very real differences on those points.

Mr. WILLIAMS. That is right, but I am citing this to indicate his attitude of mind as to what the crucial problems were. The crucial problem in his mind was one of avoiding compulsion to get into the Federal Reserve System.

Now, from our standpoint that poses a major problem of bank relations. If a large number of banks out in the country feel that way about us, then we have an important problem on our hands as to how to dissipate that attitude of mind, because in my 10 years experience with the Federal Reserve System, I have no inclination to work in any other way than in behalf of banking, both State and national.

To have others judge your actions as being something inimical to their interests is disturbing. So that I assume you cannot approach the problem via coercive means because you will not get the bill, if you attempt to approach it that way. It has been suggested that we approach it via the route of self-discipline.

If I recall correctly, the retiring president of the American Bankers' Association in San Francisco has raised the question of State banks and their forcible inclusion in the system. He takes the position that although they are 50 percent in number of all banks in the United States, they have only 15 percent of the deposits and, therefore, they are unimportant. He would rely on self-discipline. I reject the self-discipline approach just as I reject compulsory legislation. I reject self-discipline, because it does not work because of competitive forces. It cannot very well work because of competitive forces.

I turn then to still another approach, and that is one of increasing an understanding of the function of the System, and the way it operates—and not only increasing the understanding but increasing the participation of the bankers in making decisions through the process of consultation and explanation in why we are doing what we are doing. In that way will be stepped up the voluntary entrance into the System.

Now, that may be a long procedure but I prefer to follow it. Should it fail, then I am for the use of compulsory methods, maybe along the lines that the chairman devised. It is an important problem and ought to be thoroughly studied and a plan worked out only after study by both private banks and the central bank together. A thorough explanation of the problem is needed; because we are now suspect. We hear in the field directly and indirectly that the System wants "Power for the sake of power." We get evidence on every hand of a lack of understanding as to what the function of reserves is and as to how they operate.

Senator DOUGLAS. In your educational conference do you ever quote from article 1, section 8, of the Federal Constitution, which gives to Congress the power "to coin money, regulate the value thereof"—and the verb "coin" has long since been broadened to include not merely metallic coins and also printing paper money, but the general regulation of the money supply, and if there is anything clearer than that power I do not know what it is, do you?

Mr. WILLIAMS. No. I state the matter a little differently. I say to bankers we have 3½ million business enterprises in the United States. Only 14,000 are banks. Now, banks are peculiar in this capacity to create and extinguish credit. From the days of the founding of government, you have been subject to controls. Do not assume at a time when the whole drift is toward totalitarianism that you are going to swim in the opposite direction. Your important problem is: if you do not like the system, devise a better one. If you think we ought to change it, come in and help us change it. But if you do not understand the way in which reserve requirements operate, it is high time you begin to understand this function, because you have a very valuable task to perform in the operation of the economy and you cannot perform it by assuming that you are just like the fellow making sealing wax or shoes. You are a different breed of cat. I would add that in addition to understanding it is a matter of confidence. That may give you, Senator Douglas, something of the spirit of the way in which I am approaching the problem. At the same time, I repeat with equal vigor what I said earlier in the testimony here today. I say, let banking live. We need it for the reasons that I outlined earlier in my testimony.

I assume that the task of achieving understanding and confidence is one not only on the part of the Federal Reserve Governors and the 12 Reserve banks, but of banking leadership throughout the commercial banks.

I had the same feeling when I listened to Mr. Sproul make his speech in San Francisco and heard Mr. Woollen's reply, which, of course, was a very brief one, and listened to the conversations afterward in the lobbies of the hotels. It is disturbing to one who is a well-wisher of banking and who believes in general controls rather than a series of specific controls.

Senator DOUGLAS. Are you saying this: that you are somewhat afraid that if an inflationary movement should start or in the opinion of the Federal Reserve System it should start and that the Federal Reserve System in order to check this increased its reserve requirements, that it would meet with terrific opposition or with great opposition from the banks inside the System and would be subject to competition from the banks that are outside the System?

Mr. WILLIAMS. And could result in withdrawals from the System.

Senator DOUGLAS. And you know, of course, that the bill which passed the House of Representatives and was reported out by the Senate committee—namely, making possible conversions of National banks into State banks—has not yet been passed?

Mr. WILLIAMS. I think it is highly unfortunate for the State banking departments and State banking commissioners to view with alarm any change from State banks to National banks, any change from nonmembership to membership. I do not think they should look at this in terms of proprietary interest.

Mr. WOLCOTT. This is opposite.

Senator DOUGLAS. This is from National to State.

Mr. WILLIAMS. Yes.

Senator DOUGLAS. Which was fostered by the State banking commissioners.

Mr. WILLIAMS. Perhaps I ought to amplify my statement and say some look with satisfaction upon a transfer from the National system to the State system.

Senator DOUGLAS. I do not want to involve you in an argument, but the head of the State banking commission in Pennsylvania has been most active in spearheading this drive of conversion from National banks to State banks on the same basis that State banks can now convert to national banks and in trying to repeal the section of the McFadden Act which prohibits such conversions.

Mr. WILLIAMS. My problem has been made more difficult by what is going on in the States. There are complexities from a State standpoint because of the acquisition of branches by some of the larger banks; so the problem is tied in to the unit banking system. There is, however, no doubt that my problems have been made more difficult as a result of the development to which you just referred.

Senator DOUGLAS. Then you see dangers in the so-called dual banking system or 49 systems of banking?

Mr. WILLIAMS. No, I would not want to disturb the right of a State to charter banks. I would not want to disturb the right of a State banking department to set up standards, even though those standards would be competitively lower. I do look with alarm on any attempt to prevent banks from getting into the System on a voluntary basis and voluntarily subjecting themselves. The problem also has geographic aspects. In one district 70 percent of the banks are nonmembers. You get a segregation because of that geographical distribution, and in a time of crisis that might have effect.

We ought not to be impeded in our attempt to influence monetary policy by lack of understanding or unwillingness to submit themselves to the discipline of it.

I assume some of the responsibilities myself. As an operator of the Philadelphia bank I indicate to banks why they ought to subject themselves to the discipline of Reserve requirements. In the course of a discussion in one of these field meetings at which the Secretary of Banking was present, I said to him that the best way that I know for State banks to retain the privilege of staying out of the System is for them to make it clear by their actions that they are not profiting by being out of the System and not subjecting themselves to our restraints because the more people who are subjected to restraints the more might be the advantages of persons who are not subjected to it.

But I would explore and live with the problem in a sincere effort to solve it by other than coercive means before I went to coercive means; but, failing to solve it, I certainly would stand firmly for compulsory Reserve requirements.

Senator DOUGLAS. How long would you carry on this educational process?

Mr. WILLIAMS. I cannot answer that. We have not made within the System, it seems to me, a sufficiently vigorous, intelligent, and concerted effort to go after the problem.

Senator DOUGLAS. Have you put up to the nonmember banks the fact that the System indirectly gives them greater stability because in a period of crisis though you do not have to take their bonds or commercial paper, they can go to a correspondent bank which is a member, and if the correspondent bank accepts, then the correspondent bank can present the bonds or paper to you and that, therefore, indirectly you add a great element of stability to the nonmember banks; is that true?

Mr. WILLIAMS. Yes. We have pounded on the subject and will continue to do so; I have heard Mr. Bopp, whose skilled exposition you heard this morning, explain that all very clearly.

Senator DOUGLAS. Have you had any success to date?

Mr. WILLIAMS. There is no doubt that we are making progress.

Senator DOUGLAS. Are there a number of nonmember banks in your district who have become member banks?

Mr. WILLIAMS. We have accessions.

Mr. BOPP. State banks that have come into membership: In 1942, one; 1943, three; 1944, three; 1945, two; 1946, four.

Mr. WILLIAMS. We already have a pretty high proportion.

Mr. BOPP. No accessions in either 1947 or 1948.

Mr. WILLIAMS. There are cases we are now working on, but it is a case by case approach. It is slow work.

Mr. WOLCOTT. Would it be objectionable at this point if I were to reminisce a little bit with respect to history of this question as I remember it?

Senator DOUGLAS. Go ahead.

Mr. WOLCOTT. In 1935 a bill was introduced, which later became the Banking Act of 1935, which provided that all banks must become members of the Federal Reserve System in order to participate in the Federal Deposit Insurance Corporation.

It would have resulted in the creation of a highly centralized banking system. There would have been no dual banking system. There would have been no State banks as such, because, of course, no State bank, which was not a member, not having its deposits insured, could prevail against a competing bank which did have its deposits insured.

The same bill, as it was originally introduced, provided that the President would be empowered to remove all members of the Federal Reserve Board at will. About that time the NRA was crumbling, the Supreme Court later found it unconstitutional, and the charge was made that if the original bill was passed, that the Federal Government through the Federal Reserve Board, which was to be politicalized under the bill, could write into the loan agreements all of the provisions of any of the codes, which had been in existence or might be entered into, which were formerly known as NRA codes.

Of course, that contemplated that no bank would withdraw from the Federal Reserve System when once it got in.

Well, we succeeded and, of course, it also follows that if the Federal Government got control over the lifeblood of the American economy, which is credit, that they could successfully manage the entire economy. American agriculture and industry and labor and business cannot function without credit.

We compromised on this bill by providing that the President could remove the chairman of the Board of Governors of the Federal Reserve Board but not the other members. We provided also, as I recall it, a 2-year period in which the banks would come into the Federal Reserve System. Otherwise, they would not have their deposits insured.

At that time, as I recall it, we did give the Open Market Committee these initiatory powers we have discussed here. Now, at about that time the Federal Government, I assume through the Comptroller's Office or the Federal Reserve, went to some, and perhaps most, of the State banking commissioners and told them that if their legislatures would provide for a conversion from State banks to Federal banks, they would recommend to the Federal Congress that it do likewise in respect to authorizing conversion from national banks to State banks.

The Federal Congress would provide for the reconversion or the conversion, rather, of national banks to State banks.

Now, this question that we are discussing here today is to me as old as that. It goes back to 1935. The bill which was passed in 1948 authorizing the conversion of national banks to State banks, passed almost unanimously by the House, died in the Senate, and the one passed this year similarly was in consequence of the implied promises made by the Federal Government to the States in respect to the conversion of national banks into State banks.

I thought it might be interesting at this point to review some of the history of this question, and it is from memory only. I may not be correct in all my details, but in principle and substance the statement is correct.

So we apparently have with us then the only question remaining as to whether you think there can be any greater degree of economic stability if all of the banks become through force or otherwise members of the Federal Reserve System.

Mr. Williams. I think our effectiveness would be increased.

Mr. Wolcott. Your control would be increased.

Mr. Williams. And, therefore, effectiveness.

Mr. Wolcott. Whether your effectiveness would be increased would have to be proven in practice. It has not been proved yet.

Mr. WILLIAMS. That is right, and I merely expressed a judgment, and I quite agree that you could not debate that very profitably.

Mr. WOLCOTT. If I may follow up with one other question. Chairman Douglas read from the Constitution with respect to the power of Congress to coin money and regulate the value thereof, concerning which we get letters almost daily, and they provoke a discussion of a very interesting question.

The contention has been made that the Congress, notwithstanding general thinking that it does not coin money and regulate the value thereof, does by the delegation of authority to the Federal Reserve.

Now, the Constitution also provides that the Congress shall provide for the national welfare, and we are constantly enacting legislation in that respect. The Congress is not an administrative body. It can delegate the administration of its functions to departments of the Government or independent departments which it sets up. I may be wrong in this, but it always seemed to me that in keeping with the practice and the authority which the Congress has to delegate the administration of its functions, the Congress has delegated to the Federal Reserve System the authority within certain fairly well-defined limitations and in accordance with certain well-defined standards to coin money and regulate the value of it.

Senator DOUGLAS. I am glad to have this statement by my very able colleague, but I think the question is whether Congress has also provided the Federal Reserve System with powers adequate to carry out this purpose.

Mr. WOLCOTT. I was going to suggest that it seems to me to be perhaps the only question before us, as to whether we have set up sufficient standards or created such definite limitations that they can execute the function of Congress in that respect.

Mr. WILLIAMS. I was attempting, Mr. Chairman——

Mr. WOLCOTT. It would be interesting if you have suggestions as to what the Congress should do in carrying out that function by way of legislation to more clearly define the Federal Reserve Board's authority, delegated to it from the Congress, to coin money and regulate the value thereof.

Mr. WILLIAMS. Well, it is something to which we should give consideration. There are other ways of influencing the behavior of both member banks and nonmember banks by the conference methods of the sort we are experimenting with. I hesitate to build up psychological bars. I am trying to tear them down rather than constantly erect new ones and have the charge hurled at us, "Power for the sake of power."

Senator DOUGLAS. In good Philadelphia fashion, you are attempting to follow the methods of peaceful persuasion.

Mr. WOLCOTT. I forgot an important chapter in this history of this subject. In 1939 a bill—I think the number was H. R. 6940—was reported out of the House Banking and Currency Committee which, in effect, would have compelled all savings banks to convert to Federal savings and loan associations or go out of business.

That bill was passed by the House in a modified form with all of these objectionable features taken out of it the latter part, as I recall it, of that year, or possibly the following year, and never was considered by the Senate.

But at least two attempts have been made to centralize the control of banking and the credit which emanates from banking in the Federal Government without any restrictions whatsoever.

Mr. WILLIAMS. Mr. Chairman, that concludes my presentation.

Senator DOUGLAS. I would like to ask another question, if I may.

In your written statement to our subcommittee and also in the statements which were made by most of the other presidents of the Reserve banks you proposed that control, as I remember it, of member-bank reserve requirements and also approval of rediscount rates should be shifted from the Board of Governors to the Federal Open Market Committee.

Mr. WILLIAMS. Yes.

Senator DOUGLAS. I can see why you would feel that all these powers should be in the same hands in order to get concentrated and unified policy, but why do you favor concentrating them in the hands of the Open Market Committee rather than in the Board of Governors of the Reserve System?

Mr. WILLIAMS. Well, concentration, of course, in the Board of Governors would call for a transfer of the open-market operation from the committee to the Board; but we have a Federal system. We are attempting in all possible ways to bring about a representation from the field, and I know it is a subject that is close to the heart of Chairman McCabe. The representation of the Board on the committee which would handle these three instruments of banking would still not disturb the locus of control, but would give to the committee the first-hand experience of all of us in operating our institutions; we are out in the field constantly.

Senator DOUGLAS. As I understand it, the Open Market Committee is also composed of seven members of the Board of Governors plus five chosen from the presidents of the Federal Reserve banks, and these are generally, as I infer from your statement this morning, elected in some degree of rotation.

Mr. WILLIAMS. Except one; he is the president of the New York bank, where the presence of the bank in the principal money market of the country gives him permanent representation. The manager of the account is located in his bank, and there is a close liaison. But we undoubtedly can and do bring to the deliberations of the Board here in Washington a knowledge of the attitudes and values and of problems.

Senator DOUGLAS. So this proposal of yours would further federalize the System by giving the member banks a larger share in these larger policy determinations.

Mr. WILLIAMS. That is right, and I think ought not to be construed as a move that would result in greatly increased influence by commercial banks because of the presence of Reserve bank presidents on that committee.

Senator DOUGLAS. One further question. This morning you spoke of the need for very close coordination between policies of the Federal Reserve Board and policies of the Treasury. Do you consider the present methods of coordination satisfactory or would you suggest changes for this purpose?

Mr. WILLIAMS. Chairman Douglas, my experience as an administrator causes me to rely increasingly on my capacity to work with my fellow men rather than on administrative set-ups.

I will go along 100 percent with the dictum of some wise man who said, "You have power with people, not power over them." We function with a minimum of administrative procedure in my institution. I think it would be unfortunate if we had an arrangement which would call the Secretary of the Treasury over to the Federal Reserve Board for a meeting where there was a lot of administrative minutiae passing through the mill.

I think there is an opportunity for close liaison. They are both in the same city, the buildings are near to each other, they have the telephone at their elbows, they are meeting in other organizational meetings.

Senator DOUGLAS. I may remind you, but you are of course aware that the Army and Navy are together in close physical proximity to each other, and the immediate effect did not seem to be such as to make them dwell together in complete peace and concord.

Mr. WILLIAMS. What I meant when I said we have power with people is that power is derived through understanding. I take it that the great gap that exists between the Army and the Navy is due to a failure to solve what are essentially technical problems as to which arm of the service should be dominant and the relative importance of the two.

When we concern ourselves with questions of status, with who are the chief fiscal monetary officers of the Federal Government, we are getting away from the realities of life. We ought to demean ourselves before problems and say, "What must we do to solve them?"

Senator DOUGLAS. Now, if all men were as self-abdicating as you seem to be, there would probably be no problem, but we are dealing with imperfect human nature—all too imperfect.

Mr. WILLIAMS. I did not say that unctuously.

Senator DOUGLAS. I did not regard your statement that way.

Mr. WILLIAMS. I do not believe a change is necessary. I think the problem can be solved in other ways. You could bring them together, and the problem would not be solved. You could keep them apart and it would be solved. There are other approaches to the problem. I am giving you, of course, a strictly personal attitude toward it. Those are the questions in the questionnaire that did not interest me a great deal, Chairman Douglas.

Senator DOUGLAS. Congressman Buchanan?

Mr. BUCHANAN. No questions.

Senator DOUGLAS. Thank you very much, Mr. Williams and Mr. Bopp.

Mr. WILLIAMS. Thank you very much, indeed. We were very glad to be here.

Senator DOUGLAS. Is Mr. Robertson here? We are glad to welcome you.

STATEMENT OF J. L. ROBERTSON, DEPUTY COMPTROLLER OF THE CURRENCY

Mr. Robertson, we understand you are the First Deputy Comptroller of the Currency.

Mr. ROBERTSON. Yes.

Senator DOUGLAS. You seem to have a good Scotch name and are, therefore, presumably competent to handle our public moneys.

Do you want to make a prepared statement?

Mr. ROBERTSON. Just a very short one.

Senator DOUGLAS. You may proceed.

Mr. ROBERTSON. I would merely like to say that we who represent the Office of the Comptroller of the Currency are glad to have this opportunity to make whatever contribution we can to the work of this committee in its study of the effectiveness and coordination of the monetary, credit, and fiscal policies of the Federal Government.

In common with administrative agencies generally, we necessarily perform our functions in constant and close contact with the details of our job. Although we make every effort to relate our operations to broad underlying principles, it is not always possible to achieve the degree of detachment necessary for effective continuous examination of those principles in the light of constantly changing conditions.

This committee, on the other hand, can make a general survey of this important field free from such a handicap. Its members are in a position, by asking basic questions regarding matters of broad policy and procedure, to open up lines of thought leading to major improvements.

Our organization is composed of a closely knit group of people who confine their efforts to supervision and regulation of the national banking system. Perhaps unwisely, our Office does not maintain a public-relations staff, information service, or even a congressional liaison representative, to keep the general public and Congress informed of our activities, accomplishments, and purposes.

Senator DOUGLAS. May I interject to say that is a unique distinction and one which is to your credit, and I hope that it has reflected corresponding economies in your operating budget.

Mr. ROBERTSON. We think it has, sir. Furthermore, we are so busy with the actual job of supervising banks that we probably do not sit down often enough to think about the fundamental problems with which this committee is concerned. Even if we did, our thinking might very well be narrow and prejudiced. For all these reasons, we welcome a thorough and thoughtful study of our work in its broadest aspects.

The questions submitted to us center about the manner in which our bureau performs its duties regarding the structure and operation of the national banking system, and the degree of coordination of the work of all Federal bank supervisory agencies. As you have seen from our answers to the questionnaire, our guiding principle is the preservation of the national banking system which can and does perform its full share in furnishing the Nation with every proper banking service and convenience, including the supplying of credit adequate to meet all legitimate demands. We believe that in view of the nature of our work, we can make our greatest contribution to economic stability and progress through the maintenance of an independent banking system composed of sound individual banks, guided by principles of public service as well as business profit.

I shall be very glad to try to answer any questions relating to the work of our Office, and the principles in accordance with which we seek to conduct our activities.

Senator DOUGLAS. I wonder if I might ask some questions to begin with dealing with the chartering policy.

Mr. ROBERTSON. Yes.

Senator DOUGLAS. In the statement Mr. Delano submitted to our subcommittee some time ago he pointed out that in determining whether or not to act favorably on an application for a national-bank charter the Comptroller's office took into consideration at least five principal sets of factors:

First, the general character and experience of the organizers and of the proposed officers of the new bank.

Second, the adequacy of existing banking facilities and need for further banking capital.

Third, the outlook for the growth and development of the town or city in which the bank is to be located.

Fourth, methods of banking practices of the existing bank or banks, the interest rates which they charge customers, and character of the service which these quasi public institutions are rendering to their communities.

Fifth, the reasonable prospects for success of a new bank if efficiently managed.

It is also indicated that in recent years a fairly large percentage of the applicants have been denied national bank charters, ranging from 13 percent, I think, in 1 year to a high of 41 percent in 1947.

Now, I wondered if you could tell us the answers to a series of questions that I should like to ask. I would like to ask, in the first place, about the policies of the State bank chartering authorities and of your relationships with them, because if the banks fail to get charters from you, they sometimes go over to the State banking authorities.

Mr. ROBERTSON. That is true.

Senator DOUGLAS. Is there any uniformity among the chartering policies of the various State authorities or is there variety?

Mr. ROBERTSON. There is variety, but I would say from personal knowledge of the individuals, most of the individuals, who are passing upon State charters in behalf of the States themselves, that they are being very conservative in the granting of new charters. They are not granting charters unless they are satisfied that there is a need for additional banking facilities in the community. I do not think there is a single State supervisor that I know of today who is running wild in the granting of State charters.

Senator DOUGLAS. Do the State authorities apply the same kind of tests which your office applies?

Mr. ROBERTSON. That I cannot tell you.

Senator DOUGLAS. In general, are the States more or less liberal in granting charters for new banks than the comptroller?

Mr. ROBERTSON. I could not give a good answer on that, Mr. Chairman. My impression is that it will vary with various States. I doubt if there is any State which is as conservative as we are in the granting of new charters.

Senator DOUGLAS. No State as conservative?

Mr. ROBERTSON. More conservative.

Senator DOUGLAS. Therefore, some States are less conservative?

Mr. ROBERTSON. I would say that is true.

Senator DOUGLAS. And, therefore, there are some States which are more liberal?

Mr. ROBERTSON. I think that is true, but I would have to qualify my answer because there are instances where a State bank could be chartered with a smaller capital than a national bank, and that might make the difference.

Senator DOUGLAS. I will come to that. Do you have any information as to the number of cases where you have turned down an application for a national bank charter where the organizers have subsequently been able to get a charter from their State banking authorities?

Mr. ROBERTSON. I do not have that information available, and I doubt if it would be in the office, because once we turn it down we are through with it and never follow through.

Senator DOUGLAS. Do you know of cases where the States have turned down proposed banks for State charters where you have later given the same group a national bank charter?

Mr. ROBERTSON. I know of no such case. That does not mean there are not some.

Senator DOUGLAS. Do you have any agreements, written or explicit, between your office and State banking authorities offices concerning chartering policies?

Mr. ROBERTSON. No; there is no written agreement. We try to work out understandings with individuals whereby we notify them when we get an application for a charter, so they know it is there and they can give us the benefit of their views so we can consider them in passing upon the charter, and we do likewise.

Senator DOUGLAS. With how many States do you have such understandings?

Mr. ROBERTSON. I would have to guess, but I would say with approximately two-thirds, I would guess, we do have such understandings. As new supervisors come into the field, there are instances where we have not yet arrived at a new understanding.

Senator DOUGLAS. Would you be willing to indicate some of the States in which you do not have such understandings?

Mr. ROBERTSON. No; because I would be guessing at them. I would be very glad to give you that.

Senator DOUGLAS. Then this is all in the heads of the comptroller and yourself as to what States have informal agreements with you?

Mr. ROBERTSON. I would be very glad to give you some of the States where we do have very good working arrangements, if that would help.

Senator DOUGLAS. Do you find the Federal Reserve System or FDIC or any other agency interested also in the question of the chartering of national banks?

Mr. ROBERTSON. Definitely, they are interested in such chartering. FDIC, of course, must pass upon the chartering of State banks if it is going to be an insured bank and, therefore, they are very definitely interested. Of course, the Federal Reserve is interested, too, to the extent of seeing whether the bank as it comes into the System is going to be a sound institution, and they are advised immediately.

Senator DOUGLAS. Does the Federal Reserve bank have the right of veto?

Mr. ROBERTSON. No; it does not.

Senator DOUGLAS. You take their opinion as advisory only?

Mr. ROBERTSON. That is all. Our responsibility is complete insofar as the chartering of national banks is concerned.

Senator DOUGLAS. Are there any instances where they have advised against chartering a national bank where you have gone ahead?

Mr. ROBERTSON. Yes. Where one or the other would be opposed; yes. We feel we must rely upon our own findings. If upon study of those findings we think the people who are applying for that bank are the kind who will operate a sound institution and there is a need for new banking facilities in that community we grant it irrespective of whether someone has been opposed to it. We weigh carefully the recommendation which they make.

Senator DOUGLAS. Would you speak now about the capital requirements for the national banks, versus capital requirements for the State banks. What is your minimum figure of capitalization?

Mr. ROBERTSON. It is $50,000 in places where there are less than 6,000 people. Then it goes up to $100,000. This is common capital; the surplus has to be 20 percent of that. It goes up to $200,000 in places of over 50,000 population. We think those capital requirements are not too harsh. We would not like to see them reduced today.

Senator DOUGLAS. Have you ever made a comparative study of the capital requirements of the various States?

Mr. ROBERTSON. Somewhere along the line we have; yes. I remember seeing it but I haven't looked at it in some time.

Senator DOUGLAS. Would you submit that for the record?

Mr. ROBERTSON. I would be glad to do so.

(The material above requested is as follows:)

Minimum capital requirements for banks and trust companies (September 1948)

Jurisdiction citation	Banks	Trust company
12 U. S. C., secs. 51 and 248.	Up to 6,000 population $50,000 From 6,000 to 50,000 100,000 Over 50,000 200,000 20 percent surplus.	Not below State requirements.
Alabama, secs. 78 and 189.	Up to 3,000 25,000 From 3,000 to 6,000 50,000 From 6,000 to 50,000 100,000 Over 50,000 200,000	Up to 5,000 population $25,000 From 5,000 to 30,000 75,000 Over 30,000 100,000 Bank may do a trust business.
Arizona, secs. 51-202, 51-513.	Up to 5,000 25,000 From 5,000 to 15,000 100,000 From 15,000 to 50,000 25,000 Over 50,000 200,000 No bank may be required to have over $2,000,000 capital but there is no authority to make any such requirement.	Bank may do trust business.
Arkansas, secs. 825 and 858.	Up to 2,500 25,000 From 2,500 to 6,000 50,000 From 6,000 to 50,000 100,000 Over 50,000 200,000	County population: Up to 40,000 50,000 From 40,000 to 50,000 75,000 Over 50,000 100,000
California, secs. 23, 82, and 90.	Up to 10,000 50,000 From 10,000 to 50,000 100,000 From 50,000 to 200,000 200,000 Over 200,000 300,000 25 percent surplus may be required.	Up to 100,000 100,000 From 100,000 to 200,000 200,000 Trust company plus bank: Up to 10,000 150,000 From 10,000 to 50,000 200,000 From 50,000 to 200,000 400,000 Over 200,000 500,000 25 percent surplus may be required.
Colorado, secs. 3 and 109.	Up to 4,000 25,000 From 4,000 to 50,000 50,000 Over 50,000 100,000 10 percent surplus.	Bank plus trust company: Up to 500 10,000 From 500 to 2,500 15,000 From 2,500 to 15,000 20,000 From 15,000 to 50,000 30,000 From 50,000 to 100,000 50,000 From 100,000 to 150,000 100,000 150,000 and over 250,000 Apparently only the last category is operative.

Minimum capital requirements for banks and trust companies (September 1948)—Continued

Jurisdiction citation	Banks		Trust company	
Connecticut, sec. 3875	Bank and trust company:		Up to 50,000	$50,000
	Up to 50,000	$100,000	From 50,000 to 150,000	100,000
	Over 50,000	200,000	Over 150,000	250,000
	100 percent surplus.			
Delaware, sec. 2382	Up to 3,000	50,000	$200,000 minimum.	
	From 3,000 to 100,000	100,000		
	Over 100,000	200,000		
Florida, sec. 652.06	Up to 3,000	25,000		
	With permission of comptroller.			
	Over 3,000	50,000		
Georgia, sec. 13-901	Up to 7,500	25,000	Bank and trust company minimum.	100,000
	Over 7,500	50,000		
Idaho, sec. 25-201; 25-206	Up to 3,000	25,000	Up to 6,000	50,000
	From 3,000 to 6,000	50,000	Over 6,000	100,000
	Over 6,000	100,000		
	10 percent surplus.			
Illinois, secs. 10.05; 10.11	Up to 2,500	25,000	Up to 100,000	50,000
	From 2,500 to 10,000	50,000	Over 100,000	200,000
	From 10,000 to 50,000	100,000		
	Over 50,000	200,000		
	10 percent surplus and 5 percent operating fund required.			
Indiana, sec. 18-412	Up to 3,000	25,000	Same.	
	From 3,000 to 6,000	50,000		
	From 6,000 to 75,000	100,000		
	Over 75,000	200,000		
Iowa, sec. 528.1	Up to 3,000	10,000	Same.	
	From 3,000 to 6,000	25,000		
	From 6,000 to 15,000	50,000		
	Over 15,000	100,000		
Kansas, secs. 14, 77	Third class city up to 2,000	25,000	100,000 and over.	
	Second class city from 2,000 to 3,000.	35,000		
	First class city from 3,000 to 6,000.	50,000		
	Over 75,000 from 6,000 to 10,000.	75,000		
	From 10,000 to 50,000	100,000		
	Over 50,000	200,000		
	20 percent surplus and 5 percent undivided profits.			
Kentucky, secs. 287.070; 287.080.	Up to 7,500	25,000	Trust company plus bank double the requirements.	
	From 7,500 to 25,000	50,000		
	From 25,000 to 100,000	100,000		
	Over 100,000	200,000		
	20 percent surplus.			
Louisiana, sec. 568	Up to 3,000	25,000	Same.	
	From 3,000 to 30,000	50,000		
	Over 30,000	100,000		
Maine, secs. 96, 98	Bank plus trust company:			
	Up to 5,000	50,000		
	From 5,000 to 10,000	75,000		
	From 10,000 to 20,000	100,000		
	From 20,000 to 30,000	150,000		
	30,000 and over	200,000		
	50 percent surplus.			
Maryland, secs. 29 and 54.	Up to 15,000	25,000	Up to 25,000	100,000
	From 15,000 to 50,000	75,000	From 25,000 to 100,000	150,000
	From 50,000 to 150,000	100,000	From 100,000 to 250,000	200,000
	Over 150,000	500,000	Over 250,000	750,000
	20 percent surplus.		20 percent surplus.	
Massachusetts, ch. 172, sec. 18.	Bank and trust company:			
	Not over 6,000	50,000		
	From 6,000 to 50,000	100,000		
	Over 50,000	200,000		
Michigan, secs. 40, 207	Up to 2,500	25,000	Up to 50,000	150,000
	From 2,500 to 6,000	50,000	50,000 to 100,000	200,000
	From 6,000 to 30,000	100,000	100,,000 to 1,000,000	400,000
	From 100,000 to 300,000	200,000	Over 1,000,000	500,000
	300,000 and over	300,000		
	20 percent surplus.			
	Commissioner may increase or decrease based on condition of assets and adequate capital structure.			

Minimum capital requirements for banks and trust companies (September 1948)—Continued

Jurisdiction citation	Banks		Trust company	
Minnesota, secs. 48.02, 48.36.	Up to 500 if no other bank:		Bank plus trust company:	
	Capital	$10,000	Up to 25,000	$50,000
	Surplus	2,000	From 25,000 to 100,000	75,000
	From 500 to 1,000:		From 100,000 to 200,000	100,000
	Capital	20,000	Over 200,000	200,000
	Surplus	4,000		
	From 1,000 to 5,000:			
	Capital	25,000		
	Surplus	5,000		
	From 5,000 to 100,000:			
	Capital	40,000		
	Surplus	8,000		
	Over 100,000:			
	Capital	50,000		
	Surplus	10,000		
Mississippi, sec. 5159	Up to 6,000	25,000	Banks may exercise trust powers.	
	From 6,000 to 10,000	35,000		
	Over 10,000	50,000		
Missouri, secs. 7944, 7949 and 8018.	Up to 1,000	15,000	Either for trust company or trust company and bank:	
	From 1,000 to 5,000	25,000	Up to 10,000	50,00
	From 5,000 to 10,000	50,000	From 10,000 to 50,000	100,000
	From 10,000 to 50,000	100,000	Over 50,000	200,000
	Over 50,000	200,000		
Montana, sec. 6014.12	Up to 2,000	25,000	$100,000 to $10,000,000.	
	From 2,000 to 4,000	30,000		
	Over 4,000	50,000		
	10 percent surplus.			
Nebraska, secs. 8-119, 8-205.	Up to 1,000	10,000	Up to 10,000	25,000
	From 1,000 to 2,000	25,000	From 10,000 to 50,000	50,000
	From 2,000 to 5,000	35,000	Grom 50,000 to 100,000	100,000
	From 5,000 to 25,000	50,000	Over 100,000	200,000
	From 25,000 to 100,000	100,000		
	Over 100,000	200,000		
	Minimum surplus, $2,500.			
Nevada, secs. 1 and 8	$50,000 minimum capital and $10,000 minimum surplus.		Same.	
New Hampshire, ch. 313, secs. 21 and 25.	Bank plus trust company:		Same.	
	Up to 4,000	25,000		
	From 4,000 to 10,000	50,000		
	From 10,000 to 50,000	100,000		
	Over 50,000	200,000		
	20 percent surplus.			
	No bank may have a capital exceeding $500,000.			
New Jersey, draft sec. 4	Up to 10,000	50,000	Minimum capital	100,000
	From 10,000 to 50,000	100,000		
	From 50,000 to 100,000	150,000		
	From 100,000 to 200,000	300,000		
	Over 200,000	500,000		
	20 percent surplus.			
	If the bank serves outlying areas the minimum capital requirement may be increased.			
New Mexico, secs. 50-501; 50-214.	$25,000.		$100,000.	
	20 percent surplus.			
New York, sec. 90	Up to 2,000	25,000	Up to 30,000	100,000
	From 2,000 to 30,000	50,000	From 30,000 to 100,000	150,000
	Over 30,000	100,000	From 100,000 to 250,000	200,000
			Over 250,000	500,000
North Carolina, secs. 53-2, 53-39, and 53-159.	Up to 3,000	25,000	Bank may do a trust business.	
	From 3,000 to 10,000	30,000		
	From 10,000 to 25,000	50,000		
	Over 25,000	100,000		
	50 percent surplus.			
North Dakota, secs. 6-0203; 6-0503.	Up to 5,000	15,000	$100,000 minimum.	
	From 5,000 to 10,000	20,000		
	Over 10,000	25,000		
	20 percent surplus.			
Ohio, secs. 710-37	Up to 5,000	35,000	$100,000 minimum.	
	From 5,000 to 25,000	50,000	Trust company plus bank.	
	Over 25,000	100,000	Minimum capital required for both.	
	20 percent surplus.			
Oklahoma, sec. 68	Up to 1,000	10,000	Same.	
	From 1,000 to 2,000	15,000		
	From 2,000 to 6,000	25,000		
	From 6,000 to 20,000	50,000		
	Over 20,000	100,000		
	10 percent surplus.			

Minimum capital requirements for banks and trust companies (September 1948)—Continued

Jurisdiction citation	Banks		Trust company	
Oregon, secs. 40-403	Up to 3,000	$25,000	Up to 3,000	$50,000
	From 3,000 to 25,000	50,000	Over 3,000	100,000
	From 25,000 to 50,000	100,000		
	Over 50,000	200,000		
	If the bank is at least 2 miles from the main post office, then the minimum requirement does not exceed $50,000.			
Pennsylvania, secs. 401; 403.	Up to 6,000	50,000	Up to 6,000	150,000
	From 6,000 to 50,000	100,000	From 6,000 to 50,000	200,000
	Over 50,000	200,000	Over 50,000	350,000
	50 percent surplus.		50 percent surplus.	
Rhode Island	None.			
South Carolina, secs. 7833; 7834; 7838; 7831.	Up to 5,000	10,000	$25,000 minimum.	
	From 5,000 to 20,000	20,000		
	Over 20,000	50,000		
	25 percent surplus.			
	Capital must be adequate for FDIC membership.			
	If 5,000 or less population, only 1 bank may be chartered under above provisions. No dividend may be paid and no branch may be established until capital increased to amount shown below.			
	Up to 3,000	25,000		
	From 3,000 to 10,000	50,000		
	Over 10,000	100,000		
South Dakota, secs. 6-0303; 6-0305.	Up to 1,500	15,000	Up to 6,000	50,000
	From 1,500 to 2,500	20,000	Over 6,000	100,000
	From 2,500 to 5,000	25,000		
	Over 5,000	50,000		
	10 percent surplus.			
Tennessee, secs. 6019, 5936.	Up to 1,000	20,000	$100,000.	
	From 1,000 to 2,500	30,000	20 percent surplus.	
	From 2,500 to 5,000	50,000		
	From 5,000 to 20,000	75,000		
	From 20,000 to 50,000	100,000		
	Over 50,000	200,000		
Texas, ch. 3, art. 3	Up to 5,000	25,000	$50,000.	
	From 5,000 to 15,000	50,000		
	From 15,000 to 30,000	75,000		
	Over 30,000	100,000		
	May require 25 percent surplus.			
Utah, secs. 7-3-10, 7-4-2	Up to 5,000	25,000	Cities other than first class	25,000
	From 5,000 to 25,000	50,000	First class cities	100,000
	From 25,000 to 50,000	75,000		
	Over 50,000	100,000		
	Surplus 25 percent.			
Vermont, sec. 6650	Bank plus trust company: $50,000 capital.			
Virginia, secs. 4149 (16), 4149 (67).	$50,000 plus $5,000 every 10,000 population above 25,000.		$50,000 minimum.	
Washington, sec. 3226	Up to 5,000	25,000	Up to 25,000	50,000
	From 5,000 to 25,000	50,000	From 25,000 to 100,000	100,000
	From 25,000 to 100,000	100,000	Over 100,000	200,000
	Over 100,000	150,000		
West Virginia, art. 4, sec. 4.	Up to 3,000	25,000	$100,000.	
	From 3,000 to 6,000	50,000		
	From 6,000 to 50,000	100,000		
	Over 50,000	150,000		
Wisconsin, secs. 221.01 and 221.04.	Up to 5,000	30,000	The capital necessary for national bank in that locality.	
	From 5,000 to 20,000			
	From 20,000 to 200,000	75,000		
	Over 200,000	100,000		
	Up to 4,000	200,000		
Wyoming, secs. 53-105	From 4,000 to 6,000	25,000	Same.	
	Over 6,000	50,000		
	10 percent surplus.	100,000		
	Undivided profits amount for expenses of first 90 days (sum fixed by Commissioner).			

Senator Douglas. In general are the State requirements lower or higher?

Mr. Robertson. In general they are lower.

Senator DOUGLAS. Do I remember your saying that in localities of under 6,000 population your minimum capital requirement is $60,000, $50,000 of capital plus $10,000 of surplus?

Mr. ROBERTSON. Yes.

Senator DOUGLAS. Might not that figure be excessive in small localities?

Mr. ROBERTSON. We think not. We think that today, with the volume of deposits which even a small bank has (a million-dollar bank 10 years ago may be today a $5,000,000 bank, or more, and $500,000 bank 10 years ago may be today $2,500,000, or may be $3,000,000), $60,000 is the minimum with which a group of people should begin in starting off a new banking enterprise.

Senator DOUGLAS. But there are small communities and trading centers which need the services of a bank, say a trading center of less than a thousand people; would that bank have to have $60,000 of capital?

Mr. ROBERTSON. That is right. We think it should. There are many banks in communities of that size today which are national banks, and they operate profitably.

Senator DOUGLAS. Is it the size absolute of the capital and surplus which is the protection or is it the ratio of capital and surplus to deposits?

Mr. ROBERTSON. Neither would be correct. It is really the type of management you have in the bank.

Senator DOUGLAS. Do I understand you to say you do not think you could get effective management on a smaller capitalization?

Mr. ROBERTSON. No; I merely wanted to eliminate the question of management in passing upon your question. It is the amount of capital funds you have in the institution in relation to the volume and the kind of business which that bank is conducting which determines the adequacy of the capital structure of an institution.

Senator DOUGLAS. Isn't it quite possible that communities, say, of 500, 600, or 750 people could operate a bank with a capital, operate a bank that had a capital of $25,000, plus $5,000 surplus, or $30,000, and had deposits for somewhere around $300,000; might not that be the most efficient size of bank for such a small community, and by imposing your requirements do you not shut off access to the national banking system in these small farm-trading centers?

Mr. ROBERTSON. My answer would be that I think you will find very few communities where there are banks with only three or four hundred thousand of deposits. Secondly, there was a time when the amount of required capital for a national bank in this size community was $25,000. After considerable study, Congress concluded that that was too low and raised the minimum to $50,000. We have seen nothing which would cause us to think the Congress was not wise in raising that minimum.

Senator DOUGLAS. Sometimes Congress makes mistakes.

Mr. ROBERTSON. Oh, yes; definitely, but we haven't seen any indications which would warrant us in saying that Congress did make a mistake in that instance. We would not like to see the minimum capital requirement for national banks reduced at this time.

Senator DOUGLAS. Couldn't you make another classification, instead of lumping all communities under 6,000? I would agree that, with a community of 6,000, you should have $50,000 capital, plus $10,000 surplus; but I don't know that it follows at all that with communities under 1,200, or under 1,500, you should have that amount, and there are hundreds and perhaps thousands of such communities scattered over the country. Aren't you therefore depriving these communities of the advantages of the national banking system by this requirement? Wouldn't it be better to have a separate classification; say, banks in communities of from 1,200 to 6,000, a minimum capital as at present, but for the banks in communities of less than 1,200 or X population, whatever the figure is, it could go down to $25,000?

Mr. ROBERTSON. The proposition, I think, would be worthy of study, Senator, but I would offhand have very serious doubts about it, because, if you get a class as small as the one you have in mind, it is almost impossible to get satisfactory officers for that bank, because the earnings are so small today, on the volume of deposits which you speak of, as to make it very difficult to even get enough to pay a good officer's salary.

Senator DOUGLAS. Aren't you saying that this community shouldn't have a bank at all?

Mr. ROBERTSON. It may be that it cannot support a bank. If it cannot, it shouldn't have a unit bank.

Senator DOUGLAS. Then, what would you say about the fact that in most of these cases, where they can't raise the $60,000, that they go to their State, and that the State, with lower capital requirements, will proceed to charter? Now, a State bank is a bank as well as a national bank. If you think this bank would be unsafe with a national charter, do you have any greater assurance that it would be safe with a State charter?

Mr. ROBERTSON. Not in the least, but I would have to take the responsibility for the safety of that bank if it was not able to make enough to hire an efficient man to run it.

Senator DOUGLAS. In other words, you would like to see the State banks come up to your minimum figure?

Mr. ROBERTSON. Definitely so.

Senator DOUGLAS. Rather than your going down to this?

Mr. ROBERTSON. Definitely.

Senator DOUGLAS. You would depend on branch banking then in these communities to provide checking facilities, and so forth?

Mr. ROBERTSON. There are many instances where branch banking is the real solution today to meet the needs of people in these very small communities which cannot support an independent bank.

Senator DOUGLAS. You would prefer to have the national banks with branches in outlying trading centers, I suppose not too far removed, than to have separate State banks?

Mr. ROBERTSON. Or national banks.

Senator DOUGLAS. Or national banks.

Mr. ROBERTSON. Either. Definitely so. That doesn't mean that we favor branch banking over independent banking. I am saying that there are communities which are too small to support an independent banking institution. In those cases, branch banking is the solution.

Senator DOUGLAS. While on the subject of branch banking, what rules do you now observe in the case of State banks with branches which might become national banks?

Mr. ROBERTSON. They may bring into the System, of course, any branches which were in existence in 1927. Beyond that, they must get new branch authorizations. If they cannot have them under the State law, they cannot have them under the national. So, if a State bank was operating in a State which permitted branch banking, and it has branches, and it wants to convert, we would consider the entire branch set-up in determining whether to permit conversion.

Senator DOUGLAS. May I ask this, whether the Bank of California has ever been admitted to the national banking system?

Mr. ROBERTSON. The Bank of California, national association?

Senator DOUGLAS. Pardon me. The Bank of America?

Mr. ROBERTSON. The Bank of America is a national bank.

Senator DOUGLAS. With all its branches?

Mr. ROBERTSON. Definitely so.

Senator DOUGLAS. When was that admitted?

Mr. ROBERTSON. The Bank of America was—I would have to guess here and I would like to furnish the exact figures on that—but the Bank of America became a national association more than 20 years ago.

Senator DOUGLAS. What happened to its branches?

Mr. ROBERTSON. It has branches.

Senator DOUGLAS. I know, but has it added no further branches since 1927?

Mr. ROBERTSON. It has added many branches since 1927.

Senator DOUGLAS. What power do you have on national banks establishing new branches?

Mr. ROBERTSON. Branches cannot be established by a national bank without our consent.

Senator DOUGLAS. Then you have the veto power on the extension of branches by national banks?

Mr. ROBERTSON. Very definitely so.

Senator DOUGLAS. What are the standards that you follow in exercising this veto power?

Mr. ROBERTSON. Before a national bank can have a branch it must get our consent. It puts in an application for a branch in a given community. We make an investigation through our field force of the needs of that community for additional banking facilities. If the needs are there, if the bank is in a position, both capitalwise, managementwise, and assetwise, to operate additional facilities, an additional branch, then we grant the branch. We try to act on a basis which will provide adequate banking facilities for the people safely; we try to avoid competition through branches. That is, if there are two banks in a given area, and both are competing through excessive application for branches, we try to cut that off by restricting expansion branchwise. But in a place where there is a definite need for banking facilities, and there isn't an independent bank there, or there is no one who is going to put in an independent bank in this particular community, so far as we can ascertain, and the people want a banking facility, we grant the branch, keeping in mind always the need for preventing a monopoly or undue control over the banking facilities in a given area.

Mr. WOLCOTT. Don't you also always conform to State law?

Mr. ROBERTSON. Yes.

Senator DOUGLAS. Suppose you had a potential group which wanted to organize a national bank in a community which conformed to all of your standards, and at the same time a bank which wanted to establish a branch there—to which would you give the preference?

Mr. ROBERTSON. Whether the proposed organizers wanted to have a national bank or a State bank, we would give preference to the independent bank over the branch, even if it were a State bank and not a national bank.

Senator DOUGLAS. Have you been worried at all about the extent of branch banking in the Pacific Coast States and in Nevada?

Mr. ROBERTSON. It is a matter to which we have given careful consideration, and I would say we are concerned.

Senator DOUGLAS. Do you feel that the degree of concentration in California, Oregon, Nevada, Idaho, and Utah has gone pretty far?

Mr. ROBERTSON. I think it has gone very far.

Senator DOUGLAS. Do you think it has gone too far?

Mr. ROBERTSON. If I could limit that to States, I would say that there is a point beyond which further branch expansion by given institutions in California would not be in the public interest.

Senator DOUGLAS. What percentage of the bank deposits in California are held by the Bank of America?

Mr. ROBERTSON. I would want to check on my figures, Mr. Chairman, but I think very close to 50 percent; it may be one way or the other.

Senator DOUGLAS. In Nevada?

Mr. ROBERTSON. Almost 70 percent in Nevada. That is a very unusual situation.

Senator DOUGLAS. There are only five banks then, I believe.

Mr. ROBERTSON. Very, very few banks. Of course, in that particular situation, the State itself asked the bank to come in and set up banking facilities back in the days of the bank crisis.

Senator DOUGLAS. Branch banking has progressed in Oregon, too?

Mr. ROBERTSON. Very much, but you have a different situation there, because you have separate branch systems which are sufficiently large to provide competitive banking. Competition, in my opinion, is the best safeguard in the whole banking field.

Senator DOUGLAS. How many competitors do you have to have?

Mr. ROBERTSON. Enough to afford competition.

Senator DOUGLAS. How many? How many do you have to have to get competition?

Mr. ROBERTSON. You have to have at least two to get competition.

Senator DOUGLAS. Naturally. Canada has two major banks, with branches all over Canada. Would you say that they had competition?

Mr. WOLCOTT. I think it is five.

Senator DOUGLAS. Is it five?

Mr. WOLCOTT. Yes.

Senator DOUGLAS. But some of those are minor banks. I mean those two major banks dominate, in Canada, the banking system; isn't that true?

Mr. ROBERTSON. I wouldn't answer that without being more sure than I am.

Senator DOUGLAS. Would you think that two sets of banks would really provide competition?

Mr. ROBERTSON. I think it would be very undesirable to have all the banking in any State controlled by two organizations. I would much prefer to have many banks and thus afford better competition, the kind which provides freedom to go to many sources instead of just one of two sources for credit or any other banking service. I am not in favor of permitting just two competitors in any given area. I merely say that the situation in Oregon is different from that in some of the States.

Senator DOUGLAS. How many chains—that is not the precise term——

Mr. ROBERTSON. Branch organizations.

Senator DOUGLAS (continuing). Branch organizations are there in Oregon?

Mr. ROBERTSON. In Oregon there are two large ones but many independent banks.

Senator DOUGLAS. What percentage of the total banking deposits in Oregon are held by these two?

Mr. ROBERTSON. By the two?

Senator DOUGLAS. Yes.

Mr. ROBERTSON. I wouldn't undertake to answer that but would undertake to furnish that information.

Senator DOUGLAS. Will you, please.

Mr. ROBERTSON. Yes.

Senator DOUGLAS. What is the situation in Idaho and in Utah?

Mr. ROBERTSON. It is a much lower percentage. There again I would like to furnish the figures, Mr. Chairman. It is around 30 percent.

(The information above requested is as follows:)

Percentage of banking offices and deposits held by largest national banks in Western States, June 30, 1949

	Number of banking offices	Number of banking offices in State	Bank's percent of all banking offices in State	Deposits	Total deposits in all banks in State	Bank's percent of all deposits in State
				Thousands	*Thousands*	
Arizona: Largest national bank	29	59	49.2	$217,864	$413,089	52.7
California:						
Largest national bank	521	1,118	46.6	5,321,607	12,615,823	42.2
2d largest national bank	128	1,118	11.5	1,539,129	12,615,823	12.2
3d largest national bank	26	1,118	2.3	445,289	12,615,823	3.5
4th largest national bank	35	1,118	3.1	317,117	12,615,823	2.5
Total	710	1,118	63.5	7,623,142	12,615,823	60.4
Idaho:						
Largest national bank	23	96	24.0	127,886	407,249	31.4
2d largest national bank	18	96	18.7	109,073	407,249	26.8
Total	41	96	42.7	236,959	407,249	58.2
Nevada: Largest national bank	12	25	48.0	105,268	154,303	68.2
Oregon:						
Largest national bank	39	162	24.1	505,592	1,222,008	41.4
2d largest national bank	45	162	27.8	458,206	1,222,008	37.5
Total	84	162	51.9	963,798	1,222,008	78.9
Utah: Largest national bank	15	77	19.5	120,687	525,515	23.0
Washington:						
Largest national bank	45	246	18.3	589,616	1,826,796	32.3
2d largest national bank	30	246	12.2	328,411	1,826,796	18.0
3d largest national bank	17	246	6.9	97,968	1,826,796	5.3
Total	92	246	37.4	1,015,995	1,826,796	55.6

Senator DOUGLAS. Are there any other States besides California, Nevada, Idaho, and Oregon where branch banking has been carried to such extremes?

Mr. ROBERTSON. None except Arizona.

Senator DOUGLAS. And the chain banking——

Mr. ROBERTSON. Chain banking is a little different thing. The largest chain banks—there are only two in the country which amount to anything in the way of size; one is in Florida, and one is in Minnesota and the surrounding States there. The holding-company bank system is a different proposition. You are not referring to that as chain banking?

Senator DOUGLAS. I was coming to that. What about holding-company banking?

Mr. ROBERTSON. It is generally spread over larger areas. They go into different States. Your principal holding-company operations in this country are Transamerica, which operates in California as well as in Oregon, Washington, Nevada, and Arizona; and you have the First Bank Stock Corp. in Minneapolis and the Northwest Bancorporation in Minneapolis; they are the two large ones there. There are not more than a dozen substantial bank holding-company set-ups in this country.

Senator DOUGLAS. What has happened to these very strong holding-company groups of banks in the State of Michigan?

Mr. WOLCOTT. There is one very large one. The Michigan National has offices in five and possibly six cities. That is the only one that I know of.

Mr. ROBERTSON. It is a branch organization and is one that I would consider small in relation to the systems I have referred to, which have 60 or 70 banking offices.

Senator DOUGLAS. Do I understand then that the holding-company type of organization in banking that flourished in Michigan in the twenties has disappeared like the snows of yesteryear?

Mr. WOLCOTT. No. There was the Guardian group, as I recall, about which you heard so much during the crash, and I was going to say it was replaced, but I shouldn't use that word, because there is no affiliation, but there is another organization known as the Michigan National Bank.

Mr. ROBERTSON. That is a branch organization, Mr. Wolcott, rather than a holding-company organization.

Mr. WOLCOTT. I might say the Guardian apparently was not dissolved because it wasn't solvent. The fact is that since 1933 the Detroit banks have paid off more than 100 percent on all of their obligations. I would suggest in that respect that you might read Mr. Malcolm Bingley's book entitled "Detroit, My Own Home Town," which will give you the history of the banking crash in Detroit. It is very interesting.

Senator DOUGLAS. The Bank of the United States turned out all right in New York, too.

Mr. WOLCOTT. I don't know anything about that.

Senator DOUGLAS. Yes.

Mr. WOLCOTT. There have been bank crashes there, I believe.

Senator DOUGLAS. Mr. Robertson, Mr. McCabe, chairman of the Board of Governors, Federal Reserve System, has recently suggested certain changes in the standards that banks are required to meet in order to qualify for membership in the Federal Reserve System. Are you, in general, familiar with them?

Mr. ROBERTSON. In general. I must confess that I didn't get a chance to read all of that pamphlet.

Senator DOUGLAS. I quote from him [reading]:

> As a general rule, banks which are eligible for Federal deposit insurance should not be debarred from membership in the Federal Reserve by arbitrary capital requirements. The following proposed changes are desirable in and of themselves and necessary in order to eliminate unwarranted discrimination against membership in the Federal Reserve System.
>
> Instead of the present capital requirements, which relate only to the amount of capital stock and are based on population, there should be only one specific capital requirement for admission to membership—a minimum of $50,000 of paid-up capital stock—with the exception that a bank organized prior to the enactment of the proposed legislation might be admitted with paid-up capital of $25,000. The adequacy of a bank's capital structure should continue to be included among the factors to be considered by the Board of Governors in passing upon the application of a State bank for membership.

That is the end of his quotation. They refer to capital requirements for State banks which wish to become members of the Federal Reserve System. Would you like to pass judgment on the question of whether you think such a change as this would be desirable?

Mr. ROBERTSON. Only to say that I think fundamentally a decision on that matter is one which falls within the province of the Federal Reserve. They are in better position to judge whether a bank with that size capital should be eligible for membership. We in the Comptroller's Office say that we don't object to reduction of capital requirements for membership.

Senator DOUGLAS. For the Federal Reserve?

Mr. ROBERTSON. No; we do not. We don't want to reduce our own. We don't think this is the time to do it. If they wish to do so, we have no objection on that score.

Senator DOUGLAS. Do you think that would have any undesirable effect on the national banking system?

Mr. ROBERTSON. I think not at all.

Senator DOUGLAS. May I pass to a series of questions concerning Federal examination of banks?

Mr. ROBERTSON. Yes. May I add one comment on the capital requirement for membership. There is in conjunction with that suggestion, I think, Mr. McCabe, a suggestion that the capital for the establishment of branches by member banks be reduced likewise. We do object to that proposal. We say in that respect that State member banks should be on a parity with national banks. Otherwise, national banks are apt to leave the System and become member banks so they can establish a branch system without having as much capital as we must require under our statute. I must say that I am not in complete accord with the suggestion made by the Chairman of the Federal Reserve with respect to capital.

Senator DOUGLAS. Do you think the national banks should have the power to convert into State banks at will?

Mr. ROBERTSON. Definitely so.

Senator DOUGLAS. You think they should?

Mr. ROBERTSON. Definitely so. I think no national bank should be told it has to stay in the national bank system. Banks are not national banks because they are obliged to be so but because they have greater prestige, because of the quality of supervision, because of the fact that they have uniform laws throughout the United States. National banks are not going to leave the System because they are given the privilege of converting into a State bank. They can now leave the System by voluntary liquidation. The tax problem has been thrown up. It isn't serious. You are not going to find banks leaving the national system because of the conversion privilege. We do not object to it.

Senator DOUGLAS. Even though the reserve requirements of the States tend to be lower?

Mr. ROBERTSON. Yes. That would have nothing to do with whether an institution is a National bank or a State member bank. That goes to the question of whether reserve requirements are to be extended to nonmembers. It may become a member bank, in which case the reserve requirement would be the same.

Senator DOUGLAS. If the National bank becomes a State bank, then it is optional upon them to withdraw from the Federal Reserve System?

Mr. ROBERTSON. That is right. They might even become an uninsured bank. That is going a long way. Our immediate problem is only whether or not they are to be a State bank or a National bank. But we say that is a matter of choice in the banking set-up today.

Senator DOUGLAS. Do you think there is no greater safety to depositors in the National system than in the State system?

Mr. ROBERTSON. I wouldn't say that. I think the quality of our supervision is very high. I say under a system such as we have in this country, a dual banking system, where banks can come in to either system at will, they should be privileged to go out. There shouldn't be a one-way street from a State bank into a National bank. They can convert into a National bank. We say if they can do that certainly we are in no position to say you can't go back out the other way. Furthermore, just from a practical point of view, if you say that National banks cannot convert, it is only a short period of time until you have every State legislature in the United States saying, "State banks, you can't convert," and if they do that you have a fixed pattern all down the line. Then it just depends on which way an institution happens to spring when it enters the banking field, whether it becomes a State bank or a National bank. That I do not think is healthful.

Senator DOUGLAS. As I understand it, the arrangement which has been made is that the Comptroller of the Currency examines the national banks?

Mr. ROBERTSON. National banks exclusively.

Senator DOUGLAS. And the Federal Reserve Board examines the State banks which are members of the Federal Reserve System?

Mr. ROBERTSON. In conjunction with the State bank supervisors and examiners.

Senator DOUGLAS. And the FDIC examines State banks which are insured but not members of the Federal Reserve System?

Mr. ROBERTSON. In conjunction with the State bank supervisors.

Senator DOUGLAS. Do you know anything of the way in which FDIC and State banking authorities share the actual task of bank examination?

Mr. ROBERTSON. Any statement which I would make would be clear hearsay, Mr. Chairman. I think you should get more expert advice on that from the FDIC itself. The coordination is very good.

Senator DOUGLAS. Will you give us a picture of the methods now used to coordinate the policies of the Comptroller, the FDIC, and the Federal Reserve in the fields of bank supervision and examination, and I think you should subdivide your answer into coordination at the top levels, at staff levels, and at the various regional offices.

Mr. ROBERTSON. I can divide it but if I do, Mr. Chairman, it is going to be just the same, because at the top level here in Washington, between the Comptroller, the Board of Directors of FDIC, and the Board of Governors of the Federal Reserve Board, there is very close coordination. At the top staff level here in Washington—that is, myself and other Deputy Comptrollers, the chief national bank examiner, the chief examiner for the FDIC, the chief examiner for the Federal Reserve—there is very close coordination on every major problem. We hold conferences and discuss ways and means of solving problems. Even going one step further, the assistant chief examiners in our organization, the assistant chiefs in the Federal Reserve, and assistant chiefs in the FDIC, are on the telephone every day conferring about given cases.

Senator DOUGLAS. Do you have uniform rules?

Mr. ROBERTSON. No; not uniform rules in any sense that I can think of. We do have an understanding between the three agencies on investment securities, on the appraisal of assets, that is, classifying them, putting them into substandard, doubtful, or loss, and to that extent, yes, there are uniform policies, but they are not rules in any sense of the word. The policies we have are, to a large extent, uniform.

Senator DOUGLAS. When you candle eggs you separate the rotten eggs from the good eggs, and then you have an intermediate group of, say, doubtful eggs. Do you have any uniform standards, or when you hold an asset up, would it be pronounced rotten by you and by the Federal Reserve and by the FDIC, or would some of you say it is a moderately good asset, for example?

Mr. ROBERTSON. Even within our own force different examiners will come to different conclusions concerning the credit soundness of any given asset, and that would certainly be true if you would match up the examiners of the FDIC, the Federal Reserve, and our Office. It would be true if you took different examiners within the FDIC and the Federal Reserve. No two men will judge credits alike. What we try to do is to instill in them a sense of credit judgment and expect them to apply it. Each case stands on its own footing.

Senator DOUGLAS. You have no manuals?

Mr. ROBERTSON. There isn't any such thing as a manual which can be used in determining the credit soundness of a given asset, because the factors in every single situation will vary. It is impossible to have manuals. Certainly we have books of instruction to our examiners; so does the Federal Reserve; so does the FDIC. We have copies of theirs; they have copies of ours. If you were to compare them, as a layman, you would think they were pretty uniform, but that is not an answer to your question. It is the man in the field who is applying those instructions who is the large factor in determining the credit soundness of any given asset. It is impossible to obtain complete uniformity in the examination of a bank.

Senator DOUGLAS. What about loans to new business?

Mr. ROBERTSON. Loans to new business?

Senator DOUGLAS. Yes.

Mr. ROBERTSON. They will be viewed exactly on their merits.

Senator DOUGLAS. But how can you tell what the merits are?

Mr. ROBERTSON. You can't have any general rules about loans to new business. You must look at what the credit factors are in a given situation and see whether or not that is the kind of asset in which the funds of the depositors should be invested.

Senator DOUGLAS. It is sometimes said, and I hope you won't take this amiss—it is sometimes said that the national bank examiners are so tough that a good many banks are afraid to make loans, in appreciable amount, to new business, lest you put them on the carpet.

Mr. ROBERTSON. In some cases I hope that is true; in other cases it is used as an excuse for not making the loans. I would say that national bank examiners are, on the average, possessed of a very high degree of credit judgment, and I am convinced they are exercising it soundly today.

Senator DOUGLAS. In other words, you give yourself a vote of confidence?

Mr. ROBERTSON. I give them a note of confidence; not myself.

Senator DOUGLAS. I see.

Mr. Robertson, in your written statement, or the statement from your office, your office opposed a unification of all Federal supervisory activities and their concentration in the Federal Reserve. The principal reason advanced in support of this opposition was that such a move might lead to a subordination of bank supervision to national credit policy, to an excessive use of bank supervision as an instrument of monetary and credit control. This raises several questions. First, just what is the issue here? What is the essential difference between the purpose of examinations as seen by your office and the purpose of examinations as seen by the Federal Reserve System?

Mr. ROBERTSON. I can tell you what the purpose of ours is but I would prefer that they tell you what the purpose of theirs is.

The purpose of our examination is, we think, to insure the soundness of each individual bank. We want that bank to be in condition so that it can meet any eventuality.

Senator DOUGLAS. Do you consider the soundness of the system of banking as well as the soundness of the individual bank?

Mr. ROBERTSON. Definitely. We think the soundness of the system is dependent upon the soundness of the individual bank.

Senator DOUGLAS. The soundness of the individual bank, conversely, may depend upon the soundness of the system?

Mr. ROBERTSON. It may very well, but I think it works the other way.

Senator DOUGLAS. The definition once given of a banker is that he is a man who loans you an umbrella when the sun is shining and asks for it back when it begins to rain.

Mr. ROBERTSON. There have been a lot of jests made about bankers, but I think on the whole they have done a good job of carrying out their responsibilities in maintaining stability in our economy.

Senator DOUGLAS. You look to the individual bank, not to the total situation?

Mr. ROBERTSON. We look to the individual bank as being the determining factor in the over-all situation at any given time. We don't think one can sit up on a pedestal and say, "We think the conditions are going this way at a particular time and therefore you have to gear your supervision to that particular viewpoint," because the person who makes the decision may be wrong. But if we can look at each individual bank and determine that it is sound, that it is soundly managed, that the standards which it follows in administering the people's money, in investing that money, are sound, we can be far more certain of obtaining—of having, at any time—a sound banking system, than we can through any other means.

Senator DOUGLAS. Well, were you with the Comptroller during the period from 1929 to 1933?

Mr. ROBERTSON. No; I joined the office in 1933.

Senator DOUGLAS. You heard the stories of bank examinations prior to that time?

Mr. ROBERTSON. I have heard the stories.

Senator DOUGLAS. Is it possible that if the bank examiners had been somewhat more lenient there would have been fewer bank failures, and, therefore, the banking system would not have collapsed to the same degree, and some of the banks referred to by my esteemed colleague here, if they had been treated with greater gentleness, might not have gone down?

Mr. ROBERTSON. That is a story that has been circulated to a large extent and I think it is absolutely false. I think during the period, for example, between 1930 and 1933, the examiners were tight. They had to look at loans carefully, because they were made in a down-trend period, but if they had been lenient the losses which would have been sustained would have been terrific, because the principal losses to the banks which were closed in 1933 were on loans made in 1931 and 1932, at a time when we were being tough, and if we had been lenient the story would have been entirely different, because there was no one who knew that period would end at a given time.

Senator DOUGLAS. Would the trend by the examiners be to judge the worth of an asset by its market value?

Mr. ROBERTSON. The trend at that time, as I understand it, was to take into consideration the market value, but that wasn't the only criterion.

Senator DOUGLAS. Wasn't that the predominant consideration?

Mr. ROBERTSON. No; I don't think that is right. That may be true if you refer to an investment security. It isn't true as to a loan.

Senator DOUGLAS. I mean, an investment security.

Mr. ROBERTSON. I think that is true.

Senator DOUGLAS. How about real estate?

Mr. ROBERTSON. Well, real estate would fall into an entirely different category, because you have more than real estate behind any loan: you can only lend a limited percentage of appraised value. You have other safeguards behind most real-estate loans. You have the financial responsibility of the borrower. I don't think you can put those in the same category.

Don't misunderstand. There have been times I think, when bank supervisors have been wrong. There have been times when, if you look at it by hindsight, you can see that you put the pressure on when it should have been taken off, or that you were too lenient.

Senator DOUGLAS. You don't feel, then, that the bank-examining system was too tough on the national banks during the period from 1929 to 1933?

Mr. ROBERTSON. I do not.

Senator DOUGLAS. Do you think it was too lenient?

Mr. ROBERTSON. No.

Senator DOUGLAS. You think it was just right?

Mr. ROBERTSON. If I had been the one making every decision they wouldn't have been the same, but far be it from me to say, even by hindsight, that they were wrong in what they did.

Senator DOUGLAS. Does judgment of assets by market value force the liquidation of assets in a depression period and discourage the granting of new credits?

Mr. ROBERTSON. There may have been instances where it did; there may be instances where it did not. I don't think you can generalize. You have to take each individual case.

Senator DOUGLAS. You can always swamp us on individual cases, because we never know the individual cases. A civil servant can always do that. He can always stop a congressional committee by saying everything must be judged on the individual case. But we are trying to find general rules. Excuse the vehemence of my statement but this is typically what a skilled Government official gives to a congressional committee.

Mr. ROBERTSON. I think it is a correct reply.

Senator DOUGLAS. Well, it is a very baffling one. It is a reply admirably calculated to retain control in the hands of administrative officials and deny to Congress the power of making any general rules.

Mr. ROBERTSON. What we want to do is to help you in the job you are trying to do of determining what the general rule should be, Senator.

Senator DOUGLAS. That is what I am groping for, very painfully, and I find only a statement that the bank examiners, in individual instances, are using their best judgment, and that no general rule can be drawn.

Mr. ROBERTSON. If you can find a general rule, Senator, we will be delighted.

Senator DOUGLAS. I would like to have you help us.

Mr. ROBERTSON. I would like to help you.

Senator DOUGLAS. Fine. What would you say on this question of market value of assets then: Should you judge assets according to what the security will sell for at the moment in the market?

Mr. ROBERTSON. Not exclusively, but that should be one of the factors.

Senator DOUGLAS. How much weight would you give to it?

Mr. ROBERTSON. I couldn't figure a percentage weight on it. Any investment security, Senator, has behind it the same credit factors which any loan has, and we say that every banker should know as much about the credit factors involved in an investment security as he does in a loan, because all it is is a "stranger loan" he is lending money to a foreign corporation, that is, a corporation not doing business in his home town, ordinarily. He should only buy an investment security if he would be willing to lend to that borrower the same amount of money, and he should know just as much about it in one instance as in the other instance. One looks at the credit factors in determining whether or not despositors' funds should be invested in it. The market value should be considered but it should only be looked at in consideration with all other credit factors.

Senator DOUGLAS. Now, I take it that you do not want the Federal Reserve System to take over the examination of national banks?

Mr. ROBERTSON. I think it would be unwise. That is a matter though for Congress to decide.

Senator DOUGLAS. I am sure that your decision on this point is not swayed, though it may be, since you are human, it may be influenced by the fact that you are now making examinations yourself, but what considerations would you bring forward to tell us why the Federal Reserve System should not do it?

Mr. ROBERTSON. I will be glad to tell you why I think it should remain, not necessarily in our office, but it should remain in an office which is not concerned with over-all credit control.

Supervision, as I view it, and I can be wrong, should look to the individual soundness of each individual bank, and that goes to the assets in that bank, the kind of management it has, and so forth. The supervision should not be controlled by anyone who is trying primarily to provide general economic stability. There are certain measures which should be used in that respect: Rediscount rates, reserve requirements, and many others. But supervision is not one of those. Supervision should be completely independent, with no conflicting motive, no conflicting duties. It shouldn't be used as a means of carrying out what is a Government economic policy of the moment, whatever administration is in power. It should be independent, so that when anyone wants to see what the true condition of the banks is at any given moment, the facts are there.

Now, the Federal Reserve has, you see, access to all of our reports of examination. We are an independent agency in the sense that we have no conflicting duties; just supervision of banks. They can see what the status of each bank is. I think that is a much sounder basis to operate on than it would be if the examinations were being made by one whose principal duty is not the safeguarding of the soundness of that individual bank, but is providing the atmosphere for stable economic conditions.

Senator DOUGLAS. Let's take a bank that has a widely distributed set of investments and, therefore, has not shown undue favoritism toward plunging in one set of businesses, but has a pretty well distributed set of risks, and during a depression all of them go down. You have said that you do not take market value as the sole test. I take it that it is a pretty strong test. Suppose you apply that test and you find a bank in a very difficult position. You give warning to the bank. The bank therefore will, let us say, in order to be safe, at least not make loans which it might otherwise make. The effect of your examination therefore will be to exercise a constricting influence on credit, just because you have these conditions as of the moment. But it is also a law of life that just as things which go up must come down, so in the past things that have gone down come up, that is, on the general average. Therefore have not banks been restricted in expansion of credit and, therefore, recovery impeded by a tendency to take present conditions almost exclusively into account and not have sufficient faith in the future?

Mr. ROBERTSON. It depends on how far you carry that. Certainly I think you have to take into consideration the economic conditions. You just can't have supervision standing out here in a vacuum. You must have supervision geared to economic conditions because that goes into the credit soundness of any given asset.

Suppose you had a depression which extended over, say, a 10-year period. Would you permit a bank to continue investing depositors' funds in risk assets, assets which held a high degree of risk, if the market value of the security portfolio was such that the loss would wipe out everything the depositors had if it continued going down? If so, how long would you permit it to carry those investments? That is a pretty difficult decision. It depends largely on whether the bank is in a position to carry the securities to their maturity.

Senator DOUGLAS. Coming to that, the danger of the depositors losing has certainly been reduced very much by the Federal Deposit Insurance Corporation law?

Mr. ROBERTSON. Oh, yes.

Mr. WOLCOTT. But the depositors lose when the Federal Government has to come in and make good on the losses, don't they, because most depositors are taxpayers. It is just a transfer of the obligation for the loss from the depositors to the Federal Government. The point is, there is just as much necessity for maintaining sound banking, regardless of FDIC, as if we didn't have it.

Senator DOUGLAS. We are, of course, all in favor of sound banking, just as we are all opposed to sin. The question is, What is sound banking? My inquiry is whether you can't be so strict on these banks as to impede a policy of credit expansion, which is what the country as a whole may need at the moment.

Mr. WOLCOTT. I think 160 years of banking in the United States, a system which has contributed as much as it has to the standards of living in the United States, the position which we hold in world affairs, has proven itself to be a pretty good banking system. I surely wouldn't want to see the Federal Government or the Congress try to write standards into the law for the examination of banks, which up to the present time has done the splendid job they have in making this the greatest Nation in the world. I think we can compare the American system with the Canadian system. The concentration of credit power in the Dominion of Canada today obviously has prevented Canada from making the economic strides that the United States has.

Senator DOUGLAS. That is what I was objecting to in the branch banking system.

Mr. WOLCOTT. I have been strongly opposed to branch banking, except as the States allow it. I am opposed to it principally because, as seen in the Canadian system, in which the loans were manipulated from one branch to another, to protect the loans of those banks, to the prejudice of the communities. I would hate to see that system grow up in America, in the United States. I would hate to see such a loose system of examination on any of our banks that it would prejudice the obligation which the taxpayers have assumed to protect bank deposits.

Mr. ROBERTSON. May I give you another reason why I think the supervision should be in an independent agency? It seems to me that if you put bank supervision in an agency which is responsible for monetary and credit control, so that its primary functions is stabilization rather than individual banking, you will destroy the effectiveness of bank supervision, destroy it because you will lose its effectiveness.

Bank supervision today isn't effective because of the legal sanctions which stand behind the supervisor. The effectiveness is there because the banks of this country—all the bankers of this country—know that the sole motive of the supervisor is the soundness of the individual bank, or to aid in making it into a sound bank. If the bankers of this country thought that the supervisor or the examiner was going to look at loans and other assets not in the light of what they are, but in the light of what someone in Washington happened to think existing conditions demand (either going down or up, depending upon which individual is deciding that question) the bankers of this country are going to pull back, they are not going to cooperate with the supervisor, I don't care who he is, and are not going to carry out, except with force, the recommendations and suggestions of that supervisor.

When a suggestion is made the bankers of this country carry it out, with rare exceptions, and there is no force behind it. They carry it out because they know that our sole interest is in trying to make their bank a good bank and a sound bank. You are going to lose that effectiveness.

Senator DOUGLAS. The protection against fraud could be handled by one agency?

Mr. ROBERTSON. Yes; and the protection against fraud is an insignificant matter.

When we audit a bank we don't go in with any idea of trying to discover fraud but rather to build up the bank so that they can discover their own frauds. Our principal job is in seeing that the credit standards applied by that bank are sound and that its management is sound and competent. It is a mistaken notion that bank examination is designed to catch the crook. It isn't at all.

Senator DOUGLAS. That is one of its purposes.

Mr. ROBERTSON. A very, very minor function, Senator, very minor. If that were all there is to it, you could wipe out bank supervision and it wouldn't make much difference one way or another.

Senator DOUGLAS. Do you think that in a period of depression it would be a good thing for the company, for the banking system, as a whole, to expand loans, in order to give added employment, and added production?

Mr. ROBERTSON. That is a difficult question. It is one which I would like to answer by saying that I think the banker who is on the spot in his locality is in a better position to judge its credit needs than is any one person sitting here in Washington.

Senator DOUGLAS. Of course, the individual bank, which expands its loans, when other banks do not, has checks drawn against it, which in turn will find their way, most of them, into other banks, and you, therefore, draw down the reserves of the bank, and yet it is impossible for an individual bank to swim against the tide, and if all individual banks are afraid of the toughness of the examination, then none of them will stay in. You have to have sort of a general movement which proceeds by capillary attraction, so to speak, through the system as a whole, to get expansion, no one bank can swim against the tide; you know that. The vast majority of checks, I suppose, drawn against a bank will find their way into other banks and be cleared, and you will therefore draw down the reserves of the bank in question. It has to be the system as a whole which expands. We are debating a philosophic issue, but it has great importance.

You say that in order to maintain the integrity of the System you have to maintain the integrity of the individual bank. Isn't it also true that in order to maintain the integrity of the individual bank you have to maintain the integrity of the System?

Mr. ROBERTSON. I think that is so. I think my point was misunderstood, Senator.

Senator DOUGLAS. Not merely the integrity of the System but the soundness of the System.

Mr. ROBERTSON. I think that is right, but I think my point was misunderstood. It was just this, that I think the bankers of this country, not taking one bank, but I am taking the bankers as a whole, they are the ones who set the standards, and not the one which happens to be off the beam. Taking the average of the bankers throughout the country, they are in a better position to determine what is best for their own community than is any one single person sitting in Washington.

Senator DOUGLAS. On individual loans I grant you, of course, they are better judges of credit risks, on those individual loans.

Mr. ROBERTSON. No; I still don't make my point, Senator.

Senator DOUGLAS. That is the great advantage of having banks which retail credit.

Mr. ROBERTSON. I am speaking about general economic conditions. I think that the influence which they wield through the exercise of their own judgment, the judgment of their own officers, in determining what is sound for that bank, realizing their bank is dependent upon the well being of their community, and their nation, what they do in the way of extending credit, through the exercise of their own judgment, is a far safer course for banking in this country, and for the economy of this country, than to have their decisions either weighed down or pushed up by the judgment of some economist in Washington.

Senator DOUGLAS. Or some bank examiner?

Mr. ROBERTSON. It doesn't make any difference. I don't care who it is. I say that power shouldn't exist. I would rather rely upon the soundness of the judgment of the bankers of the country than on the correctness of the opinion of anyone who happened to be in power at the time. Therefore I say that bank supervision should be geared to the soundness of each one of those banks.

Senator DOUGLAS. May that not operate at times against the soundness of the System as a whole?

Mr. ROBERTSON. I think that the chances of it doing good are much better and I would prefer to risk my own stake in this country on that basis than I would in having it determined by someone at the top because I would be afraid he might be wrong.

Senator DOUGLAS. Fear is contagious too.

Mr. ROBERTSON. I think that is right.

Senator DOUGLAS. There is no doubt there was a contagion of fear amongst the members of the banking fraternity from 1930 to 1933.

Mr. ROBERTSON. Yes; I think that is definitely so. Of course, they weren't exclusive in this field. Fear was pretty general throughout the country.

Senator DOUGLAS. But the fear on the part of the banking community resulted in a cumulative contraction of credits and therefore a progressively worsening of conditions which in turn increased their fear, and it is possible that the strictness of the bank examinations may have contributed to that fear.

What would be your attitude toward a concentration of all Federal examinations in one agency if you were reasonably assured that this examination would not be converted into an instrument for credit management?

Suppose we say we won't have anything to do with credit management, we will just consider the soundness of the individual bank.

Mr. Robertson. Then I would have no objection to it whatsoever. I would say that you aren't gaining much by doing it but one Federal agency can do it, can examine all those banks, just as easily as the existing three. What it would be doing is taking the examiners from the other forces, putting them into one group, which wouldn't do the job any faster, or any more effectively; but there would be nothing wrong with one agency examining all those banks and advising the FDIC, and so forth. I would have no objection to that.

Senator Douglas. Wouldn't it save expense?

Mr. Robertson. Not at all. None of the three agencies are paid out of public moneys at all. The banks pay——

Senator Douglas. Wait; just as Congressman Wolcott said, bank failures have been paid out of taxes, these cross railroad fares have to be met by someone, and if not met by the public have to be met by the bank authorities, so that we are anxious to save private money as well as public money.

Mr. Robertson. That is true but I think if you would make inquiry you would find, from bankers of this country, that they think the examining functions are being carried on as economically as can be done. We will be glad to have you, or anyone else, show us ways of economizing. You see we are in a position where, to a certain point, we are responsible to the bankers who pay the costs of supervision. They aren't going to sit by and have us squander money.

Senator Douglas. I am not charging you with squandering money. This is a question of whether it is the most economical method of operation. It is obvious that on a division on the basis of concentric circles, with you taking national banks and the Reserve taking State bank members of the System, and FDIC taking insured State banks which are not members of the System, it is quite obvious that you will have in one community, let us say, three sets of examiners coming in, even though you don't have three sets of examiners in the same bank, you have three sets of examiners in the same community, with separate regional organizations; it would seem to me that that is obvious.

Mr. Robertson. I don't think it is obvious at all, Senator. I am trying to be frank about this.

Senator Douglas. Well, I guess I must be stupid.

Mr. Robertson. No; I don't think so at all.

Senator Douglas. Where do I fall off?

Mr. Robertson. They do examine different banks, as you know, They are never all in the same bank.

Senator Douglas. That is right. But what I say is they will be in the same town.

Mr. Robertson. They may be in the same town but if they are they merely have to stay longer, and that raises your per diem. We have thought about that a lot. We have yet to have anyone show us or be able to discover for ourselves where you would save any money by pooling them all together.

Senator DOUGLAS. Don't cross railway fares come into it; is there no saving in railway fares?

Mr. ROBERTSON. We don't think so. Maybe it is possible. I would say, if it is possible and more efficient, let's do it.

Senator DOUGLAS. Would there be no saving in branch organization?

Mr. ROBERTSON. I don't think so, because in each of the agencies the supervisory force in the field is small—cut right down to the core. We operate with a very limited force.

Senator DOUGLAS. I am quite prepared to believe that you are very thrifty, but I have never yet found a Government agency that operated right down to the core.

Mr. ROBERTSON. You come down and we will show you one.

Senator DOUGLAS. Good.

Mr. ROBERTSON. We would be delighted to show you. We think we have one. Let me say this, if there would be an economy of that sort, in that sort of an organization, I would be in favor of it. If any expert can show us where it is economical and efficient I will stand here and testify in favor of that sort of a consolidation.

Senator DOUGLAS. I haven't read all of the Hoover reports. What do they recommend on that matter, do you remember?

Mr. ROBERTSON. The Hoover Commission itself, as I recall, not having read it for a number of months, recommended only that the FDIC be placed in the Treasury, in some way, the same sort of a relationship that the Comptroller is in, that it operate under the direction of the Secretary of the Treasury, and that is all.

Senator DOUGLAS. That might carry with it a consolidation of investigatory functions, so that you would take the inner circle, and the outer circle, leaving the Federal Reserve with the circle in between the two.

Mr. ROBERTSON. I doubt if that was contemplated, because in the staff report it was recommended that the examining functions of the Comptroller, and I think the FDIC, be concentrated in the——

Senator DOUGLAS. You mean the staff report did recommend a consolidation?

Mr. ROBERTSON. Definitely so, and the Hoover Commission itself did not.

Senator DOUGLAS. But did not reject it?

Mr. ROBERTSON. Yes; they did reject it, and advocated instead of that that the FDIC be placed under the direction of the Secretary of the Treasury; but rejected entirely the staff report.

Senator DOUGLAS. Did they reject it or simply fail to mention it?

Mr. ROBERTSON. I will have to go back and read the report but it is my recollection that they rejected it.

Senator DOUGLAS. It is my recollection that they failed to mention it. Overburdened committee members sometimes fail to notice the full intricacies of staff reports, and their failure to include should not be construed as an outright action.

Mr. ROBERTSON. That is a matter easily ascertained by looking at the record, Senator. I wouldn't say that I can repeat verbatim what was in the report. I haven't seen it since it was issued.

Senator DOUGLAS. Now, these are some questions about the relationship between the Comptroller and FDIC. In the absence of Mr. Delano, I don't know whether you want to reply to these questions or not.

Mr. ROBERTSON. I would be glad to if I am in possession of the answers.

Senator DOUGLAS. The Comptroller is an ex officio member of the Board of Directors of the FDIC?

Mr. ROBERTSON. That is correct.

Senator DOUGLAS. What do you think of the system of having ex officio members of the Board of the FDIC?

Mr. ROBERTSON. In this particular case I think it is good. Ordinarily I am opposed to ex officio members, and maybe I am being very one-sided in this decision, but his membership in the FDIC does provide that Board with first-hand knowledge of the entire banking system, you see, because they get virtually the entire banking system, they get the national banks through him, they get the State banks through their close contact with the primary supervisors of the State banks. So that in this particular case I think it is worth while. As you may or may not know he is not an ex officio member who attends just once in a while. He attends every meeting. He takes an active part in the proceedings and the deliberations of the Board of Directors of that Corporation.

Is that a sufficient answer, Senator? Are there any other facts you would like?

Senator DOUGLAS. What would you say to having the Chairman or Vice Chairman of Federal Reserve as an ex officio member of the FDIC Board?

Mr. ROBERTSON. I wouldn't object. You don't get additional knowledge of a definite group of banks through such a member like you get through the Comptroller with respect to national banks.

Senator DOUGLAS. Wait a minute. You get the State banks, which are members of the Federal Reserve System. You would get that point of view.

Mr. ROBERTSON. I didn't make the first point clear. The FDIC works directly with the primary supervisors of both State and National banks. They coordinate with the State bank supervisors themselves. They make their examinations in conjunction with the State bank supervisors and with respect to the State member banks they still have the State supervisors with whom they coordinate and obtain information. National bankwise they don't have contact with the System except through the Comptroller. So you don't have that same reason for placing a member of the Board of Governors on the FDIC. That is the only reason. It may not be as valid as I think it is.

Senator DOUGLAS. Do you think the primary basis of classification is as between the national banks and State banks rather than between members of the System and nonmembers of the System?

Mr. ROBERTSON. I would have to have the background for that question.

Senator DOUGLAS. You inspect national banks?

Mr. ROBERTSON. That is right.

Senator DOUGLAS. But the responsibility for national supervision of State banks is divided between the Federal Reserve System which takes State banks which are members of the Federal Reserve System and the FDIC which inspects State banks insured but not members of FDIC; isn't that true?

Mr. ROBERTSON. Yes.

Senator DOUGLAS. What I am trying to say is that we have a three-layer cake, so to speak. The middle tier is not represented.

Mr. ROBERTSON. My point is that the FDIC does not get their knowledge of these State banks exclusively through their own examinations. That isn't as important, in some ways, as is the contact that they have with the State bank supervisors. They have close contact with the State bank supervisors themselves, irrespective of whether the banks are members or nonmembers. With respect to the national bank system, they have direct contact through the presence of the Comptroller on the Board. That is my point.

Senator DOUGLAS. Well, may I ask one final set of questions on the relationship of the Comptroller of Currency in the Treasury Department?

Have you found that the inclusion of the Comptroller's Office within the Treasury Department has in any way tended to subordinate sound examination and supervision policies to the fiscal policies or needs of the Treasury?

Mr. ROBERTSON. I would say without any qualification, "No." The Comptroller does operate under the general direction of the Secretary of the Treasury. But that means general direction and not special direction. There are very, very few cases in which the Treasury takes any part in deliberations with respect to bank supervision.

Senator DOUGLAS. Do you think there is any reason to believe that placing the FDIC under the general supervision of the Treasury Department would lead to a subjection or subordination of deposit insurance to the fiscal policies of the Treasury?

Mr. ROBERTSON. I don't think so. But I see no great gain to be made by putting it under Treasury.

Senator DOUGLAS. You don't see any harm?

Mr. ROBERTSON. No; I do not.

Senator DOUGLAS. Thank you very much. Congressman Wolcott.

Mr. WOLCOTT. I have just one thought. As to the reason why the FDIC was not put under the Treasury in the first place, when they were not affiliated with the Federal Reserve, it was the thought that it wasn't the proper thing to do, to turn the administration of the insurance over to those who were being insured, any more than it would be proper for a person who carries fire insurance being able to write the terms under which his losses should be liquidated. This is why the FDIC was set up as in independent agency of the Government, so that it would be just that, independent of any influence which might be brought to bear upon those who were vitally interested in the manner in which the insurance would operate.

Senator DOUGLAS. What is this identity of interest that you mention?

Mr. WOLCOTT. I didn't mention any identity of interest. What do you mean by it?

Senator DOUGLAS. I thought you said that the people being insured would also act as a supervisor.

Mr. WOLCOTT. I will explain it. If you put the members of the Federal Reserve Board, or the Chairman of the Federal Reserve Board, on the Board of the FDIC, Federal Reserve member banks being insured by the FDIC, then you would have a situation where the Board of Directors of the FDIC would be writing the regulations in respect to the operation of the insurance agency which insures deposits in the banks, and I used fire insurance as an example, of a man insured in a fire-insurance company, he being put in a position of writing the manner in which his losses should be liquidated.

I thoroughly disagree with the staff recommendations of the Hoover Commission. I am not sure but what I thoroughly disagree with the recommendation of the Hoover Commission that FDIC be transferred to Treasury for that very reason.

These are not new questions. These matters were thoroughly discussed in 1933 when we set up the FDIC and when we set it up as an independent agency of Government for that reason, to take any influence by the banks, by those who supervise the banks, out of the operation of the FDIC, and make certain that the regulations under which depositors' deposits were to be insured, would be independent of any other interest.

So far as I am concerned, so long as I am in Congress Iwill fight to my last breath to keep the FDIC from being transferred to Treasury or Federal Reserve, because I don't think it is any place for it.

Senator DOUGLAS. I can understand the objection as applied to the consolidation of FDIC and Federal Reserve, or possibly the question of having the Chairman or Vice Chairman of Federal Reserve on the Board of FDIC, but my questions were addressed to whether there would be difficulty in having FDIC under the supervision of the Treasury, and I didn't see that the people who were being supervised would be hurt.

Mr. WOLCOTT. The Treasury, as Mr. Robertson has suggested, has general authority over the Comptroller's Office, and there is an affiliation of interest between the Treasury and the Comptroller's Office.

I remember when, just a few short years ago, a transfer was made in personnel from Treasury to the Comptroller's Office, to bring the Comptroller's office into closer affiliation with the Secretary of the Treasury himself, because the Treasury, under the law, did not have what the Secretary considered sufficient supervision over the banks. So one of his staff was transferred to the Comptroller's office, obviously to bring the Comptroller's office in closer affiliation with the Treasury, and give the Secretary of the Treasury more jurisdiction, if I may put it that way, over national banks.

So to put FDIC in the Treasury would be no assurance that it would continue to be as independent as the Comptroller's office is now. There is a much closer affiliation there now than there was before.

This book, The Romance of Banking, gives a very interesting history. I think we should all read that before coming to any conclusions as to whether to consolidate these agencies. I have in mind also one very bad mistake, in my opinion, which was made when we put the Secretary of State on the Board of the Export-Import Bank, in one of our weak moments, thereby so affiliating the Export-Import Bank with the dollar diplomacy of the State Department as to make it possible for the State Department to dominate the loan policy of the Export-Import Bank. I have seen just enough of these examples in government so that I do know that strong men in strong places do wield unusual influences on subordinate agencies.

Senator DOUGLAS. Thank you very much, Mr. Robertson.

Mr. ROBERTSON. Thank you, Senator Douglas.

(Whereupon, at 4:30 p. m., a recess was taken until 10 a. m., Thursday, November 17, 1949.)

MONETARY, CREDIT, AND FISCAL POLICIES

THURSDAY, NOVEMBER 17, 1949

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON MONETARY, CREDIT, AND FISCAL POLICIES,
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The subcommittee met, pursuant to adjournment, at 10 a. m. in the caucus room, Senate Office Building, Senator Paul H. Douglas (chairman of the subcommittee) presiding.

Present: Senators Douglas (chairman of the subcommittee) and Flanders; Representatives Buchanan and Wolcott.

Also present: Dr. Grover W. Ensley, acting staff director, and Dr. Lester V. Chandler, economist to the subcommittee.

Senator DOUGLAS. Gentlemen, I think it might be well if we would get under way.

I wonder if you would come forward, Mr. Harl. If you would like to have anyone with you either to help you with detailed material or to testify directly we will be very glad, indeed, to have them.

STATEMENT OF MAPLE HARL, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION, ACCOMPANIED BY EDISON H. CRAMER, CHIEF, DIVISION OF RESEARCH AND STATISTICS, FDIC

Mr. HARL. Senator, as you know, the Comptroller of the Currency is the Vice Chairman of our Board. So, in addition to those members of the Board who spend their entire time at the FDIC, we have had the benefit of the advice, counsel, aid, and assistance of the Comptroller of the Currency in the preparation of our answers to the questionnaire. The three of us have worked very closely with our staff in the preparation of the text. Dr. Cramer and I will be happy to answer such questions as you or other members of the committee want to direct to me.

We have brought along, in addition to the text, a few charts which we think will be interesting to you, together with a very brief report to the insured banks of the Nation, which has been boiled down and requires only 12 minutes to read. We know that everybody connected with the committee is tremendously busy and has heavy demands on his time, and therefore we have tried to do a thumbnail sketch of the Corporation, which is the picture as it was on June 30 of this year.

Senator DOUGLAS. In other words, you would like to introduce this report and these charts and files them with the committee?

Mr. HARL. Yes, sir.

Senator DOUGLAS. We will be very glad, indeed, to have them.

(The report with the charts above referred to, entitled, "June 30, 1949, Report to Insured Banks, Federal Deposit Insurance Corporation," is to be found in the files of the committee.)

Mr. HARL. The chart on the back of this is most unusual because it shows the amount of disbursements that the Corporation had to make from the period 1934 down through December 31, 1948. That is the period since the Corporation was established.

It is extremely significant, if you look at that chart, to see that in that period of January 1934 to December 31, 1948, the number of banks requiring aid has been reduced from year to year. However, you will notice that the amount of money up to 1940 had increased, from 1934 through 1940.

In other words, it would seem that World War II, which came on in 1941, together with any inflation attributed to that war, saved the Corporation a great many dollars from the standpoint of disbursement, because certain paper, due to inflationary processes, became collectible, which might have resulted in a disbursement from the Corporation had not our economy started to enlarge or balloon in the 1940 period.

Senator DOUGLAS. I think it is historically true that very few banks, or comparatively few, fail during a period of inflation. It is in a period of falling prices that the strain comes.

Mr. HARL. Yes, sir.

Then we would like to present a chart showing the percentage composition of assets of insured commercial banks, December 31, 1934, to June 30, 1949; likewise a percentage composition of assets of insured mutual savings banks, which shows the structure of these institutions by years from 1934 to 1949. That is broken down into loans and discounts, other securities, United States Government obligations, and cash reserves, and shows that on June 30, 1949, the insured commercial banks of this country had 65 percent of their assets in cash and reserves or in Government obligations which could be converted to cash reserves almost instantaneously, and which shows the very fine condition of our insured banks as of June 30. That condition, in our opinion, prevails today.

We thought that your committee would like to have the benefit of these charts, which you will find on pages 38 and 39, of our Report No. 31, showing the assets and liabilities, June 30, 1949, of all operating insured commercial and mutual savings banks.

(The report above referred to, entitled "Assets and Liabilities, June 30, 1949, Operating Insured Commercial and Mutual Savings Banks, Report No. 31," is to be found in the committee files.)

Senator DOUGLAS. Would you begin your testimony then, Mr. Harl?

Mr. HARL. It is my understanding that the testimony desired here this morning is an amplification of our reply to the questions which were propounded in the questionnaire by your committee to the Corporation.

Senator DOUGLAS. To which you replied.

Mr. HARL. Which is set forth on page 207 of the committee print on Monetary, Credit, and Fiscal Policies.

Senator DOUGLAS. That is correct.

Mr. HARL. Our answers are found on pages 207 through 215, inclusive. We have endeavored to make them brief and at the same time make them all-inclusive of the subject of the question.

One of these questions in which we are particularly interested is that pertaining to the examination policies of the Federal Reserve System, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation. The question is question No. 9, on page 212. I would like to read the question:

9. In your review of the examinations made by the Federal Reserve and the Comptroller of the Currency, what have you found to be the principal differences, if any, between the bank-examination policies of the FDIC and those of the Federal Reserve and the Comptroller of the Currency?

Our answer speaks for itself, to the effect that there are no important differences between the bank-examination policies of this Corporation and those of the Federal Reserve or the Comptroller of the Currency. It reads:

The existing differences are unimportant and are attributable mainly to the difference in the functions and the purposes of the three agencies. Complete cooperation exists between all three agencies. Uniformity of examination policy is gradually being achieved and close liaison now obtains with respect to a uniform approach to connective programs.

I would like to amplify our answer to that question by stating that we also work very closely with the National Association of Supervisors of State Banks. As you know, we have the 48 State bank supervisors plus a supervisor in Alaska, as well as Puerto Rico and Hawaii, making 51. We meet with this group twice a year. In addition thereto, in the spring meeting, their executive committee comes in here and sits down with our examination staff and we make every effort to coordinate the examination programs.

However, I would like to call attention to the fact that we, as an insurance corporation, make our examination as to our hazard, or exposure, as we call it. It consists of loans and discounts which are reflected by the composition previously called to your attention on pages 38 and 39 of our report No. 31. Experience has taught us that the solvency, stability, and safety of the banks, as well as that of the 93,000,000 depositors, is wrapped up in that 28 percent of the assets comprising loans and discounts. If those loans and discounts are good, then we have no exposure. Therefore we are constantly, in examinations, looking at the exposure of the Corporation, and the bank's ability to meet its commitments to the depositors.

Senator DOUGLAS. As I understand it, you inspect those State banks which are not members of the Federal Reserve System?

Mr. HARL. That is true.

Senator DOUGLAS. Which are insured with you.

Mr. HARL. That is right.

Senator DOUGLAS. Now, when you come to inspect the banks, do you time your inspection so that it is at the same time as the State examiner's?

Mr. HARL. We work very closely. In some cases we examine with the State bank commissioner. In most of the States by State law there is required two examinations per year on behalf of the State bank commissioner. That is mandatory. In some cases we make one examination per year for the State bank commissioner and he makes the other one. That is on the basis of requests from the State bank commissioner. If he does not make that request, and we examine a bank by ourselves, the examinations coincide, and we call them joint examinations. In some cases the bank commissioner and our examiner sign reports together. In others the report is signed by ourselves.

Senator DOUGLAS. And when you serve as a State examiner you are deputized by the State authorities?

Mr. HARL. That is taken care of by the statutes of those respective States, which provide that in lieu of the State bank commissioner making two examinations per year, he can make one examination himself and accept our examination, in lieu thereof, for his second one.

Senator DOUGLAS. According to my figures, of the some 9,200 State banks, about 2,000 of which are members of the Federal Reserve System, you examine about 6,500 State banks, since there are only about 700 noninsured State banks?

Mr. HARL. That is right. There were, as of December 31, 1948, a total of 14,753 banks in the country, of which a total of 13,419 were commercial banks insured by us. The balance were uninsured banks and mutual savings banks, some of which are insured, and some of which are not. However, the large mutual savings banks in New York are insured. Over a third of the mutual savings banks, which have 70 percent of the deposits in mutual savings banks are insured.

Senator DOUGLAS. I was speaking primarily of commercial banks.

Mr. HARL. All right. Speaking of commercial banks, you are correct, Senator. In other words, 6,504 are not members of the Federal Reserve System.

Senator DOUGLAS. But members of the Deposit Corporation.

Mr. HARL. Yes. On that date, December 31, there were 1,924 what we call member banks, which are State banks.

Senator DOUGLAS. So that, of the 13,400 commercial banks in the System, you inspect just a little short of half of the total number.

Mr. HARL. That is correct, sir.

Senator DOUGLAS. But the deposits at those banks, since they tend to be smaller banks, are about 14 percent of the total deposits?

Mr. HARL. That is correct. A large percent of all deposits are in Federal Reserve member banks.

Senator DOUGLAS. Do you want to say anything else in your direct statement?

Mr. HARL. No, sir.

Senator DOUGLAS. As I understand it, your insurance covers the first $5,000 in each deposit account in an insured bank and the annual premium charge is one-twelfth of 1 percent on all deposits; that premium charge is not merely on the insured deposits, but on all; is that correct?

Mr. HARL. That is correct.

Senator DOUGLAS. What is the total in the insurance account now? What reserves do you have?

Mr. HARL. We have brought that, and it can also go into the committee file (June 30, 1949, Report to Insured Banks, FDIC).

Senator DOUGLAS. $1,138,000,000; is that correct?

Mr. HARL. Yes, sir. You will notice the statement of assets on June 30 shows we hold that amount of cash and Government obligations; and if you go to the second page, you see the capital account, and the total capital account and reserves comes to $1,134,213,000.

Senator DOUGLAS. What is the sum total of the annual premiums which you collect?

Mr. HARL. That premium varies, Senator.

Senator DOUGLAS. How has it been running in recent years?

Mr. HARL. On page 21 of our annual report for 1948 you will see a picture of that. On page 19 you will see the income from year to year since the inception of the Corporation. We would like to call the attention of everyone to page 21, which shows the ratio of FDIC capital surplus to deposits in insured banks is now 69 percent.

Senator DOUGLAS. You mean page 20, don't you?

Mr. HARL. Page 21.

Senator DOUGLAS. Page 21 is the statement of assets, but page 20 is the statement of income. I was asking about the annual income. Your figures on page 20 show annual income as of the calendar year 1948 as $146,800,000.

Mr. HARL. That is correct.

Senator DOUGLAS. And the reserve has been growing at the rate of something not far from $100,000,000 a year.

Mr. HARL. That is right. We call attention, on page 21, the last column to the right, in 1934, when the Corporation began to insure deposits, we had a 0.73-percent ratio of FDIC capital and surplus to deposits of insured banks. That reached an all-high point of 0.83 percent in 1938 and then receded to a low point of 0.59 percent in 1945. It has now gotten up to 0.69 percent as of December 31, 1948.

Senator DOUGLAS. In other words, the ratio of the reserve to the deposits has not increased, though the capital amounts have increased?

Mr. HARL. That is correct. Percentagewise we are not in as good a condition as we were in December, 1938. In other words, on that date it was 0.83 percent. On December 31, 1948, it was 0.69 percent. Or a difference of 0.14 percent.

Senator DOUGLAS. These ratios which you have given are ratios of the reserve funds to total deposits. What about the ratio of the reserve funds to the insured deposit? You insure only the first $5,000 of each account.

Mr. HARL. In practice, Senator, and we have checked a lot of techniques over the last 15 years, we are now in the sixth year in which there has not been a failure of a bank from the creditor's standpoint, or the depositor's standpoint, because what we do in effect is give 100 percent insurance. If a bank gets involved we immediately restore the losses of that bank and liquidate the remaining assets.

Senator DOUGLAS. That was not my question, Mr. Harl. You have the figures of total deposits in insured banks. But I wanted to get the ratio of your reserve to insured deposits, and that involves the question as to what is the total of insured deposits, or, to get at it indirectly, what is the ratio of the insured deposits to the total deposits.

Mr. HARL. Dr. Cramer might speak on that.

Dr. CRAMER. That requires a special study and we have made four such studies, the last one in October 1945.

Senator DOUGLAS. Good.

Dr. CRAMER. We are now conducting another study.

Senator DOUGLAS. What does your October 1945 figure show?

Dr. CRAMER. It shows that 46 percent of all deposits were insured.

Senator DOUGLAS. Therefore, that 54 percent of the total deposits were in excess of the first $5,000.

Dr. CRAMER. Yes.

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Senator DOUGLAS. Therefore, as a rough figure, you should approximately double this ratio, to get the percentage of the reserve upon the insured account, approximately that?

Dr. CRAMER. Yes.

Senator DOUGLAS. In other words, it looks as though it would be around 1.4 percent on the insured deposits, if this ratio holds.

Dr. CRAMER. That is correct.

Mr. WOLCOTT. May we have the percentage of depositors?

Senator DOUGLAS. Yes.

Dr. CRAMER. The percentage of depositors that are fully insured, and both of these figures include mutual savings banks as well as commercial banks, was, on October 10, 1945, 96.4 percent. If you would like the commercial bank figures separate, I have those.

Senator DOUGLAS. That would be fine.

Mr. HARL. In this connection, gentlemen of the committee, we have a questionnaire out in the banks' hands now asking for the total number of accounts they have. We can then give you, when this comes back, the number of bank accounts in the banks of this country, as No. 1; and, as No. 2, the number of accounts of $5,000 or less, and the number of accounts of $5,000 or over.

The figure that Dr. Cramer gave just now, that 96 percent, is the number of accounts insured in full by the Corporation at the present time.

Senator DOUGLAS. May I ask one question. I noticed that you said that in most of the cases where the banks fell into trouble that you would resort to a purchasing of assets, mergers, and consolidations, and pay off the depositors in full.

Now, the inquiry I should like to raise is this: Is this developing a precedent so that, in practice, if we should have widespread bank failures the Government would be committed, by precedent, not merely to guaranteeing the first $5,000 of the accounts, but guaranteeing all deposits?

Mr. HARL. I don't think so. The question has never been raised.

Senator DOUGLAS. But it would be raised if there were to be widespread failures. Are you not now establishing a precedent to pay off all of the depositors and accounts in excess of $5,000? Suppose that you get widespread failure and you decide merely to assume your legal liability. I think we can be quite certain it would be said, well, why are you changing your policy now, after you have given full protection up to this point?

Mr. HARL. I would like to amplify my answer in considerable detail on that.

We have a very excellent review board, and as fast as the examination reports come over from the Federal Reserve and the Comptroller, or from our field, those reports are studied, the results tabulated, and a chart is maintained on every insured bank in this country. We have the results of those examinations twice a year. We have set up in our organization three categories of banks: The banks which we think are sound, the banks which we think are problem cases, and the very serious problem cases. When a bank reaches the serious-problem case we immediately contact, and have had the wholehearted cooperation of the State bank supervisors, the Comptroller, and the examining officials of the Federal Reserve System. We endeavor to stop the erosion right then and there, and we have been successful in doing it.

Therefore, we think that as a result of this system we will be able to, and are very sanguine that we will be able to, meet this issue as it comes along.

Senator DOUGLAS. You have been sailing in very good weather for these last 10 years—that is, good financial weather. There haven't been many storms. But suppose we were to have a depression comparable to that of 1929–33. Would you be able to maintain, or do you feel a moral obligation to maintain, 100 percent guaranty, or would you fall back on the legal liability?

Mr. HARL. In answer to the Senator's first question, we believe that we can prove, by studies in conjunction with the Federal Reserve Board, the State supervisors, and the Comptroller, that as the result of FDIC we will never drift into the situation in which we found ourselves from 1929 to 1933.

Senator DOUGLAS. I wish you would develop that.

Mr. HARL. In these years we have developed, for example, penicillin, the sulfa drugs, and so forth. We still have sick people; but what I want to say is that, as compared with physical ills, we believe that we have made great progress in the correction of our economic ills. We still believe in the old adage that coming events cast their shadows before. We are not a bunch of shadow dodgers, but are watching those shadows to see that they do not lengthen in front of us.

When we stop to think that the first National Bank Act was in 1863, and it was only 70 years old when this thing hit us in 1933, we feel that we have made great strides in the protection of the depositors and in the solvency of the banks, through our review system and our examination system, from 1933 to 1949, more strides than we made in the 70 years from 1933 back to 1863.

In that respect I am satisfied that we have had the whole-hearted cooperation of the banking fraternity.

When we get into these situations, when we see credit policies expanding too rapidly, we have had the wholehearted cooperation of the bankers association. No more than a year ago all of us, the Comptroller's office, the Federal Reserve, and so forth, felt as if the credit policies might be expanding too rapidly. The bankers association had a credit conference; they did a splendid job.

This chart is our criterion. As this exposure goes up our exposure becomes greater. As long as we watch this factor we are not going to get into trouble. If you notice, back in 1934, 31 percent of the assets of banks were loans and discount, while in 1949 only 28 percent, and in that 28 percent was FHA paper, VA paper, RFC participation, and commodity credit loans.

Therefore, if we watch the exposure, and if all agencies do so, we can never drift into the situation we were in in 1929.

In that connection, if you go back to 1929, you had a tremendous percentage in brokers' loans. There was a lot of trading on the 10 percent basis. As you know, the Federal Reserve last year exercised its prerogatives and is controlling the brokers' loans.

Senator DOUGLAS. Do I understand from what you are saying that in your belief depressions will be impossible in the future?

Mr. HARL. It is our belief that we can control or meet any issue with which the banks are confronted coming from a depression.

Senator DOUGLAS. In other words, there will be no problem in the future of bank failures?

Mr. HARL. I am not that sanguine. I believe we will have bank failures, but we believe we can control them.

Senator DOUGLAS. How do you control bank failures? Are you saying that you think the banks of the country are now completely stable and that we will never have any widespread problem of bank failures in the future?

Mr. HARL. I would like to say this: I do not think banks or bankers cause depressions. I don't think that, at any time, we can attribute the last depression to the credit policies of banks or bankers.

Senator DOUGLAS. But suppose that a depression breaks out—we won't go into the question of whether the banks cause depressions, but it is certainly true that the banks suffer from depressions, and suppose a depression breaks out and the security of the banks is imperiled. Are you saying the banks won't fail even though the economic condition of the country is deteriorating?

Mr. HARL. I do, because the failure of the bank is determined by the note case, and if the note cases are policed properly, we are in a sound situation. The thing a bank has to meet its obligations with comes from reserves in cash or Government securities. As long as bankers keep their loans and discounts in line, and as long as the supervisory agencies see that they do, and that they do not unduly expand their credit or take chances, the banks will not suffer from depression, as they will contract as rapidly as the circulation goes down.

Mr. BUCHANAN. As to the question of coverage, the smaller banks, according to newspaper reports, seem to be advocating an increase of coverage from the present figure to a figure of about $10,000 to $25,000, whereas the larger banks seem to want to continue the present figure. Would you care to express your opinion on that?

Mr. HARL. Congressman, there has been considerable agitation by the smaller banks to increase their coverage, for this reason: They say the chain stores, utilities, and so forth are foreign to the town but do business in the town. Their comptrollers watch the accounts. When they get to $5,000, they draw down.

Take North Dakota, for example, where you have a certain chain-store operation. When the deposit gets up to $5,000, they will pull it down and then redeposit in a metropolitan bank.

The comptrollers of these large corporations are constantly calling the metropolitan banks for their statements and analyzing them. That is what we call smart money—wise money.

If you go back to the previous depression, you will find that as a rule smart money, or wise money, got out, because they watched these statements, and they sent what we call a creeper through clearings, and you had creeping runs, because it went through chains. You didn't see a line outside the bank.

The country bankers feel that if this is elevated to $10,000, that these large accounts, like the utilities and the chain stores, and so forth, will elevate their sights to where they will carry $10,000 in that country bank rather than $5,000. So we have considerable agitation from that standpoint.

Senator DOUGLAS. Your reply raises a very interesting line of thought. What you are saying is that runs are initiated by withdrawals by the large depositors. I believe in your written reply, on page 208, you pointed out that in a group of banks studied the average withdrawal was 40 percent in deposits, but in accounts of more than $100,000 the withdrawals were 70 percent, and then the percentage withdrawals diminished as the size of the account diminished, until when you reached accounts of less than $500, the withdrawals there were only 6 percent.

In other words, your statement now bears out or is in line with the analysis that you presented that runs are initiated by withdrawals of large accounts.

Mr. HARL. I was referring to before the inception of the FDIC. We state that no bank runs of any consequence have occurred since the FDIC. If you go back and study what happened in Detroit and in Cleveland prior to the advent of the FDIC, you will find out the large corporate balances were not hurt.

Senator DOUGLAS. I didn't understand that.

Mr. HARL. I say that these runs, these so-called creeper runs, took place prior to the inception of FDIC.

Senator DOUGLAS. Yes.

Mr. HARL. You see, the big difficulty, if you go back and analyze it, started in the larger banks, primarily in Cleveland, and then it spread around the lake to Detroit. This is prior to 1933.

Senator DOUGLAS. Yes.

Mr. HARL. Now——

Mr. BUCHANAN. Why wouldn't that happen again?

Mr. HARL. The reason why we don't think it will happen again is because the average corporate balance, as I said, saws off at the $5,000 level.

Mr. BUCHANAN. They are siphoning off funds?

Mr. HARL. That is right. That is the reason why the country bankers want the level raised to $10,000, which evidences the confidence that the large corporation has in the $5,000 level. You remember, prior to the FDIC, you had to have a depository bond for State funds. All States now do not require a depository bond until after they hit the $5,000 level. When they do, they require pledges and/or depository bonds to insure their funds above $5,000.

For example, in the State of Pennsylvania, the treasurer deposits tax money in the various banks. I think you will find, Congressman, that he does not require any depository bond or pledge of any assets until the deposit exceeds $5,000.

Mr. BUCHANAN. Has the Board taken any position about the suggested increase?

Mr. HARL. As yet, Congressman, we have not, because we are making this study. These studies have been made periodically about every 5 years. As to how many accounts are now in the $10,000 category or less—in 1945, 96 percent and a fraction of the accounts insured were $5,000 or less, and 98 percent were $10,000 or less.

So, if you raise the coverage to $10,000, you would almost insure in full, because our study in 1945 shows 98 percent of the accounts were $10,000 or less, which would leave a fraction of the accounts over $10,000.

So, if you went to $10,000, it is safe to say that you would insure in full 98 percent of the accounts.

Senator DOUGLAS. Mr. Harl, what puzzles me in your statement is this: You have said that in the past runs have been initiated quietly by the withdrawal of large accounts, so-called smart money. Now, it is these accounts which only get very partial insurance. The account of $100,000 only has a $5,000 insurance. What is to prevent the withdrawal of the large uninsured accounts from the big banks?

Mr. HARL. The statement I made was predicated before the advent of FDIC.

Senator DOUGLAS. The FDIC only insures the first $5,000. Suppose there is a depression and the large depositors take fright and withdraw, knowing that they are not insured. What is going to maintain the solvency of the bank?

Mr. HARL. The large accounts today, Senator, as I explained, in the country banks, are frightened off.

Senator DOUGLAS. You could have runs on the big banks.

Mr. HARL. As I said, the larger corporations are constantly asking for statements of the larger banks, and they are constantly checking on the condition.

Senator DOUGLAS. If you get a depression, and if the value of Government obligations, for example, which you have treated as being completely solid, suppose those should shrink along with loans and discounts, and the banks find themselves with declining assets, as compared with the deposit liabilities which they have set up through loans, and the big depositors take fright, knowing that they are not insured, and withdraw, what is there to protect the solvency of the bank?

Mr. HARL. You have raised a policy question there which is beyond the entire control of the FDIC.

Senator DOUGLAS. We are all groping.

Mr. HARL. We have labored under the policy that Government securities will be supported at all times. In 1940 and 1941, when the war came on, I was a State bank commissioner. I was assured by people in high places that the Government bond market would be supported. In that connection we went to our banks and asked them to participate in the war effort by making certain purchases. Naturally, the bankers who were there in 1929 to 1933, in those days, and particularly in 1920 and 1921, when Liberties dropped to, I think, 85, were reluctant to participate until we, as State bank commissioners, told them that we were told that the bankers of this country would be protected on a stabilized Government market.

Senator DOUGLAS. Was that protection a guaranty for an indefinite period of time, world without end, or was it for a stated period?

Mr. HARL. There was no statement made as to the length of guaranty or the time involved. We were told that the Government bond market would be protected. As you remember very well, in those early twenties, Liberties went to 85. Therefore, you know, if you discount 15 percent of your Government holdings in the banks of the country, it would materially affect their capital structure.

Senator DOUGLAS. But suppose the Federal Reserve, for example, should decide either to end the system of support price or to lower the support price. Where would you be then?

Mr. HARL. I think, if that were done, that good faith would have been broken with the banking fraternity which has supported, by large investment, Government bonds. I don't think we could have won the war if the bankers of the country hadn't gone in and bought these bonds like they did. I understand that it cost us one-tenth of 1 percent to dispose of our Governments. The bankers rallied and bought these bonds. I know, frankly, that I would have not recommended to any bank under my supervision at that time that they invest heavily in Governments unless there was some assurance that they would be protected.

As you notice in the statement, on December 31, 1948, nearly half of the resources of the banks in this country were in Governments. That reached an all-time high in 1945 when we had a total in insured mutual savings banks of 63 percent, and 56 percent in commercial banks. In 1945 the insured commercial banks of this country had 56 percent of their assets in Government securities.

I think that the bankers of this country believed, and had a right to believe, that their Government would see that the bond market was supported at par, or they would not, as trustees of these large sums and these large deposits, have invested 56 percent of their assets in the securities of this Government.

Senator DOUGLAS. But this is what puzzles me further, that the move to have the Federal Reserve either discontinue or lower the support price on Government bonds seems to be coming, in large part, from the bankers, who you say should be protected from such an action.

Mr. HARL. I think, frankly, that move is coming from a very few bankers.

Senator DOUGLAS. What bankers do you think are initiating it?

Mr. HARL. I would not care to say at this time.

Senator DOUGLAS. Will you meet me behind one of these pillars after the session is over and whisper in my ear where this movement is coming from? You may not want to say it publicly, but you should not conceal such a secret privately. Is this a date, that we may meet behind one of the pillars?

Mr. HARL. At your convenience, sir.

Senator DOUGLAS. All right.

Well, without identifying them, have you any surmise as to the motives of these groups, why they should want to lower the support price?

Mr. HARL. I can't conceive of any reason why any banker would want to reduce the support price of Government securities. I frankly cannot see why.

Senator DOUGLAS. It would mean an increase in the interest rate, would it not?

Mr. HARL. Then I would say, if that is the case, it is a profit motive.

Senator DOUGLAS. Profit motives are not necessarily bad. The question is whether they work for the benefit of the community or not.

Mr. HARL. The profit motive is, naturally, a tremendous incentive for anything you do. In other words, the pocket nerve is the most sensitive nerve the average man has.

Senator DOUGLAS. What you are saying is this, if you can maintain the price of Government bonds at par there will be no great runs on banks, and that even if we had future depressions, you would not have widespread bank failures, and that therefore the FDIC present policy is competent to deal with the situation?

Mr. HARL. Yes, sir.

Senator DOUGLAS. There are a lot of "if's" in that.

Mr. WOLCOTT. Mr. Chairman, I don't think we have in the record what the Government bonds are pegged at. They are pegged over par now, are they not?

Mr. HARL. Yes, sir.

Mr. WOLCOTT. Do you know the exact price?

Mr. HARL. No, sir. That is a matter over which we have nothing to do. That is a matter of monetary policy which is regulated by the Treasury and Board of Governors.

Mr. WOLCOTT. Something over 101.

Mr. HARL. The Open Market Committee of the Federal Reserve, in conjunction with the Treasury, handles that matter.

Mr. WOLCOTT. Why are these bankers advocating pegging of Governments at less than par?

Mr. HARL. You have among certain bankers, as among other people, advocates of a free-bond market, the same as you have of a free-gold market. I happen to come from Colorado. Out there we constantly hear about a free-gold market. Our people advocate a free-gold market, not because they figure gold is going down, but because they figure gold is going up. It is the profit motive.

Mr. WOLCOTT. Could we get the figures at which Governments are pegged?

Senator DOUGLAS. Yes.

Mr. HARL. That is controlled by the Open Market Committee and the Treasury.

Senator DOUGLAS. They reduced it a few months ago.

Mr. WOLCOTT. I do not know that Mr. Harl will want to put it in the record, but I think we should have also the average interest rate on Government bonds and the average yield of the banks on Government holdings.

Mr. HARL. We would be very glad to get——

Mr. WOLCOTT. I wonder if we could not have that covering the last 3 or 4 years, to show the increases in years and the interest rates.

Senator DOUGLAS. Mr. Harl, in view of the fact that runs seem to be initiated by the large depositors, would not a greater degree of security be given to the large depositors and hence less danger of bank runs if the coverage were increased from $5,000 up either to total coverage or a larger figure?

Mr. HARL. I would say that since the inception of the Federal Deposit Insurance Corporation, either because of the confidence in the Corporation's ability to pay or because of psychology, there have been no runs.

Senator DOUGLAS. Mr. Harl, I would like to go back to the parable in the Bible of the foolish man who built his house upon the sands. The rains descended and the winds blew and beat upon that house and it fell and great was the fall thereof; but the house that was founded upon the rock did not fall.

Now, the question I am raising—and my mind is open about it—is this: If bank runs are initiated by the withdrawal of large deposits and if only the first $5,000 of these deposits are insured, what guaranty is there, if the country should get into trouble in the future, that we would not have the same process repeated and the banks would crash? You have had sunshine, but we may be going into a period of storm.

Mr. HARL. I would say the old adage, "In time of peace, prepare for war"—we have had from the banking standpoint 10 years of remarkable peace and we have built up not only in the FDIC but the capital structures of the banks have increased from $6,000,000,000 to better than $10,000,000,000. Therefore, your supporting structure all the way along the line has been materially increased to where I am very confident that the Federal Deposit Insurance Corporation can protect the bank depositors. At no time do we ever attempt to speak for the banks.

Senator DOUGLAS. I do not want to interrupt constantly, but the bigger the house, the bigger the fall. Samson was in quite a large palace, you know, and he is presumed to have brought it down.

Mr. HARL. As you remember, Samson was a blind man, and I believe the bankers of this country have their eyes wide open to conditions.

Senator DOUGLAS. Let's turn from the Old Testament to the New Testament. I use this rock and sand analogy. The point I am trying to get at is this, and I repeat: If bank runs are initiated by the withdrawal of large accounts and if only the first $5,000 is insured, what is to prevent this from happening again?

Mr. HARL. In the first place, in the last 15 years the Federal Deposit Insurance Corporation has eliminated large runs.

Senator DOUGLAS. Because there has been no doubt about the solvency of the system, but suppose you do get a serious depression. You have been in the period of inflation, rising prices, full employment—and we hope, so far as full employment and rising production is concerned, that will continue, although not rising prices—but suppose we were to get into a period of declining production, declining employment, falling prices, shrinkage of assets, fear, and panic. Now, would your house stand when only the first $5,000 is insured?

Mr. HARL. Yes, sir.

Senator DOUGLAS. Is this an affirmation or a hope?

Mr. HARL. This is based on 14 years of operating procedures.

Senator DOUGLAS. I say, with all deference to you, Mr. Harl, I say the experience of 14 years of sunny weather is no guaranty that in a period of storm you necessarily can stand.

Mr. HARL. The chart here on this last page—I am trying to illustrate by that, Senator, our exposure is entirely in the bond accounts and the discounts. Therefore, if the Government bond market is maintained at par, the Federal Deposit Insurance Corporation, in our opinion, can meet any strain on the banking structure.

Senator DOUGLAS. Then your hopes are based upon the continuance by the Federal Reserve Board of the present price-support program for Government bonds?

Mr. HARL. My statement is predicated on what the bankers of this country were led to believe by those in high authority at the time they made these tremendous investments in Government securities.

Senator DOUGLAS. Suppose the Federal Reserve Board were to take the position that these assurances did not bind them in perpetuity and that while they had followed this policy for a period of years, now it was time to allow "natural forces" to determine the price of bonds.

The price of Government bonds, let us say would fall, we do not know how much they would fall. You would not be so certain that the banks could stand up then, would you?

Mr. HARL. If you had $50,000,000 invested in Government securities and you were informed or you picked up a rumor that that market might be 90 cents next week, as based on the dollar today, you would immediately start selling.

Senator DOUGLAS. Naturally.

Mr. HARL. So the old case of the law of supply and demand goes into gear. Now, whether it is Government bonds or the free gold market, if you have more gold offered than you have purchasers, you naturally are going to have a sliding market. Therefore, I think it is most essential that those who are handling our monetary policies and credit policies of this country maintain Government bonds not only from a banker's standpoint but for those individuals who took their savings and put them into Government bonds, and I think they are entitled, just as much as the $5,000 depositor is guaranteed, to have their bonds guaranteed at par.

Senator DOUGLAS. All I am trying to find out is this: Is not your assumption that your present guaranty will maintain the system based upon a further assumption that the Federal Reserve Board will maintain the support on Government bonds?

Mr. HARL. That assumption is correct. In insurance you always have something that might happen.

Senator DOUGLAS. Suppose, however, your assumption concerning the Federal Reserve Board is wrong and that for reasons, whether good or bad, the Federal Reserve Board decides to remove the peg either completely or partially. Would you have as much confidence in the insurance system taken by itself to maintain the solvency of the banks as you otherwise would?

Mr. HARL. In that case you would have to have dollar for dollar for everything you guaranteed, because if Government bonds are not worth par you would then have to have—if you guarantee anything, you would have to have almost the equivalent in cash.

By that same token, if you look at our financial statement, you will note on this assumption that you mentioned there, you will also see what would happen to the Federal Deposit Insurance Corporation, which has roughly $1,000,000,000 invested in Governments, and I will say the Congress, when they enacted this law, definitely stated we had to invest our money in Governments.

Therefore, it would seem that the Congress at that time felt as if the most gilt-edged and safest investments in the country were Government securities. By the same token, if you will pull the plug, so to speak, on Governments, you would not only hurt every man and woman who invested in Governments but you would likewise do a great injustice, whoever pulls that plug, to this Corporation, because if you look at the statement you will see the investments of the Corporation are primarily, and statutorily so, in Government securities.

So, getting back to that assumption, if this market slides off, it would not only hurt the banks per se but the insurance corporation and every man, woman, and child in this country, including some large trust funds.

Senator DOUGLAS. Here is the point I am trying to get at, and I am afraid I have not done any too well in the form of the questions I have asked.

You have no power over the Federal Reserve Board to determine their policy, but you do have power to make recommendations concerning FDIC policy. Now, since you cannot control Federal Reserve policy, should you not take into account the possibility that the Federal Reserve System may remove the price support or reduce the price support on Government bonds? In which event, you would be in trouble. Therefore, to guard against that trouble, might it not be advisable to increase the coverage of insurance as a hedge against such a possibility occurring?

Mr. HARL. Sir, if we increase the coverage—and we are not opposed to it, as yet we have not taken a position opposed to increased coverage—but in the event we increase coverage to $10,000 and the Federal Reserve or the other authorities involved should remove the support of the bond market, the very foundations of what this Corporation is predicated on, entire resources of a billion dollars, would be affected by any such policy.

If we had them insured—if we had the banks insured in full and the reserve which we are utilizing to pay those was depreciated by some action, manifestly that would curtail our ability to pay because we manifestly would not be in a position—of course, it would not be policy to carry a billion dollars in cash; so Congress decreed wisely that we invest in Governments, which we have done.

Now, if they remove the support, suppose you left the coverage to $10,000 on the one side and remove the support on bonds on the other, you will find this Corporation has a greater liability with less ability to pay.

Mr. BUCHANAN. Would there be inflationary tendencies if Congress were to increase the coverage to $10,000. Tell us what it would do to country banks to increase bank deposits there and the potential availability of bank credit.

Mr. HARL. Congressman, I do not think that increasing the insurance coverage to $10,000 would be inflationary at all. I think it might cause a shifting of deposits. It would have the effect——

Mr. BUCHANAN. Now, a siphoning off of funds, and if funds remained with country banks, it would be an increase in remaining bank deposits.

Mr. HARL. It would not be an increase in deposits in total, but there would be a shifting of deposits.

Mr. BUCHANAN. Which would cause an increase in bank credit.

Mr. HARL. The deposit level would be the same. If you have $142,000,000,000 in deposits and the corporation or the operator has $5,000 in 50 banks over the country and the rest of it in a metropolitan institution, the chances are that if you raise the coverage to $10,000, he would not consolidate his overage in a metropolitan bank.

Mr. BUCHANAN. It would cause a shift?

Mr. HARL. That is our answer. You would have a shifting of deposits. You raised a question a minute ago, Senator Douglas, about the larger corporation. The larger corporation draws its money off in many cases to the metropolitan bank, because they are insured up to $5,000, but as you well know, coming from Chicago, the directors and the boards of directors of these larger metropolitan banks are made up of those corporation officials from the corporations in the city; so they are on the inside of their own bank.

Senator DOUGLAS. What conclusion do you draw from that?

Mr. HARL. The conclusion is that you can watch much more closely the money in your pocket than you can the money in Congressman Wolcott's pocket.

Senator DOUGLAS. Does that facilitate withdrawals or impede withdrawals?

Mr. HARL. It would depend entirely on how Congressman Wolcott wants to invest your money.

Senator DOUGLAS. Does that impede withdrawals or facilitate withdrawals?

Mr. HARL. That is a policy Congress would have to determine.

Mr. BUCHANAN. Now, as to the premium rate, what is your position on the reduction of the premium rate?

Mr. HARL. We are endeavoring to analyze one thing, the premium, as to whether or not the premium should remain as it is if your coverage goes up. Manifestly, if you increase coverage from $5,000 to $10,000, it would seem by all rules of exposure, that your premium should either stay in status quo or be increased.

Therefore, we believe the premium or the so-called assessment is tied very closely to the increase in coverage.

As Dr. Cramer stated a few minutes ago, we have a questionnaire out to all banks asking for the amount of deposits in total and the number of depositors. Likewise, the number of depositors, $5,000 or less, $10,000 or less, and so forth.

It would seem from the 1945 questionnaire that if you go to the $10,000 bracket, you will then insure in full 98 plus percentage of accounts.

Senator DOUGLAS. But the question is, What percentage of deposits will you insure? The present insurance, which covered 96 percent of the accounts, only insured 46 percent of the deposits.

Mr. HARL. That will also be determined by the questionnaire.

Senator DOUGLAS. Mr. Harl, I was interested in your statement that the Corporation took no stand on increase in coverage, which you have made verbally, and then I turned back to page 209, in which you made a statement on this, in which you said, and I quote:

> Therefore, we are of the view that the Corporation, under the present insurance coverage, is making a maximum contribution to furthering the purposes of the Employment Act and in this respect there would be no benefit to be gained in changing the coverage of deposit insurance.

Now, these two statements of yours seem to be in conflict. I am not interested in indicating conflict or putting you on the spot, but I am in some doubt as to which represents your point of view.

Mr. HARL. As I said before, the matter is being predicated on the results of this last questionnaire. The answers here were predicated on the questionnaire that was gotten out in 1945.

Senator DOUGLAS. Then do I understand that the Corporation is open-minded?

Mr. HARL. It is.

Senator DOUGLAS. On this question of whether we should raise the coverage of the $5,000 limit?

Mr. HARL. Yes, sir.

Senator DOUGLAS. You are not opposed to it?

Mr. HARL. No, sir. We are open-minded all the way through. We are working with this questionnaire. The savings banks of this country as well as commercial banks have an FDIC committee, and they are working with us, and anything that we come to you gentlemen with or anything that you gentlemen come to us with after this questionnaire comes in, we can discuss more intelligently than we can today, because our answers here are predicated on the last study we made.

Mr. WOLCOTT. I wonder if your 1945 study shows what percentage of the deposits would be insured had you insured the first $10,000 in toto?

Mr. CRAMER. Fifty percent approximately.

Mr. WOLCOTT. About 4 percent more than shows under the $5,000 insurance?

Mr. CRAMER. I was speaking of the commercial banks only.

Senator DOUGLAS. Then, in other words, the deposits over $10,000, which form most of the residue of deposits over $5,000——

Mr. WOLCOTT. Over $10,000. He said if $10,000 were covered.

Senator DOUGLAS. Fifty-four percent are over $5,000 and 50 percent over $10,000; so that the overwhelming proportion is in the group above $10,000.

Mr. HARL. We have some cities out West where you have some small country banks. They in turn deposit, we will say, in Grand Junction, Colo.; Grand Junction deposits in Denver; Denver deposits in Chicago; Chicago deposits in New York.

Senator DOUGLAS. If you eliminate the interbank deposits and dealt only with the deposits of individuals and corporations——

Mr. HARL. That is what we are going to do. We will take entire bank deposits, and after you do that, it boils down to: What are the real honest-to-goodness deposits in this country?

Senator DOUGLAS. Did these 1945 figures include interbank deposits or were they deposits of individuals and corporations?

Mr. HARL. We used the entire amount of deposits at that time. We are going to eliminate that and get right down to what are deposits without interbank deposits.

Senator DOUGLAS. That would show, of course, a much higher percentage in the $5,000 to $10,000 limit of total primary deposits.

Mr. HARL. That is right. It will show that 98 percent of your depositors on the basis of $10,000, that 98 percent of your depositors are insured in full, and those 2 percent which are not fully insured come in this category of interbank deposits as well as corporate deposits.

Senator DOUGLAS. Are you open-minded on the question of increasing the coverage for the savings and loan associations as well as the commercial banks?

Mr. HARL. We have not made a study of it, but the savings and loan associations do not come under our supervision.

Senator DOUGLAS. But the Administrator of the Housing and Home Finance Agency, as I understand it, has recommended an increase of coverage to $10,000 in that type of institution, and I wonder if you have given any thought to that.

Mr. HARL. As you know, the mutual savings banks have a ceiling on the amount of deposits they will accept. In New York their ceiling is $7,500. Therefore, we are interested in going along with what the mutual savings banks recommend.

Senator DOUGLAS. What do you mean by "ceiling"?

Mr. HARL. They do not take accounts larger than that on which they pay interest and the mutual savings banks are very much interested in $7,500 accounts, because as you know, we have some tremendously large mutual savings banks. They feel there should be a ceiling of $7,500 on the coverage. That gives them 100-percent protection.

Mr. BUCHANAN. Suppose the $10,000 figure were suggested for savings and loan, what would be your position? Would you approve or take the position against it?

Mr. HARL. We would not want the savings and loan associations to have any greater advantage than the savings banks, because, as you know, when you put your money in the savings and loan association, you get a share or ownership interest. When you put your money in a bank, you have a debtor-creditor relationship. There is quite a difference there.

Senator DOUGLAS. Mr. Harl, in your written statement, on pages 212 and 213, you opposed the Hoover Commission proposal that FDIC be placed under the supervision of the Treasury Department on the ground that it was a mutual insurance fund and that it should be independent of the Treasury or any other agency or department.

Now, as you know, the Comptroller of the Currency is also under the Treasury, but the deputy comptroller testified yesterday that the Treasury had never attempted to control its policies or to go into the matter as to whether or not a given bank was solvent.

I think it is on record that the examiners for the Comptroller of the Currency are about as incorruptible as any set of men in the country.

Now, are you afraid that the integrity of your examinations would be impaired if you also went into the Treasury, maintaining the same degree of independence in the examinations that the comptroller's staff maintains?

Mr. HARL. To begin with, we choose to stand on our replies here on the pages you mentioned. No. 2, we have never impugned the integrity of any examiner, be he comptroller, Federal Reserve, and/or State supervisor.

Senator DOUGLAS. Well, you are much more charitable than I am on that point, because I have had enough experience with State banks to know that supervision in the case of State banks is not always of an extremely high level; not always.

Mr. HARL. As a matter of judgment, we think, and not integrity.

Senator DOUGLAS. Well, the national bank examiners certainly have a very high reputation for integrity and competence. We may disagree with them as to whether a sound banking system is made up solely of sound individual banks or whether sound individual banks are not also affected by the system as a whole. We may disagree with them on that point of policy, but no one, I think, can question their technical competence or integrity, and I wondered in view of that fact, just why you did not want to be put in a status comparable to them under the Treasury?

Mr. HARL. The comptroller charters national banks, as you well know.

Senator DOUGLAS. Yes.

Mr. HARL. Then you open up the whole matter of States' rights, because you would have the control of Federal chartering policies vested in the same group that does insuring. As you know, we approach each and every insurance situation on its own merits. The commissioner of New York charters a bank, and then if the bank desires and wants insurance, it is entirely voluntary. The bank can apply for insurance and we make the examination, and if we find a bank meets our standards, it is insured.

I would like to say in that respect that of the 12 largest banks in New York City, and they are large, nine of them are State-chartered banks.

Senator DOUGLAS. Does your reply boil down to this: That you think if FDIC went into the Treasury, that the independence of the State banking systems might be endangered?

Mr. HARL. I think you will find the 48 State banking commissioners likewise share that view.

Senator DOUGLAS. Then it is your view?

Mr. HARL. It is my view that the Federal chartering authority and the insuring authority should not vest in the same group.

Senator DOUGLAS. What I am trying to get at is this: Do you think if FDIC went into the Treasury that that might be the camel's nose under the tent, if I may use weighted language, the camel's nose under the tent to extend added Federal control over the State banks?

Mr. HARL. I would think that would be a pencil in the dike.

Senator DOUGLAS. If we may get away from these figures of speech, I take it that is what you do think, that it would be a possible prelude to added Federal control over State banks.

Mr. HARL. I do, sir.

Senator DOUGLAS. We finally get that point established. Why do you feel that?

Mr. HARL. As I said before, our answers are given here on this questionnaire. That is No. 1. No. 2——

Senator DOUGLAS. Well, I read your reply last night and I may have been somewhat tired. I gathered that you were opposed to it, but I did not quite gather why you were opposed to it, and I am a little bit fresher this morning and probably could understand these reasons better if you were to repeat them.

Mr. HARL. I can say it in a very few words. We do not believe that the Federal chartering authority should vest with the insuring group or vice versa. We do not believe the insuring group should have the power to charter. We believe the two should be separate and apart.

Senator DOUGLAS. I do not think the Hoover Commission proposed that you be given the power to charter State banks. Are you afraid that you would have the State system wiped out if FDIC came in the Treasury and that you would become the chartering agency or Comptroller of the Currency?

Mr. HARL. We feel if the Federal chartering authority were the insuring authority, that it would be a step toward eliminating the dual system of banking.

Senator DOUGLAS. I do not see that the chartering authority would be involved at all.

Mr. HARL. It is very much involved, sir.

Senator DOUGLAS. I do not see how it would be involved at all in your transfer to the Treasury. Chartering authority would still, in the absence of other legislation, remain in the hands of the States.

Mr. HARL. The chartering authority for a State bank would still remain in the hands of the State, but the chartering authority for the national banks——

Senator DOUGLAS. That is already there.

Mr. HARL. It is, but the FDIC is not there. Suppose you place the Federal Deposit Insurance Corporation under the same authority and the same policy operating group that does the chartering of national banks you would find that you would have a conflict immediately.

Senator DOUGLAS. Now, you are speaking not of State banks, but of national banks.

Mr. HARL. That is right.

Senator DOUGLAS. And you want to have one agency to charter and another agency to insure?

Mr. HARL. That is right.

Senator DOUGLAS. Why do you want that, aside from the well-known American desire for checks and balances and distributing authority all over the lot, so that A watches B and then if anything goes wrong can say that it is B's fault?

Mr. HARL. You have in this system——

Senator DOUGLAS. You see, we in Congress would like to get away from this "Button, button, who's got the button" game and be able to find who is responsible, because whenever we want to put someone on the mat—that is a polite term—and find out who is responsible, the responsibility is always shifted to someone else.

So that frequently Congressmen feel that they are being exposed to an administrative shell game in which the pea is always underneath another shell, and the civil servants face one with a frozen face saying it is someone else's responsibility; and, as a result, we feel frustrated and that at times may account for the impolite behavior of Senators and Congressmen toward administrative officials.

Mr. WOLCOTT. And also toward each other.

Senator DOUGLAS. Sometimes the frustration laps over.

Mr. HARL. Neither the Comptroller of the Currency, the Governors of the Federal Reserve Board, or the directors of the Federal Deposit Insurance Corporation are under civil service and, therefore, they are subject to removal.

Senator DOUGLAS. I am sorry, who is under civil service?

Mr. HARL. None of the bank supervisory authorities.

Senator DOUGLAS. That is, none of the officials of the Comptroller of the Currency?

Mr. HARL. The Comptroller of the Currency is not, the Board of Governors of the Federal Reserve System are not, and the directors of the Federal Deposit Insurance Corporation are not.

Senator DOUGLAS. Are your employees under civil service?

Mr. HARL. We are by Executive order.

Senator DOUGLAS. Well?

Mr. HARL. But the policy end of it, the staff naturally follow policy as laid down by the Comptroller or by the Board of Governors of the Federal Reserve or by the FDIC directors, and they are all——

Senator DOUGLAS. Are you saying that the purity of your employees would be contaminated by their being brought into the Treasury because the bank examiners are not under civil service?

Mr. HARL. I am not implying any such thing, but you made the statement, if the record is correct, that the Congress is sometimes frustrated by the acts of civil servants and also by acts of the bank supervisory authorities.

Senator DOUGLAS. Not bank supervisory authorities—civil-service employees in general. It is a matter of genus rather than species.

Mr. HARL. I would like to get down to the three or four bank supervisory agencies, and we did not know that we had ever frustrated the acts of Congress.

Senator DOUGLAS. I did not say you had frustrated the acts of Congress. I say civil servants frustrate Congressmen. I sometimes think the first is true also.

Mr. WOLCOTT. May I suggest, Senator, that after you have been here 10 or 12 years you do not get frustrated about anything. You get the rough edges worn off, and you take a good many things for granted.

Senator DOUGLAS. That may be the trouble.

Mr. WOLCOTT. You build up an immunity to frustration.

Senator DOUGLAS. That may be the trouble. I think a healthy frustration is very good, but the objects of frustration should be removed. New ones will develop. Go ahead.

Mr. HARL. Sitting on your left and sitting on your right are two Members of the Congress, and I believe they will testify that so far as the Federal Deposit Insurance Corporation is concerned, we have endeavored at all times to work just as closely as possible with the Congress and with their respective committees. Is that not true?

Mr. BUCHANAN. It is true, Mr. Harl.

Mr. WOLCOTT. I concur.

Senator DOUGLAS. I am sorry, Mr. Harl, my attention was diverted.

Mr. HARL. I just asked the two members of the committee if we have not at all times as members of the Corporation and as individuals endeavored to work closely with them on matters of policy as well as procedure.

Mr. BUCHANAN. My affirmative "yes" was emphatic. I do not know whether Mr. Wolcott's was as emphatic as mine.

Mr. WOLCOTT. I confirmed it without going into conference about it.

Senator DOUGLAS. Your virtue has been affirmed by my two colleagues. We are not trying to put anyone on the spot, but we are trying to work our way through a maze of Government departments and policies, and so forth, and try to integrate them, which is presumably the function of the legislative body.

I take it from your replies that you do not want to go into the Treasury, but as I say, I also take it that your reason for it is very similar to the little poem by Henry Wadsworth Longfellow, which he wrote as a young man:

I do not like you, Dr. Fell
The reason why I cannot tell
But this I know and know full well
I do not like you, Dr. Fell.

In other words, you do not want to go into the Treasury.

Mr. HARL. May I ask you: Have you asked the Treasury whether they would like to have us or not?

Senator DOUGLAS. No; they are going to come later, but we are exploring the possibilities of marriage between you two gentlemen.

Mr. HARL. I believe marriage is a contract which requires the assent of both contracting parties.

Senator DOUGLAS. Not necessarily, not in this case, because it so happens that the legislature is still supreme in theory in this country, and we can compel, if we should choose to do so, the combination, even though the two parties did not choose.

Mr. HARL. A shotgun wedding?

Senator DOUGLAS. We sometimes perform shotgun weddings.

Now, I take it that you are a very strong believer in the dual banking system. That is, the system of State banks in addition to the system of national banks.

Mr. HARL. I am a strong believer and a supporter of the dual system of banking.

Senator DOUGLAS. That is really 49 systems of banking, is that not right, because you have 48 States and the Federal Government, and rules among the States are not uniform.

Mr. HARL. We might expand it and call it 51, then.

Senator DOUGLAS. Yes. Why do you believe in that?

Mr. HARL. I would say that as compared with other countries, it has been successful. I think the greater number of banking systems that you have in the country, the greater protection you have from nationalization or centralization of banking and credit and, after all, that credit is the lifeblood of this country.

Senator DOUGLAS. I would as a follower of Andrew Jackson—I would agree it would be very dangerous to have the lending facilities of the country concentrated, but you could still have the lending facilities diffused but all the banks members of one system.

Let me ask you a question about the percentage of failures under the State banking systems and the percentage of failures of national banks. Have you ever collected figures on that point?

Mr. HARL. We have, but I think it would be more important not to deal in percentages. I think it would be more important to deal in dollar volume.

Senator DOUGLAS. No; because the State banks are the small banks, so that if you dealt in dollar volume, you would not have a picture of the comparative risk of failure of the two systems.

Now, has anyone ever collected figures on the relative percentage of failures among State banks as compared with National banks?

Mr. HARL. We would be very glad to get them, but I still go back to say——

Senator DOUGLAS. Say the last 20 years. Go back to 1929 in order to include the stormy years as well. My own impression, subject to check and correction, is that the percentage of failures of the State banks is very appreciably in excess of the percentage of failures among national banks and that the percentage of deposits in State banks which are lost through failure is much greater than the percentage in nationals. That is a simple fact, and I presume it is available.

Mr. HARL. It is available.

Mr. WOLCOTT. May I make an observation, what I consider an interesting observation along that line: That in Michigan at the time of the bank closings, there were twenty-some-odd private banks being liquidated as the owners of them died and were being dissolved otherwise.

The private banks are under no supervision at all. They are strictly on a local basis, dependent entirely upon the integrity of the manager of the bank and his judgment. A very strange thing happened in Michigan.

When all the other banks throughout the United States closed, these private banks were the only ones who remained open, and I think the record will show that there has not been a dollar lost in any of these little private banks for over 20, 25, or perhaps 30 years.

Senator DOUGLAS. I was not speaking of the private banks, which are not subject even to State inspection and examination, but I was speaking of the State banks which are subject to State rules, not national rules, and those State rules are generally much less, or, rather, the rules for State banks not members of the Federal Reserve System are much less stringent.

Mr WOLCOTT. The point I wanted to make was that the solvency or liquidity or soundness of the bank does not always depend upon the quality of the examination. It depends largely upon the efficiency and integrity of the management.

Senator DOUGLAS. Well, I would agree that it does not always depend upon that, but I would say that the rules concerning assets are certainly one factor in determining the solvency of banks.

Here is a statistical fact that can be settled one way or the other. I would like to have Mr. Chandler, who is adviser to our subcommittee, prepare material on this point and have it checked by the Comptroller of the Currency and by your office.

Mr. WOLCOTT. Would you want to bunch all nonmember banks into one package, or would you want to break it down by States, because State laws vary tremendously?

Senator DOUGLAS. We could have subdivisions to indicate the States which have been lax, but I think it would be very interesting to get figures on national banks, on State banks which are members of the Federal Reserve System, and on State banks which are not members of the Federal Reserve System.

Do you have those, Dr. Cramer?

Mr. CRAMER. I thought you might be interested in these figures. We have through December 31, 1948, 15 years' experience. We have aided 407 banks, a total of 407 banks.

Senator DOUGLAS. Failed?

Mr. CRAMER. We can very easily supply you with those, showing how many of those were national banks and how many——

Senator DOUGLAS. And the deposits?

Mr. CRAMER. And by years.

Senator DOUGLAS. And the percentage of those deposits of the total deposits of the category of banks in question.

In addition to that experience, I would also like to get the experience of 1929 to 1933, which is the real period of storm and stress.

(The information referred to above, furnished by the FDIC, is as follows:)

In the following table the data since the beginning of deposit insurance are shown not only for the entire 16 years but also for the first and second 8-year periods. During the first of these periods, the suspended insured banks were largely banks which were reopened after the banking holiday in the expectation that they would recover successfully, but proved unable to do so. It should be noted that during the past 8 years there has not been, as was the case formerly, a significant difference between the failure rates of the various classes of banks. We believe this is attributable to the great improvement which has been brought about in the examination and supervision of State banks. Since May 1944 no insured bank has been placed in receivership; all insured banks in such financial difficulty that closing was necessary have been merged with the assistance of the Federal Deposit Insurance Corporation.

Number and deposits of suspended commercial banks for selected periods since 1865

	Commercial banks		Insured commercial banks [1]		
	1865–1920 (56 years)	1921–33 (13 years)	1934–49 (16 years)	1934–41 (8 years)	1942–49 (8 years)
Number of suspended banks:					
Total	3,767	14,807	410	369	41
National banks	733	2,713	70	51	19
Other members Federal Reserve System	(2)	592	22	18	4
Not members Federal Reserve System	3,034	11,502	318	300	18
Deposits of suspended banks (millions of dollars):					
Total	1,180	8,453	527	464	63
National banks	324	2,798	105	70	36
Other members Federal Reserve System	(2)	1,464	188	176	11
Not members Federal Reserve System	865	4,192	234	218	16
Average annual number of suspensions per 100 operating banks:					
Total	(3)	4.37	0.19	0.33	0.04
National banks	0.32	2.74	.08	.12	.05
Other members Federal Reserve System	------------	3.49	.09	.20	.03
Not members Federal Reserve System	(3)	5.16	.29	.51	.03
Average annual deposits of suspended banks per $100 of deposits in operating banks:					
Total	$0.25	$1.52	$0.04	$0.12	$0.01
National banks	.14	1.10	.01	.03	.01
Other members Federal Reserve System	------------	.95	.05	.14	.004
Not members Federal Reserve System	.35	2.86	.14	.45	.01

[1] To Nov. 15, 1949. Includes banks merged with the financial assistance of the Federal Deposit Insurance Corporation.
[2] For 1914–20 included with banks not members Federal Reserve System.
[3] Not available. Deposit data for operating State and private banks during a substantial part of the period, 1865–1920, were derived from tax records. Comparable information on the number of those banks is not available.

Senator DOUGLAS. Now, if it were to be shown——

Mr. WOLCOTT. Be careful about that, because I am not so sure but what during that period there were many more Federal banks went under than State banks.

Senator DOUGLAS. I do not have an idée fixe on this. If it should develop there were more Federal failures than State failures during that period, I want to find it out. I am not starting out with the assumption——

Mr. WOLCOTT. I assumed you wanted a little more concentration of power on the part of the Federal Government over banking.

Senator DOUGLAS. I am an inquirer after truth rather than one who seeks to impose a policy. I am sure you will give me credit for that.

Mr. WOLCOTT. I have up to the present time. You have not done anything yet to cause me to change my mind in that respect.

Senator DOUGLAS. I am delighted that thus far I have not lost prestige with you. I should feel badly if that were to occur.

Mr. BUCHANAN. On the question of bank reserves, Mr. McCabe in his statement from the Federal Reserve Board proposed legal reserves—proposed on page 61 here in his statement that the legal-reserve requirements of commercial banks should not depend on whether or not the banks were members or nonmembers of the Federal Reserve. In short, the Federal Government should prescribe reserve requirements for all banks.

Now, since you are an advocate of the dual system of banking, how do you feel about raising the reserve requirements of State banks?

Mr. HARL. We are very much in favor of raising the reserves of State banks, but I think you will find, if you take all the deposits and add them up, you will find that better than 75 percent of the State bank supervisors have reserve requirements equal to or better than the Federal Reserve requirements. For example, in the State of Colorado any bank which is a depository bank has to carry at all times and has had to carry since 1927 at least 25 percent reserves.

In other words, to rephrase this answer, Congressman, I would say that the State laws and/or the regulations promulgated by the State bank commissioners in those States having at least 75 percent of the total bank deposits, their reserve requirements are equal to or greater than those presently required by the Federal Reserve System.

Mr. BUCHANAN. I was under the impression that Federal Reserve requirements ran on the rough of about 15 to 22 percent; whereas the average of the State bank reserves was around 10 to 12 percent.

Mr. HARL. If you go back into the situation in the States of New York, New Jersey, Connecticut, and a great many other States, the bank commissioner by promulgation has always insisted that the reserves of his banks run coincident with or coincide with the requirements of the Federal Reserve, and in other States it is fixed by statute.

Mr. BUCHANAN. In how many cases?

Mr. HARL. I would not know the number of cases.

Mr. BUCHANAN. I was thinking in terms of State statutes rather than administrative regulation of the State banking commissioner.

Mr. HARL. I think we can get the answer to your question in probably 1 hour.

Mr. BUCHANAN. I would like to see it in the record.

Mr. HARL. We will get the answer and have it in for the record.

Mr. BUCHANAN. I wish you would.

(The information referred to above is as follows:)

Reserve requirements of State commercial banks and trust companies, by kind of deposits (demand and time), Dec. 31, 1948 [1]

[Percent of deposits specified]

State	Uniform reserve requirements on all deposits [2]	Different reserve requirements on—	
		Demand deposits [2]	Time deposits [2]
Alabama		15	4.
Arizona		15, 20	10.[3]
Arkansas	15, 20, 50		
California		12, 15, 18	5.[3]
Colorado	15, 25		
Connecticut		16	0.[3]
Delaware		16	7½.
District of Columbia		22	7½.
Florida	20		
Georgia		15	5.
Idaho	15		
Illinois [4]			
Indiana		12½	3.
Iowa		7, 10	3.
Kansas		12½, 20, 25	5, 10.
Kentucky		7, 10	3.
Louisiana		20	0.
Maine		14	6.
Maryland		16	6.
Massachusetts		15, 20	0.[3]
Michigan	12		
Minnesota		12, 15	5.

See footnotes at end of table, p. 130.

Reserve requirements of State commercial banks and trust companies, by kinds of deposits (demand and time), Dec. 31, 1948 [1]—Continued

State	Uniform reserve requirements on all deposits [2]	Different reserve requirements on— Demand deposits [2]	Time deposits [2]
Mississippi		15, 25	7, 10.
Missouri		15, 18	3.
Montana	10, 15		
Nebraska		15, 20	5.[3]
Nevada	15, 25		
New Hampshire		15	5.
New Jersey		15	3.
New Mexico	12		
New York		14, 20, 26	7½.
North Carolina		15	5.
North Dakota		10	5, 10.
Ohio		15	10.
Oklahoma		15, 18	5.
Oregon		15	5, 10.
Pennsylvania		14	6.
Rhode Island		15	0.[3]
South Carolina		7	3.
South Dakota	17½		
Tennessee		10	3.
Texas		15, 20	5.
Utah		15, 20	5.[3]
Vermont [5]		20	6.
Virginia		10	3.
Washington	15		
West Virginia		10	5.
Wisconsin	12, 20		
Wyoming		20	10.[3]

[1] In most cases these are the rates prescribed in the State law itself. Where the law empowers banking authorities to change reserve requirements, the rates actually in effect on Dec. 31, 1948, were ascertained by correspondence or otherwise.

[2] Where two or three percentages are shown, the second and third apply to banks designated or approved as reserve depositaries, or to banks in central reserve or in reserve cities, specified cities, cities with specified population, etc., as follows:

Arizona: The 20 percent requirement applies to banks in places with population of 50,000 or more.

Arkansas: The 20 percent requirement applies to banks designated as reserve agents; 50 percent to banks in places with less than 1,500 population with capital of $10,000 or more but less than $25,000.

California: The 18 percent requirement applies to banks in places with population of 100,000 or more; 15 percent to banks in places with population of 50,000 to 100,000.

Colorado: The 25-percent requirement applies to banks designated as Reserve banks.

Iowa: The higher requirement applies to banks in Reserve cities (designated as such under the Federal Reserve Act).

Kansas: The 20-percent requirement applies to demand deposits due to banks in State banks. For all trust companies, the reserve requirements are 25 percent of demand and 10 percent of time deposits, but there are only 4 trust companies (with little or no deposits) in the State.

Kentucky: 13 percent of demand deposits for central Reserve city banks, but there never has been a central Reserve city in the State.

Massachusetts: The 20-percent requirement applies only to trust companies acting as Reserve agents.

Minnesota: The higher requirement applies to banks in Reserve cities (designated as such under the Federal Reserve Act).

Mississippi: The 25-percent requirements against demand deposits and 10 percent against time deposits apply to banks in places with population over 50,000.

Missouri: The 18-percent requirement applies to banks in places with population of 200,000 or more.

Nebraska: The 20-percent requirement applies to banks in places with population of 25,000 or more.

Nevada: An additional reserve of 10 percent is required against reserve deposits due to other banks, but no State bank reported any such deposits on Dec. 31, 1948.

New York: The 26-percent requirement applied on Dec. 31, 1948, to banks in the Borough of Manhattan: 20-percent requirement applied to banks in the Boroughs of Brooklyn and Bronx, in New York City, and Buffalo.

North Dakota: The 10-percent requirements in the time deposits column applies to secured savings deposits.

Oklahoma: The 18-percent requirement applies to approved depositaries.

Oregon: The 10-percent requirement applies to time deposits in noninsured banks, but thre was only one such bank in December 1948 and it had no deposits.

Texas: The 20-percent requirement applies to banks with capital stock less than $25,000.

Utah: The 20-percent requirement applies to banks in places with population of 50,000 or more.

Wisconsin: The 20-percent requirement applies to banks designated as reserve banks.

[3] The reserve requirements shown in the time deposits column for Arizona, California, Connecticut, Massachusetts, Nebraska, Rhode Island, Utah, and Wyoming apply only to deposits in the asvings departments of commercial banks and trust companies. Other time deposits are subject to higher requirements, but inspection of State banking department annual reports discloses that such deposits in California, Connecticut, Massachusetts, and Rhode Island are relatively small in comparison with deposits in savings departments; the same thing probably is true in the other States, to the extent they have separately operated savings departments in commercial banks.

[4] No statutory reserve requirements.

[5] The 20-percent requirement against demand and 6 percent against time deposits became effective Feb. 15, 1949.

Mr. BUCHANAN. By statute, by banking commissioner regulations, administrative regulations, as compared to here where we have the Federal Reserve figures.

Senator DOUGLAS. Mr. Harl, I was called to the telephone for a minute, and I did not gather whether you favored Mr. McCabe's proposal of minimum reserve requirements for all banks, including those not members of the Reserve System.

Mr. HARL. We are very strong for reserves. As I told Congressman Buchanan, I think a survey will show that requirements, either administrative or statutory, of all States, at least covering 75 percent or more of the deposits, that they are equal to or greater than the present requirements of the Federal Reserve.

Senator DOUGLAS. The reserve requirements under the Federal Reserve city banks are now 18 percent; is that correct?

Mr. BUCHANAN. It runs from 24——

Senator DOUGLAS. Reserve city banks?

Mr. BUCHANAN. Twenty, and country banks 14.

Senator DOUGLAS. Well, in connection with another matter, I have had the reserve requirements in a number of States studied; and, with the exception of Louisiana, District of Columbia, Vermont, and Wyoming, I found no State which had reserve requirements in excess of 15 percent.

Mr. BUCHANAN. By statute?

Senator DOUGLAS. By statute, which would be 1 percent higher, it is true, than country banks, but 5 percent lower than Reserve city banks, and Reserve city banks cover quite a wide range. In a number of cases the reserve requirements were below this. In Iowa, 7 percent; Kentucky, 7 percent; Montana, 10 percent; California, 12 percent; North Dakota, 10 percent; New Mexico, 12 percent; South Carolina, 7 percent, Tennessee, 10 percent; Virginia, 10 percent; West Virginia, 10 percent; Wisconsin, 12 percent; and, further, that this composition of the reserve under the State laws for the major part could not only be cash but balances with depository banks.

So there seems to be quite an area, at least, in which the reserve requirements of State banks not members of the System are very appreciably below the requirements of banks which are members of the System.

Now, that gives to the nonmember banks greater earning power for any given amount of reserves; they can extend more credit upon a given amount of reserves; and their multiplier is greater, and one can understand why bankers would favor that; but there is always the question (*a*) as to whether it is adequate for safety and (*b*) whether it does not exercise an inhibitory influence upon attempts to check inflation through alteration of the reserve requirements.

Those are the problems of public policy which we have. I wonder if you would be willing to comment on that.

Mr. HARL. I believe the Senator earlier in the conference made the statement that 84, between 84——

Senator DOUGLAS. Eighty-five percent.

Mr. HARL. Eighty-five percent were Federal Reserve members.

Senator DOUGLAS. Eighty-five percent of the deposits were in banks which were Federal Reserve members.

Mr. HARL. That means 85 percent of deposits are affected by those reserve requirements, does it not?

Senator DOUGLAS. Yes.

Mr. HARL. Then we are talking about 15 percent of the aggregate.

Senator DOUGLAS. Yes; but it is also true that since the State banks, 2,000 of which are members of the Federal Reserve System, and which have roughly 35 percent, roughly 35 percent of the deposits, have the right of withdrawal from the Federal Reserve System at any time, and the Board is always faced with the possibility that if they raise the reserve requirements and thus reduce the earning capacity of the banks, that the State banks will exercise their option and will get out of the System——

Mr. HARL. Has that ever happened?

Senator DOUGLAS. Is that proof that it does not operate upon the minds of the members of the Board?

Mr. HARL. I naturally do not know what is in the back of their minds, because that Board changes, you know, quite rapidly. There have been three or four people appointed there since I have been here in a very brief time, and therefore the policy would change as they go along; but I think we have to operate on the basis of antecedent practices and what has happened in the past.

As you know, the reserves of the banks in the Federal Reserve System have varied over the years, and I think that you will find there is a constant upstreaming, I think you will find banks containing a greater amount of deposits now in the Reserve System than before. As you said correctly a few minutes ago, 85 percent of the deposits were in the Federal Reserve System. Based on $147,000,000,000 in assets, you would see that that leaves about $20,000,000,000 not in the Federal Reserve System.

However, you will find in those States that it is safe to say that better than 90 percent of the deposits of this country are in banks which require reserves equal to or better than the Federal Reserve System.

In my State of Colorado a State bank has to maintain a 15-percent reserve and has had to maintain that reserve since 1927, and the bank which accepts bank deposits in Colorado has to maintain a reserve of 25 percent, whether it is in the Reserve city or not.

Senator DOUGLAS. Denver banks under the Reserve System would have to maintain 20 percent?

Mr. HARL. Under the Federal Reserve System but under the State system they have to maintain 25 percent if they take bank deposits.

Senator DOUGLAS. Well, let me come back——

Mr. HARL. In other words, a Reserve bank in Colorado at the present time has to maintain 25 percent greater reserves than that presently prescribed by the Federal Reserve.

Senator DOUGLAS. That is rather a unique case.

Mr. HARL. I do not know. We would be very glad to present a study for you.

Senator DOUGLAS. The list I read—I think it is correct—indicates a considerable number of States where the reserve requirements are below the Federal Reserve requirements, not only for the Reserve city banks but for the so-called country banks.

Mr. HARL. We would be glad to make that study, but I took a small Western State to bring across that point.

Senator DOUGLAS. I was not clear whether you favored Mr. McCabe's proposal of minimum reserve requirements across the board or not. I wondered if you would state whether you favor it or not?

Mr. HARL. That members have a 20 percent, 18 percent, or——

Senator DOUGLAS. No. I do not know that it is tied to definite figures, but that it would be uniform at any one time, so that you could still have State chartering and State banks, but uniform reserve requirements.

Mr. HARL. I will go further and say this board has never opposed any bank joining the Federal Reserve System.

Senator DOUGLAS. This is not a proposal of Mr. McCabe that they join the System, but if they stay outside the System, that they should observe the reserve requirements which are imposed on the banks which are in the System.

Mr. HARL. I think that is a matter for the States to decide.

Senator DOUGLAS. Not for the Federal Government?

Mr. HARL. Yes, sir.

Senator DOUGLAS. Not a matter for Congress to legislate?

Mr. HARL. I do not think so.

Senator DOUGLAS. Why not? You mean it is not constitutional for Congress to pass on it?

Mr. HARL. I do not know anything about the constitutionality of it at all. I think, since you quoted Andrew Jackson a few minutes ago, I believe that the theory is to keep as much as you possibly can at the State level. But I will go further and say I think an analysis will disclose that reserve requirements for better than 90 percent of the deposits of the country, either by State or Federal Reserve requirements, are as high as the Federal Reserve requirements are at the present time.

Senator DOUGLAS. Therefore, that there is no need for such a proposal?

Mr. HARL. That is my theory. I want to amplify that further. The Federal Deposit Insurance Corporation is very much in favor of all banks maintaining substantial reserves in cash and/or Governments at all times, but I think there is a difference in the sterilization of reserves and the nonsterilization of reserves.

Senator DOUGLAS. Of course, Mr. McCabe had a second feature to his proposal, which was that the nonmember banks should have the same access to reserve loans as member banks. That would give a privilege which might make this more attractive to the State banks, since they would be getting something in return for the higher reserve ratios which might be imposed; and, in the case of banks which already had reserve ratios equal to those in the System, it would give them a privilege without any loss of earning power.

Mr. HARL. On that basis, every bank in Colorado today would have the right to borrow from the Federal Reserve, because in Colorado, as I said before, you have to maintain a 15-percent reserve in the country banks, and the banks which take deposits of other banks have to maintain 25, and the Federal requirement is 20; therefore, Colorado banks which take deposits of banks have to carry the difference between 15 or 20 and 25, or 25 percent greater reserves than required by the "Fed" at the present time. That has been on the statute books 22 years.

Senator DOUGLAS. There is involved not only the amount of the reserves but also the form of the reserves; in an analysis which we made of the various States, in virtually all the States the vast proportion, and in some cases the exclusive amount, of the reserves could be in the form, not of cash but of deposits in other banks, which is a very different thing from a reserve with the Federal Reserve System.

Mr. HARL. You mentioned 85 percent are controlled. Do you think that 15 percent which is not under their supervision has any detrimental influence on our economy? We do not.

Senator DOUGLAS. I am an inquirer, not an arguer.

Mr. WOLCOTT. He answered the question.

Senator DOUGLAS. I beg your pardon?

Mr. HARL. I asked the question and then answered it. I said we do not.

Senator DOUGLAS. I beg your pardon.

Mr. HARL. We testified, I believe, before the Banking and Currency Committee to that effect.

Senator DOUGLAS. What would you say to the national banking system lowering the minimum capital requirements from $50,000 to $25,000 on banks which have already been organized under the State banking laws, under the Federal Reserve?

Mr. HARL. For some reason which we do not know, the Congress, probably with the advice and counsel of the authorities, enacted the present capital requirements at a time when you had smaller deposits and greater capital ratios than you have at the present time.

I believe the capital ratios in this country were better or about 25 to 1, or $1 of capital to $4 of deposits, when these laws were written.

As of December 31, 1948, the capital ratio was 6.7, or $16 roughly, in depositors' funds to $1 bank capital. Therefore, if they saw fit to raise these standards at that time, when the capital ratios were greater, we cannot understand why they seek to reduce those standards when the capital ratios are much less.

Senator DOUGLAS. Here is my question: If $25,000 is enough to qualify a bank safely under a State banking system, why is it not sufficient to admit them into the Federal Reserve System?

Mr. HARL. It may be.

Senator DOUGLAS. Do you want to express an opinion?

Mr. HARL. We do not think so because we stand for greater capitalization, and the record of the Federal Deposit Insurance Corporation has been at all times for heavier capitalization.

Senator DOUGLAS. But you insure the $25,000 bank.

Mr. HARL. We do not insure every bank that applies for insurance.

Senator DOUGLAS. You will insure a $25,000 bank, will you not?

Mr. HARL. We do at times.

Senator DOUGLAS. Do you discriminate against the bank because it has only $25,000?

Mr. HARL. We make a survey of the community.

Senator DOUGLAS. There are only 700 State banks which are outside your insurance, and if a $25,000 bank is good enough for the States and good enough for you, why shouldn't it be good enough to be admitted to the Federal Reserve System?

Mr. HARL. I think you will find in the last 3 or 4 years we have insured very few banks that have had only $25,000 capital. They have had more capital than that in practically every case.

Senator DOUGLAS. Do you have a statement of the division of State banks which are insured by you according to capital? Mr. McCabe's proposal is not to lower the requirements on newly formed banks, but to permit State banks already formed with the capital of $25,000 to come in if in other respects they are satisfactory.

Mr. HARL. I will say to your committee, Senator, we would gladly subscribe to the matter of capital structure. If the law were so enacted, we would be very glad to go along with the law if, in order to obtain insurance, the capital requirements were raised.

Senator DOUGLAS. You do not want them lowered, but you would like them raised?

Mr. HARL. We would like them raised; yes, sir.

Senator DOUGLAS. And, therefore, you do not agree with Mr. McCabe in his proposal?

Mr. HARL. We can see no reason for it. At the present time 85——

Senator DOUGLAS. This is what puzzles me. If a $25,000 bank is good enough under the State laws—and you think the State laws on the whole are correct—and if this $25,000 bank already formed is good enough to be insured by you, then why is it not good enough to be admitted to the Federal Reserve System?

Mr. HARL. We have never said it was not good enough for the Federal Reserve System.

Senator DOUGLAS. That is what I am trying to find out.

Mr. HARL. We want to be shown the advantage of that because it has been developed here this morning that banks containing better than 85 percent of the deposits are members of the Federal Reserve System. We have no quarrel with the Federal Reserve System whatsoever.

Senator DOUGLAS. Then you would not oppose this proposal to lower the entrance requirement into the Reserve System?

Mr. HARL. I will go further. To my knowledge this Corporation has never opposed any bank at any time joining the Federal Reserve System.

Senator DOUGLAS. And you would not oppose lowering the requirement on State banks already organized by nonmembers of the System to $25,000 so that they could come in?

Mr. HARL. I would not make the statement until I could discuss the matter with my Board of Directors, because, as you know, one member of this Board happens to be the Comptroller of the Currency, and his requirements——

Senator DOUGLAS. Are for national banks but not for State banks?

Mr. HARL. That is very true; and, as you know, any bank he charters, they have not only Federal Reserve membership but likewise FDIC membership at the same time; and I would rather reserve that question until I talk to my colleagues.

Senator DOUGLAS. In other words, you want to have deferred judgment on that?

Mr. HARL. That is right.

Senator DOUGLAS. But what would you say as a person without committing your organization to this query of mine that, if a $25,000 bank already in existence is good enough for the States and good enough for FDIC, why should it not also be eligible for membership in the Federal Reserve System?

Mr. HARL. I think my judgment in that case would be absolutely predicated on discussion with the other two members of our Board, bearing in mind that one member is the Comptroller of the Currency and the other member is past president of the National Bank Division ABA and has always operated in a national bank.

Senator DOUGLAS. There is one final question I should like to ask you, and I want to state it as precisely as I can.

As I go over the Federal laws and regulations which are applicable to banks which are members of the Federal Reserve System, I find that many of these laws and regulations do not relate directly to monetary and credit control, but to a series of technical requirements such as the adequacy of bank capital, soundness of bank lending and investing operations, and the maintenance of competition in banking.

I can see why these Federal laws and regulations were attached to membership in the Federal Reserve System when that was the only Federal agency attempting to increase the uniformity of standards applying to State chartered banks.

But now we have your organization, the Federal Deposit Insurance Corporation, whose primary purpose it is to insure the safety of deposits and to try to raise banking standards so as to avoid losses on deposits.

In view of that fact, would it not be appropriate to cease attaching these laws and regulations to membership in the Federal Reserve System and transfer them instead to the privilege of deposit insurance? Thus taking in some 13 percent of the deposits which are in your system but not in the Federal system.

Mr. HARL. You understand when a bank fails, whether it is a State bank, a National bank, or a member bank, we have to pay the bill.

Senator DOUGLAS. Should you not, therefore, be given the safeguards? At present you have the liability in these cases.

Mr. HARL. Yes, sir; we would leave the monetary and the credit policies to Federal Reserve, but we think we should have the right to examine those 1,900 banks.

Senator DOUGLAS. It is not merely a question of examination, but it is a question of the adequacy of bank capital, soundness of bank lending and investing operations, and maintenance of competition in banking as laid down by Federal laws and regulations.

Should not those rules be attached to your organization, which is primarily concerned with safety of deposits rather than to the Federal Reserve System covering a smaller area, whose primary function is monetary and credit control?

Mr. HARL. As you know, the Federal Reserve System leaves examination of the national banks to the Comptroller of the Currency.

Senator DOUGLAS. That is right.

Mr. HARL. The Comptroller of the Currency is a member of our Board, which is the policy-making end of the Federal Deposit Insurance Corporation. Therefore, it can be said that we do exercise considerable influence over every bank in the United States except 1,960 banks to which you referred.

Senator DOUGLAS. That is the point.

Mr. HARL. We feel we can do the same examining job for the Federal Reserve as is now done by the Comptroller of the Currency.

Senator DOUGLAS. I am a very literal man, I am afraid. Would you say that these laws and regulations concerning soundness of bank lending and investing operations and maintenace of competition in banking, which are now attached to the Federal Reserve System, should be transferred to FDIC, and, therefore, cover this wider area of state banks not members of the Reserve System but members of the insurance system?

Mr. HARL. Well, if I knew what those laws and regulations were, we would be very glad to undertake to enforce those laws and regulations as laid down by the Congress.

Senator DOUGLAS. Well, we have made a listing of provisions which apply to National banks and to State banks which are members of the Federal Reserve System, but which do not apply to State banks not members of the System, but members of the FDIC.

You say that if you knew what they were—well, I have a list of 30 which I should like to read. [Reading:]

1. Limitations on total loans to one borrower.
2. Regulations governing purchase of investment securities.
3. Prohibition against purchasing stocks.
4. Prohibition against engaging in underwriting of investment securities and stocks.
5. Restrictions on loans to executive officers.
6. Restrictions on dealings with directors.
7. Restrictions on interlocking directorates or other interlocking relations with other banks and with securities companies.
8. Prohibition against bank having less than 5 or more than 25 directors.
9. Provision authorizing supervisory authority to remove officers and directors for continued violations of law or continued unsafe or unsound practices.
10. Prohibition against affiliation with securities company.
11. Restriction on holding companies affiliates.
12. Restrictions on bank stock representing stock of other corporations.
13. Limitations on loans to affiliates.
14. Requirements of reports of affiliates and publication thereof.
15. Requirements for examination of affiliates.
16. Limitations on investment in bank premises.
17. Minimum capital requirements.
18. Minimum capital requirements for branches.
19. Prohibitions against loaning on or purchasing on stock.
20. Restrictions on withdrawal of capital and payment of unearned dividends.
21. Requirement that reserves specified in the Federal Reserve Act be maintained.
22. Prohibition against making loans or paying dividends while reserves are deficient.
23. Requirement for specific number of condition reports annually and for publication thereof.
24. Requirements in connection with the par clearance collection system.
25. Prohibition against false certification of checks.
26. Limitations on acceptance powers.
27. Prohibition against acting as agent for nonbanking institutions in making loans to brokers and dealers in securities.
28. Limitations on loans to one borrower on stocks or bonds.
29. Limitations on aggregate loans to all borrowers on stocks or bonds.
30. Limitations on deposits with nonmember banks.

Now, it may be that some of these restrictions are unduly severe, but I would think probably the vast majority of them were designed to get greater security and safety. Now, if these are good for the banks within the System, why should they not be also good for the residue of banks which are not in the System but are in the Federal Deposit Insurance Corporation?

Mr. HARL. Senator, I think you will find by your statement a few minutes ago that 90 percent or more of these very regulations are written into the State statutes.

Senator DOUGLAS. Then you think the State laws are sufficient on this point?

Mr. HARL. I think we can take what you read item by item and you will find that 90 percent of those provisions are statutory in respective States at the present time.

Senator DOUGLAS. Would you have these repealed, therefore, at the Federal level for the State banks which are members of the Federal Reserve System?

Mr. HARL. Not necessarily, but I think you will find a great many of those——

Senator DOUGLAS. If the State laws are adequate, then why should you require them for State banks which are members of the System, since they would be covered by these State laws?

Mr. HARL. I did not require them. That is the Federal Reserve requiring them.

Senator DOUGLAS. Why should they be required?

Mr. HARL. That is a question I think that the Board of Governors of the Federal Reserve should answer.

Senator DOUGLAS. Fundamentally, it is Congress which makes the laws on these points, and we are seeking guidance, and in a problem if we depend solely on the judgment of the agency concerned we get a partial view. So we are trying to get the opinions of others.

Mr. HARL. We have no complaint with those regulations.

Senator DOUGLAS. Why not extend them? If you have no complaint with the regulations, why not extend them to the State banks which are members of the insurance system but not members of the Reserve System?

Mr. HARL. As I said before, 90 percent of those very same edicts or regulations or statutes are on the State books at the present time.

Senator DOUGLAS. It would be interesting to get a comparative analysis on that point, but what about the rules which are not on the State statute books, rules which are desirable but which are not on the State statute books?

Mr. HARL. I think any rule which is desirable should be on the State statutes, and I will say this: When you come to a law which is beneficial to banks, we have found the State banking commissioners sincerely interested in having those statutes passed in their local States. I do not believe the Federal Reserve or the FDIC——

Senator DOUGLAS. Or the Congress?

Mr. HARL. Or the Congress has ever had any opposition from the State banking advisers to passing any legislation which was constructive at the State level, and in your own State you have a thing which has really upset things very much.

Senator DOUGLAS. Please do not think for one minute that I am making any apology for the State banking laws of my State, which are in many ways, I want to say, about as bad as you could get in any section of the country.

Mr. HARL. As you know, for many years a stockholder in a bank was always faced with a liability, an assessment liability. The Congress, after the passage of the Federal Deposit Insurance Corporation Act, dissolved that liability for national banks. In many States they had assessments up to 200 percent by statute for which bank stockholders were liable.

Unfortunately, in the State of Illinois, that was written into the constitution, as the Senator, I believe, is familiar with, with the result that nobody out there wants to organize a State bank.

It has not been too long ago that certain officials of the Illinois Bankers Association came down here and wanted to know why the Comptroller was chartering so many national banks in his State as compared with State banks. The Comptroller and members of our Board sat in that conference, and we told them because there is discrimination in Illinois against the State banker.

Senator DOUGLAS. I may say that the Governor of Illinois and other members of my party have been doing the best they could to get the Constitution of Illinois altered and a new constitutional convention called, but we are having some difficulties in that respect.

I am very glad you have furnished this further evidence as to the need for constitutional revision in the State of Illinois.

Mr. HARL. I do not believe, Senator, that bankers as a rule are affiliated with the same or belong to the same party that you and I happen to belong to, but I think you will find that both parties subscribe thoroughly to what you said a few minutes ago. I think it transcends party philosophy in the State of Illinois.

Senator DOUGLAS. You mean the desire for constitutional reform?

Mr. HARL. I am talking about the banks. I do not know about the rest of it.

Senator DOUGLAS. I wish the desire for constitutional reform did transcend the party lines in the State of Illinois, but that is neither here nor there.

Mr. WOLCOTT. I think the Republicans—and I cannot speak for them—and, of course, I am sorry politics have been brought into these hearings—would be perfectly in favor of the amendment of the constitution in that respect.

I think that is in keeping with our philosophy of government.

Mr. HARL. Congressman, I will say everybody is working wholeheartedly out there and has for many years to get that constitutional prohibition out of there, because it discriminates against the dual system of banking.

Mr. WOLCOTT. In that connection, of course, it aids this movement toward centralization of power in the Federal Government.

Mr. HARL. Yes.

Mr. WOLCOTT. Which, of course, every Republican would be violently opposed to.

Senator DOUGLAS. As followers of Alexander Hamilton, I am surprised that you favor decentralization.

Mr. WOLCOTT. You referred to Andrew Jackson. I finished reading the biography of Andrew Jackson by Marquis James, and I think my father and my grandfather would have considered it sacrilegious if they knew I read it, but I was amazed to find out what close affiliation there was between his advocacies and the Republican Party policies at the present time. I do not think you Democrats have any more right now, after that book has been written and the facts have been brought out, to claim him as your patron saint. We are going to adopt him.

Senator DOUGLAS. Probably departing from the principles of Alexander Hamilton.

Mr. WOLCOTT. Union now and forever.

Senator DOUGLAS. One and inseparable.

Mr. BUCHANAN. On the question of concentration of all Federal bank examinations in one agency, you are opposed, of course, to that concentration; are you not?

Mr. HARL. We are.

Mr. BUCHANAN. And for what reasons? Would you care to give them?

Mr. HARL. Again you transcend and cross the Andrew Jackson philosophy of State rights. The Comptroller, of course, should have a right to examine banks he charters.

Senator DOUGLAS. I have always believed that Andrew Jackson was a great man in his day, even willing to concede reluctantly that Alexander Hamilton may have been a great man in his day, but we are now living in 1949 and not in 1799 or 1834.

Mr. BUCHANAN. A hundred years to convert some Republicans.

Senator DOUGLAS. In view of the present situation, this is what we have. You are supposed to insure the soundness of these banks and yet we find a rim of banks which have about 13 percent of the deposits which are State banks but not members of the Federal Reserve System, that do not have imposed on them the requirements for soundness—and I am not speaking of monetary and credit control, I am speaking simply of soundness—which are imposed on banks which voluntarily come into the Federal Reserve System.

My query is whether you are not being held financially liable for possible failures of these banks while you are being denied the safeguards which the majority of the other deposits have, and in view of the fact that this deposit insurance is not a perfect protection, and is only a partial protection, I am wondering if you would be opposed to having such regulations as are reasonable—I do not say every one of these 30 restrictions is perfect—such regulations as are reasonable, designed to get the security of deposits extended to the some 4,500 banks and to the $20,000,000,000 of deposits which are in your system but not in the Reserve System?

Mr. HARL. Senator, I believe it is fundamental that the insurer has the right to look at his risk.

Senator DOUGLAS. So that you can decline to accept these risks?

Mr. HARL. Once they are insured, we have the right to continue to appraise and otherwise look at our risk. We look at those risks in all but 1,900 members through our examiners or those of a member of our Board of Directors. Therefore, we believe that you are correct that we should not be denied the right to look at our risk in those other 1,900 banks.

Furthermore, we again believe that you are correct in that we are for every one of those regulations which are reasonable and we also believe, as we said a few minutes ago, that you will find 90 percent of those regulations which you read and put in the record are now in the statutes of the various 48 States.

Senator DOUGLAS. So would you be willing to prepare a memorandum on this point, covering what regulations you believe are reasonable and which are not now adequately provided for under State laws?

Mr. HARL. We would be very glad to.

Senator DOUGLAS. Thank you very much.

(The following memorandum to Senator Douglas was later supplied for the record. The September 1948 tentative draft of the model State banking code with notes, statutory references and index are in the files of the Joint Committee on the Economic Report:)

FEDERAL DEPOSIT INSURANCE CORPORATION,
Washington, December 6, 1949.

Hon. PAUL H. DOUGLAS,
Chairman, Subcommittee on Monetary, Credit, and Fiscal Policies,
Joint Committee on the Economic Report,
United States Senate, Washington, D. C.

DEAR SENATOR DOUGLAS: During my testimony before your subcommittee on November 15, 1949, you mentioned certain Federal statutory provisions some of which were applicable only to national banks and some of which were applicable to national banks and to State banks which are members of the Federal Reserve System. You inquired whether I would favor the extension of these provisions to the insured State banks which are not members of the Federal Reserve System. At the hearing I stated in effect that I believed that most of these provisions were covered by the laws and regulations of most States.

The most recent general research on this whole question of State banking laws was made in connection with the drafting of a model State banking code by a special committee of the American Bankers Association. There is enclosed, for your committee's use, a copy of the September 1948, tentative draft of that model State banking code with notes, statutory reference, and index. We have been advised by the American Bankers Association committee on this code that the draft is in tentative form and is now being put in final shape with hopes of completion in 1950. The notes accompanying the enclosed tentative draft of the model State banking code set forth the various State banking statutory requirements and the States in which certain requirements are made.

In the varied requirements of the banking laws of the 48 States naturally some of the provisions are less restrictive than the present requirements for national banks and State banks which are members of the Federal Reserve System. However, in some respects the State banking requirements are more restrictive. State bank supervisory authorities and State banking associations have been very cooperative in making necessary improvements in State banking laws. Because of this and because of the effective powers which Congress has given this Corporation we have not felt the necessity of requesting Congress to extend to State-insured banks which are not members of the Federal Reserve System the particular Federal banking statutes mentioned by you.

After our operations from 1933 to 1935, this Corporation recommended and Congress enacted an entire revision of our law to make our deposit insurance more effective. Congress authorized this Corporation to consider the following factors in admitting a bank to insurance and in approving the establishment of branches:

"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."

With our authority to consider the adequacy of the capital structure we are not limited to the minimum State capital requirements but may require capital which we consider adequate in relation to the expected deposits of a new bank. This makes possible a somewhat uniform capital requirement for all State-insured banks which are not members of the Federal Reserve System in spite of the existing differences in State requirements.

In considering whether a bank's corporate powers are consistent with the purposes of our law we consider its powers and the applicable State banking laws. Where the bank's corporate powers are inconsistent or where the State banking laws are inadequate in any matters this Corporation requires the bank to agree not to engage in certain powers or to restrict its activities in certain respects. (See 12 CFR, pts. 332 and 333.)

This Corporation is authorized to terminate the insured status of any insured bank found to be continuing unsafe or unsound practices in conducting the business of the bank or to knowingly or negligently permit any of its officers or agents to violate any law or regulation to which the insured bank is subject. In this connection provision is made for a period in which the bank may make correction and for a hearing prior to any order terminating insured status.

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Statutory requirements and restrictions are but minimum aids in maintaining a sound banking system. Successful banking operations and bank supervision are grounded on the good judgment of bankers and examiners. It is to them that we attribute the present excellent condition of banks and the success of deposit insurance.

With the existing State banking laws, the cooperation of the State banking authorities, the statutory powers of this Corporation and the effectiveness of our examiners in dealing with the individual banks, this Corporation sees no necessity, at this time, for the general extension to insured State nonmember banks of Federal banking laws now applicable to national banks and State banks which are members of the Federal Reserve System. As matters may arise needing correction we would prefer to seek needed changes in the State banking laws or request Congress to enact appropriate legislation applicable to all insured banks.

We are reconsidering the Federal statutory requirements mentioned by you which are applicable to national banks and State banks which are members of the Federal Reserve System for the purpose of recommending to Congress the extension to insured nonmember banks of any particular provision which may be desirable and which would improve the soundness of the Federal deposit insurance system.

With kindest regards, I am,

Sincerely yours,

MAPLE T. HARL, *Chairman.*

Senator DOUGLAS. Mr. Wolcott?

Mr. WOLCOTT. I assume that Senator Douglas has been referring to in respect to the lack of regulation he implies is a lack of regulation on the part of the Federal Government. Your contention is that the nonmember banks are regulated at least 90 percent as much under State laws as member banks are; is that correct?

Mr. HARL. Yes, sir.

Mr. WOLCOTT. So the issue seems to boil down as to whether the Federal Government shall promulgate the regulations, either statutory or otherwise, or whether the State governments shall do the same job. I think perhaps the record is full of it, but may I ask you, Mr. Harl, if you can tell us offhand what the losses have been in FDIC.

I know there are not many losses, have not been many—you know what I mean by losses—the losses you have had to suffer. You do not show any loss on your statement, of course, because of your reserve and capital, but what losses have there been to the Corporation?

Mr. HARL. Around 8 percent.

Mr. WOLCOTT. Eight percent of what?

Mr. HARL. Of the total deposits in the closed banks. In other words, we have liquidated up to 92 percent.

Mr. WOLCOTT. Those are the banks which have been closed?

Mr. HARL. Yes, but I will say furthermore that in the last 6 years we have had very fair weather because of economic conditions and in many cases we are taking banks now which pay out 100 percent.

Mr. WOLCOTT. In terms of dollars about how much would that be?

Mr. HARL. It is going to boil down, we think, when we get through this liquidation, to where we are going to lose between 26 and 30 million dollars.

Mr. WOLCOTT. You have ample reserves?

Mr. HARL. Those reserves have been set up for that now, and are included in this statement, and this statement is net.

Mr. WOLCOTT. You think your somewhat-over-a-billion dollars of reserves is sufficient for all ordinary purposes?

Mr. HARL. No, sir; we do not. We came to the Congress as you remember, Congressman, 2 years ago and asked for the right to obtain from the Treasury up to $3,000,000,000 by the debenture route, in the event that money was needed, and that was predicated on the following formula.

As a result of the 1929–33 depression it took over $4,000,000,000 to put a floor back under the banks. Now, with our billion dollars in reserves, plus the $3,000,000,000 that we can get from the Treasury through debentures, we feel that that $4,000,000,000 makes the corporation invulnerable to these depressions.

That was the reason for our statement a few minutes ago that we felt we were invulnerable.

Mr. WOLCOTT. Was that three times the reserves?

Mr. HARL. It is spelled out, $3,000,000,000.

Mr. WOLCOTT. In figures, not three times your reserves?

Mr. HARL. No, sir; so that we have absolutely at the present time in reserves or contingent reserves $4,000,000,000.

Now, as we accrue more money in our fund we would have to borrow less money from the Treasury. Predicated on what happened—and you can only judge the future by the past—with our present insurance coverage and assessment rate our actual reserves or contingent reserves are probably ample to take care of and protect us against any storm we have in the future, provided that storm is not greater than 1933. We do not believe it will be greater than 1933 because we think there are better practices in the banks.

Mr. WOLCOTT. Under the law—I should know, but I do not—what is the obligation of the Federal Government over and above your reserve in respect to your losses?

Mr. HARL. The only obligation we have with the Federal Government at the present time is that the Treasury is mandated to purchase from the Federal Deposit Insurance Corporation, when, as, and if offered, up to $3,000,000,000 in our evidences of indebtedness.

Mr. WOLCOTT. Any loss to depositors over that, there is no obligation upon the Federal Government to pay them?

Mr. HARL. There is no obligation on the Federal Government at the present time to pay any loss. The whole obligation vests in the Corporation's guaranty.

Mr. WOLCOTT. Where do you get your capital?

Mr. HARL. Our capital has come from the banks. They pay, as you know, one-twelfth of 1 percent of deposits per year, and our capital comes from the amount of the assessment paid in annually, plus income from our investments, which are Government securities.

Mr. WOLCOTT. Where did you originally get your capital?

Mr. HARL. Originally in 1933, when the act was initiated, we sold $150,000,000 common stock to the Treasury and $139,000,000 common stock to the Federal Reserve System, or $289,000,000 from the Treasury and the Federal Reserve System.

Mr. WOLCOTT. Has that all been retired?

Mr. HARL. Yes, sir. The act was introduced in the House by, I think, you and Congressman Spence, repaying the Treasury and repaying the Federal Reserve System, and that has all been consummated.

Senator DOUGLAS. What about the earnings on this capital? Have those been repaid?

Mr. HARL. The earnings have accrued to our reserves.

Senator DOUGLAS. So that while the loans of the Treasury and Federal Reserve to the Corporation have been repaid, you retain among your assets the earnings which accrued on these assets prior to retirement?

Mr. HARL. That is correct.

Mr. WOLCOTT. I recall very indefinitely that this $139,000,000, which the Federal Reserve put up, was the so-called profit of the Federal Reserve System.

Mr. HARL. It was half of their surplus at that time from their earnings.

Mr. WOLCOTT. The law provides that shall be paid into the Treasury, as I recall it, but it does not say when; and the Federal Reserve Board interprets that to mean they pay in any profit they have upon liquidation.

Mr. HARL. This $139,000,000 went direct to the Treasury. The act provided that would go to the Treasury.

Mr. WOLCOTT. You paid it to the Treasury and not to the Federal Reserve?

Mr. HARL. We paid $289,000,000 to the Treasury.

Mr. WOLCOTT. The Congress in that manner settled the question as to whether the profit of the Federal Reserve should be paid to the Treasury now or upon liquidation.

Mr. HARL. That $289,000,000, of which $139,000,000 came from the Federal Reserve, by that act you decreed we pay the entire amount to the Treasury, which we did.

Mr. WOLCOTT. Of course, we have no way of knowing whether even this $4,000,000,000—is that it, your billion reserve and $3,000,000,000 you can get on debentures from the Treasury—we have no way of knowing whether that would be adequate. That would depend somewhat upon how deep the depression was and how much of the reserves of the banks had been used or otherwise dissipated previous to the crash. We will call it a crash, because it would have to be a crash to absorb that much, probably.

How far would you go in times of stress in supporting the bond market? How far would you recommend that we go in supporting the bond market if and when the conditions of the banks were such that for their normal purposes they had to unload an unusually large amount of Governments?

Mr. HARL. I think the bond market should be supported always at par.

Mr. WOLCOTT. Regardless of the amount of sales by the banks of Governments?

Mr. HARL. That is right.

Mr. WOLCOTT. I guess that is all.

Mr. BUCHANAN. If there are no further questions, the committee will adjourn until 2 o'clock this afternoon.

(Whereupon, at 12:45 p. m., a recess was taken until 2 p. m., of the same day.)

AFTERNOON SESSION

Senator DOUGLAS. We welcome this afternoon representatives of the Reconstruction Finance Corporation, Mr. Gunderson, one of the directors; Mr. Dougherty, General Counsel; and Mr. Considine, Comptroller. I would appreciate it if you gentlemen would take seats here.

We originally invited Mr. Harley Hise, the Chairman of the Board of Directors of the Reconstruction Finance Corporation. He said that he would be prevented from coming and asked if these representatives might come in his stead. We replied that we would be very glad to see them personally and would be glad to welcome them officially, provided it was understood that they spoke as representatives of the Reconstruction Finance Corporation and not merely as individuals. We have since received a letter from Mr. Hise saying that these three gentlemen have the right to speak for the Reconstruction Finance Corporation, and that Mr. Gunderson will be spokesman.

STATEMENT OF HARVEY J. GUNDERSON, DIRECTOR, RECONSTRUCTION FINANCE CORPORATION, ACCOMPANIED BY JAMES L. DOUGHERTY, GENERAL COUNSEL, AND JAMES W. CONSIDINE, COMPTROLLER

Senator DOUGLAS. Do you want to add anything, Mr. Gunderson, to the statement that Mr. Hise made in reply to our questionnaire?

(Mr. Hise's statement is found on p. 218 of the committee print on Monetary, Credit, and Fiscal Policies.)

Mr. GUNDERSON. No, sir. We think Mr. Hise's statement covers the questions that you propounded to us, perhaps not as fully as you might wish, but we think that it covers the points, at least briefly, and we are here to answer additional questions the committee might wish to ask.

Senator DOUGLAS. Mr. Gunderson, the Reconstruction Finance Corporation was originally set up, I believe, in the summer of 1931, as a means of helping to meet the business depression or cataclysm which was breaking upon the country and to make available to private business funds which would enable them to continue and which were not available through security issues or from bank loans. At that time the security market was flat and the banks were contracting rather than expanding. Undoubtedly the Reconstruction Finance Corporation saved many businesses and contributed a great deal to the stability of the business structure.

I think the question which is in the mind of a great many people, and which I should like to probe, is this: The depression has been over for at least 10 years now; the Reconstruction Finance Corporation is still in business, it is still making loans. I wondered what the reasons in your mind are for the continuation of direct lending by the Government. Before you go into that, I would like to say that I assume you have the same presumption that I have; namely, that the retailing of credit should in the main be in private hands rather than in public hands, because any public agency which retails credit is necessarily in a difficult position to determine who gets credit and who doesn't get credit, and is liable to be damned if it does and damned if it doesn't. So that I wondered if you would make a statement as to why you regard direct Government lending as a continuing function of the Government, in good times as well as in bad times.

Mr. GUNDERSON. Senator Douglas, commencing with the statement that you made, when the Reconstruction Finance Corporation was originally set up it did not make any loans to business.

Senator DOUGLAS. It insured loans?

Mr. GUNDERSON. It did not insure. It did no operation except in financing banks, savings banks, insurance companies, and railroads. The first authority to assist industrial businesses was put in the act by Congress in 1934. One of the provisions was that RFC could not make any loan if private sources of financing were available. That provision continues in the act today and is a condition precedent to any financing of business by the Reconstruction Finance Corporation.

In the original act it was required that adequate security be obtained for the making of any loan, and at a later date—I believe it was 1936 or 1937—Congress eliminated the requirement of full and adequate security and inserted into the act the provision that any loan to a business enterprise should be so secured as to reasonably assure repayment; and although the act has been changed and amended and rewritten and readapted by the Congress, in 1947, those provisions, as they affect loans to business, have remained substantially the same, for about the last 12 years.

This leads up to the question as to why the Reconstruction Finance Corporation would continue to make loans. It is a question that I am not sure I can answer satisfactorily but it is a fact that during the years of our lending to industrial enterprises there seems to have been a fluctuating availability of money to business. In the authority of the Reconstruction Finance Corporation to lend money, the two requirements that Congress has imposed—the first one being that we have to be sure that business has exhausted the private sources, and the second, that it has to be secured so that we are assured that it will be repaid—have really restricted the lending operation to a very narrow field, namely, those cases where the borrower, who is unable to secure his needs privately, still has sufficient collateral so that we feel the loan could be made, even in the event the business fails and we have to realize on the assets.

Senator DOUGLAS. What is the total amount of your outstanding loans at the present time?

Mr. GUNDERSON. $433,000,000 in business loans at September 30, 1949.

Senator DOUGLAS. What is the total of the losses suffered by the Reconstruction Finance Corporation since its beginning?

Mr. GUNDERSON. Maybe Mr. Considine can give you the dollar figure. Percentagewise I believe it is less than three-quarters of 1 percent.

Senator DOUGLAS. Three-quarters of 1 percent of the loans?

Mr. GUNDERSON. Three-quarters of 1 percent of our loans.

Senator DOUGLAS. Then the interest upon the loans paid more than offsets the losses?

Mr. GUNDERSON. So far our profit on lending operations is about $560,000,000.

Senator DOUGLAS. So that the Government to date has not had any losses and the profits are in excess of the total volume of present outstanding loans?

Mr. GUNDERSON. Yes, sir.

Senator DOUGLAS. By $100,000,000?

Mr. GUNDERSON. Yes.

Senator DOUGLAS. Well, I think these are very valuable figures to have.

I wasn't quite able to gather in what way you thought the private banking system failed to furnish adequate or selected credit so that you regarded direct Government lending as a continuing necessity.

Mr. Gunderson. Mr. Chairman, I think it is necessary to qualify the type of lending you are talking about. For example, the bulk of lending, in banks, is in the form of commercial loans, open lines of credit to borrowers, loans on receivables and warehouse certificates, and most well-run banks confine themselves to short-term credits of a year or less, and if they do enter the field of making loans for more than a year, or for a term of years, they usually confine the dollar amount to a percentage of their capital, their capital structure, so that they will always be in a position to meet their depositors' needs for funds.

The Reconstruction Finance Corporation almost never makes a loan of this type. If you were describing a typical business loan made by the Reconstruction Finance Corporation it would be a loan for between twenty-five and fifty thousand dollars, because 87 percent of our loans are under $100,000, and about 52 percent are under $20,000. So the typical loan is one of $20,000 to $50,000, then it is usually to a business to allow it to expand its facilities or put in more machinery, or do something that is strictly a term debt and requires, on the average, from 3 to 5 years to repay out of earning.

Senator Douglas. What you are saying is that the commercial banking system does not have a type of commercial paper sufficiently long to permit such loans to be made?

Mr. Gunderson. That is my belief.

Senator Douglas. What about the ability of these concerns to finance themselves through stock or bond issues, which would be the normal recourse for longer term capital?

Mr. Gunderson. Of course, Senator, I think our type of lending more closely approximates some of the investments in business loans by insurance companies. And the insurance companies, as a matter of expense of operation, prefer loans, it has been our experience, if they are of $1,000,000 or larger. They can handle just as many of the larger loans as the smaller ones, on a cost basis. I think some of us feel that our loans of $25,000 to $50,000 cost us money to put on the books. That was gone into before the Banking and Currency Committee at some length during the past few years and was one of the reasons that Congress left our capital and surplus where it is, to take care of that part of the work.

Coming down to the question of the equity market, it is our opinion, based on information we have received from our borrowers, and some knowledge that I think is generally prevalent, that the equity market is almost nonexistent, regardless of the soundness of the enterprise, particularly with regard to small businesses. Since the beginning of the war, under our present system of income taxation, it is not attractive for a person with money to invest in small business, because it is unremunerative to him in proportion to the risk.

Senator Douglas. Then what you would say is that small business has such difficulty in borrowing for capital improvements, from the banks, getting money from insurance companies, or floating security issues, that there is a gap left, and that the Reconstruction Finance Corporation performs very useful functions in enabling this type of business to get capital, which otherwise would not be the case?

Mr. Gunderson. Yes, sir.

Senator DOUGLAS. I personally tend to agree with you on that but I am in more doubt about your loans to larger businesses. You mentioned the fact that 52 percent of your loans are for less than $25,000 and 87 percent——

Mr. GUNDERSON. Less than $100,000.

Senator DOUGLAS. Less than $100,000. What percentage of the loans, however, are for these small businesses and what percentage of the loans are in large magnitudes?

Mr. GUNDERSON. I would say that we are making an increasing number of loans of larger amounts. If the situation of the first part of this year had continued—what I would call the frightened condition of people who have money, their belief that economic conditions were going to demand that they preserve and keep their cash—we would have had a considerably increased number of much larger loans, because we would be the only place left that could make them.

Senator DOUGLAS. Then the argument now turns away from small business to the drying up of the banking system for big business.

Mr. GUNDERSON. In our act, Senator, any business concern, where we think it will continue employment and increase the economic stability of the United States, can get a loan from us, if it can't get it privately. That is the way the act reads.

Senator DOUGLAS. Let me ask you this: What proportion of your loans are made to firms to whom you have loaned a million dollars or more?

Mr. GUNDERSON. In the last quarter we made 1,273 loans and 28 were for over a million dollars.

Senator DOUGLAS. How much of the total was loaned to those 28?

Mr. GUNDERSON. The gross amount was $205,000,000.

Senator DOUGLAS. How many?

Mr. GUNDERSON. Twenty-eight received $122,000,000.

Senator DOUGLAS. In other words, 60 percent.

Mr. GUNDERSON. Of the dollar amount.

Senator DOUGLAS. Of the dollar amount went to firms which borrowed more than a million.

Mr. GUNDERSON. Yes.

Senator DOUGLAS. And of the total of approximately 450 millions of outstanding business loans, what proportion of those are in concerns which had borrowed more than a million dollars?

Mr. GUNDERSON. I would have to get that information for you, Senator, but I would venture a guess that it is that much or more.

Senator DOUGLAS. Sixty percent?

Mr. GUNDERSON. Yes, sir.

Senator DOUGLAS. Is it not true that one of your loans, the Kaiser-Frazer loan, amounts to almost one-third of the total amount which you have loaned?

Mr. GUNDERSON. That is not correct.

Senator DOUGLAS. The Kaiser-Frazer loan——

Mr. GUNDERSON. About 10 percent.

Senator DOUGLAS. The Kaiser-Frazer loan——

Mr. GUNDERSON. I think you are thinking of the steel loan, the loan to the steel division of the Kaiser Co., and which I believe was a war loan. I don't believe we carry that as a business loan; it is a national defense loan; it was made during the war. That loan, though, is approximately $96,000,000, against which the corporation holds approximately $8,000,000 of unapplied funds, pending completion of certain construction.

Senator DOUGLAS. Who collects the interest on it?

Mr. GUNDERSON. Pardon me?

Senator DOUGLAS. Who collects the interest on it?

Mr. GUNDERSON. We collect it. We carry it——

Senator DOUGLAS. You did not authorize the loan originally but interest payments are made to you; and to whom will the principal payments be made?

Mr. GUNDERSON. I don't want any misrepresentation. We made the loan but it was made under our wartime authority that Congress passed in June of 1940 and rescinded, I mean, revoked in 1947. Under that we could make 100-percent loans, build plants, buy materials; we could do anything needed for the war effort.

Senator DOUGLAS. Is that 96 million included in the figure of 450 million which you gave me?

Mr. GUNDERSON. Yes; it is included.

Senator DOUGLAS. So that if you take the 450 million what is the total now loaned to Kaiser-Frazer, or to Kaiser, in their various enterprises—aluminum, steel, and automobile?

Mr. GUNDERSON. About 140 million.

Senator DOUGLAS. 140 million?

Mr. GUNDERSON. Yes.

Senator DOUGLAS. Does that include the new loans just authorized?

Mr. GUNDERSON. Yes, sir. The loans the Reconstruction Finance Corporation has to any Kaiser enterprise is the loan made as a national defense loan to the steel corporation of 96 million and the recent loans to the Kaiser-Frazer Co. for 44,000,000.

Senator DOUGLAS. That is 96 plus 44; 140 million dollars. Then any other loans that the Kaiser-Frazer group may have owing to the Government have been borrowed from other governmental agencies?

Mr. GUNDERSON. I am not aware that they owe the Government anything else other than perhaps part of the purchase price of the plant that they have purchased from War Assets Corporation.

Senator DOUGLAS. Did you give to Kaiser-Frazer an initial loan to get them started in business?

Mr. GUNDERSON. No, sir. The first loan to Kaiser-Frazer was made this fall, within the last 2 or 3 months.

Senator DOUGLAS. A loan to help them in business rather than a loan to start them in business?

Mr. GUNDERSON. There was this distinction, Senator, in the case of the steel company: That is a wholly owned part of Kaiser. In the case of Kaiser-Frazer, the Kaiser interest is less than 10 percent; the balance is owned by the public.

Senator DOUGLAS. I understand. But if you have $140,000,000 loaned to the Kaiser steel interest, plus the Kaiser-Frazer automobile interest, that means that 30 percent of your loans are, approximately, given to one set of interests.

Mr. GUNDERSON. Well, if you assume that they are one set of interests, I think the interests in the car are a lot different than in the other.

Senator DOUGLAS. They are certainly under central management control.

Mr. GUNDERSON. That is correct.

Senator DOUGLAS. Have you ever had any qualms as to whether you were not putting too large a proportion of your eggs in one basket?

Mr. GUNDERSON. I think such qualms as we have had, Senator, have been our desire to see that each loan we make comes under the act and is properly collateralized, and we are confident that they are.

Senator DOUGLAS. Let me ask you, what is the total of loans to Lustron as of this date?

Mr. GUNDERSON. Approximately $37,000,000.

Senator DOUGLAS. So that we have a further 8 percent loan to another——

Mr. GUNDERSON. Senator, I would like to point out, in the Lustron case, that the initial loan to Lustron was not made under the Reconstruction Finance Corporation lending authority; it was made under the war powers pursuant to the Veterans Emergency Housing Act, and that the recent loans have been made pursuant to the congressional enactment of section 102 of the National Housing Act of 1948, which gave us $50,000,000 without any collateral requirements to help the prefabricated-housing program.

Senator DOUGLAS. Are there any other large individual loans which the Reconstruction Finance Corporation has made?

Mr. GUNDERSON. I would like to go back for a minute, Senator. We have 127,000 loans outstanding, which include mortgages——

Mr. BUCHANAN. 127,000?

Mr. GUNDERSON. Yes, sir.

Mr. CONSIDINE. That includes FHA and VA mortgages.

Mr. GUNDERSON. Of which 246 are for a half million or more, and the 127,000 are for loans representing a total of $1,682,000 loaned. The 246 for a half million or more, represent $750,000,000.

Senator DOUGLAS. Yes.

Mr. GUNDERSON. Approximately. It is a little less than half. But included in here are a lot of mortgages loaned through the "Fanny May." If you took it out of the business loans it would be 60 percent or better.

Senator DOUGLAS. Is it a matter of secrecy, or a matter of public record, as to some of the other large loans which you have made to individual companies?

Mr. GUNDERSON. No; we report the loans of over $100,000 to Congress.

Senator DOUGLAS. Would you read some of the loans over $5,000,000?

Mr. GUNDERSON. Over $5,000,000?

Senator DOUGLAS. Yes. We will start on that end and then get down to over a million.

Mr. GUNDERSON. Mr. Considine, will you read those?

Mr. CONSIDINE. You wish the amounts authorized over $5,000,000 or the amount outstanding over $5,000,000?

Mr. GUNDERSON. I think the amount outstanding.

Mr. CONSIDINE. The first I come to is the Lustron Corp.

Senator DOUGLAS. $38,000,000?

Mr. CONSIDINE. $37,486,000. That involves the complete loan, both under section 102 of the Housing Act and under the prior act.

Senator DOUGLAS. Yes.

Mr. CONSIDINE. The McLouth Steel Corp.

Senator DOUGLAS. How much to them?

Mr. CONSIDINE. $11,723,000.

Petrol Refineries, Inc., $5,240,000.

Carthage Hydocol, Inc., $11,100,000.

Glen L. Martin Co., $11,177,000.

Reynolds Metals Co., $30,700,000.

These balances are as of September 30.

Kaiser Co., Inc., $95,865,000.

Senator DOUGLAS. The loan of $44,000,000 recently authorized to them would bring that total to approximately $140,000,000.

Mr. CONSIDINE. Not to them. This is to the Kaiser Co., Inc. The other loan was to Kaiser-Frazer, of which the Kaiser interests are only 10 percent.

Senator DOUGLAS. Well, to the group of companies in which Mr. Kaiser is one of the dominant figures, let's put it that way.

Mr. CONSIDINE. That was an October loan. These are September 30 loans.

Senator DOUGLAS. So, we would add to the Kaiser-Frazer Co., $44,-400,000?

Mr. CONSIDINE. That is right.

Senator DOUGLAS. Making a total to the two groups of companies, however we manage this semantically, of $140,000,000.

Mr. CONSIDINE. Northwest Airlines, Inc., $9,143,000.

This amount that I am reading to you is RFC's share in those cases in which a private bank or banks participated. For instance, in the Northwest Airlines the total amount of the loan was $21,000,000. RFC's share outstanding at September 30 was $9,143,000.

Mr. BUCHANAN. Is that on a 75–25 basis? Was it originally?

Mr. GUNDERSON. No. We have four-sevenths. Banks took $9,000,-000; we took $12,000,000.

Senator DOUGLAS. What about the Waltham Watch Co. loan?

Mr. GUNDERSON. Probably isn't up to $5,000,000 yet. It is about $3,000,000.

Mr. CONSIDINE. Waltham Watch, the amount outstanding is $2,916,000.

Senator DOUGLAS. I don't know how well I can add, but I bring these totals of outstanding loans of over $5,000,000 to the nine companies that you read, to $256,000,000.

Mr. GUNDERSON. That is right.

Senator DOUGLAS. These were not cases. Mind you, I am not necessarily condemning the policy of the Reconstruction Finance Corporation, but these are not loans to small business. Here you have over half of the outstanding loans of Reconstruction Finance Corporation made to nine companies, aggregating $256,000,000, of some $450,000,000 outstanding; so this is obviously not aid to small business.

Mr. GUNDERSON. There is nothing in our act which restricts our operation to aid the small business. Of the total of $256,000,000, only $203,000,000 is included in the $433,000,000 outstanding on September 30.

Senator DOUGLAS. Pardon me?

Mr. GUNDERSON. There is nothing in our act——

Senator DOUGLAS. I understand, but the argument you started out with, as a justification for direct loans, was that small business did not have access to short-term loans from banks, and now big business is getting in that position.

Mr. GUNDERSON. Since the last year, sir. If the present trend continues, and nothing is done to free equity-investor capital, talking about double taxation of corporate dividends for one thing, it will continue this way.

I am not arguing that Kaiser-Frazer is a small business, but it is a small business in the automotive field.

Senator DOUGLAS. Well, I seem to remember advertisements by Kaiser-Frazer saying that they were the fourth-largest automobile concern.

Mr. GUNDERSON. But the larger ones have sold a lot more. Kaiser-Frazer has about 400,000 automobiles on the road. The first three sell in the millions a year. They do over 95 percent of the business. Kaiser-Frazer does about 2 percent of the total automotive business.

Senator DOUGLAS. Taking the Kaiser-Frazer concern, is it your theory that this was a desirable loan in order to preserve a greater degree of competition in the automotive business?

Mr. GUNDERSON. No, sir. It does that, but that is not the reason for the loan. The reason is, after it was determined that the money was not available privately, the fact that between 10 and 11 thousand people are employed at Willow Run, and the people employed by the dealers and suppliers, there are the jobs of 48,000 people at stake in the continued operation of that business.

Senator DOUGLAS. Therefore, to keep those jobs going you felt this further loan should be made?

Mr. GUNDERSON. And they subcontract to about a thousand small businesses.

Senator DOUGLAS. The initial portion of this $44,000,000 Kaiser-Frazer loan was $19,000,000; is that true?

Mr. GUNDERSON. No. The initial part, the first disbursement, was about that amount.

Senator DOUGLAS. Do you know how Kaiser-Frazer spent this $19,000,000?

Mr. GUNDERSON. I don't know what you mean by that $19,000,000.

Senator DOUGLAS. Isn't it true that you gave them $19,000,000—made available $19,000,000?

Mr. GUNDERSON. That was the first disbursement.

Senator DOUGLAS. That is right. Do you have any information as to the purpose which Kaiser-Fraser put this $19,000,000 to?

Mr. GUNDERSON. I think most of it was used as working capital and a part was used to retire an existing bank loan.

Senator DOUGLAS. What was that bank loan?

Mr. GUNDERSON. It was a loan from the Bank of America and the Mellon National Bank for working capital during the past year.

Senator DOUGLAS. And that loan has been repaid?

Mr. GUNDERSON. I am not informed that it has been repaid.

Senator DOUGLAS. Is it true that this loan amounted to $16,000,000?

Mr. GUNDERSON. No; the loan amounted to $20,000,000, of which the highest outstanding money taken under it was $16,000,000.

Senator DOUGLAS. Which was it, the Bank of America or the Mellon Bank, which got the $16,000,000, that had the $16,000,000?

Mr. GUNDERSON. The credit was by them jointly. I don't know which got which. It didn't make any difference because each had a half interest.

Senator DOUGLAS. Each had $10,000,000 of $20,000,000?

Mr. GUNDERSON. That is correct.

Senator DOUGLAS. Is it true this $19,000,000 disbursed to Kaiser-Fraser has been devoted almost exclusively to reducing or eliminating that loan?

Mr. GUNDERSON. I don't believe that is a true statement. I think at the time the loan——

Senator DOUGLAS. When you made the loan didn't you know the purpose for which the $19,000,000 was to be used?

Mr. GUNDERSON. Yes; but——

Senator DOUGLAS. What did they state was the purpose?

Mr. GUNDERSON. I don't want to run around, Senator, but at the time we made the loan they had $35,000,000 in working capital, and I am sure they didn't use over $8,000,000 of the loan to apply on any back debt.

Senator DOUGLAS. They must have stated to you why they wanted the $19,000,000 cash.

Mr. GUNDERSON. They stated to us why they wanted it.

Senator DOUGLAS. You don't know how they spent the $19,000,000?

Mr. GUNDERSON. I am sure we do.

Senator DOUGLAS. Could you tell us?

Mr. GUNDERSON. I would prefer to get that from our loaning agency and provide you with an accurate statement.

Senator DOUGLAS. But this is a transaction of such magnitude that it seems strange that it is not known to the men at the top and that it is only known to people in the lower level.

Mr. GUNDERSON. No——

Senator DOUGLAS. $19,000,000 seems like a large sum of money.

Mr. GUNDERSON. I don't think there is anything strange about it. The loan was approved on the basis that so much of it—and I can give you the exact figures—would be used for working capital and so much for retooling.

Senator DOUGLAS. To the best of your knowledge and belief, was or was not the major portion of the $19,000,000 which you gave to Kaiser-Frazer used to retire this outstanding bank loan?

Mr. GUNDERSON. Less than 50 percent. I can get the exact figures.

Senator DOUGLAS. You think around $10,000,000?

Mr. GUNDERSON. It was less than $8,000,000.

Senator DOUGLAS. If they had working capital, why did they need to borrow to retire the loan?

Mr. GUNDERSON. We will be glad to tell you the reasons they gave us, and the reasons we gave them the loan. One was that when Kaiser-Frazer began making this automobile—they sold the same automobile for 3 years—they were coming into a more competitive period in the sale of cars. They had attempted to put an automatic transmission on the car last year. Due to certain circumstances, they did not get it. They were faced with sales that were not increasing. They became convinced that it would be necessary to bring the car out on a new basis with some of the competitive characteristics of the other cars, and they had prepared as a part of their operation a car that they believed would do this job. Also, up to the present time, they have only made one automobile, a four-door sedan, which restricts them to 50 percent of the market, because only about 50 percent of the automobiles sold in this country are four-door sedans. So, they are not competitive across the field.

The two banks that agreed to finance them on working-capital requirements would not finance them for tooling, which was necessary in order to bring out the new car. It was on that basis that they came in and applied to us, believing that, if they retooled to bring out their new cars, they would be in a competitive position and would work themselves out of this situation.

Senator DOUGLAS. What was the attitude of the Mellon Bank and the Bank of America on continuing to loan Kaiser-Frazer these sums? Were they calling loans on Kaiser-Frazer?

Mr. GUNDERSON. The Kaiser-Frazer people informed me that the banks were entirely willing to continue with those funds, but the $20,000,000 credit was secured by a guaranty of two of the Kaiser companies and an agreement that they wouldn't pledge any of the assets, and in order to give the Reconstruction Finance Corporation a mortgage of the assets as required it was necessary to reduce that loan, which was partially reduced with cash they had on hand and part of the loan proceeds. The bank line was an open account.

Senator DOUGLAS. I don't want to use any invidious terms, but isn't the net effect—a large part of the net effect thus far—that you bailed the banks out on this initial disbursement?

Mr. GUNDERSON. We use the term, Senator "bail out," to mean "remove them from a loss." Used in that sense, I do not think we "bailed them out." They were paid off.

Senator DOUGLAS. They were paid off out of the proceeds of the loan that you advanced to Kaiser-Frazer?

Mr. GUNDERSON. Partially out of the proceeds.

Senator DOUGLAS. Well, from where else were they paid?

Mr. GUNDERSON. The company had $35,000,000 of working capital.

Senator DOUGLAS. It is just a bookkeeping feat. You say that they had $35,000,000. You gave them $19,000,000 more, making $54,000,000. They paid, let us say $8,000,000 to $10,000,000 out of the $19,000,000 you gave them and paid the rest due out of the $35,000,000. In practice, you put $19,000,000 in and then they took $16,000,000 out. I would say, on the theory of indistinguishable funds, that you bailed the bank out.

Mr. BUCHANAN. Were the terms of the loan any better than they were with the bank?

Mr. GUNDERSON. I think they are more severe. The bank line was unsecured except for a guaranty. We had a pledge of some $56,000,000 in machinery and equipment of the company.

Mr. BUCHANAN. What about interest rate to the company?

Mr. GUNDERSON. I don't know what the banks' interest was. It was probably lower than ours.

Senator DOUGLAS. What is the interest rate that you have?

Mr. GUNDERSON. Four percent.

Senator DOUGLAS. For how long a period of time?

Mr. GUNDERSON. Well, there are two loans. The $10,000,000 credit is 18 months, and the $34,000,000 credit, I think, is 3 years.

Senator DOUGLAS. What security do you take?

Mr. GUNDERSON. The company itself, at the time the loan was approved, had $56,000,000 in machinery, equipment, tools, automotive equipment, cash, accounts receivable, and cars. We have taken a first lien on all that. We also required a first lien on the plant.

There should be no misunderstanding on that plant. The plant was sold by War Assets to them for $1,000,000 down payment and a total of $15,000,000. It had a cost of $42,000,000. A reproduction cost of $47,000,000. The appraiser gave the plant a net value of $58,000,000. We have a first lien on the plant, on the equipment, and we have a $15,000,000 guaranty by Henry J. Kaiser Co. and Kaiser Engineers, secured by $10,000,000 in marketable value of securities.

Senator DOUGLAS. Let me double back for a minute. Is it your understanding that Kaiser-Frazer is now out of debt to Mellon National Bank and Bank of America?

Mr. GUNDERSON. That is my understanding.

Senator DOUGLAS. And that the $20,000,000 loan outstanding has been retired?

Mr. GUNDERSON. Yes, sir.

Senator DOUGLAS. And your contention is that $8,000,000 of that came from your $19,000,000?

Mr. GUNDERSON. That is the way I would attempt to explain it. I would say, if we were satisfied we had the collateral, that it was necessary to make this loan in order to keep the business running, we would pay the banks off. We don't like to pay the banks off, and we do our best to avoid paying banks off; but, when they flatly refuse to go ahead and do what is necessary to help a business, we pay banks off. That is not new.

Senator DOUGLAS. In practice, isn't that what happened? Prior to your loan, the Kaiser-Frazer Co. had $35,000,000 in cash but it owed $20,000,000 in loans to these two banks.

Mr. GUNDERSON. Never got over $16,000,000.

Senator DOUGLAS. $16,000,000, then, in loans to these two banks. You put in $19,000,000. They had a net asset of $19,000,000, let us say. You put in $19,000,000, building them up to $54,000,000. They retired $16,000,000 worth of indebtedness. So that their net assets were now $38.000,000. So, their net assets were increased by the amount of the loan, $19,000,000, and the banks were really paid off out of the proceeds of your loan. So that, in effect, you did bail out the Mellon National Bank and the Bank of America.

Mr. GUNDERSON. Senator, paying off is not a bailing out. That is the only point I have made.

Senator DOUGLAS. I don't want to use invidious terms, such as "bail out."

Mr. GUNDERSON. I think that has a definite meaning that does not exist in this picture.

Senator DOUGLAS. Then, let us say that the Mellon National Bank and the Bank of America were paid off out of the proceeds of your loan.

Mr. GUNDERSON. They were partially paid off.

Mr. WOLCOTT. Wasn't the indebtedness to the Bank of America endorsed by Kaiser as an individual?

Mr. GUNDERSON. Not as an individual. Most of the Kaiser assets are in two companies: Henry J. Kaiser Co. and the Kaiser Engineers. Those two companies had endorsed that line of credit.

Mr. WOLCOTT. So the assets of all of those companies were behind the $10,000,000 which was involved?

Mr. GUNDERSON. The line of credit that was arranged was for a maximum of $20,000,000, of which they only used $16,000,000. That was an open line of credit unsecured except for this guaranty.

Mr. WOLCOTT. Two loans?

Mr. GUNDERSON. No; one loan by the banks jointly. Each bank had a half of it. I mean, the banks joined in making that credit available.

Mr. WOLCOTT. $10,000,000; a line of credit of $20,000,000, and the 2 banks split it?

Mr. GUNDERSON. That is right.

Senator DOUGLAS. Why couldn't Kaiser-Frazer Co. have obtained the capital which they needed for retooling, and so forth, by a securities issue?

Mr. GUNDERSON. Their investment brokers, I think it was the First Boston Corp., advised us that it would not be possible for them to sell their securities. We went into it very carefully to be sure that the banks—the insurance companies and the investment bankers—could not raise this money for them. That came up when they first came in to discuss this with us last spring. We were satisfied that they had exhausted the possibilities of either getting the banks to stay in and participate with us or getting insurance company loans, or of selling their securities.

Senator DOUGLAS. Do you see any dangers, if this Kaiser-Frazer example is blown up into a general practice?

Mr. GUNDERSON. Yes, sir; speaking personally. I don't think the RFC is in a position to answer that question, but I wouldn't hesitate to say, personally, that you are in a very dangerous position if you do not have an adequate supply of equity money for business. There definitely is not an adequate supply of equity capital funds for business today available.

Senator DOUGLAS. And in the absence of that equity capital you feel that it is an obligation on the part of RFC to make individual loans?

Mr. GUNDERSON. I think that Congress, in writing our act, has written it so that when a borrower has adequate collateral, and is unable to get his money elsewhere, plus the other requirements, we have to do what we can to help them; I think that is the job you have given us to do.

Senator DOUGLAS. You didn't take equity in these companies?

Mr. GUNDERSON. These are capital, working-capital loans; they are capital loans, really. They are well secured, in my opinion; they will be paid off, regardless of what happens to the borrower.

Senator DOUGLAS. What you are saying is that the inability of Kaiser-Frazer to get equity capital forced them to turn for intermediate capital to you?

Mr. GUNDERSON. That is correct. Some of our people, very frankly, have doubts about the future of Kaiser-Frazer Co. and its automobiles. However, if I did not believe that they had a very good chance of being successful, I wouldn't have, personally, worked so hard to try and help them. I think perhaps, if the private money market turns around a little bit, they can refinance this whole thing privately in another year or two.

Senator DOUGLAS. Do you have the same confidence about Lustron Corp.?

Mr. GUNDERSON. No, sir. I have never expressed a similar confidence about Lustron.

Senator DOUGLAS. Did you recently make a loan of about $8,000,000 to Lustron?

Mr. GUNDERSON. No, sir. They applied for a loan of about $14,000,000 on the first of September; and, as we advised the Banking and Currency Committee, we have been working very hard to try and get the final answer as to whether that business can be made successful, and we have kept them merely on a very small operating basis until we reach that decision.

Senator DOUGLAS. How much have you advanced in recent months?

Mr. GUNDERSON. I am sure it wouldn't be over a couple of million dollars. I think we have made three $1,000,000 loans since about August.

Senator DOUGLAS. And you are keeping them on a month-to-month basis?

Mr. GUNDERSON. Yes, sir; until we can reach a decision. We have had an engineering firm, an outside engineering firm, as we told you before, on the original loan. On two of the second advances, we had Stone & Webster in there. We employed the firm of Boos, Allen & Hamilton, and they are about ready to complete their report on the possibilities of that business and its future. When we get that— and there has been some work we have been doing ourselves—why, we should be in a position to reach a decision.

Senator DOUGLAS. Have you ever wished that you were out of the business of making large loans to companies?

Mr. GUNDERSON. Well, I have never wished to be out of the business of trying to be helpful to people who couldn't be helped elsewhere.

Senator DOUGLAS. Is there not a danger, when you make loans, that you may not be able to get the funds, when the Government makes large loans, you may not be able to get the funds into the best hands?

Mr. GUNDERSON. I don't believe so, Senator. In the history of the Reconstruction Finance Corporation we have always made, dollarwise, a lot more big loans than we have made small loans. When it was first set up, we used to make hundred-million-dollar loans, as, for instance, to the Central Illinois Bank, to keep it going. I think we are doing the same kind of business today in a different field. I think until something can be done, and I am not saying this in the sense that we feel we know the answers, but I believe that the problem is to ease up investment money sufficiently so that it will go into businesses, and when that is done the RFC will be only making a few business loans. It will be back so that it won't be as large a factor as it is today. On the other hand, if investment funds are going to be discouraged from going into business, I think something will have to be done to help business stay open, when they have the collateral and the possibility of paying off a loan.

Senator DOUGLAS. In the field of agriculture, the problem of providing credit is largely met, but not wholly, of course, by the creation of intermediate credit banks and by the creation of cooperative banks. In Germany, beginning about a century ago, they created the so-called Schultze Delitsch banks, which were cooperative banks, to make available credit for small business.

Now, what would you say to the creation of new credit agencies to provide for small business, to meet these needs?

Mr. GUNDERSON. I don't believe that is the answer, Senator. I think you have got to free equity capital to go into business. You have got to eliminate some of the double taxation on corporate earnings and make it attractive for people who have money to buy something more than municipal tax-free bonds and put it into businesses. And when that is done the Reconstruction Finance Corporation business of this nature will sink to a very low volume. I am sure of that, because that was our experience.

Senator DOUGLAS. Then, you would say the remedy lies in the abolition of tax on corporate profits and taxing individual income when received?

Mr. GUNDERSON. I think some change should be made. I wouldn't say it should be abolished. I think it should be modified so that investing in a corporation is at least as attractive as some other means of investing, because that is the reason for the dearth of capital in business, and particularly in small business. It is no longer attractive for people to have investments of that character.

Senator DOUGLAS. What about noncorporate small business?

Mr. GUNDERSON. They should probably have some assistance. I would like to say this, Senator, that during the years I have been with the RFC we are making today a much better type of loan, in my opinion, than we made from 1934 to 1940. The loans we are making now are good loans. You remember our discussions this spring in the Banking and Currency Committee about the Northwest Airlines? I have never understood why we had to make that air-line loan, because that is a fine loan. It was a good loan at the time the banks made the original commitment. And there was no reason at all why it shouldn't have been financed privately. But it was not financed privately. I have every confidence that this loan will be fully repaid on or before its maturity date. On the basis of operating results for the first 10 months of 1949, the cash available from earnings and depreciation should exceed $6,000,000 for the full year. Over the next 5 years the depreciation account alone will average approximately $6,000,000 per year. If operations in these years are only at a break-even level, the cash available from depreciation will be more than sufficient to meet the required repayments on the loans.

Senator DOUGLAS. Do you see any need for a new type of lending agency to meet the needs of small business?

Mr. GUNDERSON. I don't believe so, sir. I think that we may not do as thorough a job as we would like to do, but I think as far as lending money goes, we are supplying the needs of small business for a loan. I don't think an additional source would facilitate it.

Senator DOUGLAS. What would you say to giving to the Federal Reserve banks limited power to make direct loans?

Mr. GUNDERSON. Well, the Federal Reserve banks have that authority, to make direct loans, have had it for about 11 or 12 years, and they have not done very much business under it.

Senator DOUGLAS. How limited are their powers?

Mr. GUNDERSON. I do not have a record of the loans they have made during the time they have had this authority. I don't know that I can quote the power. It is the authority to make direct industrial loans—13 (b), I think it is. There is a limitation. Is the limitation monetary?

Mr. DOUGHERTY. Yes; both.

Mr. BUCHANAN. For working capital purposes only.

Mr. GUNDERSON. Something like that. There are limitations both as to type and amount of money.

Senator DOUGLAS. Would you favor reducing those limitations?

Mr. GUNDERSON. I don't have any feeling about it, Senator.

Senator DOUGLAS. My general feeling is that it is a very distinct function of the Federal Government to regulate total supply of credit in order to stabilize business and to maintain an expanding production as well as a stable price level, but that the Government should be very cautious about getting into direct lending activities and insofar as possible it should have these functions performed by middlemen.

Mr. GUNDERSON. I think that is a sound approach.

Senator DOUGLAS. Well, now, following that out, might it not be well to create intermediate institutions which are not governmental agencies, as the RFC necessarily is, to help make loans to small business?

Mr. GUNDERSON. I don't see any advantage in it, Senator.

I don't think, because something has worked satisfactorily for 17 years, it is a reason for trying to change it. I don't think that as long as you are making loans any agency you could set up would do the job much better than we have tried to do it.

Senator DOUGLAS. I am sure you have tried to do well.

What we are all holding our breath for, I suppose, is because there is a general fear that the Lustron loan will blow up; and while we wish Mr. Kaiser well, we are not at all certain that that is going to come through. If those two loans should go sour a very heavy blow would be struck at the Reconstruction Finance Corporation.

Mr. GUNDERSON. I can't agree; if we were to have a 100 percent loss on Lustron, I don't think it would be any blow to the Reconstruction Finance Corporation. That was done under the Veterans Emergency Housing Act with as near a directive of Congress, short of them appropriating the money, as anything I have ever seen, and if there is any blow at anybody, it certainly wouldn't be us, because we have done nothing but carry out the assignment the best we could under all of the conditions. In the case of Mr. Kaiser, I am confident that loan will be repaid.

Senator DOUGLAS. We certainly all hope so.

Mr. GUNDERSON. I feel far more strongly than a hope. I don't think there is any doubt about it.

Senator DOUGLAS. Mr. Dougherty, did you want to ask something?

Mr. DOUGHERTY. No; thank you.

Senator DOUGLAS. Mr. McCabe, Chairman of the Federal Reserve Board, states, on page 77 of the committee print on monetary, credit, and fiscal policies [reading]:

> It is my view that both the Federal Reserve banks and the Reconstruction Finance Corporation may, without inconsistency, operate together to provide financial assistance for business enterprises, provided, however, that there is written into the law a provision which would require the Reconstruction Finance Corporation, before it extends financial assistance to a business enterprise, to consider whether such assistance is available, not only from commercial banks, but through the Reserve banks. This would be in the nature of a clarification of the present statutory requirement that the Corporation shall render financial assistance only if it is "not otherwise available on reasonable terms."

I wonder if you have any comment concerning that.

Mr. GUNDERSON. We have taken the position, as expressed at some length to the Banking and Currency Committee a year or two ago, and which I might summarize briefly, that if you want a central bank, perhaps you should give the powers to the Federal Reserve to lend money, but there are two things about the Federal Reserve that lead some people to believe they should not be in the direct lending business or even in the indirect lending business. That is their banking discounts. If they were to commit their funds on loans then in times of stress they wouldn't have anything left.

Senator DOUGLAS. The discount function of the Federal Reserve bank has virtually disappeared through attrition. The amount of commercial paper which is presented to the Federal Reserve banks for rediscount forms only about 2 percent of the total volume of business.

Mr. GUNDERSON. In economic emergency it might be a great deal larger.

But the other thing is that they are a supervisory agency of banks, and it is questionable whether they ought to be supervising their own operations.

Senator DOUGLAS. I think the second consideration is of much more weight than the first.

Mr. GUNDERSON. Personally, I don't have any feeling at all as to whether the Federal Reserve should or should not be given authority to make loans. I do not think that people trying to get loans should be put through any more of a devious process than they are now. By putting in the Federal Reserve, it is just one more place they must go to before they come to us for help.

Senator DOUGLAS. What would you say to the creation of banks similar to the agriculture cooperative banks and intermediate credit banks for agriculture, which are fairly well decentralized from government?

Mr. GUNDERSON. Well, of course, you know we are fairly well decentralized. Each of our loan agencies has authority to make loans up to $100,000, and handle all that business without recourse to Washington.

Senator DOUGLAS. The governing boards of these agencies, as I understand it, are not appointed by the Government but chosen by the groups which are served by the loan. So the shifting is from primarily governmental agencies to primarily voluntary agencies.

Mr. GUNDERSON. I don't believe that you would get the results with voluntary agencies. It is difficult to get it with an agency charged with the job of doing it sometimes. I presume you would capitalize such entities, if you are going to be successful with Government funds. A private pool of bank credit has never been successful in meeting this situation. So I think it is largely a question as to what kind of a job Congress wants done. If Congress wants a certain job done, as they have in the last 17 years with RFC, I think RFC is as good an entity to get that result as any. If it is more desirable to eliminate this function or change it, I don't have any feeling about doing something different, but on the job we are doing I think we can do it as well as anybody else and maybe better.

Senator DOUGLAS. Mr. Gunderson, would you describe briefly the purposes and functions of the Federal National Mortgage Association, familiarly known as Fanny May.

Mr. GUNDERSON. In some housing act a long time ago, Congress provided for the creation of a national mortgage association. Pursuant to that, February 10, 1938, the Federal National Mortgage Association was set up, I believe, with the primary purpose of creating a secondary market for FHA mortgages.

Senator DOUGLAS. You mean it was to be in the real-estate mortgage field what the Federal Reserve was to be in the commercial banking field?

Mr. GUNDERSON. That is correct. And as such its entire function has been in the past and is today purchasing or agreeing to purchase mortgages insured by the Federal Housing Administration, and today that is enlarged because it also purchases loans that are insured by the Veterans' Administration.

Back in 1938, at the time when there was a credit stringency, the Federal National Mortgage Association bought a considerable volume of mortgages, which were subsequently sold at premiums, and for a number of years, including the war years, it did very little if any business. After the war there was a lot of conjecture that private people who bought mortgages didn't wish to hold them, but I believe probably the best reason is the fact that they believed the interest rate might go up, and there seemed to be a considerable need for an agency to provide a secondary market for FHA and Veterans' Administration insured mortgages, and as a result the Federal National Mortgage Association started in to buy mortgages again. At the time that Congress indicated to us, by eliminating the RFC Mortgage Company and the other real-estate operations, that they didn't desire to have us make real-estate loans as such——

Senator DOUGLAS. May I interject? Am I correct in my understanding that the "Fanny May" is run by the directors of RFC?

Mr. GUNDERSON. Yes, sir.

Senator DOUGLAS. So that——

Mr. GUNDERSON. It is for all intents and purposes the same thing.

Senator DOUGLAS. It is the left hand of RFC?

Mr. GUNDERSON. It is just a different account.

Senator DOUGLAS. Yes. What is the value of the real estate mortgages which you now hold in your portfolio?

Mr. GUNDERSON. $637,400.000.

Senator DOUGLAS. Do you hold these or do you try to resell them?

Mr. GUNDERSON. We have launched a program, beginning about August, of setting prices on these things. We are not particularly anxious to make a profit, but we believe there should be some penalty to the people who sell to us; we shouldn't just buy and sell at par. We have aggressively undertaken the sales, and I would say I think we are progressing satisfactorily. At the time we started systematically to go about selling them, we believed it would take 6 or 8 months to build these sales up in any great volume. If my memory is correct we sold about half a million dollars' worth in August and about a million and a half in September and about a million and a half in October, and we have tentative commitments for the sale of about $21,000,000. We have other individual sales of $10,000,000 each under consideration that are not included in the figures I am talking about. I would say that by spring we should be moving at a more rapid and increased rate and in substantial amounts.

Senator DOUGLAS. Well, now, on the mortgages which you hold, what charge do you make for rediscount?

Mr. GUNDERSON. Under the FHA and VA acts there are several different kinds of mortgages. I think the highest premium we ask, that is, on old 4½'s, is about 2 points, but we have a schedule of premiums for each type of loan, and I would say that on the bulk of the loans the premium is about a half of 1 percent.

Senator DOUGLAS. What do you pay out?

Mr. GUNDERSON. Mr. Dougherty is president of the company. He might discuss that.

Mr. DOUGHERTY. For those that we buy over the counter we pay par and accrued interest. We pay par and accrued interest for those mortgages we buy over the counter.

Senator DOUGLAS. Where do you make your profit then?

Mr. DOUGHERTY. Well, we will sell them at a premium after a while.

Senator DOUGLAS. You mean the mortgages will sell at a premium?

Mr. DOUGHERTY. Yes.

Senator DOUGLAS. Isn't that hope rather than realization?

Mr. DOUGHERTY. Senator, prior to the war we bought $271,000,000 of those mortgages and sold them at premiums of between 5 and 6 million dollars.

Senator DOUGLAS. That was prior to the war.

Mr. DOUGHERTY. Yes. Presently——

Senator DOUGLAS. You bought in a period of low construction cost and sold in a period of high costs, but now you have been buying in a period of high costs and certainly you cannot sell in a period of still higher costs.

Mr. DOUGHERTY. I hadn't finished the answer, Senator.

Senator DOUGLAS. I am sorry.

Mr. DOUGHERTY. For those we buy over the counter we pay par and accrued interest. For those for which we issue a commitment to purchase, and those are in the majority, we pay 99½. If we issue a commitment to purchase a mortgage and it is not sold to us, we charge a quarter of a percent for having issued the commitment, and return the commitment fee except one-quarter of 1 percent. At the time we issue the commitment, the seller asking us to purchase the mortgage and seeking the commitment pays us 1 percent cash fee, of which we will return him one-half if he sells the mortgage to us and one-quarter if he doesn't sell it to us.

Senator DOUGLAS. But in practice, don't you make a profit, not from a resale at a higher figure but from the fact that you borrow from the Treasury at a rate of interest which, I assume, is around 2 percent?

Mr. DOUGHERTY. So far as income is concerned, that is correct; so far as sale is concerned——

Senator DOUGLAS. Speaking of income; on income, you borrow from the Treasury at what rate—2 percent?

Mr. DOUGHERTY. About that, 1⅞ percent is the correct rate.

Senator DOUGLAS. Then you collect how much, 4 percent?

Mr. DOUGHERTY. Four percent less a half that we pay for servicing the mortgage to the mortgagor.

Senator DOUGLAS. You have a 1½ percent credit——

Mr. DOUGHERTY. That is right, approximately.

Senator DOUGLAS. Out of which you meet your operating costs?

Mr. DOUGHERTY. Yes.

Senator DOUGLAS. Then, in addition, to make any profit on a higher resale figure?

Mr. DOUGHERTY. I might say that one of the sales to which Mr. Gunderson has referred was made at: $500,000 at 1¼ premium, and for about $7,000,000 of it, 101⅛ is the sale price.

Senator DOUGLAS. If we would have a decline in building costs and in the general price level, you would not have the same confidence, would you, that you would be able to sell at a premium?

Mr. DOUGHERTY. Well, they are all the same; regardless of what the cost level may be, your mortgage is insured 100 percent by the Government of the United States and the FHA, and up to 50 percent——

Senator DOUGLAS. You pass the losses on to someone else?

Mr. DOUGHERTY. No. The Government guaranty doesn't change because building costs go up or down. It remains the same.

Mr. WOLCOTT. You sell them in bulk also?

Mr. DOUGHERTY. Yes.

Senator DOUGLAS. Why do the building and loan associations, and so forth, want a rediscount market if they have a hundred-percent guaranty?

Mr. DOUGHERTY. That is a mystery we will never be able to solve. We do not know why they do not keep them as investments and why Congress has been obligated to increase the amount of money we spend for them and place limitations upon the kind of mortgages we can buy.

Senator DOUGLAS. That is a mystery that is running up into hundreds of millions of dollars.

Mr. GUNDERSON. It can be broken down. I believe one of the principal reasons during the past year was the belief by people that the interest rate might be increased of the insured mortgages, which would mean a half percent or more yield. Say FHA would be 4½.

Senator DOUGLAS. They want cash to go into new mortgages?

Mr. GUNDERSON. Yes. I think when the feeling becomes prevalent that the market is stabilized at 4 percent, they will move back out largely where they were. That may not be the only reason, but I think it is one of the important reasons.

Senator DOUGLAS. That is all the questions I have.

Mr. BUCHANAN. How are the lending activities of RFC coordinated with the Federal Reserve in general credit processes?

Mr. GUNDERSON. Rather loosely. They are coordinated. In order to explain the position, the type of loan that we make is confined to a rather narrow group of loans when you consider the over-all credit, the types of credit available in the country. For example, probably the largest bulk of credit available is consumer credit. Time credit of appliances and purchases at retail stores and that type of credit run into billions of dollars. One of the others, also, which you could probably include in consumer credit, is the short-term bank loans of one type or another, both to individuals and to stores, with which to purchase, carry, and sell merchandise.

That field of short-term consumer credit is a very, very vast field. I have seen figures on it which run up into the billions of dollars.

Our field, on the other hand, is restricted to a very narrow field where the borrower must have enough collateral. We cannot lend a fellow, no matter how good he is, if he has marketable securities or Government bonds or money in the bank; our field of lending is usually on fixed assets. So the typical loan we make is one on a plant or a store, and it is usually for the purpose of either replenishing loss incurred in operating the business or to build an addition to the store, and so forth.

Now, the only case that has come up recently was the administration's and Congress' wish to restrain inflation a number of years ago. At that time the President, in his message, indicated that the Federal Reserve would take certain steps, and one of the steps the Federal Reserve took was to restrict and curtail in very large measure certain aspects of consumer credit such as monthly payments on automobiles and that kind of thing.

Now, at that time we advised all our people to avoid making any loans that were inflationary. At the same time, the President indicated he wanted every possible aid given to production, with the idea that if you increase production sufficiently, you will overcome scarcity and decrease inflationary tendencies. Except for the fact that we made a few loans in the past, maybe to theaters or bowling alleys or something like that, almost every loan the RFC makes is one in production and distribution. So we told our officers and our people that we did not want to make any loans that were inflationary. As near as we can define an inflationary loan it was some loan for what I would say would be a nonessential purpose that used up scarce building materials—that type of thing. It is a very loose thing, but we conscientiously tried to conform to what the Federal Reserve is doing, and in the very small and narrow sphere in which we lend, I think it is adequate.

Mr. BUCHANAN. What percentage break-down do your loans take in the form of production and distribution and the other fields?

Mr. GUNDERSON. Can you give that, Mr. Considine?

Mr. CONSIDINE. For the quarter ended September 30 of the loans we made, the RFC's share of the loans we made, which was $177,600,000, 31.7 percent represented loans for construction purposes, 30.3 percent represented loans for working capital purposes, 27.8 percent for debt payment, and 9.6 percent for machinery and equipment, 0.6 percent for purchase of real estate to be used in the business, which accounts for the whole 100 percent.

Mr. BUCHANAN. How much on accounts receivable in consumer goods?

Mr. CONSIDINE. That would be 30.3 percent; inventory loans, accounts receivable.

Mr. BUCHANAN. Is there a break-down in that figure?

Mr. GUNDERSON. I do not think we can give a break-down on accounts receivable, but I can tell you that our loans on accounts receivable are minute. They are very small.

Mr. BUCHANAN. Would they be about 15 percent of that figure?

Mr. GUNDERSON. My guess is it might even be less than five, might be down around one, because we never make an accounts receivable loan by itself, and usually the only time we take them is when it is absolutely essential to the business to have a little more money than he can get on his building, equipment, etc., and he has to have it in order to make a go of it.

If the only source of collateral remaining is a few accounts receivable, we try to do it, but in almost any business, except up in

Boston last spring when the banks quit loaning on accounts receivable, they can borrow on accounts receivable.

Our lending is largely restricted to term loans on plants and equipment.

Mr. BUCHANAN. I was thinking of the problem of small business in regard to contraction by banks on that type of loan and their availability of funds and the only assets left are accounts receivable that they are able to pledge. It is a growing problem with those lines of activities such as furniture and household appliances.

Mr. GUNDERSON. Unless we have a local bank participating—we have had loans, for example, to dry-cleaning and pressing establishments, which may have thousands of accounts that will run from 75 cents to 3 or 4 dollars. With our set-up, although we can go to any extent to be helpful, if we do not have a participating bank in that town which can function with the substitution and release of those accounts receivable monthly, you get unwieldy. We would rather lean over backward and leave them freer on that because, while we do everything we can to help small business, we are not in a position to service things like a vast amount of small accounts receivable loan. It is difficult for the borrower as well as for us.

Mr. BUCHANAN. Even things of a semidurable nature such as household furniture and refrigerators?

Mr. GUNDERSON. We have never done much of it. We did it in the Kaiser-Frazer loan, that $10,000,000 loan.

Mr. BUCHANAN. That is where the business units have outgrown the banking facilities?

Mr. GUNDERSON. That is where CIT, for instance, does not wish to operate. The bulk of dealers will be financed on the floor plan by credit agencies, and none of that money is available until the regular credit agencies turn one of them down.

We have run into more applications in the last 6 or 8 months asking for us to lend them money to assist them in financing certain types of their business, which is accounts receivable, than we have had in a long time.

Mr. BUCHANAN. The present moratorium in the strike areas of the steel and coal sections—is that going to lead to a demand for that type of loan? I have had inquiries.

Mr. GUNDERSON. We can certainly help them if they cannot handle it privately.

Mr. WOLCOTT. What profits do you show on your loan operations?

Mr. GUNDERSON. Gross to date about $560,000,000, Mr. Wolcott. Have you got it for this year, Mr. Considine?

That is after setting up reserve for losses of over a hundred million. So far it has totaled $568,000,000.

Senator DOUGLAS. Does that include interest on Government advances to RFC? Have you deducted interest paid to the Government?

Mr. GUNDERSON. Yes; that is correct bookkeeping; net.

Senator DOUGLAS. That is profit over and above cost of capital furnished to you by the Government?

Mr. GUNDERSON. Yes, sir.

Mr. WOLCOTT. Your net would be minus your reserves, so you have made something over $500,000,000?

Mr. GUNDERSON. Yes.

Mr. CONSIDINE. I might add, $307,000,000 of that was paid as a dividend to the Treasury last December, subject to the requirements of a recent act.

Mr. WOLCOTT. Do you think, Mr. Gunderson, in the operation of RFC in making investment capital available to small industry, that you perhaps have prevented concentration or helped to prevent concentrations of industrial and commercial power?

Mr. GUNDERSON. Definitely, Mr. Wolcott. We have certainly done that, and we have done one other thing that is a little difficult to explain, but it interests me.

I had a record kept in one of our loan agencies for about 18 months, from July 1946 to about March 1948. I had them keep an individual detailed record of each application from a borrower, the type of business he was in, the amount of money he asked for, and the amount of the loan that the RFC approved.

Then we did one other thing: We broke that list down into the loans that we actually paid out the money on; and the loans thereafter, after we had done all the work, banks and insurance companies took over the commitment and paid it out on our terms. The amount of loans made in which we did all the work and disbursed no money was $13,400,000, and during the same period we made and disbursed loans to the amount of $3,500,000. That was just one of our loan agencies.

So we have done and continued to do an excellent job in putting together a situation in businesses that are in difficulty, whereby private sources that were not available to them before we went to work on it come to their assistance after we have put the picture together.

Mr. WOLCOTT. After you have made a survey, a study, and a commitment, then a bank takes over the loan, and there is no way of reimbursing you for the service you have performed?

Mr. GUNDERSON. No, sir. That is a gratuitous service on our part.

Mr. WOLCOTT. What is your total borrowing power now?

Mr. GUNDERSON. Three billion five.

Mr. WOLCOTT. What part of that has been theoretically set aside for capital for "Fanny May" [FNMA]?

Mr. GUNDERSON. Two and one-half billion.

Mr. WOLCOTT. So there is a very definite limitation upon your operations?

Mr. GUNDERSON. Yes, sir.

Mr. WOLCOTT. You have in the neighborhood of a billion and a half of borrowing power with which to compete with our entire economy, and the Congress can or cannot, just as it pleases, expand your authority in that respect as it did during the war; is that right?

Mr. GUNDERSON. Mr. Wolcott, in addition to the monetary limitations, the much more real limitation is the wording of the act and the requirement that credit cannot be privately available and that a loan has to be so secured as to assure repayment. In my opinion, enforcement of those two conditions is such that it is almost a physical impossibility, no matter what the situation, to find enough loans to use up the money over a very long period of time.

Mr. WOLCOTT. That language surely prevents you from getting into open competition with private lending institutions.

Mr. GUNDERSON. It means that we have to exhaust every possibility of having a thing financed privately; and we have been, I think, very successful. I know of a case where the fourth largest biscuit-manufacturing company in the country came in to get a loan from us about a year ago, and it already had a loan from one of the insurance companies, and it had embarked upon a program of modernization following the war in which they put in automatic bake ovens.

They had spent about $2,000,000 more than they had expected. They came down because they had exhausted all possibilities of getting credit privately, and I suggested that they go back to the insurance company and offer the insurance company the same rate of interest we would require and the same term of years.

After about 6 weeks' negotiating they got the insurance company first to agree to take half of the loan we might make to help them, and finally the company took it all.

Those types of our assistance are in carrying out the direction to be sure private capital is not available; and it results in, I would say, on an average, two or three loans being made privately that have been turned down by private sources after they have come to us throughout the country. That is why I say that business of exhausting them is a restriction on the amount of work you do. Also, the limitation that it must be so secured as to reasonably secure repayment ties it down to where they must have physical assets, and it eliminates the consideration of all the types of loans that constitute the largest bulk of credit in this country, like a note at the bank for a line of credit. We cannot do any business like that. Somebody has to have a building or machinery with a market value to it before we can do anything for them, and it is a very real limitation and one that restricts the rate at which we can lend and the number of loan applications, short of some major economic catastrophe.

Mr. WOLCOTT. We built you up during the war so that in the spring of 1947 you had a potential borrowing authority of—we never could determine just what it was, but it was between 14 and 18 billion, was it not?

Mr. GUNDERSON. That is correct.

Mr. WOLCOTT. It is not your impression that we changed the identity of the Corporation in respect to loans to business and banks when we cut you back 2 years ago to the $2,000,000,000 and you became a sort of stand-by organization to meet any emergencies that might arise in the future—it isn't your impression that it was the intent of Congress to give you any more or less power to compete with private enterprise than you had before that?

Mr. GUNDERSON. No, sir. The two actual changes in the act, the elimination of loans on purchase of preferred stock, the only change in this business-loan section——

Mr. WOLCOTT. Preferred stock in banks?

Mr. GUNDERSON. Yes. The only change in the wording of the section of the RFC Act which covers loans to business was the addition of three words: "encourage small business."

Mr. WOLCOTT. Now, I just want to make this statement for what it might be worth. Back in 1940 when we gave you these very broad powers, especially under 5 (d), and then later on increased your borrowing authority to upward of $14,000,000,000, it was very apparent that the RFC had the authority, the power, if it had missed it, to socialize our banking structure and to control the flow of credit to agriculture and business and industry.

I think it is to the great credit of the Board of the RFC that that power was never abused in that respect. The Congress has always been very cautious not to continue those powers beyond the time when it was found necessary for war purposes, so that any Board in the future that might think otherwise would not have the power to socialize our banking and credit or industry generally.

I have always thought that the RFC did a very splendid job during the war in financing our war effort, and especially that it did not at any time misuse its powers to the prejudice of the American system of government. The fundamental and basic issue before the country today appears to be whether we are going to perpetuate the American way of life.

Government was set up to encourage and regulate business but not to control it to the point where there would be through Government control or otherwise a too high concentration of financial and industrial power. I think that the RFC has done a very splendid job in contributing to that ambition, which we all should have that America continue strong.

I think I should correct a thought I had and I might have expressed to loans made by the Federal Reserve. Mr. Buchanan called my attention to that paragraph on page 76 of the preliminary hearings which states that the restrictions on those loans which it says under present law they—that is, the Federal Reserve banks—may make commitments on loans only for working capital purposes, only to "established" business, and only with maturities not exceeding 5 years. These are severe limitations upon the ability of the Reserve banks to render effective assistance in meeting the requirements of smaller businesses.

Of course, that does not remove in any manner the basic objection to Federal Reserve banks making direct loans. We have always successfully fought attempts which have been made to make the Federal Reserve banks banks of deposit and to authorize the Federal Reserve banks to make loans, whether to small business or to big business or anyone, which would put them in direct competition with the members over which they have control. It is directly contrary to the theory behind the establishment of the Federal Reserve System in 1913 and the amendments which we have adopted to it.

I can readily understand why the Federal Reserve System might think that the only way they can control the volume and velocity of credit is to get control over the issuance of credit; but, of course, that is to me a rather superficial reason because, of course, if the Federal Reserve Board is going to do an effective job in that field, which the Congress itself delegated to it, then the Federal Reserve System would have to be given control over all expenditures in respect to our foreign affairs and ECA and every other expense which the Government has which involves the raising of money. The only other way you could concentrate control of credit would be to transfer the RFC, the Federal home loan banks, the Federal Reserve banks into the Treasury and put them all under the single head; and I do not think anybody is advocating that.

So I think we should proceed rather cautiously in any recommendation we make that the Federal Reserve Board change its identity from that of its present set-up to one in which they are doing a general banking business. We did give them the authority at one time, the Federal Reserve Bank of New York, as I recall it, to accept some deposits to the account of foreign countries temporarily. That is the nearest we have come to giving Federal Reserve banks authority to accept deposits.

I guess that is about all.

Senator DOUGLAS. One final question, Mr. Gunderson, which I would like to ask you. Who owns the profits of the RFC? The same question has from time to time arisen in connection with the Federal Reserve banks and System, and the Federal Reserve System brought some gifts up to the altar and presented them to the Treasury in possible anticipation of congressional legislation and possibly with a desire to forestall congressional legislation. Now, in the case of the RFC, who owns these five-hundred and sixty-odd million dollars?

Mr. GUNDERSON. The United States.

Senator DOUGLAS. Not the RFC?

Mr. GUNDERSON. Under our act Congress has permitted us to retain $100,000,000 worth of capital and $250,000,000 in surplus, together with the adequate reserves; anything we make over and above that it has to be paid into the Treasury at the end of each year.

Senator DOUGLAS. How much have you paid into the Treasury?

Mr. GUNDERSON. We have paid $307,000,000.

Senator DOUGLAS. Over a period of time?

Mr. GUNDERSON. In the last couple of years, because that provision was just put in our act about 2 years ago.

Senator DOUGLAS. In addition to that, you have accumulated your capital and surplus?

Mr. GUNDERSON. Yes, sir.

Senator DOUGLAS. You have retired the advances?

Mr. GUNDERSON. All but $100,000,000 in capital stock, but we have surplus and reserves. The best picture on it is that our gross earnings to date are $568,000,000, of which $307,000,000 have been paid into the Treasury.

Mr. BUCHANAN. Since the inception of the RFC in 1932?

Mr. GUNDERSON. That is correct.

Mr. WOLCOTT. We did write off in legislation about $2,000,000,000 of losses in the RFC as a result of extracurricular activities during the war.

Mr. GUNDERSON. Nine billion.

Mr. WOLCOTT. You had been mandated to raise money for activities upon which you could get no return.

Mr. GUNDERSON. That was written off, and on the liquidation of that we still, as a liquidation of the war activities, run by direction of Congress the synthetic-rubber program, the tin smelter at Texas City, certain abacá properties in Central America, and a handful of leases on plants in the process of liquidation; but all proceeds from all that activity goes to the miscellaneous proceeds of the Treasury.

Senator DOUGLAS. As I remember, financial statements on those activities showed a profit, too; is that right?

Mr. GUNDERSON. No, sir. They did not show a profit, for the reason that much of the money we spent during the war was in the payment of subsidies.

Senator DOUGLAS. The operations in the last fiscal year, I mean.

Mr. GUNDERSON. Oh, yes. There is profit on most of these operations.

Mr. WOLCOTT. You paid butter and other food subsidies.

Mr. GUNDERSON. All metal and food subsidies were paid out of those funds during the war.

Senator DOUGLAS. Will you furnish statistics on various points which we have brought out; that is, the loans outstanding, classified by size, the earnings of the Corporation above costs, and so on?

Mr. GUNDERSON. Yes; that will be done.

(The following tables were later submitted for the record:)

Business loans outstanding, by size, as at Sept. 30, 1949

DIRECT LOANS

	Number	Amount
Less than $500,000	5,477	$148,297,000
$500,000 to $1,000,000	41	26,338,000
$1,000,000 to $5,000,000	33	69,320,000
$5,000,000 and over	11	189,640,000
Total	5,562	433,595,000

DEFERRED PARTICIPATIONS IN BANK LOANS

	Number	RFC share
Less than $500,000	6,453	$127,048,000
$500,000 to $1,000,000	8	5,247,000
$1,000,000 to $5,000,000	3	7,241,000
$5,000,000 and over	1	9,143,000
Total	6,465	148,679,000

Business loan authorizations, by size, July 1, 1948, through Sept. 30, 1949

	Number	Gross amount	RFC amount
$5,000 and under	798	$2,392,203	$2,313,894
$5,001 to $10,000	591	4,616,783	4,188,419
$10,001 to $25,000	1,084	19,508,780	16,962,959
Total $25,000 and under	2,473	26,517,766	23,465,272
$25,001 to $50,000	935	36,521,041	31,236,608
$50,001 to $100,000	759	60,306,969	51,957,735
Total $25,001 to $100,000	1,694	96,828,010	83,194,343
$100,001 to $200,000	243	37,423,372	32,883,772
$200,001 to $500,000	224	71,929,355	63,601,195
Total $100,001 to $500,000	467	109,352,727	96,484,967
$500,001 to $1,000,000	71	52,474,892	46,810,295
Over $1,000,000	77	308,461,361	276,568,313
Total $500,001 or more	148	360,936,253	323,378,608
Total	4,782	593,634,756	526,523,190

Reconstruction Finance Corporation—Consolidated statement of income from lending activities cumulative from inception through June 30, 1949

Total income		$1,328,117,141
Less:		
Administrative expense	$193,767,680	
Interest expense	369,453,214	
All other expenses	11,780,287	
		575,001,181
Income before provision for losses		753,115,960
Provision for losses		188,039,575
Total		565,076,385

Senator DOUGLAS. Is there anything further, Mr. Buchanan?

Mr. BUCHANAN. Nothing further.

Senator DOUGLAS. Mr. Wolcott?

Mr. WOLCOTT. No questions.

Senator DOUGLAS. Thank you very much. The committee will stand adjourned.

(Whereupon, at 4:10 p. m., a recess was taken until 10 a. m., Friday, November 18, 1949.)

MONETARY, CREDIT, AND FISCAL POLICIES

FRIDAY, NOVEMBER 18, 1949

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON MONETARY, CREDIT, AND FISCAL POLICIES,
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The subcommittee met, pursuant to adjournment, at 10:20 a. m., in the caucus room, Senate Office Building, Senator Paul H. Douglas (chairman of the subcommittee) presiding.

Present: Senator Douglas, Representatives Buchanan and Wolcott.

Also present: Dr. Grover W. Ensley, acting staff director, and Dr. Lester V. Chandler, economist to the subcommittee.

Senator DOUGLAS. Mr. Burgess, we are glad to welcome you this morning. I understand that you are chairman of the executive committee of the National City Bank of New York, member of the Federal Advisory Council from the New York Federal Reserve district, and, I believe, formerly vice president of the New York Federal Reserve Bank; so you are able to review this situation both from your present position as a private banker and your former position as a public banker or quasi public banker.

I understand you have a statement which you have prepared. I will be very glad to have you read it.

STATEMENT OF W. RANDOLPH BURGESS, CHAIRMAN OF THE EXECUTIVE COMMITTEE, NATIONAL CITY BANK OF NEW YORK

Mr. BURGESS. Senator, I might add that I have been on three sides of this triangle. I have also done some tours of duty with the Treasury from time to time, but I am speaking wholly for myself in appearing before you today.

I would like to present a very brief statement as perhaps a quick way of giving you my general philosophy about the place of the Federal Reserve System in the economy.

In today's search for economic stability we ought to reassess the position and operations of the Federal Reserve System, for I believe it can be the most powerful instrument the Government possesses for avoiding booms and busts. Properly used, it can be more effective than fiscal policy or any of the newer gadgets which have been highly advertised, but have never proved themselves.

This and other countries have today committed themselves to the principle that the Government must intervene in economic life, not only to see that the game is played according to rules that are fair for all, but also to seek to avoid sweeping instabilities which bring with them the excesses of speculation on the one hand, and the distress

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of unemployment on the other. By education and the accumulation of experience and wisdom the business and agricultural communities ought by themselves to reduce some of the causes of instability; since the war they have demonstrated their ability to do so. I am not sure it is clear what I mean by that, but it seems to me in the period since the war that business and agriculture have exercised a great deal of restraint. In the inflationary period they did not go off the deep end. The farmer paid off his debts instead of acquiring more as he did after World War I. The businessman, when prices went down in 1948 and 1949, found himself with inventories, which he liquidated, but it did not disclose serious weaknesses, which is an evidence to my mind that the business community has been learning something.

Nevertheless, Government has a duty to exert a positive influence for greater economic stability. Too often, alas, Government has been the chief offender in creating instability.

Senator DOUGLAS. Then I take it you do not object to the general thesis that the Government should exercise powers to help create stability, that your objection is to what you believe an improper use of these powers?

Mr. BURGESS. Yes; as to the use of the powers we have experimented with—we have not got the final answer yet, but we are committed definitely to the Government's intervention.

Senator DOUGLAS. You would not alter that?

Mr. BURGESS. No; I would not alter that.

Our own and other governments have tried in recent years three different methods for checking booms and depressions. One of these is establishing direct control—somebody at headquarters makes a plan of fixing prices and wages and rationing goods, general exchange controls, and what not, and compels the people to follow it.

Except in a completely totalitarian country like Russia or in wartime these methods do not work well.

Senator DOUGLAS. You would make an exception in wartime for democratic countries?

Mr. BURGESS. That is right, you have to do it in time of war.

Senator DOUGLAS. What about the period immediately following the war?

Mr. BURGESS. You have to work out of it gradually. Obviously, you cannot simply drop them immediately. Of course, anybody who goes to Europe is impressed with the fact that these controls lose their effectiveness as they go on and people find they way around them and they do not do the job.

They grow more and more difficult to enforce, and they gradually choke off the free flow of initiative and enterprise which are the lifeblood of our economic system. They are abhorrent to our democratic notions of the freedom of the individual.

The most fashionable recent idea in this country for combating economic instability is the "compensatory spending" theory. A whole metaphysics has been developed on precisely how to manage fiscal policy in a way that will stabilize the economy.

The Federal budget is of course an important economic influence, but not always a salutary one. Experience of recent years is discouraging to the belief that the budget can be so subjected to economic control that its fluctuations will become a stabilizing influence in the business cycle. According to the theory, spending should be reduced when the economic goose hangs high, and increased in depressions.

So far, about all we have succeeded in doing since this theory gained official sanction has been to increase the budget in both booms and depressions, with the notable exception, of course, of the fiscal year 1948, when we really did have a surplus.

Budgets are instruments of politics, and to make them also economic tools is asking much of human nature.

That is simply saying in other words what you yourself, Mr. Chairman, have said in these hearings: that so many people participate in these decisions that to get the thing agreed on and going one way is very hard to do.

The best practice will be to fortify insistently the old tradition that budgets are to be balanced. Circumstances themselves will unbalance them often enough despite all that can be done.

Senator DOUGLAS. Would you say budgets should be balanced in a depression period?

Mr. BURGESS. No; I think the principle is that you want your budget balanced. You recognize you cannot always do it. You plan out a balance, and your income drops away, and you find yourself with an unbalanced budget.

Senator DOUGLAS. You say you should not increase Government expenditures during a depression, and any unbalance would come from shrinkage in revenues?

Mr. BURGESS. I would not go that far. There may be occasions when you find it necessary to increase expenditures in a depression.

Senator DOUGLAS. I think the presumption would be in favor of increasing expenditures in a depression to offset the decline of private business.

Mr. BURGESS. Well, that is one of those difficult questions where we would probably mean the same thing. The thing that, of course, impresses one at this time is the extreme difficulty in getting a democracy to balance the budget, to overbalance it at the right time——

Senator DOUGLAS. You mean it is difficult to get a government to balance a budget in a period of prosperity?

Mr. BURGESS. Yes; it is difficult at any time.

Senator DOUGLAS. Now, I go with you on the principle that in prosperity the budget should be balanced, and you should have a surplus to retire a portion of the public debt; but I think that there is danger that the advocates of balancing a budget in a period of prosperity may go too far and say that you should not expand expenditures in a period of depression.

Mr. BURGESS. I think there is a danger. I do not think I differ fundamentally from you.

Senator DOUGLAS. What you are afraid of is that it will get Congressmen and economists in bad habits if they embrace the principle of unbalancing budgets in periods of depression?

Mr. BURGESS. That is right.

Senator DOUGLAS. And you are afraid of a relative system of economic ethics lest it destroy the desirability of balancing budgets in periods of prosperity?

Mr. BURGESS. So many of us do not determine our immediate actions by long-term objectives, but by rules and by what you call ethics, the ethics of a thing, and the ethics are highly in favor of a budget balance.

If we say that does not mean anything, push that old rule to one side, the danger is we go along year after year with an unbalance. In the very laudible effort to seek to control our expenditures with an eye on the economic climate, we must not give people the impression that we are just putting aside that old ethic. That is all I am arguing.

The third of the traditional methods of affecting business fluctuations is the regulation of money through changes in the supply and cost of money. History records many instances of the successful use of this instrument. For years, the Bank of England, by changes in its discount rate, or by its purchase or sale of bank acceptances or Treasury obligations, influenced the flow of funds in and out of the London market. More important still, it influenced the activity of the investment market. The Federal Reserve System now has a long history of attempts at credit control—some more, some less successful.

There are great advantages in trying to influence economic fluctuations through the money supply. In the first place, it can be done. The central banking system has the power to change the price of money and to influence the volume of money.

It can act with the decisions of a relatively small group of men. It does not have to have the number of people in agreement that you do when you deal with the budget.

The second advantage of using monetary action as a method of influencing business is that this method is consistent with democracy. You don't have to tell the individual borrower or lender what to do, but you create the conditions under which he makes his own decision. If we must have some form of Government control, the best form in all our experience is control through money, because that involves the least interference with the freedom of the individual to make his own choices in his economic life.

Any skeptic as to the power of money in any economy does well to examine the dramatic illustrations of the results of recent basic changes in money values and credit policies in Belgium, Germany, and Italy. These were extreme cases, but they revealed vividly the improvement that can follow large doses of good old-fashioned monetary medicine.

Mr. WOLCOTT. I think perhaps, when Mr. Burgess uses the term "money" here, we understand that he does not narrow it to hard money; that the term also embraces credit.

Mr. BURGESS. That is right, bank deposits, and the credit currency we all use.

Mr. WOLCOTT. I suggest that be in the record. Somebody reading the record might think he is referring to Federal Reserve notes, tens, twenties, and so on—hard money.

Mr. BURGESS. The Federal Reserve System is our mechanism in the United States for money management, and I suggest that today it offers a better hope for successful Government influence toward business stability than any of the newer products of the economic laboratories.

But, if the Federal Reserve System is to realize the high purpose for which it was created, it will require from the American people, and more directly from the Congress and from the other arms of Government, better support and cooperation in three special directions.

1. THE PRESTIGE TO ATTRACT ABLE MEN

The symbol of the standing of the System is the salaries which are paid the Federal Reserve Board. The salaries recently approved by the Congress would condemn the System to a position as simply one of many Government regulatory agencies. They should be higher.

Senator DOUGLAS. Mr. Burgess, as I remember it, in the recent top-bracket salary bill which Congress passed, we raised the salaries of members of the Board to $16,000.

Mr. BURGESS. That is right, from $15,000 to $16,000.

Senator DOUGLAS. Now, I personally wanted to raise them more than that, but the difficulty that we ran into was that there was quite a demand that the salaries of the members of the Federal Deposit Insurance Corporation should be on a parity with the Federal Reserve Board, and there was a reluctance to raise the salaries of the members of the Federal Deposit Insurance Corporation Board to $22,000; and, therefore, holding the salaries of the Federal Deposit Insurance Corporation Board to $16,000, on the principle of equality, meant keeping the Federal Reserve Board down to $16,000.

I wondered if you would comment on that.

Mr. BURGESS. I think they are all underpaid for the work that they do.

Senator DOUGLAS. Would you recommend raising the Federal Deposit Insurance Corporation Board to $22,000?

Mr. BURGESS. I would be inclined to suggest $20,000 for both the Board of Governors and, let us say, the Comptroller of the Currency and the head of the FDIC.

Senator DOUGLAS. I am not a suspicious man, but we received lots of telegrams from banking groups insisting on the FDIC being kept on an equality with the Federal Reserve.

It crossed my mind that that might be a move to keep down the salaries of the Federal Reserve. I wondered if you were at variance—whether my suspicions were entirely unjust or whether you were at variance with a large proportion of the banking fraternity on this issue.

Mr. BURGESS. I would not be able to read their minds, Mr. Senator.

Senator DOUGLAS. At any event, irrespective of what is done in the case of the Federal Deposit Insurance Corporation, you would be in favor of increasing the salaries of the members of the Federal Reserve Board?

Mr. BURGESS. I would. I think what they do is of enormous importance for the economy of this country.

Senator DOUGLAS. I notice you use the term "symbol" rather than "payment." You think that it is not so much the increase in salary but the fact that the gentlemen would have more chips and would, therefore, be indicated to be good poker players in the game of life; is that right?

Mr. BURGESS. That is a pretty good way to express it. There is a lot of protocol in Washington as well as everywhere else, and what you get is a symbol of your rating. There are some members of the Board to whom the salary does not mean anything of importance.

The other point, of course, is that it has been difficult to get members of the Board. I know of a good many cases where people declined membership on the Board, people of the sort you would like to have there. Younger men with other opportunities and a family to educate find it very difficult with those salaries.

Mr. BUCHANAN. You do feel, Mr. Burgess, that the members of the Federal Reserve Board should be compensated on a higher level than other comparable agencies, such as, for example, the FDIC?

Mr. BURGESS. I think the work of the FDIC is enormously important and might be critical in a time of emergency. But the work of the Reserve Board in terms of the broad movement of the economy is just out of the class of Government regulatory agencies which deal with special sectors of the economy. They have got the full thing to deal with, and it takes men with breadth of understanding and experience. That is my long way of saying "Yes," Mr. Congressman.

2. INDEPENDENCE OF ACTION

During the war the System necessarily became an instrument for enabling the Government to finance the war swiftly, surely, and economically. That role has been continued too long into peacetime. If the Reserve System is to act vigorously and effectively to check inflation or deflation, it must be free to take action in controlling credit volume, which will inevitably raise or lower interest rates, and hence the prices of Government securities. There can be no tightening or loosening of credit without affecting interest rates. They are the thermometer of credit.

I am one of those people who think there should be flexibility in rates and prices.

Senator DOUGLAS. I want to have you finish the next paragraph, and then I will ask some questions.

Mr. BURGESS. Neither can the Federal Reserve System be treated as just one of the political instruments of the administration. The wise Executive will yield to the Reserve System a substantial measure of independence of action so that its judgments can be objective and free from political bias. Only so can it do promptly some of the hard things that have to be done—and politically unpopular things—if inflationary tendencies are to be checked before they blossom into the booms that so often induce depressions.

Senator DOUGLAS. May I ask you some questions on those two paragraphs, because they hint at a lot of issues.

Mr. BURGESS. I come back to some of that later.

Senator DOUGLAS. Would you prefer to finish your statement?

Mr. BURGESS. Perhaps so, because I think we are wading into some very deep water.

The Federal Reserve System needs a certain measure of cooperation from other Government agencies. In the recent inflation, for example, the Reserve System and the commercial banks were conducting a vigorous campaign to resist inflationary extension of credits. At the same time other Government lending agencies were pumping out credit vigorously and freely.

The activities of these other agencies partly offset restraining action taken by the Reserve System. Some plan of coordination of the activities of lending agencies along the line of the proposed credit council, which Chairman McCabe referred to in his testimony, warrants thorough examination.

If we will act to restore the prestige of the Federal Reserve System, to give it greater independence and better cooperation from other Government agencies, I believe it does not need any new powers. It has at its command in open-market operations and the discount rate instruments of tested worth which have been used in country after country with success.

Senator DOUGLAS. Mr. Burgess, isn't the discount rate virtually obsolete as a method of control now due to the fact that the volume of paper presented for rediscount is infinitesimal?

We had testimony on the first day of our hearings that the amount of commercial paper which is rediscounted by the Federal Reserve banks is less than 2 percent of the total transactions at the banks, and I wondered if this is not just a carry-over from the original purpose of the Federal Reserve System, but which has become obsolete with the passage of time.

Mr. BURGESS. No, sir. I disagree with that point of view completely and emphatically. That point of view would imply that the importance of the discount rate was that a member bank had to pay a little more when it borrows from the Federal Reserve System. That has very little to do with the use of the discount rate.

The discount rate is an indication of what a very responsible group of people in a controlling position think about money; and, when the discount rate changes, all money rates change, not just the rates of that limited amount of paper that they deal with.

For example, the discount rate was used very effectively by the Reserve System during the past few years. They had a preferential rate of a half of 1 percent in 1945 to encourage the banks to do their job in war and postwar lending. They moved that up until you got a rate of 1½ percent.

Senator DOUGLAS. But, Mr. Burgess, the total amount of paper, as I remember it, which has been rediscounted by the Federal Reserve System, now in its vaults, amounts to $300,000,000.

Mr. BURGESS. Yes.

Senator DOUGLAS. As compared to $17,000,000,000 in Government securities and—well, what is the total volume of commercial loans outstanding by the banks? That is well over $20,000,000,000. So how would $300,000,000 affect $20,000,000,000 of commercial loans? That is 1½ percent of the commercial loans possessed by the banks not rediscounted.

Mr. BURGESS. Well, it is the marginal difference, it is the marginal straw that makes the difference in the whole thing. A change in the discount rate has frequently, if not usually, changed the rate that several million borrowers pay at their banks. The rate on some loans is tied to the discount rate, and the rate on all loans is influenced indirectly. A discount-rate change has often changed the rate which the Standard Oil Co. of New Jersey, for example, has to pay when it goes to the market and sells debentures.

My old chief, Ben Strong, used to say that the country's credit pool is one pool. You drop a rock in at one point and the ripple runs throughout the pool.

Senator DOUGLAS. If the banks are out of debt to the System, how does this rediscount rate affect the rates they charge?

Mr. BURGESS. The main avenue of contact now between the banks and the Federal Reserve is not the discount window but the Government-security window.

Senator DOUGLAS. That is the point.

Mr. BURGESS. And through that window they control the whole money market, both in terms of buying and selling; and the rate at which they buy and sell and the rate of buying and selling moves with the discount rate.

Senator DOUGLAS. That seems to me to be the center of attention, the open-market operations.

Mr. BURGESS. They go together. The open-market operations and rediscount rate are twin instruments used together.

Senator DOUGLAS. I would say one twin is of the size of Primo Carnera and the other twin is like one of Sanger's Midgets.

Mr. BURGESS. He has been wounded, but I think you will find he gives a pretty good account of himself over a period.

Senator DOUGLAS. What about changes in reserve requirements?

Mr. BURGESS. I refer to that later.

Senator DOUGLAS. Excuse me. It is always the tendency of a cross-examiner to anticipate points a witness will later develop.

Mr. BURGESS. There must be freedom and courage to use them. I am here expressing agreement with the statement by Allan Sproul, on page 156 of the committee print, and I quote just a few sentences, although the whole passage is worth reviewing:

> * * * for the type of inflationary situation through which we have just passed, I should think our present powers are adequate, provided they are used to the necessary extent.

With respect to the requests which were made for more powers over reserve requirements, Mr. Sproul said:

> A request for more powers was sidestepping the real issue, an issue which would have remained and reemerged once any new powers have been granted and put in operation.

Mr. Sproul further says:

> So long as the System cannot allow moderate changes in rates to occur—

he means interest rates—

> as a result of its decisions to ease or tighten credits, then it cannot in fact accomplish an easing or tightening of credit—

omitting a few sentences—

> A resort to special powers to increase reserve requirements would, in my opinion, only conceal or delay recognition of this central fact.

Senator DOUGLAS. Does that complete your statement?

Mr. BURGESS. That completes my statement.

Senator DOUGLAS. May I ask you to turn back to page 3, the bottom paragraph. You speak of the fact that the System during the war helped the Government to finance the operations swiftly, surely, and economically. Would you describe briefly how this was done?

Mr. BURGESS. Well, the Treasury and the Federal Reserve System, with the concurrence of the banking community—some of us were members of groups that were called in by the Treasury and the System—agreed on a general scale of rates at which the war could be financed, running from three-eights on Treasury bills up through to 2½ on bonds.

Then the Federal Reserve by its purchases in the open market stood back of those rates so that, whenever bonds were offered in the market below the prices that these rates indicated, they would buy them in amounts necessary to maintain it.

Senator DOUGLAS. Maintain the price?

Mr. BURGESS. Maintain the rates and prices.

Senator DOUGLAS. And give to the sellers credits on the books of the Federal Reserve banks which would serve as reserves?

Mr. BURGESS. They would get a Federal Reserve check which would be deposited in a bank, and that bank presents it to the Federal Reserve, and that creates credit, of course. It formed the basis for credit expansion which, of course, in some measure you had to have.

Senator DOUGLAS. Would it have been possible for the banks to have created some $70,000,000,000 of credit with which they took title to Government bonds without the cooperation of the Federal Reserve System?

Mr. BURGESS. No.

Senator DOUGLAS. So that you think this function was necessary for the prosecution of the war?

Mr. BURGESS. I agree. As a matter of fact, I was chairman of the economic policy commission of the American Bankers Association at that time. We wrote a pamphlet, which we sent to all banks, explaining just exactly the process that was called for and supporting it to the fullest extent of our ability.

Senator DOUGLAS. Now, you say that role has been continued too long into peacetime.

Mr. BURGESS. Yes, sir.

Senator DOUGLAS. I wonder if you would state why you believe that to be true.

Mr. BURGESS. We sold savings bonds to the people. Since the war the buying power of those bonds has been reduced very substantially because commodity prices have risen. It is my feeling that a somewhat more vigorous campaign of checking credit expansion could have held back that price increase in some measure.

Senator DOUGLAS. We have had the increase in prices, have we not, because during the war we had this expansion of credit with which to purchase the Government bonds, and while that increase was held back by specific controls during the wartime, when the dam finally burst you had such a quantity of bank credits available that finally it caused prices to rise.

Mr. BURGESS. I do not think anything could have been done that would have wholly avoided a price increase. There was a shortage of goods and there was a large supply of money. It is a question of degree.

The Federal Reserve System went at the problem; they appreciated what it was; they did raise their discount rate as I have said; and, working with the Treasury, the yields on short-term securities were increased.

That led to some further absorptions of these securities by corporations and others. It was my feeling, however, that more of the debt would be in the hands of others than banks if rates had been raised more rapidly. I think in this I am simply echoing what I gather to be the feeling of many people in the Reserve System.

Senator DOUGLAS. I have a chart here which shows that the yields began to rise about the middle of 1947. That is page 30 of this chart book of the Federal Reserve System, October 1949.

Mr. BURGESS. That is what I have in mind. They made an adjustment toward the end of 1947. It is known in the market as the Christmas present by the Federal Reserve System to the banks, when they dropped the support level on Government bonds by one or two points, which I think was very wise. It slowed up the process of new financing, made people who were planning investment programs—I mean business people who were going ahead with accumulating inventory or building new plants or buying machinery—go a little slower.

This was an illustration, to my mind, of what can be done, even with only moderate action.

Looking at it from the point of view of hindsight, it is my view that they could have acted a little sooner and a little more vigorously.

Mr. WOLCOTT. Do you not think that perhaps support of the bond market is a very material influence and should be included with the manipulation of the rediscount rate and operation of the Open Market Committee in respect to economic stabilization?

Mr. BURGESS. That is a big question, and, of course, it is the question, because the minute you try to put the heat on credit expansion you inevitably depress the Government market.

I have read some of Mr. Harl's testimony here yesterday. In the first place, I want to say that I think the Treasury has no obligation to hold the prices of Government bonds at par. I was the chief salesman for the Treasury in the third and fourth war loans in the New York area, where we sold as many bonds as anybody, and I can assure you that as a salesman for the Treasury we made no such commitment.

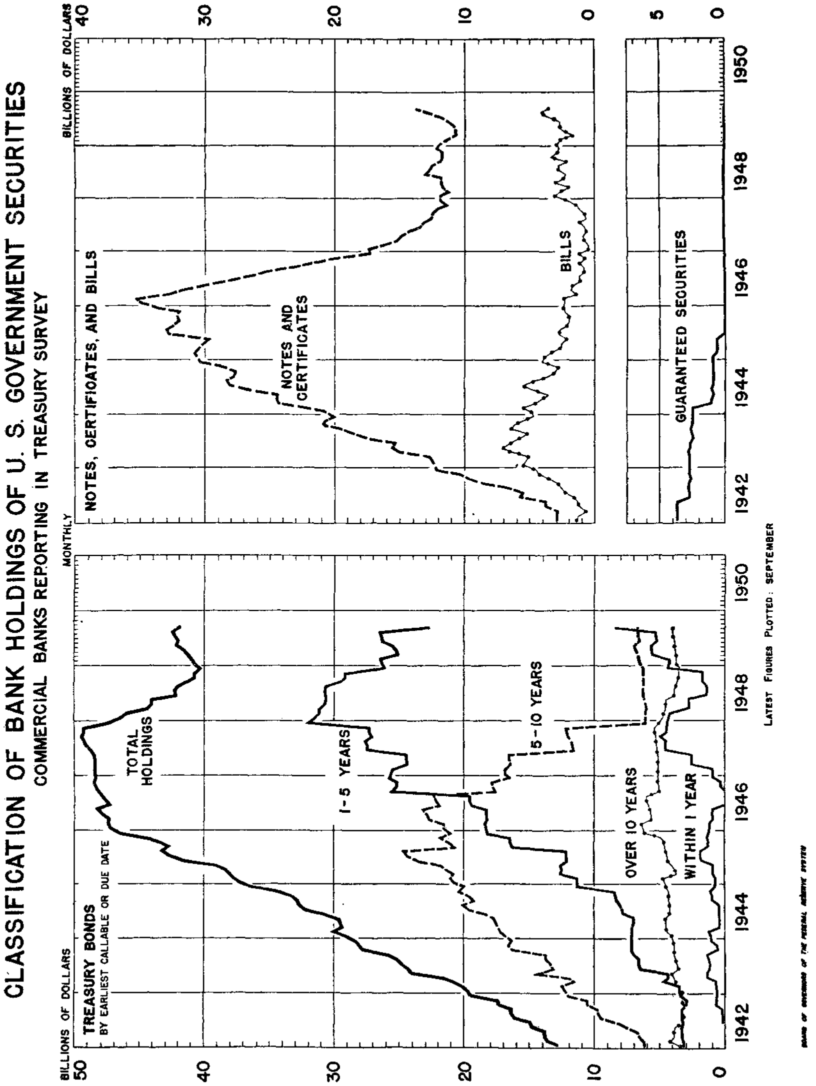
I can assure you that the banks that I know do not regard themselves as having had a commitment; when you buy a bond you take the risk of decline.

I think the facts are evident that the banks do not think they have a firm commitment. If they felt they had a firm commitment, there is no reason in the world why they should not buy all long-term bonds and get the benefit of the high yield, but they do not. Their average maturity is down around 3 years. I have the figures here in a chart from the Federal Reserve chart book. It shows the figures for a group of banks that report to the Treasury regularly. Of a total of $58,000,000,000 of Government securities held by these banks as of the end of July, $47,000,000,000 are under 5 years' maturity, and only $11,000,000,000 are over 5 years' maturity. The banks are keeping pretty close to the shore, because they know there is always a risk of changes in prices of bonds.

The other conclusion that would be drawn from these figures is, as far as a bank is concerned, a moderate decline in bond prices is nothing very serious. If our holdings are reasonably short, we are prepared to have fluctuations in the market. We think these are the best securities in the world.

Senator DOUGLAS. What about the general investing public? These bonds are widely distributed. I suppose they are more widely distributed than the bond issues of any previous war. You have virtually everyone in the United States holding Government bonds.

Mr. BURGESS. Yes.



Senator DOUGLAS. Now, if you raise the interest rate, you indirectly lower the price; or, if you lower the price, you raise the interest rate.

So your proposal in effect might well mean an appreciable decline in the price of Government bonds and, therefore, a capital loss (*a*) to individuals and (*b*) to banks.

Mr. BURGESS. Well, let's look at that one. That raises the real issue, as you suggest.

Mr. WOLCOTT. May I interrupt a moment? When you use the term "interest rate," does that embrace the yield? The interest rate does not change, does it? Yield changes.

Senator DOUGLAS. I mean, of course, the yield.

Mr. Burgess. That was part of the plan that was worked out at the very beginning of the war. The Secretary of the Treasury at that time was keenly conscious of what happened after World War I when a great many small people bought Liberty bonds and some sold them as low as 82 or 83. He was resolved that that should not happen again.

I think he was right, and there was devised this plan for the sale of savings bonds, which are redeemable by the Treasury at any time at a price above what the man paid for them. If you hold them a short time, you get less; if you hold them a long time, you get more interest.

So that our great pressure on all these drives which I participated in, was to get people to buy these bonds that were guaranteed by the Government against depression. The small man was sold those bonds. The other bonds, the market issues, were not issued in denominations of less than $500, it was very carefully planned so there should be two types of bonds sold: One, the bond for the man who is not used to investing, does not want to take a risk; the other, the market type of bonds which are bought by people who could afford to take the risk. The people who bought these market-type bonds were insurance companies, wealthier individuals, who take the risk.

Senator Douglas. The price on one goes down, and the price on the other goes down.

Mr. Burgess. The price on savings bonds cannot go down, because that is fixed by the Treasury. They are redeemable at any time at fixed prices.

Senator Douglas. What about the insurance companies?

Mr. Burgess. Well, that is a good point. In your statement you suggested the possibility of loss. In the first place, these are the best securities in the world. I think we will all agree on that. There is nothing better than the bonds of the United States Government. While they may fluctuate in value, they will be paid off at maturity in dollars at the face amount. There is no loss if you hold them.

As far as the banks are concerned, I pointed out their holdings are mainly short. Their holdings of long-term bonds are so modest that they are well within the amount that they can hold to maturity.

So, the banks can weather a very considerable change in those bonds, if necessary. So far as insurance companies go, they are holding those bonds against long-term contracts, which mature over a long period of years. They probably will never sell any substantial part of them unless they do it as a matter of policy because they can get a higher yield somewhere else.

I am on the finance committee of a large insurance company, and we are perfectly comfortable with our Government bonds, even if they fluctuate a little. The individuals who bought the bonds are perfectly able to take some fluctuations. Let's not get our attention focused solely on the dollar price of things. Let's think in terms of the buying power

Now, I say that the responsibility of the United States Government for the buying power of the savings bonds that it sold under high pressure—and I helped to do it—to the people of this country is fully as important as the cash redemption of these bonds at the price you sell them. I do not know any way of controlling credit expansion without really putting on the brakes, and really putting on the brakes means that you are going to get high money rates and feel it in bond prices, but that is part of the responsibility for keeping the purchasing power of these bonds that we have sold.

Senator DOUGLAS. How would you have the Federal Reserve System raise interest rates? I take it what you are saying is interest rates should be raised if we move into an inflationary period.

Mr. BURGESS. There is not much point in it now. Looking back to the period when prices were going up, I am suggesting that they would not have gone up so far and so fast if we had not somewhat made a fetish of this matter of maintaining Government bonds at a fixed price. It held back the Federal Reserve System from using the instruments, not just the discount rate, but open-market operations. They could not reduce their holdings. It made completely ineffective these changes in reserve requirements.

Take the case of a specific bank. When they raise the reserve requirements 2 points, it means the National City Bank has to turn $65 million of its Government securities into cash. So we go out in the market and sell them. Who buys them? The Federal Reserve System buys them and puts exactly that amount of money back in the banks. So there is no decrease in the amount of money in the market at all. It is just an exchange of ownership of those bonds, that is all.

So changes in reserve requirements are ineffective so long as the Federal Reserve System is standing there with a basket to catch all Government bonds that are dropped in at a given price.

Mr. WOLCOTT. May I follow up in that respect what I intended to earlier?

Mr. Harl yesterday expressed the opinion that he thought it advisable as a stablizing influence for the Federal Reserve to support the price of Government bonds, notwithstanding the demands upon the Federal Reserve to purchase them from the banks, the point being that in times of depression where there was a need on the part of the banks to get an unusually large amount of cash, which would otherwise affect very materially the price of bonds, notwithstanding the depths to which the bonds might otherwise go, the Federal Reserve should support them—he did not say at par—but substantially. Would you comment on that?

Mr. BURGESS. I am glad you asked that. That enables me to clarify it a little more. Here I may say Mr. Sproul's statement clarifies this whole thing very much along the lines I am saying. It happens that he and I had at different times the responsibility of administering this matter of supporting the market. I had it for some 8 years in the Federal Reserve Bank in New York, and now it is in his lap. So, we are giving you the results of our experience in dealing with the market.

Now coming to the point that Congressman Wolcott makes, with a debt of $254,000,000,000, or it may have gone beyond that figure since I looked at it, you cannot ignore that as a factor in the economic situation. The Federal Reserve System has got to take account of it.

I think it would be foolish to suggest, as the papers reported some of the statements here, that the Federal Reserve should withdraw from the market, withdraw its support. I am not suggesting that. Since Government bonds are such a tremendous factor in the whole monetary economy, there must be responsibility somewhere for their market. In the Reserve System we developed phrases that are used in distinguishing between "pegging markets" and "maintaining orderly markets."

We use those two phrases. One thing is to peg at an absolute fixed price, the other is to make sure there is always somebody there to buy at a price. In the price economy, there needs to be a buyer at a price.

The Federal Reserve System used to try in the old days, when the debt was smaller, to maintain an orderly market, and did exactly that for a good many years; they tried to see that there was a buyer at a suitable price. That way you cushion any serious decline and make sure that you cut off distress selling. In that way you keep the price declines from getting out of hand.

That, of course, ought to be done. But that is very different from standing there and taking everything anybody wants to offer you, whether he is a speculator or dealer or whoever he is, at a fixed price. Much of the buying of the Federal Reserve has, in fact, been done way above par to maintain a pattern of rates.

Mr. WOLCOTT. Would you consider it advisable for the Congress to enact the standards or the limitations upon which the Open Market Committee would be bound in the stabilization of the bond market.

Mr. BURGESS. No, sir. I think it would be impossible to phrase any limitation of that sort in such a way that you could work it out. It is a problem to be worked out within the Federal Reserve System, with the Treasury. There has been very close understanding between the Reserve System and the Treasury in recent years.

I think it is a problem of working it out, and nobody can lay down a formula which would govern it, a legal formula.

Mr. WOLCOTT. If we were to enact legislation, Mr. Chairman, that would provide that the Open Market Committee should never support the Government bond market at less than, say, 95—as an arbitrary figure—there probably would be some danger in respect to that; would there not? That might become the ceiling or the ceiling the people might expect to be put on the bonds?

Mr. BURGESS. It would either be worthless or dangerous, one or the other, because you could not anticipate the events that might occur.

Senator DOUGLAS. Is the immediate problem inflation?

Mr. BURGESS. Well, I do not know. I notice the President said yesterday that he felt the danger of recession had rather passed. I agree with him. I think that the inventory adjustments that we have been through have passed over; and, very happily, we have done it without any serious difficulty. Where we go from here, of course, nobody ever knows ahead of time.

There are both depressing and inflationary elements. I do not think the adjustment is fully completed in the capital-goods area. Farm income is likely to be a little lower, looking ahead.

On the other hand, there are definite inflationary elements in the situation, foremost among which is the unbalanced Federal budget, the plan of distributing more than 2½ billion dollars to the veterans as dividends on their insurance, spending by municipalities and States.

I am inclined to think that the inflationary possibilities are now a little stronger than the deflationary.

Senator DOUGLAS. Suppose you were a member of the Federal Reserve Board. Would you believe that the support price should be lowered at the moment?

Mr. BURGESS. The support price—there isn't any support price at the moment. They have not bought at support price for some time, and I interpret their statement of June 30 as a kind of declaration of independence, a move in exactly the direction I have been talking about.

Senator DOUGLAS. Your proposal to increase interest rates to check bank expansion of credit and, hence, increase in prices would operate through a lowering of the price at which Government bonds were purchased and, hence, an increase upon their yields; isn't that true?

Mr. BURGESS. Yes. Or they would push out some bonds. For example, the particular situation in the market today that is interesting is that the long Government bonds have been rising a bit in price, and the Federal Reserve has a huge holding of these bonds and is not selling any of them. The statement shows week after week no change.

Now, they scooped in all these bonds, and they are holding on to them. If I were a member of the Federal Reserve today, I would vote to let some of those bonds go as there was demand for them, so that the longer-term rate of interest was a little higher.

Now, those bonds are way above par. This does not involve the question of par, but the yield rate now on longer-term Government bonds is so low and the prices are so high that the market is restricted. The market is very restricted.

Senator DOUGLAS. Let me see if I follow your train of thought. You would say that the Reserve should sell long-term Government securities in the open market?

Mr. BURGESS. That is right.

Senator DOUGLAS. And that this would diminish, directly and indirectly, the reserves which member banks would have in the System, and hence reduce their lending capacity; is that true?

Mr. Burgess. That is the logic of it, but it isn't exactly what would happen, Mr. Senator.

Senator DOUGLAS. I was going to ask the further question: Would it not then be possible for banks to present these bonds back again to the Reserve System; and, if the Reserve System had the policy of buying, it would put back in the right-hand pocket deposits for the bank which it had taken away from the left-hand pocket?

Mr. BURGESS. They don't have to buy them back.

Senator DOUGLAS. No. They don't have to; but, suppose they didn't, what would happen?

Mr. BURGESS. Prices would go down a little. That is what would happen. And the whole investment market——

Senator DOUGLAS. Yields would go up; interest rates would rise?

Mr. BURGESS. Yes; interest rates would rise.

Senator DOUGLAS. How far do you think the prices of bonds would fall if the Reserve System stopped buying?

Mr. BURGESS. They can decide that almost completely. They can put those bonds down 2 points or down one point. They have almost complete control over that market.

Senator DOUGLAS. Do you feel that this is the time for putting such policy into effect?

Mr. BURGESS. Well, I don't think the situation is clear enough to pursue the policy vigorously.

Senator DOUGLAS. And you say "watchful waiting for the moment"?

Mr. BURGESS. And a little feeling out of the market.

Senator DOUGLAS. And if prices should rise by, say, 5 percent——

Mr. BURGESS. I would move sooner than that. I think they can tell sooner than that.

Senator DOUGLAS. You would say that with any appreciable increase of prices, defining "appreciable" as less than 5 percent, that the Federal Reserve System should temporarily cease buying bonds, until they depreciated in price sufficiently to raise the interest rate by X amount?

Mr. BURGESS. Well, I would have to go back over all those steps and rephrase it, but the effect is the same. I don't think that you can judge the situation completely by the price level. I think they can catch it sooner than that. If they see the volume of credit rising, due to deficit financing, and see some speculative tendencies, they may move sooner than the wholesale price or retail price reflects that change. But, in general, I think they ought to start moving a little in the direction of firmer money and restraint.

Senator DOUGLAS. What weight would you give to the presence of unemployment as an index?

Mr. BURGESS. Well, I think it has very important weight.

Senator DOUGLAS. You might have wholesale prices rise slightly, but unemployment in excess of 5 percent.

Mr. BURGESS. You could and you would have to decide where median judgment lay as to whether the economy was moving too fast or not fast enough.

Senator DOUGLAS. Do you have any bench marks in your own mind?

Mr. BURGESS. Yes. Employment is one of them; the movement of wholesale prices is another bench mark; production index; movement of security prices, stocks and bonds; stocks is an indication of the atmosphere, whether speculative or not; the movement of loans of the banks, bank loans, whether they are going up or down.

Senator DOUGLAS. When all of the indexes point in one direction, the decision is fairly clear; but when you get——

Mr. BURGESS. That is a cinch.

Senator DOUGLAS (continuing). But when you get contradictions of indexes, that is the difficult problem. If we found, for example, that unemployment had been reduced to, say, 2 or 3 percent, and production had ceased to increase, and that prices were rising, then I think it would be pretty clear that we were in inflation, and that we should check any further increase in price.

Mr. BURGESS. That is right.

Senator DOUGLAS. Suppose production is rising, prices are rising, and unemployment falling, it is still, let us say, above 3 percent or 5 percent; that is where the difficulty is.

Mr. BURGESS. That is right.

Senator DOUGLAS. Yes.

Mr. BURGESS. That is why you need such competent people in the Federal Reserve System.

Senator DOUGLAS. We are trying to get a little light on that subject, because the Federal Reserve System, after all, although it dwells in a handsome building (we hope not in an ivory tower) finds that its decisions are, in part, conditioned by public opinion.

Mr. BURGESS. That is right.

Senator DOUGLAS. These hearings perhaps, to some degree, help to build a more informed public opinion. So, we would appreciate very much your judgment on it.

Suppose production were to go up, unemployment were to fall, but would still be above, let us say, 2,000,000, and prices would be rising slightly.

Mr. BURGESS. Yes.

Senator DOUGLAS. Now——

Mr. BURGESS. And the money supply rising. If the money supply were rising, I would think that was a time——

Senator DOUGLAS. Because it would be rising faster than production?

Mr. BURGESS. Yes. That is the time, I think, to begin to firm things up a little.

Senator DOUGLAS. Even though it meant a decrease in the rate of absorbing the unemployment and the slackening in production?

Mr. BURGESS. Well, I doubt if it would mean that. I should say, if your unemployment condition were as at present, the indication would still be for "firming" because you have had a period of high employment and still have.

Senator DOUGLAS. High employment, but, if you can believe the unemployment figures, probably 3,400,000 unemployed, which is about 7 percent of the nonagricultural labor force.

Mr. BURGESS. But still below normal—isn't it?—for unemployment.

Senator DOUGLAS. It all depends on what you mean by "normal."

Mr. BURGESS. I will leave that to you; you are the expert in that field.

Senator DOUGLAS. Do you mean average, or what exists at the peak?

Mr. BURGESS. Yes.

Senator DOUGLAS. It is certainly less than full employment; let's put it that way. It is certainly less than full employment.

Mr. BURGESS. Yes. Of course, there is a tremendous lag in employment figures. They represent the result of business plans made a long time ahead. So, it isn't a very good immediate index.

Senator DOUGLAS. You see, what we would like to do is to get some of these mysterious decisions which the Federal Reserve Board makes in quiet out in the open, so that they can be appraised.

Mr. BURGESS. Yes. Well, I think they have a remarkably able research service that turns up the various factors in the business front.

Senator DOUGLAS. I have always believed that the Egyptian priests were extremely able too, but they tried to conceal all their information from the Egyptian public and make it an esoteric secret; and, therefore, I would like to have some of the elements of these decisions made public.

Mr. BURGESS. Yes. Well, I think that perhaps this chart book by the Federal Reserve Governors shows what they are thinking about. It is a beautiful job of presenting data.

Senator DOUGLAS. Do you have any judgment in your own mind as to how low the Federal Reserve Board should allow Government bonds to fall?

Mr. BURGESS. Well, there again, that is dependent on so many factors in the situation. I have felt that we have been in a period where very modest changes in credit policy have substantial effect. Periods are very different that way. There was a period during the middle 1920's when the economic situation was extraordinarily sensitive, when a change of one-half of 1 percent in the discount rate of the Federal Reserve Bank seemed to make a difference whether speculation or prices or production moved forward or backward. That is, the economy was very responsive. You take other times, like 1928 and 1929, when you put your foot hard on the brake, nothing happened.

Mr. Wolcott. How high was the rediscount rate finally?

Mr. Burgess. It went to 6 percent, I think.

Mr. Wolcott. About 7?

Mr. Burgess. It went to 7 percent in 1920. My impression is that 6 is as high as it got in 1929.

Mr. Wolcott. Is there any statutory limitation upon the amount by which they could increase the discount rate?

Mr. Burgess. None.

May I just finish this thought: In 1928 and 1929 the situation was very insensitive to Federal Reserve policy. The same was true when you were in the midst of the depression in 1932 and 1933. The System bought a billion dollars' worth of Government securities in the spring of 1932, and it had some effect, but the effect was very slow. Low money rates had very little effect in stimulating things in the early thirties.

My impression is that the present time is one where small changes make quite a difference. The market is watching the Federal Reserve very closely. At the present time I don't think you have to take any action which would result in putting Government bonds below par in order to get the effects you want. We don't have to think in terms of 95 or 99, or what have you. The situation is very sensitive. But I can see other situations where, if you got a very active inflation going, commodity prices were leaping upward, you might really want to put on the brakes.

But that is just part of the problem. The question is the objective. Is your object to stabilize money rates or is your objective to stabilize the United States economy so that you have in the long run a period of stability and good employment and sound economic activity, not sowing the seed for difficulty in the future? The latter is the objective for the Reserve System.

Senator Douglas. I think there is one point that has to be faced: namely, any such move would be criticized as a means of having the effect of increasing the earnings of the banks by giving them higher interest rates.

Mr. Burgess. I am prepared to defend that. I think that the banks are earning too little at the moment. They are earning about 7 percent on their capital fund. We are told by the Reserve System and by the Comptroller, and others, that our capital is too small. The only way we can get more capital is by earning it. Bank stocks are now selling at a discount from their book value of 20 to 25 percent, in many cases more. There are only a few banks in the country whose stocks sell at their break-up values. In other words, at the moment the market says we are worth more dead than on the hoof.

Senator Douglas. Isn't it also true that the average rate of bank earnings are appreciably higher than virtually every other line of business?

Mr. Burgess. On the contrary, it is lower than almost any other line of business. It is 7 percent on its capital.

Senator Douglas. Seven percent has always seemed to me to be quite a high rate of return.

Mr. Burgess. The bank stockholder gets a return of 3½ or 4 percent on his money. If he buys industrial stocks, he gets 7 or 8 or 9 percent.

Senator Douglas. But you get also an accumulation of surplus.

Mr. Burgess. We are putting about half away into our surplus, as other businesses are, too.

Senator Douglas. Is it not true that over a period of time—I don't know how you could make allowances for the losses during the depression, but over a period of time is it not true that bank earnings upon capital have been higher than in most other lines?

Mr. Burgess. I think exactly the opposite is true, Mr. Senator. The stock market shows it. I would like to show you a chart which shows what has happened to the bank shares in the market as compared with the shares of other companies. Bank shares have gone down steadily in relation to the rest of the market.

The test of it is that banks can't sell stock in the market. The buyers don't want them because they have such a low yield. The reasons for that are the very low interest rates and the fact that a large part of our funds are immobilized in cash because of high reserve requirements.

Senator Douglas. That is a very interesting observation. I had not thought that the productivity of capital in other areas was as high as 7 percent; and I have believed that your earnings had averaged well over 10 percent.

Mr. Burgess. The banks of the country are earning 7 percent.

Senator Douglas. Now. But have they not many times gone over 10 percent? I think it is sometimes hard to translate the Federal Reserve figures on earnings on assets into earnings on capital, but I made some computations which indicated that in a number of years it was over 10 percent.

Mr. Burgess. Net profits of the member banks in the year 1947–48 were 7.2 percent; they were 10.9 percent in only one year, 1945, when bond profits were large. For the past 10 years bank earnings have averaged 7.9 percent, as compared with over 100 percent for leading business corporations. We are told we ought to have more capital, but the market doesn't want to provide the capital, and we have to earn it. So, we pay smaller dividends. Maybe we should pay larger and push the stock up higher. But the accumulation of capital seems very important. Banks are like other business. If you are to have a sound banking system that can stand the strains and stresses, they have to earn money and have to put aside reserves and increase their capital.

Senator Douglas. I was impressed by the fact that you have not discussed the question of reserve requirements of the Federal Reserve System. I wonder if you would comment upon that.

Mr. Burgess. I will be very happy to.

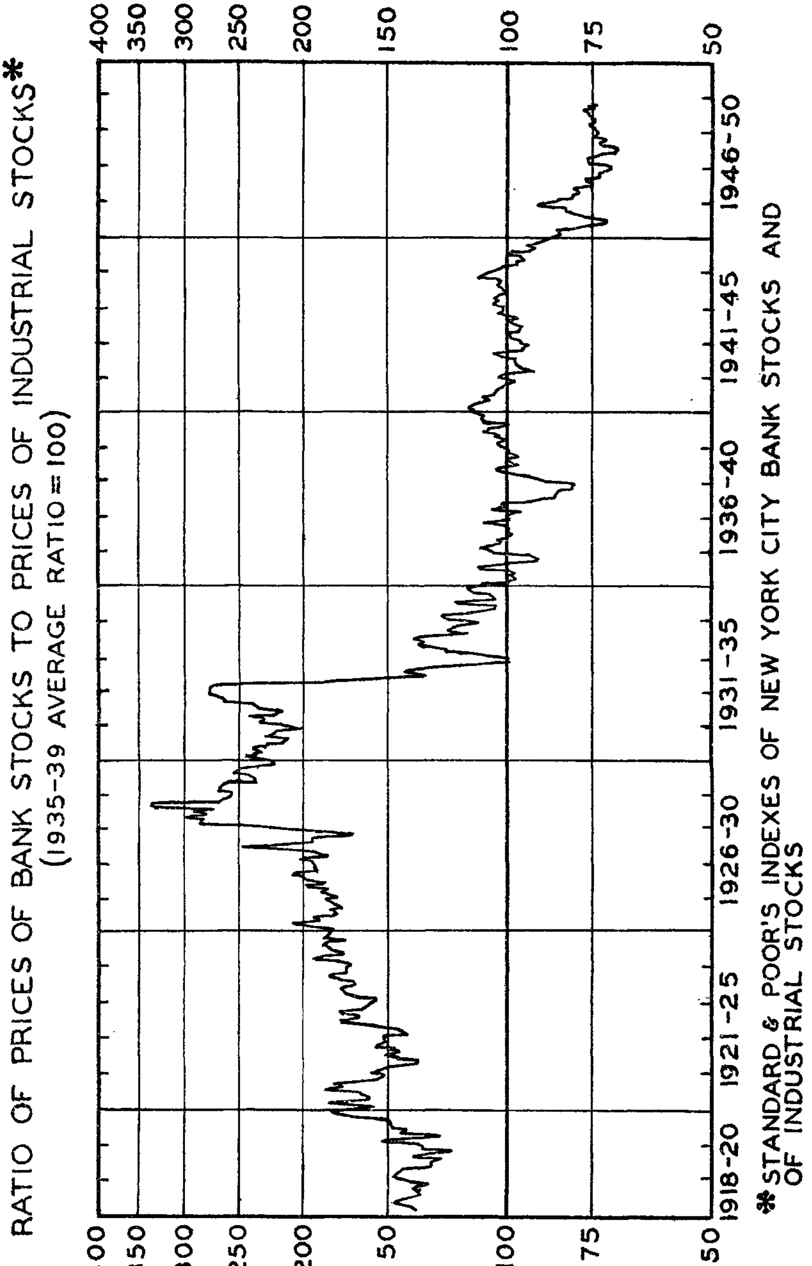
Senator Douglas. For commercial banks.

Mr. Burgess. Yes. The reserve requirements.

Senator Douglas. Yes.

Mr. Burgess. My feeling is that reserve requirements should be changed only when there is a basic change in the monetary situation.

Senator Douglas. In a period of inflation. Isn't this a direct method of control by increasing reserve requirements. You diminish the amount which banks can lend rather than merely enabling them to get a higher interest rate.



Mr. Burgess. I have already indicated that I think, as long as your Federal Reserve stands ready to buy Government securities at a price which brings increases in bank reserves, they are completely ineffective because, as you increase the reserve requirements, the bank simply takes its Government securities to the Federal Reserve bank and gets the cash to meet them; so, it doesn't make any change in the lending policy. All it does is to decrease the earnings of the member banks and increase the earnings of the Reserve bank.

Senator DOUGLAS. Doesn't that tighten the amount of credit which they can extend for other purposes to private lenders?

Mr. BURGESS. No, sir, because they can always get the credit they need from the Federal Reserve bank. They always would prefer to lend to commercial borrowers than to hold Government securities. That is our permanent business. We want to do business for our customers.

So, I would say that the changes in reserve requirements that have been made over the past few years have been almost completely ineffective; made ineffective by the policies with respect to Government securities.

Senator DOUGLAS. But is it a question of alternative policies; can you not do both of these at the same time?

Mr. BURGESS. You could, of course, and my belief is that the changes in reserve requirements should be used only rarely and for fundamental changes.

One of those took place in 1940, I think it was. We had tremendous gold imports over a long period. The excess reserves of the banks were over $6,000,000,000. The Reserve Board, Reserve banks, and the Federal Advisory Council all recommended giving the Federal Open Market Committee power to double the legal reserve requirements. I advocated it myself. That was an appropriate time. But as a method of current credit control these changes in reserve requirements are pretty painful. If you are trying to operate a bank, you need to know from month to month what money you are going to have to use. These changes in reserve requirements make it difficult to plan.

If they accomplish the purpose, of course, credit policy has to come ahead of the convenience of the banker. But, since they didn't accomplish the purpose, my belief is that the proper instruments to use were the open market and discount rate, at that time. The Reserve System now has a portfolio of $20,000,000,000 of Government securities to feed the market through open-market operations. Under those circumstances, I see no occasion for any further increase in their power to change reserve requirements.

Mr. WOLCOTT. As an example of that, what happened when the Board did increase their reserve requirements?

Mr. BURGESS. It simply resulted in a transfer of Government securities from the commercial banks to the Federal Reserve Bank in the exact amount of the change in reserve requirements. It didn't change our attitude toward our commercial borrower. We were already engaged in a very thoroughgoing and careful campaign of scrutinizing our loans and trying to resist the forces of inflation.

Mr. WOLCOTT. They asked for an increase of 10 points. We gave an increase of 4 points. Would it have made any difference had the Congress given the increase of 10 points? They didn't use their authority up to 4 points. But would it have had any psychological effect if we had given them 10 points instead of 4?

Mr. BURGESS. It would have had the psychological effect of creating fear of how these vast powers would be used. It is my view that any change was entirely unnecessary at that time. As long as the policy of pegging the prices of governments was maintained, they were completely ineffective on credit and unnecessary. They simply kept things stirred up.

Mr. BUCHANAN. This was December 1947 or 1948?

Mr. BURGESS. No; this was last summer. I mean, a year ago.

Mr. BUCHANAN. 1948?

Mr. BURGESS. The summer of 1948.

Mr. WOLCOTT. What new legislation might be necessary, in your opinion, or is any new legislation necessary, to give the Federal Reserve adequate controls over the volume and velocity of credit as it affects our economy?

Mr. BURGESS. I think they have the necessary powers already, if they feel free to use them.

Mr. WOLCOTT. Is there any statutory restriction on the use of it?

Mr. BURGESS. No; I don't think that is necessary or desirable.

Mr. WOLCOTT. Your answer indicates that they might not be free to use the powers in some particulars. Why aren't they?

Mr. BURGESS. That is largely a question of their relationship to the Treasury market. I think they have already been facing that, have taken steps to indicate they feel they have more freedom now. How far that will actually be the case when the test comes we don't know, but it is a matter of which they are thoroughly aware, where I think they have taken very wise steps.

Mr. WOLCOTT. Is it reasonable to assume from your statement that you are somewhat in favor of a higher concentration of credit control in the Federal Reserve than we have in the Government at the present time?

I perhaps should explain that a little bit and give you a little of the background for my question.

In the Legislative Reorganization Act of 1946, although the Banking and Currency Committees of the House and Senate are given the duty and obligation of exercising jurisdiction over credit policies, we find that as a consequence of the Legislative Reorganization Act the credit policies are distributed over perhaps a half a dozen other legislative committees.

Now, I was wondering if perhaps that didn't prevail in the executive establishment and among the independent agencies to a point where, if the Federal Reserve is given the obligation to stabilize our economy, perhaps we shouldn't do something to more highly concentrate the control over the issuance of Government credit as it affects our economy in the Federal Reserve?

Mr. BURGESS. Yes. Well, I think I see what you mean. That perhaps is related——

Mr. WOLCOTT. I mean this: We have the RFC, the Farm Credit Administration, the Export-Import Bank; there is a coordinating influence, of course, through the National Advisory Council, but that is purely advisory; they have no administrative function——

Mr. BURGESS. Purely with respect to their foreign operations.

Mr. WOLCOTT. Yes. You might find a situation where, when the Federal Reserve is increasing discount rates or pegging the Government bond market to prevent inflationary tendencies, other agencies of the Government might be expanding their activities and completely offsetting it.

Mr. BURGESS. Yes. I think that there is a need for coordination of some sort at that point. You have the RFC, the Federal Housing Administration—it has some new name now——

Mr. WOLCOTT. Housing and Home Finance Agency.

Mr. BURGESS. And the Farm Credit Administration, all of whom are dispensers of credit. There is no Cabinet officer, I believe, who controls all of those. They are operated with appropriations from Congress directly. What they do greatly influences what the Federal Reserve is trying to do. I think there ought to be some way of pulling that policy together. I think the suggestion for a credit council in the Treasury has a lot to commend it. I think there should be some place of meeting with the Secretary of the Treasury as the appropriate chairman where these various credit-granting agencies review their problems together in the national interest, with the chairman of the Federal Reserve Board there to indicate what the Board's policy is, so that you won't have one group of agencies running off in one direction and the Federal Reserve off in another.

Now, how much power such a council should have I am not prepared to say. I think there should be some power so that programs could be slowed down, programs of RFC lending or housing guaranteeing or what have you, could be slowed down in a period where the Federal Reserve was trying to check inflation, and speed it up in a period when you want money put out more freely.

Mr. BUCHANAN. Wouldn't the recent inflation, the situation relative to easier finance terms for housing, and the housing picture in 1948 and 1949, as the result of these easier terms, have tended to offset the deeper drop in the curve if we had followed the recommendations of the Reserve System in the Banking and Currency Committees of both sides and refused to liberalize terms in the face of a concrete shortage in the housing field?

Mr. BURGESS. I am not perfectly sure that I understand you, Mr. Congressman.

Mr. BUCHANAN. In your statement, you refer to the recent inflation.

Mr. BURGESS. Yes.

Mr. BUCHANAN. While the Reserve System was conducting a vigorous campaign to resist inflationary extension of credits.

Mr. BURGESS. Yes.

Mr. BUCHANAN. And one of the resistant proposals was, of course, to tighten up on housing financing terms.

Mr. BURGESS. Yes.

Mr. BUCHANAN. As we look back over the current recession of the past 12 months, it was the housing situation that tended to hold up above all others.

Mr. BURGESS. That carried through. Of course, you have a difficult problem of timing. In 1946, 1947, and early 1948, let us say, things were moving too fast. You wanted to hold back a little. There is no question in my mind that the cost of housing was increased for the veteran by reason of the enormous amount of money that was trying to crowd into the housing field in those years. I think the price of housing for the veteran is higher today because of the amount of money that was poured in, partly through Government channels.

Senator DOUGLAS. But the veterans are getting more houses than they otherwise would have obtained. I think that is the Congressman's point.

Mr. BURGESS. That is always the problem, to try to assess the weight both ways. That is all the more reason why there should be current consultations on this matter. You have to change policy with some rapidity from time to time. That is hard to do in a housing campaign, I realize.

Mr. WOLCOTT. Mr. Chairman, I wish that some witness—and perhaps Mr. Burgess could do it—for the record could discuss the influence of deficit financing on the value of our currency, on inflation, depression, and so forth.

Senator DOUGLAS. I think that is a very good question. I hope that Mr. Burgess in making his reply will distinguish between a period of depression in which you have idle capital and idle labor, and a period of prosperity in which capital and labor are relatively fully employed, because I think it makes a great deal of difference which period one is talking about.

Mr. WOLCOTT. I think that is true. But I don't think he should be restricted.

Senator DOUGLAS. No.

Mr. BURGESS. Mr. Chairman, I was a member of the Committee on Public Debt Policy, which spent the better part of 3 years studying that question. We have written a booklet on the subject which is now published and, I think, in your hands.

Of course, deficit financing long continued is inflationary. As it goes to the point where you lose complete confidence, then it becomes deflationary, perhaps.

Of course, we recognize the effect of deficit financing in every country that the ECA is working with. Our representatives in England and in France and in Italy have applied the greatest pressure on all those countries to bring their budgets into balance.

Senator DOUGLAS. That is because they have full employment, isn't it?

Mr. BURGESS. It is because they are creating money faster than they are creating goods.

Senator DOUGLAS. The British are not operating on deficit financing.

Mr. BURGESS. The British budget is, apparently, balanced.

Senator DOUGLAS. That is right.

Mr. BURGESS. They are going to have difficulty the coming year. They are cutting their expenses somewhat. Some of the other budgets are balanced for current operations but in deficit for special operations.

Those countries illustrate very clearly the principle that deficit financing is one of the fastest and most vigorous ways to inflate your economy and to destroy economic soundness and the prosperity of the workingman.

Our problem is that we are so rich and prosperous and productive that we can violate some of these rules for a time and get away with it. But in the long run the economic laws usually work out. So that in the long run, if we continue deficit financing over a period, I think we will pay the penalty.

Senator DOUGLAS. If we continue it in periods of prosperity as well as in periods of depression.

Mr. BURGESS. That is right.

Mr. WOLCOTT. We have been told that inflation is sometimes 90 percent psychological. If we indulge in deficit financing, there is a psychological reaction on the value of our currency before the time when it actually affects it.

Mr. BURGESS. It is very hard to untangle those two things. There are always plenty of people who are trying to anticipate what is going to happen next and move ahead.

Mr. WOLCOTT. Is it reasonable to assume that it follows as an actual consequence of deficit financing that prices and values go up and the value of the dollar goes down; in anticipation of that people start converting their savings into goods, and they create a demand which, if it becomes unusually large in proportion to the supply of goods, causes the prices to go up or the value of the dollar to go down before the deficit financing would itself cause it?

Mr. BURGESS. That, of course, is the logic of it. That is what happens. You could run into cases of people who say, "Well, the money isn't worth anything; let's spend it; let's build that house we were talking about," and so forth; but I think the figures show that for the American people as a whole they haven't taken that step; they still have sufficient faith in the dollar so they are saving a great deal of dollars; our savings accounts are going up in the banks; the people are putting money into savings bonds, building and loan associations, insurance policies, and so on; they are still saving.

Mr. WOLCOTT. When it was announced some time ago that the anticipated deficit for fiscal year 1951 might be something over 5 billion, and especially since that has been confirmed by the President's statement the other day, that we might expect a deficit of 5½ billion—which some of us believe is conservative, that it might go up to 7 billion—since that time, I think, all of the Members of Congress, although I only speak for myself, have experienced an increase in mail on that issue daily; and I think in the last week I have been asked the question at least a dozen times by people as to whether we are going to have inflation; and, if so, they are going to use some of their savings.

I have a newly rich friend who has a home that I think perhaps he paid five or six thousand dollars for, and he wants to know whether he should build a house which is going to cost him about $32,000. I explained that he was newly rich. He thinks that we are going to have inflation and that he can afford now to buy the $32,000 house with a reasonable assurance that when he gets ready to turn it over in the market he can get at least $32,000 out of it.

So there is undoubtedly some influence being brought to bear; people generally are affiliating deficit financing with inflation, although we haven't commenced to see it in volume yet; but I think perhaps after 60 days we might see much more of it and much more demand for goods.

Is that a reasonable assumption?

Mr. BURGESS. That is really what I had in mind, Mr. Congressman, in suggesting that I thought in the current situation the inflationary forces looked a little stronger than the deflationary ones.

Senator DOUGLAS. Then do I understand that you say for the fiscal year 1951, assuming that we do not move into a depression, and assuming that we get reasonably full employment, that we should strive to reduce the deficit, and, if it is possible, to balance the budget?

Mr. BURGESS. Exactly. I am sure that is right.

Senator DOUGLAS. That happens to be my own view too.

Mr. BURGESS. Yes.

Senator DOUGLAS. Mr. Burgess, you were reported in the press the other day as advocating the adoption of what was termed the gold-coin standard for this country, by which I suppose was meant that the Federal Reserve notes should be made convertible into gold, redeemable in gold?

Mr. BURGESS. Mr. Senator, I didn't say gold-coin standard. I said that as an objective of monetary policy I think we should work toward convertibility into gold.

Senator DOUGLAS. Yes.

Mr. BURGESS. I didn't say whether I felt that should be gold bullion or gold coin. I also said emphatically that I saw no occasion to change the price of gold and that it was foolish to even think about it. The dollar is the anchor of world commerce and should be held at a fixed price.

Senator DOUGLAS. The President and the Secretary of the Treasury made the same statement.

Mr. BURGESS. Yes, sir. I agree with that. I also said that it was premature to talk about domestic convertibility, that with so many of the countries of the world still in economic uncertainty, and with our own picture not fully settled down after the war, this is not the time to restore convertibility. I did say that as a long term objective I thought we should work toward it; I thought there were some things that might well be done toward that end, particularly reconsideration of the Gold Reserve Act of 1934, which appears to some people, at least, to be a little ambiguous as to the Treasury's authority with respect to the buying or selling of gold.

Senator DOUGLAS. Would you expand on that point?

Mr. BURGESS. Yes. A section of that act appears to give the Secretary of the Treasury power to buy or sell gold at any price. That has been interpreted by some people to mean that the Secretary simply by his purchases or sales of gold could change the gold content of the dollar. There is legal opinion that the Bretton Woods Act supersedes that, when it provided that nobody can change the gold content of the dollar without act of Congress. If there is an ambiguity there, after carefully examining it, it ought to be cleared up, because that is one of the surest of these insidious rumors about changing the price of gold.

Mr. WOLCOTT. If I may interject, for what it may be worth: That provision of the Bretton Woods Enabling Act was put in there definitely and with deliberation in an attempt on the part of the Congress to prevent any further increase or change in the dollar value of gold without congressional assent.

I think, and I am sure I am not speaking only for myself, that if it wasn't clearly stated in the committee report, it was intended by the members of the House Banking and Currency Committee, and I believe I can speak for them as a whole, that we could not otherwise have stability in world currencies. As Mr. Burgess has said they were anchored to the dollar, with the danger of fluctuations in the dollar value of gold. For that reason it was clearly our intent when we wrote that provision that there should not be any changes in the dollar value of gold unless the Congress approved it.

Senator DOUGLAS. Mr. Burgess was raising the question as to whether the original act did not give the power.

Mr. WOLCOTT. No. The trouble comes from the ambiguity in the Gold Act, which I think is corrected, or explained, in the Bretton Woods Agreement Act. I think it is section 3 of the Gold Act, isn't it?

Mr. BURGESS. Sections 8 and 9 of the Gold Reserve Act of 1934.

Mr. WOLCOTT. Yes; whatever it is. But the Bretton Woods Act explains and is, perhaps, in clarification of the ambiguity which appeared in the Gold Act.

Senator DOUGLAS. You think the Bretton Woods Act will make it impossible to alter the price of gold without consent of Congress?

Mr. WOLCOTT. That was clearly our intent in writing that law.

Now, how the lawyers would interpret it, I don't know, but if they interpret it as I know was the intent of Congress, whether it is expressed in such language that they would get the same interpretation or not, I don't know, but I do know that was our intent, and, from my indirect contact with the Treasury, I think the General Counsel of the Treasury has taken that attitude recently, and I think the President has made the same statement. I don't know as he made the statement, but I think the General Counsel of the Treasury has given an opinion, formal or not I don't know, that the dollar value of gold could not be changed without the consent of Congress.

So it is very apparent that they are not going to change it, notwithstanding the ambiguity and the possibility of authority.

Senator DOUGLAS. One final question which I should like to ask: From time to time the responsible officials of the Federal Reserve System imply or state that their power to control credit is restricted by the some 50 percent of the banks which are outside the Federal Reserve System and which create about 15 percent of the total volume of outstanding commercial credit, and that as long as you have this residual, with the power of State banks to secede at any time, that the Federal Reserve Board goes into the battle of stabilization with one hand tied behind its back. What do you think of that contention?

Mr. BURGESS. I don't agree with it. I think they are overemphasizing that difficulty. When I used to be with the Reserve System and made speeches about it I used to say there were in the System a third of the banks with two-thirds of the banking resources. The proportion of resources in the System has steadily increased. There hasn't at any time been any substantial defection from the System, in spite of the very large rise of reserve requirements that took place.

There again we come back to the question that you and I discussed a little, about how the policies of the Federal Reserve become effective, do they become effective because this particular member bank has to borrow at the Reserve System and finds the rate of interest a little higher, or because the Reserve System tells it to do something?

My whole belief, based on my experience, is that that isn't the way credit controls work. I quoted Ben Strong in saying that the country's pool of credit is one pool, and if you just stick your toe in at one side and start the ripples going they go right across. A credit policy is effective primarily, not so much on the loans that banks make, but in the investment markets, where people get capital, and where they make their decisions as to whether to do something a year from now or 2 years from now in the way of building a new plant and employing people.

It is the climate that you create in your money markets and your investment markets that has much more to do with changing the swings of business than your relationship with any single member bank.

Senator DOUGLAS. I think it is logical that you take this position, because you seem to minimize the effect of alterations in reserve requirements.

Mr. BURGESS. Yes.

Senator DOUGLAS. But if reserve requirements were to be an appreciable factor in controlling the supply of credit, then the fact that State banks can secede at any time and go under State laws, with perhaps less stringent reserve requirements, and therefore give them greater earning power upon a given set of assets, that might exercise a restraining influence upon the Board to use this instrument which they have in their possession, and which, if escape by member banks were impossible, they could and would use.

Mr. BURGESS. Well, of course, you can't just say there is nothing at all in that argument. I don't think there is very much. I think a little restraint on the Board in using those powers might have some merit. I don't think very much of changes in reserve requirements as a means of handling current credit problems. They are rather for meeting substantial alterations in the gold supply or similar basic changes. We advocated a change in requirement, and a very substantial one in 1940; so our record is reasonably good on that.

Senator DOUGLAS. At that time did you recommend that they be made applicable to nonmember as well as members?

Mr. BURGESS. As a matter of fact we did.

Senator DOUGLAS. Why are you opposed to it now?

Mr. BURGESS. Because of the fear of encroachments of centralized Government power. There also is a change in the situation which is that in the States the nonmember banks have been decreasing, relatively, in their assets, the members have gradually been coming into the System, and the State banking laws are becoming more adequate.

I think this committee has not had called to its attention the efforts of the American Bankers Association in this respect. We have had for a good many years a group of people, a committee, and some staff members, who have been examining the provisions of the State bank legislation and the instruments that the States have for controlling the banks that are under their supervision. We have suggested to the States a model banking code that has been adopted in many States and that provides that a State banking board, or the supervisor of banks, would have the power to apply to the State banks the same requirements, or substantially the same requirements, in terms of percentages, that the Reserve System can impose on the member banks.

In my own State, in New York State, when the Reserve System acts the State banking board gets together and they have, without exception adopted a similar change in reserve requirements for their State banks.

I would like to place in the record a resolution adopted by unanimous consent of the administrative committee of American Bankers Association on September 28, 1942, proposed by the committee on State legislation, which makes this recommendation to the States. I don't need to read it. I will put it in the record.

(The resolution referred to is as follows:)

RESOLUTION

PROPOSED BY THE COMMITTEE ON STATE LEGISLATION

Whereas in the determination of the adequacy, the control and the composition of nonmember bank reserves, it is considered preferable that the power of such determination be vested with the proper State supervisory authority; and

Whereas it is deemed further advisable that the minimum and maximum reserve requirement of nonmember banks be clearly defined by statute, and made, insofar as may be consistent, to conform with regulations of the Federal Reserve System, and that such reserves be limited to cash on hand or on deposit with reserve depositaries approved by the supervisory authority, which depositaries may include, in addition to other nonmember banks subjected to additional reserve requirements, Federal Reserve Banks or member banks of the Federal Reserve System: Therefore be it

Resolved, That the administrative committee approve in substance the report and recommendations of the committee on State legislation, and authorize the drafting of appropriate legislation to accomplish the purposes therein expressed, which legislation when approved by the legal department, shall become a part of the ABA program of approved State legislation.

Adopted by unanimous vote.

ADMINISTRATIVE COMMITTEE OF AMERICAN BANKERS ASSOCIATION.

WALDORF-ASTORIA, NEW YORK CITY, *September 28, 1942.*

Senator DOUGLAS. You say a number of the States have adopted this?

Mr. BURGESS. There are 21 States.

Senator DOUGLAS. That have adopted this standard?

Mr. BURGESS. Yes, or substantially that, which grants discretion respecting reserves to their State banking authorities, so that they can follow the Federal Reserve System. When you take account of this action it narrows down this nonmember problem to very small proportions.

Senator DOUGLAS. Are these States with large numbers of private bankers?

Mr. BURGESS. Arkansas, Connecticut, Delaware, Illinois, Kentucky, Maine, Maryland, Massachusetts, Michigan, New Hampshire, New York, Ohio, Pennsylvania. That is the list.

Senator DOUGLAS. No minimum or maximum requirement, it is purely optional upon the State board as to whether or not it is followed?

Mr. BURGESS. Optional on the State board. They have minimum requirements. They can be raised optionally by the banking authorities, I understand.

So that this type of cooperation I think is growing. I think this is a method that can appropriately be used and carried further so that this whole question of nonmember banks boils down to one of very small proportions.

Mr. BUCHANAN. California or Texas are not in the list?

Mr. BURGESS. I think not.

Senator DOUGLAS. Thank you very much, Mr. Burgess.

(Whereupon, at 12:15 p. m., a recess was taken until 2 p. m., of the same day.)

AFTERNOON SESSION

Senator DOUGLAS. Mr. Foley, will you come forward and bring with you anyone you wish to have with you?

Mr. Foley. I will have the Deputy Administrator, Mr. Fitzpatrick, at the table with me, and others from the agency will be available.

Senator Douglas. Mr. Fitzpatrick is an old friend.

Mr. Foley. I have also Dr. Husband from the Federal Savings and Loan Insurance Corporation, Commissioner Richards of the Federal Housing Administration, and Mr. Hardy, Assistant Administrator of the Housing and Home Finance Agency, and others here whom you may want to call upon for details.

STATEMENT OF RAYMOND M. FOLEY, ADMINISTRATOR; ACCOMPANIED BY B. T. FITZPATRICK, DEPUTY ADMINISTRATOR AND GENERAL COUNSEL, HOUSING AND HOME FINANCE AGENCY; FRANKLIN D. RICHARDS, COMMISSIONER, FEDERAL HOUSING ADMINISTRATION; DR. WILLIAM H. HUSBAND, GENERAL MANAGER, FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION; AND NEAL J. HARDY, ASSISTANT ADMINISTRATOR, HOUSING AND HOME FINANCE AGENCY

Senator Douglas. You have already submitted a statement for this committee, and unless you have additions which you would like to make, there are a few questions I should like to ask. I do not think it need take us too long.

Mr. Foley. We submitted answers at some length to the questions that had been sent to us, and I do not feel I have anything to add. I would be glad to try to answer any further questions.

Senator Douglas. This is the question I would like to start off with. I personally believe that one of the fine features in the Public Housing Act was the provision that the number of housing units started would vary in a countercyclical manner with the business depression; that while the average was, I believe, 162,000 a year, it could fall as low as 50,000 starts in a year of acute prosperity and rise to 200,000 in a year of acute depression.

I may say that in the bill as originally introduced, we provided a variation between 50,000 and 250,000, and it was on the motion of Senator Taft that we reduced the peak from 250,000 to 200,000.

This makes it possible, if the act is so administered, to build approximately the same number of houses over a 5-year period, which would otherwise be done, but to vary the rate of building between years so that in years of prosperity there would not be as much inflationary pressure upon the economy as a whole as there otherwise would be and that, on the other hand, during a period of depression you would have a larger volume of construction to throw into the breach, and to that degree, therefore, you would be able to check the cumulative forces of depression.

I personally believe that is a very wise provision. The question I should now like to ask is whether some similar provision should not be introduced into the FHA insurance field. At present FHA insurance is written in boom times as well as in depression times. There are those who have contended—I personally do not take too great stock in it—that the high volume of residential construction in 1948 may have contributed to the booms of that year and similarly in 1947.

If we adopt as a policy that FHA should be geared to help produce stability as well as be an end in itself, could we not approach this in two ways: First, by having FHA write insurance only in periods of depression and then to suspend its taking on new business during prosperous periods or, second, to have FHA insurance mortgages continuously but to liberalize its terms when housing activity needs to be encouraged and to tighten its terms when an inflationary boom develops or threatens.

Among the terms which could be thus varied would be: (*a*) the amount of down payment required; (*b*) the length of the period of repayment; (*c*) the amount of the insurance charge; (*d*) the basis for appraisal; and, possibly (*e*) the height of permitted interest rates.

In other words, so manipulate these terms as to encourage FHA insurance and, hence, construction in periods of depression and dampen it down somewhat in periods of prosperity and inflation.

I wonder if you would be willing to comment on that or if you want to ask any members of your staff to comment on it, we would be grateful for that, too.

Mr. Foley. I would like to comment on it, but I think my remarks would have to be general, without considerable study of the implications of both those suggestions. As between the two, I think the second suggestion would be the more practicable, if either were to be adopted.

As a matter of fact, much of the effect that your question contemplates has already been inherent in the System as applied, both in the terms of legislation as passed by Congress and in the activities of the agency in the past. I think you would have first to look at the situation we are trying to meet at a given time.

Since the war—and it has been since the war and particularly in the last 2 or maybe 3 years—discussions of this kind have arisen and we have been contending with the basic and urgent necessity for producing a very large supply of housing, as against a variety of difficulties and changing conditions. The original difficulties after the war were chiefly material and labor shortages.

That necessity has not yet passed. One, at least, of the chief causes for inflation in the price of housing after the war was the drastic shortage of housing and the tremendous and suddenly effective demand for it. So that the task we had to do was not only to build as many units as possible, but to build them insofar as possible in certain price ranges for sale and for rent, and underlying all of that to build an industry organization sufficient to carry that kind of volume through a long period of time without the various strains of competition that add to inflation.

Now, if the contemplation in either of these proposals were as against the condition of the kind that we met immediately after the war, I think you would have to give an entirely different consideration to it than you would if you were contemplating when we get into a fairly stabilized situation as a safeguard against the future.

Senator Douglas. This is an important qualification. In the year 1948 we built something over 900,000 housing units, and I am informed the record this year looks as though we are going to have approximately that number. Suppose that over a period of the next 2 or 3 years we build 900,000 units, and while I know new families are forming at a rapid rate, we get this housing development, the housing shortage may ease; is that not true?

Mr. FOLEY. The acute edge of need from the standpoint of supplying an absolute lack of shelter, yes. I think the studies made by the committees of Congress in the past several years, Senator, have been pretty thorough and have pretty well demonstrated that we need from a million to a million and a half added units per year for perhaps 10 years. Assuming no other situations that would cause inflation, I am of the opinion that production of a million and gradually in excess of a million houses a year, if they are properly distributed into types and price brackets and as to geographical locations, would not necessarily be an inflationary factor.

In other words, I think we have developed the capacity to produce materials and have developed and are developing the techniques, and the skills so that kind of production need not put a strain on the supply of either materials or men to the point that would cause inflation.

Senator DOUGLAS. A leading public figure made a speech a day or two ago setting the goal as between a million and a half and two million dwelling units a year for 10 years.

Mr. FOLEY. I would not attempt to make an exact statement any more than I think the committees of Congress in their studies would. It depends on what you are approaching as a goal in the way of total betterment or improvement in the housing situation.

Senator DOUGLAS. In other words, what you are saying is that as long as housing construction does not exceed a million units a year, you do not believe that should be dampened off even in periods of prosperity?

Mr. FOLEY. As against the further assumption I made of no other factors creating an inflationary boom, which would cause inflation in housing other than for reasons of that production.

Senator DOUGLAS. If you got to a million and a half units a year, do you think that might possibly be dampened down in periods of prosperity and accelerated in periods of depression?

Mr. FOLEY. Taking the million and a half as a figure that could be assumed to make the degree of speed in improvement of the over-all housing situation that, for instance, was contemplated in the reports of Congress, I think I might say yes.

I was going on to add that actually the operation of the insured mortgage system at present has anti-inflationary effects.

Senator DOUGLAS. I would be very glad to have you develop that.

Mr. FOLEY. That, as we pointed out at some length in our answer to your question, has been applied chiefly through the valuation and appraisal system. I do not believe it is necessary to repeat the detail we had there as to how that actually operates. I will not recite the successive stages of application, imperfect I grant you, but pointing to the possibilities and the trends of thought in application of the insured-mortgage system.

The fundamental philosophy in the whole insured-mortgage system, except the emergency types of title VI, has been in itself an effort to apply the financing aids involved in insured mortgages in an anti-inflationary way in a sense that the more liberal types of insurance have been made available in the lower price fields, so that the incentive furnished through the financing aids to the industry has been downward, away from an inflationary increase in prices.

Again, of course, it has not worked perfectly, but that has been the philosophy under which it was set in title II and section 203 and originally in section 207 in the rental field, although not nearly so closely applied there.

The emergency type of financing, beginning in the defense period, carried on through the war, lapsed and then renewed for the veterans' program after the war, got away from the valuation theory to the current cost, first a reasonable current cost and then a necessary current cost; so that that philosophy was only imperfectly applied.

I think the general effect of the basic philosophy of the permanent phases of the mortgage-insurance system is in the direction of an anti-inflationary influence upon the market.

Senator DOUGLAS. You mean because the appraisals are based not on present cost but upon what the expected normal sales value will be?

Mr. FOLEY. Yes; and in normal times the amount of mortgage funds available in a large-volume market is an important factor in determining sales price and controlling sales price.

Senator DOUGLAS. How much under cost have you been insuring houses?

Mr. FOLEY. I am not sure I understand your question, Senator.

Senator DOUGLAS. You say you have been making your appraisals on the basis of expected normal sales value, which is lower than current costs in a period of inflation.

What I was trying to find out is how much under has it been on the average.

Mr. FOLEY. That would depend on the scale. For instance, if the insurance is under title II, the possible maximum mortgage would range from 95 percent of appraised value down to a maximum of 80 in certain types.

Senator DOUGLAS. But what is the relationship of appraised value to cost?

Mr. FOLEY. That is what I was coming to. The distinction between title II and title VI, in which necessary current cost was recognized on the for-sale side until, I think, 2 years ago and on the for-rent side until now, with certain qualifications, is that you did not have an appraisal of value but rather a determination of necessary current cost.

Now, the sale price of housing on which insured mortgages are placed is not fixed by the Government. It is fixed by the seller.

In times of a strong seller's market, there may be a wide variance, a very large down-payment required. In times of what becomes more a buyer's market, your sales price is more likely to approximate the appraisal fixed by the FHA.

As of now, I am not sure I could give you any close idea. Perhaps Mr. Richards could tell you what the current experience on sales prices against our valuation is. Do you have any such information, Mr. Richards?

Mr. RICHARDS. During the period that was referred to the variations would range, I would say, from 5 to possibly 30 percent or more, according to the area. During the last year, of course, the line or difference between current cost and appraised value has been coming closer and closer together, due to these many factors; and I would say in the majority of instances today, all other things being equal, such as your not trying to build a larger house in an area than the area will absorb, and that sort of thing, that the difference between long-term value and reproduction cost is very little or approximately the same in a great number of areas throughout the country.

Mr. Foley. But the Senator, I think, wants to know if you can give some estimate of what it is currently.

Mr. Richards. That is what I say.

Senator Douglas. You think the two are identical?

Mr. Richards. Virtually so, all other factors being equal insofar as the house being a suitable house for the area, and so forth.

Senator Douglas. You expect present costs to reflect almost precisely future values?

Mr. Richards. Virtually so. There is very little difference between what we construe now to be current costs and long-term mortgage value.

Mr. Foley. That is assuming you would allow estimated replacement costs.

Mr. Richards. Yes.

Mr. Foley. Costs vary with different buildings on the same house. The cost estimation has to be made typical.

Senator Douglas. In other words, do I take it that you think this suggestion should not be seriously considered until we get a much larger volume of building than we now have?

Mr. Foley. I think the suggestion is well worthy of study. I do not think it is susceptible of a simple answer of "Yes" or "No" at this time. I think we can and do apply the FHA-insured mortgage system generally in the direction of trying to hold down an undue inflation of prices, but there are so many factors in the consideration such, for instance, as the suggestion for varying the amortization terms.

That becomes a very complicated question, and I do not think a yes-or-no answer on the question of whether it should be varied for anti-inflationary purposes—in fact, shortening it might have the effect, perhaps would have the effect, of reducing the amount of construction.

It might, however, have the effect of reducing the amount of construction in the very fields where you want to focus your limited amount of construction at that period; so it is a complicated question, I think an important question and a significant one, but I think it would require much more study than would be possible to answer "Yes" or "No" now.

Senator Douglas. In our questionnaire, which you were kind enough to reply to, we asked as one of the queries: What legislation would you recommend for the purpose of increasing FHA's contribution to general economic stability?

You responded, as I remember it, with two recommendations. The first recommendation was to place on a permanent basis the program for home improvement. The second of your recommendations I shall read in full:

> To provide the President with authority to terminate or reinstate emergency insurance program on an economically sound basis, depending on the economic conditions prevailing in the Nation. Such authority would provide a degree of flexibility in the administration of the insurance programs which would increase the FHA's contribution to general economic stability. The success of the emergency insurance program during the defense period, war, and postwar periods

testifies to their effectiveness in meeting the housing needs of the Nation. By meeting the housing needs of the Nation a significant contribution can be made to general economic stability.

I found that interesting but somewhat general, and I wondered if you could describe more fully the kind of authority you believe should be given to the President.

Mr. FOLEY. The suggestion was made as against the background of title VI, which we mentioned there as having served a very useful purpose in defense, wartime, and postwar. The history is very interesting in that the number of times that it had to come before Congress for renewal, consideration, amendment, change to meet changing conditions, current conditions; for instance, it had expired and then was renewed or reestablished to take care of the veterans' emergency housing program after the war.

During the past year, I forget how many extensions there have been, but it has been a stop-and-go proposition all the time. It had to be brought up and considered by Congress as to whether it should go on, and Congress has determined each time that this was a need and that it should go on. Then it would be extended perhaps for a few months, 6 months, or 1 month, depending again on the Congress.

That has made an extremely difficult situation, not only for the administrative agency but for the building industry as to making plans for even a single building season.

What was contemplated in that suggestion and limited rather to that one consideration, since that is the only emergency program that we have had to deal with, was that such an authority, if it were coupled with an authority for the President to say it shall go on or it shall stop or it shall stop and be revived within an over-all period that Congress had originally determined——

Senator DOUGLAS. In other words, Congress would authorize for a longer period of time, with the President given discretionary powers to start or terminate within that period.

Mr. FOLEY. Perhaps within other maxima and minima broadly set forth, so that it could be applied flexibly by the President.

Senator DOUGLAS. Could your suggestion not be combined with the suggestion I have just previously made, that administrative officials be given power to vary the terms according to the state of business conditions? Could not the two suggestions be combined?

Mr. FOLEY. If the first suggestion were to be adopted, I think the variants of it suggested here would be desirable.

Senator DOUGLAS. President Truman recently stated that the Federal National Mortgage Association has been accumulating insured mortgages at a rapid rate, I think around a hundred million dollars a month. I wonder if you would explain the purposes of FNMA, the reason why its mortgage purchases are so large at the present time and the types of mortgages which have been acquired.

Mr. FOLEY. The Federal National Mortgage Association was originally established in pursuit of the program for a national mortgage association set-up in title III of the National Housing Act originally back in 1934, I think, the original contemplation being they would be financed privately to deal in insured mortgages, particularly as a secondary market to furnish an avenue of liquidity when needed by the initiators thereof.

Senator DOUGLAS. In other words, it was designed to play the same part for building and loan associations which the Federal Reserve banks had been designed to play for the commercial banks?

Mr. FOLEY. No; I think that is hardly the parallel, since it was designed to serve all approved mortgages of the system, which might be building and loan associations, banks, mortgage companies, insurance companies, etc.

Senator DOUGLAS. To do for real-estate financing what the Federal Reserve banks were supposed to do for commercial banking?

Mr. FOLEY. It was part of the declared plan or purpose in the act for the establishment of a national home mortgage market, seeking to make that security, a mortgage on a loan, a standard security, the insurance being one of the factors in making it that.

It was furnished that avenue of liquidity for lenders that needed it from time to time as perhaps their portfolio filled up and they had demands for home loans and no funds; so they could dispose of the mortgages they had made, if insured.

It also was designed to be and did operate successfully as a sort of way-station for the gathering, packaging, and disposing of mortgages to private investors in the secondary mortgage field. It worked very successfully on that basis all through the thirties and during the war and early postwar period. It works very successfully on that basis now.

I should add that subsequently this market was broadened to include the guaranteed mortgages of the Veterans' Administration as well as the insured mortgage of the FHA. There is, of course, a definite difference and distinction between insured mortgages of the FHA and the common type of VA guaranteed mortgage, which is under section 501.

Senator DOUGLAS. How do you account for the recent transfer of so many mortgages from the building and loan associations to the "Fanny May" [FNMA]?

Mr. FOLEY. To start with, Senator, at the time that I am talking about, when the Federal National Mortgage Association market was used more sparingly than it is now, it was never on a perfectly level basis, it changed in its volume as conditions changed, the availability of funds, and so on, but at that period and during the war period the demand for mortgage funds was much less. We had a total production far below what we now have, perhaps as low as a quarter during the war of what we now have. So that the opportunities for investment of mortgage funds were much more limited, and there was stronger competition for getting them and premiums actually were paid for them, even by the originating mortgagee as well as the secondary mortgagee.

Now, you have a volume calling for readily available, current, rapid flow of mortgage funds to sustain upward of a million-house production. You consequently have local situations frequently in which a portfolio of a bank or a savings and loan company gets too full of mortgages, cannot continue to meet the need locally; so they have the necessity to dispose of some. The private secondary market does not absorb them sufficiently rapidly, and so they go to the Federal National Mortgage Association.

You have also in that picture a greater activity on the part of a nonportfolio type of mortgagee than you used to have. That is the mortgage company as distinguished from the bank or savings and loan association.

They have served a very useful purpose, but they must have a rapid turn-over of their portfolio if they are going to continue to loan; so they seek more frequently the Federal National Mortgage Association as a quick and assured outlet. There are other factors of the relative desirability of mortgages.

Senator DOUGLAS. On page 222 of the committee print, Mr. Hise stated that as of the present, "Fanny May" held 55,000 FHA insured mortgages totaling approximately $390,000,000; 41,500—and I am giving this to the nearest rough figure—VA guaranteed mortgages, total amount of $247,000,000; and in addition had outstanding contracts to acquire additional mortgages—namely, a little over 18,000 FHA mortgages, amounting to $346,000,000; 52,000 of VA mortgages, amounting to $376,000,000.

So, if you add those totals together, you get approximately $735,000,000 of FHA mortgages and about $650,000,000 of VA mortgages, or a total of $1,400,000,000.

Now, apparently that has been growing very rapidly.

Mr. FOLEY. That is right.

Senator DOUGLAS. Have you ever awakened in the middle of the night and wondered whether possibly sour mortgages were being unloaded upon you?

Mr. FOLEY. I think one would never be in the situation of the Federal National Mortgage Association or any other purchaser of mortgages without being aware of the necessity of wondering whether you are going to have mortgages go down.

Senator DOUGLAS. Perhaps I used the wrong pronoun, because of course "Fanny May" is not under your direction.

Mr. FOLEY. That is right. I knew you meant in the broad sense, but I do not think it is to be deduced from the fact that this volume of mortgages is being offered that it in any way implies that the mortgages might be called sour in the sense that they would be unsafe and go bad more than others.

There are other factors. Interest rates are one, the matter of the application of standards in the construction of the houses is another, as to why at one or another time a given type of mortgage may not be attractive to private lenders in the secondary market in the volume necessary to sustain this over-all production.

Senator DOUGLAS. I am told that I am very indiscreet in the way I ask questions. I hope you will forgive me.

I asked Mr. Gunderson, who represents the RFC yesterday if he could explain why such large quantities were being sold to "Fanny May" [FNMA] or RFC.

At first he said he could give no explanation, and then he thought that possibly the real estate lending agencies thought the interest rate was going to rise and that they wanted to divest themselves of this type of security in order to have liquid funds to invest at a higher rate of interest. That seemed acceptable to me at the time, and then during the night I got to thinking it over, and I wondered if possibly they were not sorting out their mortgages and taking those mortgages which they thought were perhaps a bit overinsured and turning them over to "Fanny May."

Mr. FOLEY. Of course, I am not familiar with all details of the portfolio nor the current handling or offerings made to the Federal National Mortgage Association. It would be interesting to examine a list of the exact offerings for a current period.

I think you would find, Senator, that they are not being presented that way. I think you would find, for instance, that from certain types of institutions a very considerable percentage of their current loans are offered not on a selective basis but as made and without the idea of selecting this one as better than that one or that one being a little worse than the others.

I think that has been the experience during the past 2 years, and I think you will find it so now.

The increase of offerings very lately is probably due in considerable part to the expansion of the mortgage authority of "Fanny May" [FNMA] to 100 percent as against the 50 percent limitation that existed before. I would not believe from any information that we have that it is a selective offering of what they consider poorer mortgages from the standpoint of risk. They may be poorer mortgages from the standpoint of——

Senator DOUGLAS. They are insured by FHA and, therefore, the holder would have no chance of losing.

Mr. FOLEY. I think a little more exactly than that. From the standpoint of the risk of there being a foreclosure likely to take place, they may be less desirable from the standpoint of yield or some other reason to the particular institution involved. I think it is a little bit early to draw conclusions as to what the present flow of mortgages into the "Fanny May" may really mean. It may well be that their sales plan or effort to dispose, which is now under way and beginning to acquire some momentum, I understand——

Senator DOUGLAS. Not too much momentum.

Mr. FOLEY. Not at present, but it may well be that within six months the situation in the investment market will be such that sales will develop rapidly. I think it is too soon to come to a final conclusion as to the meaning. The question of yield is involved.

Senator DOUGLAS. Suppose they were to turn out sour. Then "Fanny May," one Government agency, would have claims against the FHA, another Government agency.

Mr. FOLEY. And against VA. It would make no difference as far as the claim is concerned, however, since if they had not been sold to the Federal National Mortgage Association and resulted in a foreclosure, the claim would come from a private holder rather than from the Federal National Mortgage Association.

Mr. WOLCOTT. May I ask a question?

Senator DOUGLAS. Yes, sir.

Mr. WOLCOTT. The bank or savings and loan association or mortgage association which sells the mortgage to "Fanny May"—what do they get as a service charge? Is it 1 percent?

Mr. FOLEY. The original mortgagee who keeps it and services it, I think their present rate is a half percent allowance.

Mr. WOLCOTT. Then let's work this out in a case. I gave a bank a mortgage on my house, which is FHA, which I agreed to amortize over a period of time. That bank sells the mortgage to "Fanny May"; I continue making my payments to the bank; the bank reimburses

"Fanny May"; there is a servicing charge there that they make, isn't there, representing "Fanny May? Is that the one-half of 1 percent?

Mr. FOLEY. "Fanny May" pays them a service charge. You do not pay that.

Mr. WOLCOTT. That is right. They get one-half of 1 percent service charge.

Mr. FOLEY. Yes.

Mr. WOLCOTT. Now, the reason why there was an adjustment in "Fanny May" operations was perhaps not primarily due to but was influenced by the fact that there were a few—and I know of a very few—mortgage-investment concerns which sprang up and organized on a shoestring and were selling their mortgages without recourse to "Fanny May," and in that way there was direct financing by the Federal Government of a good many builders, some of them had perhaps controlling shares in these mortgage associations.

Now, I am making this as a statement, but I hope it will be interpreted as a question, because I am seeking information.

Perhaps there is another or a third reason why there has been this increase in sales of mortgages to "Fanny May." That is, that when the mortgagee sells a great enough volume of mortgages to "Fanny May," which he services and is getting one-half of 1 percent on, it becomes quite a profitable business to him. That is my question in the form of a statement.

Mr. FOLEY. The question, as I get it, is whether or not he is making the mortgages with a view simply to establishing a servicing business which will be profitable in itself and using the existence of the publicly financed secondary market as an easy avenue to do that. I doubt that many mortgage institutions have engaged in the mortgage business with sales to the Federal National Mortgage Association primarily to establish a servicing account, although the servicing ascount, if it gets large enough, can be a profitable business.

Unless they continue in operation, it will gradually decline. I think it has probably been an incidental cause in an unknown number of cases, that type of lending institution.

Senator DOUGLAS. The Hoover Commission recommended that "Fanny May" be transferred from the RFC to your agency. Is it an unnecessary question to ask you if you favor that?

Mr. FOLEY. In the sense that if it were unnecessary I would have said "Yes," or that you would assume I would say "Yes"? As a matter of fact, the matter has been discussed many times in the course of various recommendations for reorganization; and actually in some legislative proposals of 2 years ago—S. 866, I believe—it was proposed; and we testified in favor of the establishment of the Federal National Mortgage Association in the housing agency. I am familiar with the answer of the RFC to that question.

Senator DOUGLAS. Which was "No."

Mr. FOLEY. And from the standpoint of the reasons they advanced, if those were the only factors under consideration, I would probably agree with them. As a matter of fact, I do not think it is possible to separate the operation so entirely from the character of an agency concerned with housing as to describe it solely as a financing and investing firm.

So that, in the face of the type of conditions we confront and may continue to confront, while I am not at this time recommending a transfer, I would not give an unqualified "No" to it, such as has been given.

Senator DOUGLAS. Do you remember Dickens' novel, David Copperfield?

Mr. FOLEY. Barkis is willing?

Senator DOUGLAS. Do you have any such implications?

Mr. FOLEY. I would not say "Yes" to all the implications. His explanation of it, as I recall it, was that when he said that he was really very anxious.

Senator DOUGLAS. It amounted to a marriage proposal.

I was not quite certain what this diplomatic reply of yours boiled down to.

Mr. FOLEY. At this point what I am saying is that I would not go along with the answer of the RFC to the extent of saying "No; it should not be considered," because at this point I think the operation is one that cannot be considered strictly and solely as a financial operation.

Senator DOUGLAS. You do not say "No," but do you say "Yes"?

Mr. FOLEY. I say that, if present conditions continue and we have to continue to rely as heavily upon a secondary mortgage market as we apparently now do, I think we should give serious consideration to incorporating it in the agency.

Senator DOUGLAS. Those are all the questions that I had.

Mr. Wolcott?

Mr. WOLCOTT. I do not think I have any.

Mr. FOLEY. I have tried to be as responsive as I could. I hope it has been helpful.

Senator DOUGLAS. Thank you very much.

Gentlemen, I should announce for the benefit of the press that we open our hearings again on Tuesday, and in the morning at 10 o'clock Mr. Marriner Eccles, now member and former Chairman of the Board of Governors of the Federal Reserve System, will testify; at 2 o'clock in the afternoon Mr. E. E. Brown, chairman of the board of the First National Bank of Chicago, will testify.

(Whereupon, the committee adjourned at 3 p. m., to reconvene at 10 a. m., Tuesday, November 22, 1949.)

MONETARY, CREDIT, AND FISCAL POLICIES

TUESDAY, NOVEMBER 22, 1949

Congress of the United States,
Subcommittee of Monetary, Credit,
and Fiscal Policies,
Joint Committee on the Economic Report,
Washington, D. C.

The subcommittee met, pursuant to adjournment, at 10:00 a. m. in the caucus room, Senate Office Building, Senator Paul H. Douglas (chairman of the subcommittee) presiding.

Present: Senator Douglas (chairman of the subcommittee) and Representative Wolcott.

Also present: Dr. Grover W. Ensley, acting staff director, and Dr. Lester V. Chandler, economist to the subcommittee.

Senator Douglas. Mr. Eccles, we are very happy indeed to have you with us this morning. We were glad to get the expanded statement of Chairman McCabe, which I suppose represented official Federal Reserve policy on the matters which we raised in our questionnaire, and I assume that may have been one of reasons why you as an individual did not submit a reply to our questionnaire. But we are happy to welcome you here this morning, and I understand that you have a statement which you would like to give first. I think perhaps I should say for the record that you are here on our invitation and not on your solicitation.

STATEMENT OF MARRINER S. ECCLES, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Mr. Eccles. I would like to comment on your observation. The reason I did not reply to the questionnaire is that I understood, as did the rest of the Board members, that it was submitted to Chairman McCabe as a personal matter, and I did not see the questionnaire, nor have I seen the replies. The replies to the questionnaire, as Chairman McCabe indicated, were his views and not necessarily those of the Board. I would not say, however, that there may not be a lot of agreement on the Chairman's replies, but at the same time there may be some different points of view and some disagreement. I appreciate this opportunity, Chairman Douglas, to appear before your committee.

Mr. Chairman, I am here, as you know, in response to the invitation in your letter of October 31, 1949, to discuss issues that have been raised during the study initiated by your subcommittee in the field of monetary, credit, and fiscal policies. I shall be glad to try to answer such questions as may be uppermost in your mind, but I should like first to present for your consideration a short statement which I hope may anticipate and answer some of your questions. My views are the cumulative results of 15 years of participation in developing and carrying out policies of the Federal Reserve System, preceded by long experience in private banking under State as well as National authority and membership in the Federal Reserve System.

I therefore could not fail to be aware of the vigorous opposition that has so often been voiced against new proposals with respect to Federal authority over banking. In recent years it has seemed that nearly every recommendation emanating from the Federal Reserve Board has been assailed as a threat to destroy the dual banking system. As one who has spent his business life in that system, I have been unable to see the justification for such agitation.

Our commercial banking system is composed of banks that receive deposits subject to withdrawal upon demand, make loans, and perform other services. About half of the total dollar amount of bank deposits are insured up to $5,000 for each depositor by a Federal agency, the Federal Deposit Insurance Corporation. Banks holding 85 percent of the resources of the banking system are in the Federal Reserve System, another Federal agency. Approximately 5,000 of these banks operate under Federal charters, issued by the Comptroller of the Currency, and about 9,100 operate under charters from the 48 States. This is the dual-banking system.

Senator DOUGLAS. May I interrupt a minute? And, of the 9,100 State banks, about 2,000 are in the Federal Reserve System?

Mr. ECCLES. That is correct.

Senator DOUGLAS. About 7,100 outside?

Mr. ECCLES. I do not know the exact figure, but I think it is less than 7,000 that are outside, between 6,000 and 7,000.

While I am sure that those who are its most vociferous supporters would not seriously contend for the abolition of the Federal Reserve System, with the consequent restoration of the intolerable conditions that prevailed before its establishment, they nevertheless constantly oppose measures that would enable the Reserve System to be far more effective in carrying out its intended functions—functions that help to protect not only all banking but the entire economy.

Two proposals, more than any others, stir up this agitation. One is the proposal for the equal application of a fair and adequate system of reserve requirements to all insured commercial banks. The other proposal is that the Federal Government apply the principles and objectives of the Hoover Commission to the Federal agencies concerned with banking, monetary, and credit policy. Bankers believe in the objectives of the Hoover Commission, at least as applied to all other activities of the Government—why not the banking activities?

The red herring of the dual banking system is always brought up to obscure the real merits of the fundamental questions involved in the proper administration of fiscal monetary, and credit policy, which concerns commerce, agriculture, industry, and the public as a whole; it is by no means the sole concern of bankers.

The major responsibility of the Federal Reserve System is that of formulating and administering national monetary policy. It does this chiefly through the exercise of such influence as it may bring to bear upon the volume, availability, and cost of commercial bank reserves. It must operate through the commercial banks of the country, because they, together with the Federal Reserve banks, are the institutions through which the money supply is increased or decreased. It is of paramount importance to the entire country that someone have the means as well as the ability to discharge this responsibility. It cannot be left to the voluntary choice of some 14,000 individual and competing banking institutions. It cannot be split up among the various agencies of the Federal and State Governments. The framers of the Federal Reserve Act undoubtedly intended that it should be in the Federal Reserve Board under the direct control of Congress.

Others have pointed out that existing bank reserve requirements are inequitable, unfair, and ineffective at the very time when they are most urgently needed to restrain excessive expansion of bank credit. They should not depend as they do now on whether a bank is located in a central Reserve city or in a Reserve city or whether it is outside of one of these cities or away from its downtown area, nor should they depend on whether a bank is a member or a nonmember. There is no good reason for such distinctions from the standpoint of effectuating monetary policy.

Senator DOUGLAS. May I interrupt a minute? Are you suggesting, therefore, that you should have one set of reserve requirements and abolish the present distinction between central Reserve cities and country banks?

Mr. ECCLES. That is right.

Senator DOUGLAS. That is one set across the board?

Mr. ECCLES. That is right.

Senator DOUGLAS. For banks wherever located?

Mr. ECCLES. The next paragraph will cover that, I think.

In addition to other handicaps of membership, members of the Federal Reserve System are subject to much more onerous reserve requirements than nonmember banks. Member banks are required to carry certain percentages of their demand and time deposits in non-interest-bearing cash balances with the Federal Reserve banks. Apart from these required reserve balances, member banks necessarily carry some vault cash to meet deposit withdrawals, and in addition they carry balances with correspondent banks, none of which can be counted toward statutory reserve requirements. On the other hand, nonmember bank reserve requirements not only are generally lower in amount but may also consist entirely of vault cash and balances carried with city correspondents. In some instances reserves of nonmember banks may be invested in United States Government and other specified securities. Thus to a considerable extent nonmember banks may receive direct or indirect compensation for a substantial part of their reserves. These discrepancies are most obvious and difficult to explain when two banks, one a member and the other not, are doing the same kind of business as competitors on opposite corners of the same town. Member banks therefore bear an undue and unfair share of the responsibility for the execution of national credit policy.

There should be a plan under which the responsibility for holding reserves to promote monetary and general economic stability would be as fairly distributed as possible. This would require a fundamental revision of the existing basis for bank reserve requirements. They should be based on the nature of depoits rather than mere location; they should be somewhat higher upon interbank deposits than upon other demand deposits. Vault cash should be given consideration because it has much the same effect as deposits at reserve banks.

In any such revision of reserve requirements, it is of primary importance to take into account the fact that they are a means of contracting or expanding the liquidity position of the banking system and of making other credit instruments more effective. Reserve funds of banks may expand through large gold inflows or silver purchases, or return of currency from circulation, or borrowing from Reserve banks, or Federal Reserve purchases of Government securities through necessary open-market operations. There should be sufficient authority over reserve requirements to permit taking such developments into consideration when necessary.

There is widespread misunderstanding even among bankers of the function of reserve requirements as a means of expanding or contracting the supply of bank credit. In sharp contrast with State reserve requirements, those applied to member banks under the Federal Reserve Act are primarily designed to affect the availability of credit; that is to say, the money supply. The Federal requirements are not primarily applied for the purpose of providing a cushion to protect the individual bank. They are not basically reserves in that sense at all, and incidentally the Reserve banks do not and cannot use them to buy Government securities, as most of the bankers seem to think.

The Federal Reserve System is a creature of the Congress. You can make it weak or you can make it strong. We have recited to the Congress over and over again the dilemma that we face. It is perfectly simple. So long as the Reserve System is expected to support the Government bond market and to the extent that such support requires the System to purchase marketable issues, whether sold by banks or others, this means that the System is deprived of its only really effective instrument for curbing overexpansion of credit. It means that the initiative in the creation of reserves which form a basis on which credit can be pyramided rests with banks or others and not with those responsible for carrying out national monetary policy. To the extent that banks or others can at will obtain reserves, they are thus able to monetize the public debt. In view of this situation, if the Congress intends to have the Reserve System perform its functions, then you should by all means arm it with alternative means of applying restraints. The only effective way to do that is through revision and modernization of the mechanism of reserve requirements. The Congress will not have done the job at all if it fails to include all insured banks. Reserve requirements that are limited only to member banks of the Federal Reserve System impose upon them a wholly unfair and inequitable burden which becomes the more intolerable as the need arises to increase reserve requirements as a means of curbing overexpansion of bank credit. Of course, organized banking and its spokesmen, chiefly large city banks, do not want any change. They never do.

Throughout the long history of banking reform in this country—and it is still very far from complete—the same bankers or their prototypes have been for the status quo. Beginning with the National Banking Act, they have fought every progressive step, including the Federal Reserve Act and creation of the Federal Deposit Insurance Corporation. If you abide by their counsels or wait for their leadership, you will never do anything in time to safeguard and protect private banking and meet the changing needs of the economy in such a way as to avoid still further intrusion of the Government into the field of private credit, to which I am really very much opposed—an intrusion which the public has demanded in the past because private banking leadership failed.

I may add that whenever Congress sees fit to enact into legislation the principle of equitable reserve requirements applied uniformly without regard to membership in the Federal Reserve System, there might well be changes in other relations of the Federal Reserve System which would be of benefit to all commercial banking, as, for example, to offer the credit facilities of the Reserve banks on equal terms to all banks which maintain their reserves with the Reserve banks, together with further improvements in the check-collection system. These and other beneficial changes could well be brought about with great advantage to banks and to the public in general.

The rôle of the Reserve System in relation to Government lending to business also should be clarified. This is particularly important to the functions exercised in that field by the Reconstruction Finance Corporation and with respect to the authority of the Reserve banks to extend credit to industrial enterprises under section 13b of the Federal Reserve Act. The latter should be modified as proposed in S. 408, the bill favorably reported by the Senate Banking and Currency Committee in 1947, and the enactment of which was again recommended by the Board in 1948.

There is unquestionably a need for such an agency as the Reconstruction Finance Corporation in emergency periods for direct Government lending for projects outside the field of private credit, but I have always taken the position that the Government should not compete with or invade the domain of private banking and credit institutions. When aid is necessary to facilitate the functioning of private credit, then such aid should take the form of guaranteeing in part the loans made by private institutions, just as was done in the V-loan program of the Federal Reserve for financing war production. That is what S. 408 proposes. The profound difference in the principle at stake here ought to be obvious.

In relation to the second question, that of organization, which I mentioned at the outset, I feel that students of government, and particularly those who endorsed the objectives of the Hoover Commission, ought to be more interested than they appear to have been in the problems of organization of the agencies of Federal Government concerned with bank supervision. Some, however, may have been misled into thinking that there is no problem in this field because the expenses of these agencies are not paid from governmental appropriations.

The establishment of a system of insurance of deposits by the Federal Government was one of the great accomplishments of the Congress in the direction of fostering public confidence in the banking system. I favored Federal deposit-insurance legislation at a time when most of my fellow bankers were denouncing it. But I never expected, and I am certain Congress never intended, that this protection for depositors would be used either to hamper effective national monetary policy or to give any class of banks special advantages over others. I regret to say that the Federal Deposit Insurance Corporation has been used to discourage membership in the Federal Reserve System and to weaken effective monetary policy.

There is no logic whatever in the present provisions of law, which say, in effect, to a bank, "You can't joint the Federal Reserve System unless you also join the Federal Deposit Insurance Corporation, but you can join the Federal Deposit Insurance Corporation without joining the Federal Reserve System." The law compels a national bank to join both, but a State bank has the option of joining one or the other or neither. I should like most earnestly to urge upon you the importance of making this a two-way street by providing that a bank can be a member of the Federal Reserve System without joining the Federal Deposit Insurance Corporation, in the same way that a State bank is now privileged to be a member of the Federal Deposit Insurance Corporation without being obliged to join the Federal Reserve System.

Senator DOUGLAS. Mr. Eccles, may I ask a question there? Is this a counterattack which you are proposing that the Federal Reserve System make——

Mr. ECCLES. It is a logical answer to some of the comments.

Senator DOUGLAS. Are you serious about this?

Mr. ECCLES. I have proposed a uniform system of reserves. Certainly, if there is not to be a uniform system of reserves, the Federal Reserve System is weakened, and its position can only be maintained by having a two-way street as proposed. In other words, it seems to me that, unless you have uniform reserve requirements, then certainly this proposal here is an alternative that should be taken into account, not as a counterattack for the purpose of any destructive effects, but merely, as it seems to me, a necessary piece of legislation so that the Federal Reserve is in a position at least to protect itself or to defend itself.

Senator DOUGLAS. This might be a very effective means of bringing the Federal Deposit Insurance Corporation and some of its supporters into line with your proposal for uniform reserve requirements.

Mr. ECCLES. I would hope that would be the result.

Senator DOUGLAS. But if it were not the case, do you think this proposal of yours would strengthen the banking system as a whole?

Mr. ECCLES. I do not think it would hurt it.

Mr. WOLCOTT. Would it strengthen it?

Mr. ECCLES. No; I do not know that it would strengthen it. I think there may be some member banks that would decide they would not need Federal deposit insurance just as there are many State banks now that have decided they do not need the Federal Reserve as long as they have Federal deposit insurance.

I think some of the bigger banks may well say that as members of the Federal Reserve they do not need FDIC.

Senator DOUGLAS. Do you think that Federal deposit insurance has lowered the value of a bank belonging to the Federal Reserve System?

Mr. ECCLES. No; I do not think so. I favored FDIC. Neither do I think that membership in the Federal Reserve System would lower the standards of a bank which is a member of the FDIC.

The Federal Deposit Insurance Corporation was designed in the public interest, and it should be maintained for that purpose; but this is not to say that the continued existence of three Federal agencies performing similar or allied functions in the field of bank supervision, regulation, statistical, and other services is justifiable. There is unnecessary duplication and triplication of offices, personnel, effort, time, and expense. While the maintenance of separate and often conflicting viewpoints may serve selfish interests, on the old principle of "divide and conquer," it seems to me that this should not prevent improvements wherever possible in the organization of a Government already overburdened with complexity and bureaucracy.

In this connection various suggestions as to where responsibility should be lodged for the examination of banks subject to Federal supervision have been offered, ranging from the setting up of a new agency with no other responsibility to maintaining the status quo.

The Reserve System must have currently accurate information, procured through examination, bank condition reports, special investigations, constant correspondence, and contacts with the banks. The System must have examiners and other personnel responsible to it, specially trained and directed for the purpose of procuring such information. The Reserve System is in position to determine policies to be pursued by examiners, to coordinate them with credit policies, and at the same time decentralizes the actual administration by utilizing the facilities of the 12 Reserve Banks and their 24 branches. They examine all State member banks, receive copies of examination of all national banks, are in close touch in this and in other ways with all member banks, as well as the State and National supervisory authorities.

Through their daily activities of furnishing currency, collecting checks, seeing that member banks maintain their reserves, and extending credit to them, the Reserve banks obtain current information about banks which is invaluable for purposes of bank supervision. The Federal Reserve is and must be at least as vitally concerned with the soundness of the individual bank as anyone in the organization of the Comptroller or the Federal Deposit Insurance Corporation. The Federal Reserve Act places in the Federal Reserve a specific responsibility for effective supervision over banking in the United States. Soundness of the individual bank and soundness of the economy must go hand in hand. Therefore, Federal Reserve concern with the maintenance of stable economic conditions should be and is in the interest of sound banking as well as the public welfare. It has not destroyed the effectiveness of Federal Reserve supervision over State member banks, and it is absurd to think, as I understand has been suggested to you, that it would destroy the effectiveness of supervision or examination of other banks. Moreover, is it reasonable to believe that the intelligence of the officials of the Federal Reserve banks, combined with the judgment of a seven-man board appointed by the President, confirmed by the Senate, responsible to the Congress, should be regarded as less independent than a bureau in the Treasury under one official whose deputies are appointed by the Secretary of the Treasury? No single individual in the Federal Reserve System determines its policies.

Since examination supplies information essential to the right conduct of the business of the Reserve System and since the Reserve authorities must review reports of examination of all member banks, it is illogical to argue that they should be deprived of all examination authority. Examination procedure is a tool of bank supervision and regulation which should be integrated with and responsive to monetary and credit policy. If directed as though it were not concerned with such policy it could nullify what otherwise could be effective monetary and credit policy. In fact, too often in the past, bank examination policy became tighter when conditions grew worse, thus intensifying deflation, and conversely examination policy has gone along with inflationary forces when caution was needed.

Only one of the three Federal supervisory agencies, the Federal Reserve System, is charged by Congress with responsibility over the supply and cost of credit, which is directly affected by reserve requirements, discount policy, and open-market operations. The Reserve System views the economic scene principally from the standpoint of national credit conditions as effected by monetary, fiscal, and related governmental policy. Other agencies do not have these responsibilities. Their differences of interest often lead to prolonged discussions which delay or prevent agreements.

Let me turn now to the question of the composition and responsibilities of the Board of Governors and the Open Market Committee, which committee is composed of the seven members of the Board plus five Reserve bank presidents. The New York bank has one of those five, and the position is continuous. The other banks rotate in their membership on the committee.

I do not suggest that the present system has not worked. It was a compromise and your committee is interested, and properly so, in the question whether the present structure could be improved. I feel that I should point out its defects and how they could be remedied.

While the Board of Governors has final responsibility and authority for determining, within statutory limitations, the amount of reserves that shall be carried by member banks at the Federal Reserve banks, for discount rates charged by the Federal Reserve bank for advances to member banks, and for general regulation and supervision of the lending operations of the Reserve banks, the responsibility and authority under existing law for policy with respect to the Government security market, known as open-market operations, is vested in the Open Market Committee. These operations have become an increasingly vital part of Federal Reserve policy. In practice they are the principal means through which debt-management policies of the Government are effectuated. They are the means by which an orderly market for Government securities is maintained. With the rapid growth of the public debt, chiefly as a result of wartime financing, with the continuance of a budget of extraordinary size, with major refunding operations in view and the prospect of deficit financing, there can be no doubt of the responsibility that will continue to rest with the Federal Reserve System for open-market policy .

Suggestions have been made and I believe will appear in answers to your questionnaire, with a certain degree of logic in their support, that the interrelations between the considerations of policy governing open-market operations and those governing reserve requirements, discount rates, and perhaps other functions, are such as to justify transferring these major instruments of policy to the Federal Open Market Committee, leaving to the Federal Reserve Board as such only matters of secondary importance. This would not justify the continued existence of a seven-man Board of Governors. To the extent, however, that such suggestions recognize the principle that responsibility for over-all credit and monetary policy should be fixed in one place, I would agree. On the other hand, they accentuate the major inconsistency in the present set-up.

It should be noted in this connection that the president of a Federal Reserve bank is not a director of that bank but is its chief executive officer. He is elected for a 5-year term by a local board of nine directors, three of whom are appointed by the Board of Governors and the other six by the member banks of the district. In addition to making the appointment, the directors fix his salary. Both of these decisions are subject to approval by the Board of Governors. Neither he nor the directors of the bank have any direct responsibility to the Congress, or the administration, for that matter.

When a Reserve bank president sits as a member of the Federal Open Market Committee, however, he participates in vital policy decisions with full-time members of the Board of Governors, who are appointed by the President of the United States and confirmed by the Senate and whose salaries are fixed by Congress. Those decisions, which must be obeyed by his bank as well as by the other Federal Reserve banks, affect all banking. So far as I know, there is no other major governmental power entrusted to a Federal agency composed in part of representatives of the organizations which are the subject of regulation by that agency. President Woodrow Wilson expressed himself very vigorously on this subject when the original Federal Reserve Act was under consideration. If this principle is not to be discarded, it follows that further inroads should not be made into the functions of the Federal Reserve Board and on the other hand that responsibility for open-market policy should be concentrated in the Board. I am convinced in this connection that there is no need for more than five members, instead of seven as at present, and that the Congress should recognize by more appropriate salaries the great importance of the public responsibilities entrusted to the Federal Reserve System, of which the Federal Reserve Board is the governing body. Such recognition would be more likely to attract to the membership of the Board men fully qualified for the position.

If, however, it is believed preferable for national credit and monetary policy to be determined in part by some of the presidents of the Reserve banks, then the presidents of all 12 Reserve banks should be constituted the monetary and credit authority, and they should take over the functions of the Board of Governors, which body should be abolished. The governmental responsibility of such a body should be recognized by requiring their appointment by the President of the United States and their confirmation by the Senate; their salaries should be fixed by Congress, to whom they should report. May I point out that if the presidents of the Reserve banks can, in addition to performing their manifold duties as chief executive officers of these very important institutions, take on in addition the principal functions of the Federal Reserve Board, it must be that these functions do not justify a full-time seven-man Board, and this would be another reason for abolishing it, and substituting a part-time Board composed of the 12 presidents.

You would have to add, of course, an administrator and a proper staff in Washington, and you would possibly have to add committees made up from the 12.

I am offering this seriously. This is not a counter-proposal. This is a serious proposal based upon the experience that I have had in Washington over a long period of time.

Senator DOUGLAS. Is this your first choice or is your first choice the abolition of the Open Market Committee and the lodging of powers of the Open Market Committee in the Federal Reserve Board?

Mr. ECCLES. Well, I would be pretty neutral on that. I think either would work. I think it is largely a question of placing responsibility in a governmental body, whether it be the President's or whether it be another board. I think either would work. I would be neutral.

Senator DOUGLAS. But you would prefer either to the present set-up?

Mr. ECCLES. I would.

The views I have expressed have developed out of a long experience in and out of Government and they have not been altered by the fact that I have ceased to be Chairman of the Board after serving in that capacity for more than 12 years or by the fact that I expect sometime to return to the field of private banking.

In the foregoing I have not attempted to include some other important matters which may be of interest to the committee in its deliberations and might well be considered by a national monetary commission, such as that proposed in S. 1559 which I strongly support. Accordingly, I would appreciate it if you would permit me to file a supplemental memorandum for the record in the even that it appears to be desirable to do so in order to complete my statement.

Senator DOUGLAS. Thank you very much, Mr. Eccles. Of course we will be glad to have you file a supplementary statement. I want to thank you for your very interesting testimony.

(The following supplementary statement was later furnished by Mr. Eccles:)

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
December 1, 1949.

Hon. PAUL H. DOUGLAS,
United States Senate, Washington, D. C.

DEAR SENATOR DOUGLAS: In connection with my testimony presented on November 22 before your committee, I indicated that I had not attempted to include in my statement some important matters which may be helpful to the committee. You granted me the privilege of filing a supplementary statement should that appear desirable.

In the course of my testimony you asked if it would serve a useful purpose if Congress were to instruct the Treasury further as to the policies to be followed in debt management where they are dependent upon the monetary policies of the Federal Reserve System. You also stated that you would appreciate it if you could get some suggested standards of an instruction that might be given to the Treasury by Congress with reference to Treasury relations with the Federal Reserve.

Since presenting my testimony I have given a great deal of thought to this subject. In reading over the record of my remarks, it was apparent to me that I had not responded as fully as I could have to some of your questions. Therefore, I should like to take advantage of the privilege of making a supplementary statement.

A very fundamental dilemma confronts the Federal Reserve System in the discharge of the responsibilities placed on it by Congress. The System has by statute the task of influencing the supply, availability, and cost of money and credit. In peacetime, the objective is to do this in such a way that monetary and credit policy will make the maximum possible contribution to sustained progress toward goals of high employment and rising standards of living. Federal Reserve System powers for carrying out this responsibility are at present basically adequate. But the System has not, in fact, been free to use its powers under circumstances when a restrictive monetary policy was highly essential in the public interest. It has been precluded from doing so in the earlier postwar period in part because of the large volume of Government securities held by banks, insurance companies, and others who did not view them as permanent investments. Reasons for supporting the market under these conditions I have already presented before your committee.

This policy of rigid support of Government securities should not be continued indefinitely. The circumstances that made it necessary are no longer compelling. But the Federal Reserve would not be able to change these policies as long as it felt bound to support debt-management decisions made by the Treasury, unless these were in conformity with the same objectives that guide the Federal Reserve. The Treasury, however, is not responsible to Congress for monetary and credit policy and has had for a long time general easy-money bias under almost any and all circumstances. As long as the Federal Reserve policy must be based upon this criterion, it could not pursue a restrictive money policy to combat inflationary pressures.

Decisions regarding management of the public debt set the framework within which monetary and credit action can be taken. As the size of the debt grew through the period of deficit finance in the thirties and particularly over the war period, Treasury needs came to overshadow and finally to dominate completely Federal Reserve monetary and credit policy. When the Treasury announces the issue of securities at a very low rate pattern during a period of credit expansion, as it did last Wednesday, the Federal Reserve is forced to defend these terms unless the System is prepared to let the financing fail, which it could not very well do. To maintain a very low rate pattern when there is a strong demand for credit, the System cannot avoid supplying Federal Reserve credit at the will of the market.

Under these conditions it can hardly be said that the Federal Reserve System retains any effective influence in its own right over the supply of money in the country or over the availability and cost of credit, although these are the major duties for which the System has statutory responsibility. Nor can it be said that the discount rate and open-market operations of the System are determined by Federal Reserve authorities, except in form. They are predetermined by debt-management decisions made by the Treasury. This will be true as long as the System is not in a position to pursue an independent policy but must support in the market any program of financing adopted by the Treasury even though the program may be inconsistent with the monetary and credit policies the System considers appropriate in the public interest.

The Federal Reserve System was established by Congress primarily for the purpose of determining and carrying out credit and monetary policy in the interest of economic stability and is responsible to Congress for that task. There is a seven-man Board of Governors, appointed for 14-year terms with approval of the Senate. The Board is assisted by an experienced and highly qualified staff of experts. There are 12 presidents of the Federal Reserve banks, each with a staff of specialists, and each Federal Reserve bank has a board of directors composed of leading citizens in its district drawn from professional, business, farming, banking, and other activities. There is also the Federal Advisory Council, composed of a leading banker from each of the 12 districts, established by Congress to advise the Board. All of these supply information and advice and many participate in formulation of monetary policies appropriate to the needs of the economy.

Under present circumstances the talents and efforts of these men are largely wasted. Views of the Federal Reserve Board and Open Market Committee regarding debt-management polices are seldom sought by the Treasury before decisions are reached. The System, however, has made suggestions on its own initiative to the Treasury in connection with each financing, but very often these have not been accepted. Decisions are apparently made by the Treasury largely on the basis of its general desire to get money as cheaply as possible.

In a war period or a depression, there is reason for financing a deficit through commercial bank credit—that is, by creating new money. The Federal Reserve System has supported such financing at very low rates by purchasing Government securities in the market at such rates, thus pumping the needed reserves into the banking system. In the early postwar period some support was desirable, especially for the 2½-percent long-term bonds, but it should not have been as inflexible as it was for short-term rates.

The outlook at the present time is for an expanding economic activity with high employment. We also now anticipate a Government cash deficit of over $6,000,000,000 in the calendar year 1950. It would be inexcusable to finance this deficit at very low rates of interest by creating new money should inflationary pressures resurge. But if the Treasury, under these conditions, insists on continuation of the present very low rates, the Federal Reserve will have to pump new money out into the economy even though it may be in the interest of economic stability to take the opposite action. In making a cheap money market for the Treasury, we cannot avoid making it for everybody. All monetary and credit restraints are gone under such conditions; the Federal Reserve becomes simply an engine of inflation.

With respect to the problem of how future monetary and credit policies are to be established, it seems to me Congress must choose from the following three general alternatives if the present dilemma confronting the Federal Reserve System is to be resolved:

(1) Congress can permit the present arrangement to continue. The Treasury would control in effect the open market and other credit policy as it does now by establishing such rates and terms on its securities as it pleases, with the requirement that the Federal Reserve support them. It should be recognized that under this course, limitations over the volume of bank credit available both to private and public borrowers, and accordingly limitation over the total volume of money in the country, would be largely given up. Such credit and monetary restraint as might be required from time to time to promote economic stability would be entirely dependent upon the willingness of the Treasury to finance at higher interest rates, and in the past the Treasury has been resistant to doing this. If this alternative is followed, which is the present arangement, Congress should recognize that the responsibilities for monetary and credit policies are with the Treasury and not with the Federal Reserve System and that the principal purpose of the Federal Reserve System is then to supply additional bank reserves on the demand of any holder of Government securities at rates of interest in effect established by the Treasury.

(2) The Congress could provide the Federal Reserve System with a partial substitute for the open market and discount powers which debt-management decisions of the Treasury have rendered and can continue to render largely useless for purposes of credit restraint. Some measure of control over the availability of credit under inflationary circumstances could be regained if the System were given substantial additional authority over basic reserve requirements of the entire commercial banking system. With such authority, the System could, if necessary, immobilize new bank reserves arising from a return of currency from circulation, gold inflows, and System purchases of securities from nonbank investors and thereby prevent the multiple expansion of the money supply. In addition, the System would need authority to require banks to hold a special reserve in Government bills and certificates. This would be necessary in case banks entered upon an inflationary credit expansion through the sale of Government securities to the Federal Reserve or in the event it was necessary to assist the Government to finance large deficits without creating additional bank reserves which serve as a basis for multiple credit expansion.

(3) Congress, if it wishes credit and monetary policy to be made by the Federal Reserve System in accordance with the objectives of the Federal Reserve Act and the Employment Act of 1946, could direct the Treasury to consult with the System in the formulation of its debt-management decisions in order that these decisions may be compatible with the general framework of credit and monetary policy being followed by the System in the interest of general economic stability. It is obvious, of course, that Government financing needs must be met and the responsibility of the Federal Reserve to insure successful Treasury financing must continue to be fully recognized. But Treasury financing can be carried out successfully within the framework of a restrictive credit policy, provided the terms of the securities offered are in accordance with that policy.

To sum up briefly my views, I believe that Congress should fix clearly the responsibility for national monetary and credit policy. Although the Federal Reserve System was established as an agency of Congress for determination of monetary and credit policy, as it must function now it is responsible both to Congress and to the Treasury for that policy. These two responsibilities are often conflicting, and both cannot be satisfactorily discharged. The responsibilities and authority of the System need clarification and for that purpose one of three alternative actions might be taken by Congress:

(1) Recognize in the statute that responsibility for monetary and credit policy is with the Treasury and recognize the Federal Reserve for what it is today—an agent for advising the Treasury and carrying out monetary and credit policy determined by the Treasury.

(2) Give the Federal Reserve System such additional authority over bank reserve requirements as would adequately serve as a partial substitute for discount and open-market powers.

(3) Give the System a mandate to determine monetary and credit policies on the basis of guide posts stated in terms of the language of the Full Employment Act of 1946, with the Treasury required to advise and consult with the Federal Reserve and take into account the mandate of Congress in connection with its debt-management decisions.

I recognize that monetary or credit policy by itself cannot assure economic stability. It should be accompanied by a fiscal policy, as well as a bank supervisory policy, in harmony with it.

I appreciate very much having the opportunity to express my views on this matter.

Sincerely yours,

M. S. ECCLES

Senator DOUGLAS. Now, Mr. Eccles, I take it that the three main methods by which the Federal Reserve System attempts to control the general supply of money and credit are first, rediscount; second, open-market operations; and third, the reserve requirements which the Board can impose on member banks; and I would like to ask you whether you think the rediscount powers under the present conditions of banking furnish any appreciable strength to the Reserve System.

Mr. ECCLES. By themselves, practically none.

Senator DOUGLAS. We had testimony last week which indicated that the total amount of commercial paper rediscounted by the System and held by the Federal Reserve banks amounted to less than 2 percent of the assets of the System.

Mr. ECCLES. So long as the banking system owns such a large amount of Government securities, and there is an immediate market for those securities, banks have little or no use for the rediscount facilities, and therefore the discount rate by itself is not effective.

The discount rate may have some psychological effect, but it must closely adhere to the Open Market Committee's buying rate on short-term Government securities. Otherwise, it would be considered a penalty rate, and would not be used at all to the extent that the buying rate on short-term securities is very close to or below the discount rate.

The banks, in order to meet their reserve requirements, which in the Reserve city and central Reserve city banks are figured on a weekly basis, will sometimes borrow over-night funds, perhaps for 2 or 3 days, rather than go through the market. The sale and the repurchase of securities contains an element of cost in the commissions that they have to pay in the buying and the selling.

If, however, the discount rate is substantially higher than the buying rate, of course, banks will buy and sell bills and certificates to adjust with their reserve position.

Senator DOUGLAS. Now may I ask some questions about the open-market operations which imply not merely the purchase of Government securities by the System, in order to build up the reserves and therefore to expand credit, but I take it also it was at least originally intended to imply the sale of Government securities in order to reduce the member bank reserves and therefore curtail expansion. That is true, is it not?

That is a preliminary question. Then I was going to follow that up. Is that statement correct?

Mr. ECCLES. If the banks have excess reserves, and the System does not sell its Government securities, that is, the Open Market Committee does not sell out of its portfolio of Government securities, then the banks would bid up the prices of Government securities; interest rates drop, and an exceedingly easy-money situation develops.

An example of that occurred when the emergency authority of the Board to increase reserve requirements was permitted to lapse on the 1st of July. The banking system immediately received very substantial excess reserves. The Open Market Committee did not sell securities in the market, and as banks endeavored to invest their funds the bill rate, which was approximately one and an eighth, went down to three-quarters within a week's time or less. Certificate rates dropped accordingly and bond prices went up. In order to keep the short-term rate from practically going to the vanishing point, the System then permitted the sale of sufficient securities to absorb the excess reserves.

Let me put it this way: The money market banks as well as most of the Reserve city banks generally maintain practically no excess reserves with the Reserve System. They immediately invest any excess reserves that they have in short-term Government paper, almost irrespective of the rate. It has been definitely demonstrated that it is impossible to maintain more than about three-quarers of a billion of excess reserves, which are maintained largely by what are known as the country banks—smaller banks throughout the country.

Reserves are supplied through gold imports, the return of currency and Treasury operations which put funds into the market. The Treasury may also take funds out of the market, as would an increase in currency or a loss of gold. `Variations in reserves through all of these immediately affect the short-term rate.

Senator DOUGLAS. Well, I take it that you believe that during the period of expanding prices, and a period in which there is a tendency toward inflation, one way of checking this would be, if it could be made effective, for the System to sell Governments in the open market and thus draw down the——

Mr. ECCLES. It cannot be made effective.

Senator DOUGLAS. That is the next point I was coming to. But if it could be made effective, that is what you would like to have done?

Mr. ECCLES. Oh, yes; if the banks or the public would buy securities out of the portfolio of the System, that would be fine.

Senator DOUGLAS. That would draw down the reserves and therefore diminish the lending power?

Mr. ECCLES. Yes; but there are not any reserves during those periods. What really happens is that not only the banking system but nonbank holders, such as insurance companies and investors, generally may sell Government securities. The only market for the securities during those periods is the Federal Reserve, and System purchases, of course, monetize the public debt. Every dollar's worth of securities that the Federal Reserve buys, whether from banks or otherwise, adds to the total deposits of the banking system and the reserves of the banking system upon which a multiple expansion of credit can be created. What would be required under the conditions which you have indicated would be not that the Federal Reserve, the Open Market Committee, sell securities in the market, but that it withdraw from the market and refuse to buy.

Senator DOUGLAS. Well, now, that was the next point. Are you saying that the weapon of the open-market operations has been virtually made inoperative to check inflation because of the readiness of the System to buy unlimited quantities of Governments at relatively pegged prices?

Mr. ECCLES. That is correct.

Senator DOUGLAS. And that as long as the banks can take bonds, go to the Federal Reserve System, sell them and get reserves, that the process of selling to them is taking money out of one pocket, which they promptly proceed to put in the other?

Mr. ECCLES. When the System buys securities it creates new reserves upon which the banking system can loan six times that amount of money on the basis of the present reserve requirements.

Senator DOUGLAS. Now who decides whether or not the Federal Reserve System shall buy Governments?

Mr. ECCLES. That is a decision that is made by the Open Market Committee in conjunction with the Treasury.

Senator DOUGLAS. Well, do they determine the amount or do they determine the rate?

Mr. ECCLES. Well, they do not determine the amount. You cannot determine the amount not knowing what the supply of securities is going to be.

The support price is really what is determined, and if you have a support price, then whatever amount is offered is what we take.

The best example of that was last year when there was very heavy selling of the long-term 2½-percent Treasury bonds. They were mostly the 2½ marketable bonds not eligible for purchase by banks. The insurance companies particularly were very, very heavy sellers, and the System over a period of a few months purchased over $3,000,000,000 of these securites in the market and within a year such purchases were nearly $7,000,000,000. In the same period over 2½ billion of bonds—eligible bonds—were purchased by the System.

Senator DOUGLAS. Mr. Eccles, I have never believed that congressional hearings were designed to exploit administrative differences, but you have been a member of this Open Market Committee, a very influential member, and yet now you are saying that this policy that the commitee has followed is in your judgment incorrect?

Mr. ECCLES. I did not say it was incorrect. I merely outlined the effect of it. When I appeared before this committee November 25, 1947, this same committe of which Senator Taft was then chairman and again before this committee on April 13, 1948, I discussed very fully this whole question of monetary policy. You may recall that there were some very important inflationary pressures in existence in the fall of 1947 and in the spring of 1948. On those occasions I requested for the Board certain powers.

I made this statement in April of last year. It is very short:

> So far as the monetary and credit yield is concerned, we have tried to make clear the action on these fronts alone cannot guarantee stability. Nevertheless we believe that the Reserve System should be armed with requisite powers, first to increase basic reserve requirements of all commercial banks, and, later on, if the situation requires it, to provide that all such banks hold an additional special reserve.

That was in the form of short-term Governments.

Both of these would be protective measures. The first could be used to offset gold acquisitions and purchases of Government securities by the Federal Reserve—

That is, from insurance companies and others. It would neutralize, lock up the effect of such an operation—

and thereby restrict continued expansion and the already excessive money supply. The second would be essential in case banks embark upon an inflationary credit expansion through the sale of Government securities to the Federal Reserve, or to assist the Government in case of large-scale deficit financing.

Now that was the gist of what was recommended at that time.

I supported a policy of maintaining a 2½ percent rate for the longest term Government securities at the time when that policy was being pursued.

That policy likewise had the support of the Reserve bank presidents including Mr. Sproul, who was vice chairman of the Open Market Committee, and also of Mr. Brown, who was the chairman of the Federal Advisory Council of the Board, and of the great majority of the bankers of the country.

Last October, before the Iowa bankers, in answer to Mr. Parkinson, the insurance company executive who criticized that policy, Mr. Leffingwell of J. P. Morgan & Co., and Mr. Burgess of the National City Bank—the three leaders opposed to the support policy—I presented a statement in justification of the support of the long-term 2½ percent rate, at that time, and gave the reasons for it. I will read this later.

Senator DOUGLAS. Then you wanted the short-time interest rate on Government notes, certificates, and so forth, to go up and not the long-time rate?

Mr. ECCLES. Over the last several years the Open Market Committee was, I believe, in almost unanimous agreement on the question of raising the short-term rate. We advocated a much freer short-term rate than was in effect. We ran into resistance always with the Treasury. During the war period we had a pattern of rates for the purpose of carrying out the war financing which seemed very necessary and desirable. We assured the Treasury that we would see to it that whatever deficit financing was required would be carried out at a fixed pattern of rates. We did that because it seemed to us, with the very large amount of deficit financing that the war required, and not knowing, of course, just how large it would be or when it would end, that we could not have a speculative Government bond market. I don't mean to say there wasn't considerable speculation on the "up side." There was too much speculative bidding up of prices which was not our fault—but we realized that it would be exceedingly difficult to finance the Government with increasing interest rates, which would mean declining prices for securities after issuance.

When the war ended we tried to get out of what we called a strait-jacket by raising the short-term rates. We had difficulty with the Treasury, commencing with Secretary Vinson—Secretary Morganthau, of course, left the Treasury prior to the end of the war. We continued to have difficulty with the Treasury in getting them to agree to freeing the short-term rate. That could have been a flexible rate, if it could have been permitted to go wherever it would go, in relation to the 2½ percent long-term rate. It may well have gone as high as the long-term rate—short-term rates in the past have gone as high or even higher than long-term rates—and we would have then followed up that change in the short-term rate with an increase in the discount rate.

Senator DOUGLAS. May I ask: When did the Federal Reserve first suggest raising the short-term rate Treasury bills?

Mr. ECCLES. In 1946.

Senator DOUGLAS. But it was not carried into effect until the middle of 1947?

Mr. ECCLES. Yes. I think that is true. We had a buying rate of bills of three-eighths.

Senator DOUGLAS. Was there a disagreement in Government circles?

Mr. ECCLES. There was.

Senator DOUGLAS. You felt the short-time rate should go up?

Mr. ECCLES. The Open Market Committee felt it should go up.

Senator DOUGLAS. The Treasury did not think it should go up?

Mr. ECCLES. That is correct.

Senator DOUGLAS. Why did you think it should go up?

Mr. ECCLES. Well, I felt that you had no flexibility in the market at all. You could, as many of the banks were doing, sell the shorter securities to us and buy the longer-term securities. This practice, which we call playing the pattern of rates, tends to force the long-term rate down as long as short-term rates are not permitted to rise. In other words, we had a spread between short-term rates and long-term rates that didn't make sense, in view of the support policy. Why should anyone want to handle any short-term securities at seven-eighths if you could get 2½ percent for a demand liability in long-term securities?

Senator DOUGLAS. You were in favor of the pegging of the long-term rate?

Mr. ECCLES. I couldn't figure out any alternative. I didn't like it but it seemed to me that we were confronted with a dilemma, that the size of the public debt was so great, the amounts of E. F. & G. bonds outstanding, which were demand liabilities, were likewise very great and—I am going to read this from the Iowa statement, to which I previously referred, because really it is the heart of the problem, and I might just as well cover this point here. [Reading:]

Now, just what does this type of program actually contemplate?

That is pegging.

It seems to involve a continued willingness on the part of the Federal Reserve System to take Government bonds and to supply Reserve bank credit, but at yields higher than 2½ percent.

That is the policy that some were talking about.

Apparently, however, the System should follow a policy of gradually easing bond prices down and yields up, but buying aggressively, if necessary, to maintain orderliness in the market.

What would be the position of a Government bond owner or a potential bond buyer under such circumstances? Would they have any confidence in the market? Holders would tend to sell and potential buyers to hold back, creating increasing downward pressure on bond prices, until substantially lower prices were reached. If yields should rise only ½ percent on the longest 2½ percent bonds, their price would fall to less than 93. But in a falling bond market, with general credit demand strong, rates on other securities and loans would tend to rise at least proportionately as much. Under these conditions, can it be expected that insurance companies or savings and loan associations or other institutional investors would act materially differently with the yield on Governments at 3 percent than they do now at 2½ percent?

We have had tax-free Governments, entirely tax free, selling at almost 6 percent in the past with a small public debt.

Loans or investment, other than Government securities, would have as much, if not more, relative attractivenes to lenders and investors. Few, if any, borrowers would be priced out of the market for funds by rate increases of the size contemplated by advocates of this "flexibility" policy.

The long-term rate.

Any moderate rise in long-term interest rates would not, in itself, reduce significantly the demand for money. Investing institutions, which are now switching from long-term Government bonds to private credit forms, would still be motivated to do so by a continuing margin of return between the two kinds of investment.

Thus, under the "flexible" policy, the Federal Reserve System would still be called upon to support the bond market and would thereby continue to create bank reserves. It is possible that the amount of support required under these conditions would be much greater than is now the case. Investors generally would lose confidence in the market and would rush to sell their securities before prices declined further.

Money and reserves created by Federal Reserve purchases below present support prices would be just as high-powered as those created by support at existing prices, and the reserves thus made available could support nearly six times as much in bank loans.

Senator Douglas. Mr. Eccles, may I interrupt for a minute. Your program was not, therefore, to raise the yield on long-time securities?

Mr. Eccles. That is right.

Senator Douglas. But to raise the yield on short-time securities nearer to the 2½ percent on long-time?

Mr. Eccles. That is right; that is correct.

Senator Douglas. And this was opposed by the Treasury?

Mr. Eccles. Well, the Open Market Committee and executive committee of the Open Market Committee meet regularly and discuss the question of the open-market operations in relation to the constant and current problem of debt management. As you know, with the billion dollars of bills falling due every week, and with the 25 billion of certificates, something of that sort, outstanding, falling due, with several billions of bonds falling due periodically, debt management is a current and constant problem. It is important that the Federal Reserve policy be coordinated with the refunding operations, or the "rolling off" operations of the Treasury with reference to short-term debt.

In other words, we couldn't let the short-term rates go completely free. We never proposed that it go free. But what we did propose is that the bill rates and the certificate rates be permitted to go up. The Treasury was unwilling to permit our buing rate to go up as far as we recommended it, and thus permit the rates on short-term Government securities to rise.

Senator Douglas. They didn't want the short-term rate to go up because it meant a greater interest charge on the short-term debt; is that right?

Mr. Eccles. That was one of the reasons, I suppose.

Senator Douglas. And they, also, did not want fluctuating prices?

Mr. Eccles. During this period of time, over a period of 2 or 3 years, the rate did go up on the certificates from ⅞ to 1¼. There were three raises of an eighth in a period of a little over a year.

Senator Douglas. Well, this is something that puzzles me a bit: As I remember it, the Federal Reserve System was supposed to be an independent agency; the Treasury, another independent agency. Yet, it is inevitable that the views of one be taken into consideration by the other, and highly desirable. What is the machinery for coordinating the policies of the Reserve System with the policies of the Treasury?

Here was a case in which the Federal Reserve Board, or rather the Open Market Committee, wanted a higher rate on short-time Government securities; the Treasury did not. Now, what is the process of osmosis by which the views of one becomes communicated to the other?

Mr. ECCLES. Well, our staff of people are constantly in contact with the Treasury staff people, giving them the point of view of the Federal Reserve; and the Chairman of the Board was in close touch with the Treasury. Mr. Sproul and I met with the Secretary of the Treasury periodically to discuss with him the recommendations of the Open Market Committee with reference to this question. We were successful in persuading the Treasury to permit some modest changes. That is how we got the changes that we did, but we were never able to get the short-term rate as free as we desired to get it, and there has been——

Senator DOUGLAS. Suppose you had gone ahead and raised the short-term rate; what would have happened?

Mr. ECCLES. Well, I suppose that the System could have done that, in defiance of the wishes of the Treasury. My views of the independence of a central bank are these: That the Congress appropriate the money; they levy the taxes; they determine whether or not there shall be deficit financing. The Treasury then is charged with the responsibility of raising whatever funds the Government needs to meet its requirements. They have the responsibility not only for raising new funds and determining the types of issues and the rates that should be paid, but they also have the responsibility for the refunding of the debt.

The mechanism, however, for establishing money-market rates is in the hands of the Open Market Committee.

I do not believe it is consistent to have an agent so independent that it can undertake, if it chooses, to defeat the financing of a large deficit, which is a policy of the Congress.

In other words, it seems to me that it is up to the Federal Reserve, the Open Market Committee, to advise, to recommend, to the Treasury and to the Congress. But it is not the position, I believe, of the Federal Reserve Board, or the Open Market Committee, to enforce its will. It has its day in court. It has its opportunity to make its views known. It has an opportunity to persuade and to influence, to whatever extent it can. I feel, however, that the final responsibility for making the decisions with reference to public financing is up to the Congress and the Treasury.

Any open-market committee, or any central banking system, that for any length of time did not go along with that conception would not survive.

Now, I do think, when the policies pursued by the Government are sufficiently displeasing to the central banking authorities, their redress is to resign, but not to undertake to enforce their will.

Senator DOUGLAS. Mr. Eccles, I can quite understand that during the period of the war, when the amounts collected in taxes and subscribed for bond purchase out of current income were not sufficient to meet the total cost of the war, we had to create credit by banks. But in the period of 1946 and the first part of 1947, of which you speak, the Government did not have a deficit; it had a surplus, so that the policy of low rates on short-time securities was not necessary for current financing. You can say that it was desirable for refunding, but not for current financing.

Mr. ECCLES. There was no current financing. It was all a problem of refunding.

Senator DOUGLAS. Then the question comes, For how long will the refunding needs of the Treasury dictate reserve policy? Is this going to continue forever?

Mr. ECCLES. I think so. If Congress would, as a result of hearings of this sort, make it apparent that this support policy on the part of the Open Market Committee was not desirable, I think you would find, maybe, a greater independence on the part of the Open Market Committee. But in the hearings that have been held up here during the past 2 or 3 years we were unable, though the agent of Congress, to get any indication from any of the committees of Congress as to whether or not this support program should be discontinued. I don't think the System expected to get an opinion, but it only indicated that they had to do the best they could under the circumstances that existed.

Senator DOUGLAS. And in default of such a mandate you felt that, while you should advise and conciliate and attempt to persuade the Treasury, you should not act in opposition to its wishes?

Mr. ECCLES. That is correct. We felt that increasing the short-term rates or permitting a long-term rate to go up would not necessarily stop an inflationary development unless we went so far as to withdraw from the market. To buy Government's, whether you buy Government's in the market at par or at 75 cents on the dollar, you still create reserves. To stop the growth of bank credit, it would have been necessary to deny banks Federal funds, either through rediscounting or through the support of the Government bond market. That, of course, would have stopped the growth of bank credit and the supply of money.

An increase in rates of 1 percent or 2 percent, or even more, is not going to stop, in a period of inflationary development, the borrower from desiring to borrow if he needs that credit in order to do what he considers necessary to do business. The psychological effect on borrowers and lenders of such rate increases is, of course, hard to judge. It would depend upon the degree of inflation, and the amount of confidence or lack of confidence in the Government security market.

Senator DOUGLAS. In order to get an appreciable increase in yields and in interest rates, you would have to let the price of Government bonds depreciate markedly?

Mr. ECCLES. A half of 1 percent in interest rate would put the long-term Government bonds to 93. Now, you must consider what would then happen to the fifty-some-odd billion of E, F, and G savings bonds that are outstanding.

Senator DOUGLAS. I understand those are to be redeemed at par.

Mr. ECCLES. No, but they could be redeemed for cash. Those bonds, first, are demand liabilities on the Treasury, and if——

Senator DOUGLAS. The Treasury will redeem at par?

Mr. ECCLES. It will redeem them for cash at stated prices. But, if the Treasury has to redeem those bonds, then the Treasury has got to raise money in the market, in order to pay them off, and the Federal Reserve would have to see to it that the Treasury could raise the money. Therefore, you have a process of monetization there.

Senator DOUGLAS. In other words, what you are saying is that, for the stability of the banking system, perhaps the stability of the finances of the country, you can only permit minor changes in the price of government; and, therefore, in yields—very minor changes?

Mr. ECCLES. I think so.

Senator DOUGLAS. And that these minor changes will not have very much effect in damping down inflation?

Mr. ECCLES. Well, if the demand for credit is great, or if the lack of confidence in the long-term rates is greatly weakened, if confidence in the purchasing power of the dollar, which usually takes place in a rapid and continuing inflationary condition, developed, then certainly merely a change of a few points in the interest rate is not going to stop your inflationary development.

As was pointed out, there are two ways that inflation must be stopped. One is through fiscal policy, budgetary surpluses. But budgetary surpluses, in and of themselves, will not stop inflationary development, if the effect of budgetary surplus, which is anti-inflationary, is neutralized or nullified by the banking system expanding credit of an amount equal to the budgetary surplus. That is what took place in 1946 and 1947.

Senator DOUGLAS. But couldn't the budgetary surplus be used to purchase a portion of the bank-held public debt?

Mr. ECCLES. It was used entirely for that purpose.

Senator DOUGLAS. That should have diminished the reserves.

Mr. ECCLES. It diminished the amount of deposits and reserves, but the banking system expanded bank credit, for housing particularly under a Government-sponsored program, for consumer credit through commercial loans, and various types of credit, which were encouraged. The banking system expanded credit and created money by an amount in excess of the budgetary surplus which the Government created through a sound fiscal policy.

Senator DOUGLAS. But they expanded by less than would have been the case had there not been a budgetary surplus.

Mr. ECCLES. One largely neutralized the other, or you would have had a much more serious inflationary development.

Now, the principal reason why the Board proposed what was known as the special reserve was in recognition of what I am saying. It was desirable to put the banks under pressure not to loan, not to expand credit. Merely changing the interest rate further encouraged the banks to want to loan. To increase the rates wouldn't discourage bank lending. The small increase in the rates would not discourage borrowers from borrowing. So, what seemed to us to be required was to put pressure on the banks by requiring that a substantial part of their deposits be locked up against the short-term Government securities which in their purchase created the deposits.

And I would like to read, in that connection, what I said on November 25, 1947, to the Joint Committee on the Economic Report, in hearings that were held for the purpose of considering inflationary problems, just a paragraph on this very point. [Reading:]

It is unfortunate, I think, that banking leaders oppose protective measures against inflationary forces arising in the credit field. They seem to forget that, in order to assist in war financing, the Government provided the banking system with additional reserves which enabled the banks to buy Government securities; that this created new deposits in the banks; and that banks have also had the benefit of interest received on the Government securities they have held and will continue to hold for an indefinite period. They object even to a temporary limitation on the further use of these funds as a basis for loans to private borrowers, which would in turn create more and more deposits. The Government has an obligation and a duty to step in at this time of national danger to say to the banks, "We are not proposing to deprive you of benefits you have already derived and will continue to derive from the vast increase in bank deposits resulting from your purchases of Government securities, but we do say that you should be willing to accept a reasonable limitation on using a war-created situation to multiply private loans in peacetime when they serve to intensify inflationary pressures."

Senator DOUGLAS. That was to be a limitation on the purchase of short-time securities?

Mr. ECCLES. That was to require a reserve to be held in short-term securities.

Mr. WOLCOTT. May we identify what he is reading from, Mr. Chairman?

Mr. ECCLES. Hearings before the Joint Committee on the Economic Report entitled "Anti-Inflation Program as Recommended in the President's Message of November 17, 1947," page 145.

Mr. WOLCOTT. Testimony which you gave before this committee or the House Banking and Currency Committee?

Mr. ECCLES. Before this committee.

Mr. WOLCOTT. What was the other one you read from; was that testimony before this committee?

Mr. ECCLES. They were both before this committee.

Mr. WOLCOTT. On what dates?

Mr. ECCLES. November 25, 1947, the one that I have just read; and the other was April 13, 1948.

Extensive hearings were held before your committee, Mr. Wolcott, in the House at that time. I appeared for two full days before your committee in connection with this entire subject.

Mr. WOLCOTT. I remember you did. I thought there was something nostalgic about what you were reading.

Mr. ECCLES. That is right. There will always be, of course, nostalgia, I think, about this subject of inflation and monetary and credit control. There is nothing new about it, and there is not likely to be over the ages.

Senator DOUGLAS. Mr. Eccles, when Mr. Burgess testified last week, he contended that an increase in the member-bank reserves ordered by the System could not restrict the growth of credit extended by the banks so long as the Federal Reserve follows the policy of pegging the prices of governments and is therefore committed to purchasing all securities offered to it. Do you agree with that?

Mr. ECCLES. I agree with it.

Senator DOUGLAS. So that, in effect, you are saying that the open-market operations of the Reserve System and the reserve requirements of the System are relatively inoperative as a means of checking inflation because of the debt-management policy?

Mr. ECCLES. Well, I think the debt-management policy is, of course, the most important factor in this whole situation. What Mr. Burgess said, of course, is, like a great many statements, true as far as it goes; but more could be said upon the subject of how to exercise more effective credit controls through increasing reserve requirements to offset the effect in reserves of Federal Reserve purchases of securities sold by nonbank investors. When insurance companies or other long-term investors decide to sell, so long as the Federal Reserve is supporting the long-term 2½-percent rate, reserves are created in the banking system. The banks themselves don't create those reserves. They get reserves and are under pressure then to use the money. Gold imports or silver purchases, or a reduction of currency in circulation, all of those factors add to the excess reserves of the banking system; and the banks themselves, either individually or collectively, have nothing to do with the creating of those reserves. Yet when reserves are available, the banks are under pressure to expend credit, to use those funds to drive interest rates down and to drive prices of securities up.

Now, an increase in reserve requirements sterilizes the effect of reserves going into the banking system from these sources. But to increase reserve requirements very materially and not include nonmember banks would drive member banks out of the System. The Reserve banks would be, in effect, holding an umbrella over the banking system as a whole, and that is why we argue strongly that reserve requirements should be applied to all banks, so as to help the System get new members and to help the System hold the members we have.

Now, there is one other point on that that I want to make. The banker who chooses to sell securities doesn't see how or why he is necessarily creating more money. He only sees that he has a good customer who gets the credit. Even though that customer gets the credit and uses it to compete for goods in short supply, the individual bank doesn't see that you must stop the growth of bank loans and investment in order to stop the growth of bank credit. The special reserve requirement that would require the banks to hold a substantial part of their demand deposits in short-term Governments would put the banks under pressure to restrict loan expansion, because they wouldn't be able to sell their short-term securities. They would have much more hesitancy to sell the longer-term securities which give a higher yield, and they would want to maintain such liquidity as was left to them if a reserve of short-term securities was applied.

Now, I merely mention that as reviewing the proposal made, because we saw this situation fully at the time. We saw the dilemma, and we tried to point out to the committees what we could do as an alternative to withdrawing support from the Government security market, which may have been necessary to prevent monetization of the public debt. We hesitated to withdraw support for the reasons which I have indicated to you: Because of the effect upon the entire problem of management of the public debt, the problem of refunding, and particularly the effect that might be had upon the demand liability in the form of E, F, and G bonds.

Senator DOUGLAS. Mr. Eccles, earlier you said that in default of a congressional mandate you felt that you should not disregard the considered judgment of the Treasury on the question of yield of Government securities.

Mr. ECCLES. That is correct.

Senator DOUGLAS. I would like to ask: Would it serve a useful purpose if Congress were to instruct the Treasury further as to the policies to be followed in debt management and the procedures of cooperating with the Federal Reserve System?

Mr. ECCLES. I think it would be of great assistance.

Senator DOUGLAS. Do you have any suggestions as to the policies which Congress might instruct the Treasury to follow?

Mr. ECCLES. Well, I hadn't thought of the subject, but I will be glad to do so. I can't think of the practical language of a resolution or bill that would be required. It would require action on the part of Congress. It would certainly be debated plenty within the Congress.

Senator DOUGLAS. But you are saying, if properly constructed, it would be helpful. I take that if such an instruction were unwise it could cause great damage. Therefore, we would appreciate it very much if we might get some suggested standards, standards of instruction.

Mr. ECCLES. Of course, the Federal Reserve System—that is, the Board in particular, more than the Open Market Committee—is in a particularly difficult situation. The Members of the Congress and the public blame the Federal Reserve for not restricting credit expansion and not preventing inflationary developments on the one hand, while on the other hand the Board would, of course, be condemned by many who would be opposed to such action. Certainly the Reserve Board is no place for a person who does not have the courage to take unpopular action.

It would be of great assistance, of course, to the Board if that were made perfectly clear, that this responsibility for credit and monetary control is theirs and not the Treasury's.

I don't know that it would be practical to work out an arrangement, for the reasons I stated a while ago, to create an independent Reserve Board, independent to the extent that it was expected to enforce its will. It is now independent and should continue to be independent to the extent that it has an opportunity to recommend and to advise. That is, of course, desirable, and is a better situation than would be the case if the Federal Reserve authority and power were vested in the Treasury itself.

Senator DOUGLAS. Well, would you favor a national monetary council composed of the chief officers of the Gocernment who deal with fiscal and credit policies, so that there might be a formal opportunity for them to meet and try to arrive at common decisions rather than have these matters discussed at informal conferences on a staff level?

Mr. ECCLES. I don't think that would improve the situation. It may be desirable to have an interdepartmental statutory council, such as the NAC in the foreign field, for the purpose of coordination of certain credit activities. You have the Farm Credit Administration, and you have the Housing Administration, you have the RFC, and you do have a great many Government agencies whose activities affect the field of money and credit. It might be desirable to have such an interdepartmental committee; but it would seem to me that, whatever the policy of the administration was at the time, it would prevail in such a council; and it would, if anything, reduce the independence of the Board and not increase it.

Senator DOUGLAS. We asked Secretary Snyder a question as to how we could get better coordination of fiscal policies; also, among other questions we asked him, whether he believed that the Secretary of the Treasury should be made a member of the Board of Governors of the Federal Reserve System; and he replied [reading]:

The Secretary of the Treasury is the chief fiscal officer of the Government. It seems to me that any proposal to make him a member of the Board of Governors of the Federal Reserve System for the express purpose of bringing about better coordination of Federal Reserve and Treasury policies would appear to subordinate the responsibility of the Treasury Department in fiscal-monetary matters. In the final analysis, the principal responsibility in the fiscal-monetary area must rest with the President and his fiscal officers who are accountable to the electorate for their actions (p. 11 of the committee print on Monetary, Credit, and Fiscal Policies).

Now, if what you have been saying amounts to this, that on these vital matters the Federal Reserve Board defers in its credit policies ultimately to the Secretary of the Treasury, that means that the Secretary of the Treasury ultimately has responsibility both for the fiscal and for credit policies?

Mr. ECCLES. Well, there is no difference between money and credit. They are one and the same thing. We say "money and credit," but credit is merely the basis for creating money.

Senator DOUGLAS. Debt management, perhaps.

Mr. ECCLES. That is right. There is a distinction, of course, between what we call fiscal policy and monetary and credit policy.

Now, I have advocated that the Federal Reserve Board or some organization should have the sole responsibility in the field of monetary and credit policy; and, as I have indicated here, examinations are closely related to that question of monetary and credit policy.

Senator DOUGLAS. Including the management of the public debt?

Mr. ECCLES. No; when it comes to the question of management of the public debt, the Treasury is the huge borrower; and I don't know whether you can, as a practical matter, improve a situation that merely gives to an independent Federal Reserve agency the opportunity to advise—the opportunity to recommend. It is difficult for me to see how you can go further than that. When the administration in power at any given time is put there by the electorate and is responsible to the electorate, to have an independent agency deprive them of the most important tool in the economic kit doesn't seem to me to be very practical.

It has never operated that way in any other country. In Canada, in England, France, and every other country in the world, so far as I know, the central bank has never successfully used its authority to enforce its will over any administration in power.

Senator DOUGLAS. Mr. Eccles, in connection with the responsibilities of the Treasury for debt management, which you now say you do not propose to change, does not that necessarily carry with it, in the final analysis, control over credit policy and therefore over money policy?

Mr. ECCLES. Well, you could make a good argument for that.

Senator DOUGLAS. Isn't that just a statement of fact under the present situation?

Mr. ECCLES. I would question that. Certainly the desirability of it.

Senator DOUGLAS. I am not speaking about the desirability of it. I am just saying, isn't that a statement of the situation?

Mr. ECCLES. Well, I must admit that that is where the logic of the situation leads you; I must admit that. And yet we all know, I think, as a practical matter, that to increase the direct authority of the Treasury over the whole field of money and credit—in other words, set up within the Treasury itself a division or a department of monetary and credit control—may well lead, in time, to a socialization of the credit structure, which, I think, would be very undesirable and very dangerous.

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Senator DOUGLAS. I want to make it clear that I am not advocating that. I am merely raising the question as to whether, in the present situation, the power of the Treasury to manage the debt, which you do not question, does not, as a matter of fact, also carry with it the virtual control over credit and monetary policy. That is all. I am not saying this should be permanent.

Mr. ECCLES. I wouldn't say that it carried the complete control.

Senator DOUGLAS. No; predominant control.

Mr. ECCLES. I would say that it exercised a tremendous influence. I would say that it possibly carries a much greater control than is generally recognized and understood. That control, of course, can be extremely dangerous if the Treasury would be, for political reasons, enforcing a monetary and credit policy in connection with its debt-management responsibility that was contrary to the best interests of the country at a given time. They could do that and it could be dangerous.

Senator DOUGLAS. Mr. Eccles, I am aware of the fact that I have probably asked more questions than I should, in justice to my colleague, Congressman Wolcott, but I do have one or two more questions, and then I will defer to him.

In hearings last week I asked a number of witnesses whether the Federal Reserve Board, in their judgment, should not be given powers to impose uniform reserve requirements on all banks, whether members or nonmembers, and their reply was almost uniformly "No." The chief argument which they brought forward was that already 85 percent of the deposits of the country are in the Federal Reserve banks, and that the dog in the System was a big dog, and that the tail outside of the System was a relatively small tail, and that in practice the Federal Reserve Board did not need this control on reserve requirements to control the total amount of credit.

Now, I replied to this argument of theirs by saying "Yes," but if the Reserve Board raises requirements to check inflation there is always the danger that State banks will resign from the System. They replied, "Have any ever done so," and their implication was, in practice, that the advantages of being in the System are such that even if reserve requirements are raised that State banks, members of the System, holding 35 percent of the total deposits, will not get out.

What is your judgment on that?

Mr. ECCLES. I don't agree with that at all. I think if reserve requirements were substantially increased that you would not only find a substantial number of State banks getting out, but you would find national banks converting to State banks. You would weaken the entire structure of Federal control over the banking system. Not only would that happen but the State banks which are now out of the System would certainly not come into the System.

Senator DOUGLAS. They only have 15 percent of the deposits.

Mr. ECCLES. That is right; but that is a pretty good size hole in the dike. There is always a terrific opposition to an increase in reserve requirements by member banks and national banks because of the discrimination. That is one of the great arguments against further increasing reserve requirements.

Now, as a banker with a good many years of practical experience I can say that I cannot see any good reason why a bank would remain in the Reserve System under conditions of an expanding increase in reserve requirements. The advantages of the System are very minor aside from the use of its credit facilities.

Senator DOUGLAS. What about the clearance of checks?

Mr. ECCLES. Well, you can clear checks through the banks which are members. That is no problem. They are delighted to have your balances.

In other words, most nonmember banks might get by on 15 percent of their demand deposits held as reserves—in cash and correspondent balances; whereas a member bank today cannot get by on less than 25 or 30 percent. Now, that is already a great penalty.

Senator DOUGLAS. That includes vault cash?

Mr. ECCLES. That is vault cash and correspondent bank balances that member banks must carry, in addition to required balances with the Federal Reserve, in order to get the services that the Reserve System is unable to give them. Nonmember banks can count their vault cash and balances with correspondents to meet any reserve requirements they are subject to. There would be no good reason why banks should stay in the Federal Reserve System so long as they have a large portfolio of Government securities which they are able to sell in order to get funds to meet their situation.

Senator DOUGLAS. May I ask this, Has the fear that the raising of reserve requirements might cause State banks to get out of the Federal Reserve System ever operated to make the Federal Reserve Board abstain from putting into effect an increase in reserve requirements which otherwise it would have thought desirable?

Mr. ECCLES. We didn't have authority to increase reserve requirements any further than we did.

Senator DOUGLAS. Then has this fear operated to restrain you in the past?

Mr. ECCLES. The fear hasn't operated to restrain the Reserve Board, no; but had we gotten the authority that was requested it may well have. I appeared before the committee and said that, unless authority to increase reserve requirements applied to nonmember banks, the Board did not want that authority, because they would be under pressure not to use it, because of the discrimination.

Senator DOUGLAS. How much more did you want to raise it?

Mr. ECCLES. We asked for authority, as I recall, of 10 percent. I think that was in April 1948. In December of 1947 we had suggested authority to impose a special reserve requirement of up to 25 percent of demand deposits in short-term Governments, which would have permitted the banks, of course, to hold their reserves in the form of Governments, which are earning assets.

What I have said here this morning, of course, with reference to this subject, had application in an inflationary situation that existed in 1947 and 1948, and does not have the same application today.

This is now an academic discussion, which does not necessarily have application to the present economic situation.

I see no urgency at the present time for increased authority. If the System had increased authority I can't see any use that they would have for it at the present time. That does not mean, however, looking to the future, that whatever authority may be necessary to deal with inflationary situations, should not be available.

Senator DOUGLAS. I think those are all of the questions I have. Congressman Wolcott.

Mr. WOLCOTT. Mr. Eccles, I don't know as you intended, and I surely am not going to interpret your remarks as critical of the congressional action, but, of course, you have known for some time of the difficulty which Congress has had in trying to reconcile the policy as it was announced by the Treasury and the Federal Reserve Board—and sometimes, as I recall it, you haven't been in hearty agreement with other members of the Board in respect to these problems——

Mr. ECCLES. I do not think that statement is correct.

Mr. WOLCOTT. Perhaps not on these problems, but on others.

Mr. ECCLES. I think that the statements I have presented are the statements of the Board.

Mr. WOLCOTT. At that time?

Mr. ECCLES. At this time.

Mr. WOLCOTT. What I was leading up to is the statements you are making today and the suggestions and recommendations which you have made—are they your own, or are they the Board's?

Mr. ECCLES. They are my statements. I am not Chairman of the Board, and I was asked to come up here and express my own views.

Mr. WOLCOTT. Do you believe that they substantially conform to the thinking of the other members of the Board?

Mr. ECCLES. Well, it would be my judgment that they do conform, in general, with certainly the majority of the Board. That is my judgment. I may be wrong.

Mr. WOLCOTT. You have been dealing principally here in the past tense as to what our attitude should have been in previous inflations. Do you believe that the Government should, either through the Federal Reserve or the Treasury, continue to support the Government bond market?

Mr. ECCLES. Well, the Open Market Committee is not supporting the Government bond market at this time.

Mr. WOLCOTT. If there should be a case where the Government bond market has to be supported, do you believe they should? They are surely influencing it to a point where it is supported in some measure today.

Mr. ECCLES. Yes; as a matter of fact the Federal Reserve has reduced its holdings of Government securities during this year; it has sold into the market something over $4,000,000,000 of securities; including $3,000,000,000 of bonds.

Mr. WOLCOTT. Why have they sold them?

Mr. ECCLES. Well, they have sold them to meet the demand. We have let the market have securities; otherwise prices would have gone sky high, interest rates would have gone exceedingly low.

Mr. WOLCOTT. All of the operations of the Open Market Committee are predicated upon the desirability of maintaining a stable market, are they not; that is, since 1935, when you were given this authority, these mandatory powers? Before that the Open Market Committee was purely advisory.

Mr. ECCLES. You mean the Board was advisory. The Open Market Committee was composed of the governors of the 12 banks.

Mr. WOLCOTT. Yes.

Mr. ECCLES. The Board was advisory. The Board had the veto power.

Mr. WOLCOTT. Yes.

Mr. ECCLES. But they had no initiative; the initiative was in the hands of the governors of the 12 banks.

Mr. WOLCOTT. The Open Market Committee had no initiatory powers previous to 1935?

Mr. ECCLES. The Open Market Committee had initiative before 1935. The Open Market Committee was set up in 1933. Prior to that they acted informally. From about 1922 they acted informally, largely under the leadership of New York. But it wasn't until the Banking Act of 1935 that there was an Open Market Committee that had the authority to force the Reserve banks to buy and sell.

Prior to that time all the Open Market Committee could do was to adopt a policy over which the Board had a veto power. But whatever policy they adopted, any Reserve bank could refuse to participate. It was, of course, a very impractical and unsuccessful operation. That is why the Banking Act of 1935 changed that entire open-market structure. At the time of the Banking Act of 1935, and I sponsored that legislation and carried it through Congress, it was recommended that the authority of the Open Market Committee be put in the Board, and the bill passed the House in that form. It was the Senate that set up the present form, and that compromise was accepted in the conference committee.

Mr. WOLCOTT. Mr. Eccles, can you give us some idea as to where you think the bond market should be pegged, where the Government bonds should be pegged?

Mr. ECCLES. It seems to me you asked me the question, Did I feel the Government bond market should be supported?

Mr. WOLCOTT. Yes.

Mr. ECCLES. And I answered by saying that the Government bond market was not requiring support, but the System was selling securities in the market.

Mr. WOLCOTT. Let me put it this way: What we are trying to get at is whether the Congress should enact legislation to help in the stabilization effort. I gather from what you have said that you believe the authority to peg the Government bond market should be continued?

Mr. ECCLES. Well, there is no direct requirement that the Government bond market be pegged. I am not saying, looking to the future that the $2\frac{1}{2}$ rate should be maintained.

It seems to me that nothing could be worse than that the Reserve system be given a mandate, or that it be indicated, either by the Congress or by the Open Market Committee, that it should peg the Government bond market at a $2\frac{1}{2}$-percent rate indefinitely, as Mr. Harl suggested the other day. Nothing could be worse.

It would be perfectly stupid then to have more than one rate. Why on earth, if the Open Market Committee, or the Congress, were to publicly announce that from here on out the long-term rate of $2\frac{1}{2}$ percent on Government securities was going to be maintained on market securities would anyone want a bill or a certificate that yields $1\frac{1}{4}$ or $1\frac{1}{8}$? All the Government would need to have is just one security, which would be a demand liability of $2\frac{1}{2}$ percent.

Why have obligations maturing in 20 years?

Mr. WOLCOTT. That brings up the question of the standards under which you should be given the authority. My point is, Should the Congress just say that either the Treasury or the Federal Reserve, through the Open Market Committee, shall have the authority to support the Government-bond market, and stop there? What more authority would that get you over what you have at the present time?

Mr. ECCLES. It wouldn't give us any. We have got that authority now.

Mr. WOLCOTT. Then it becomes a question of standards. What standards, as Senator Douglas has suggested, could the Congress enact into law that would clarify your position in respect to supporting the Government-bond market any more than has been done by giving the Open Market Committee initiatory powers under the Banking Act of 1935?

Mr. ECCLES. I don't know.

Mr. WOLCOTT. We don't know. That is what we have been trying to find out here ever since 1935. Surely we should make it flexible enough so that you wouldn't create a situation where you would destroy your market for the short-term stuff.

Mr. ECCLES. What the Board suggested was that the authority that the Open Market Committee has was not in itself sufficient and that further powers were needed; namely, the authority to increase reserve requirements or to apply special reserve requirements, as supplemental to the other authority.

Mr. WOLCOTT. All right.

Mr. ECCLES. The authority of the Open Market Committee was adequate only to the extent that you denied the market Federal Reserve funds by withdrawing.

Mr. WOLCOTT. We did give you authority in respect to reserve requirements, and you say they weren't operative and you couldn't effect your purpose because we did not give you authority over reserves of nonmember banks?

Mr. ECCLES. No; we got authority about a year ago to increase requirements by 4 percent, but it was temporary and lapsed last June.

Mr. WOLCOTT. Yes.

Mr. ECCLES. It applied to member banks only. If you recall, that authority was not given until a year after it was asked, and then we were heading into a recession.

Mr. WOLCOTT. You asked for a 10 percent authority?

Mr. ECCLES. Yes.

Mr. WOLCOTT. The reason that the Congress did not give you the 10 percent was because it was self-evident, it was thought, that if you exerted that authority up to the limit you could have put almost every bank in the United States out of business; we thought it was too broad an authority. We eventually compromised on your 4 percent, and you did not use all of that, did you?

Mr. ECCLES. We pointed out that the 10 percent at the time would still leave the banking system with enough Governments. They had about 50 percent of their deposits in Governments; and a 10 percent increase, we pointed out, would leave them with nearly 50 percent of their deposits in Government securities, and therefore it was not as drastic as you have indicated.

Mr. WOLCOTT. Well, we were told, as I recall, that you would never use that much authority.

Mr. ECCLES. Well, the very fact that we had the authority to use——

Mr. WOLCOTT. Because there was no other alternative given to the Congress, we had to use our own good judgment as to what we considered equitable and what we considered sufficient authority to do the job at the time, so we compromised on 4 percent.

Mr. ECCLES. We got no authority at that time.

Mr. WOLCOTT. You didn't get the authority, Mr. Eccles, because you asked for this unwarranted amount, in the opinion of the majority of the Congress.

Mr. ECCLES. No; they didn't even give us 4 percent; they gave us nothing at the time.

Mr. WOLCOTT. Because there was no alternative. The Congress had to create an alternative, as between 10 percent and 4 percent; and they did; and you did not use it. That is purely academic, of course.

Mr. ECCLES. But that is just part of the truth of the whole.

Mr. WOLCOTT. This is what I am trying to find out. What do you recommend as a figure that the Congress should enact in respect to the reserve requirements over and above what they are at the present time?

Mr. ECCLES. I am not making any recommendations with reference to what Congress should enact with reference to either reserve requirements or special reserves. I am merely pointing out here what the problem has been and——

Mr. WOLCOTT. Has the Board taken any action as to the amount of authority which it needs in that direction; has the Board agreed upon any figure?

Mr. ECCLES. No; the matter has not been discussed, because at the present time, I think, it is academic. We have been reducing reserve requirements during the past year. Reserve requirements have been reduced below the statutory limit by 2 percent. The Board would have authority, of course, to increase reserve requirements by that amount in the future. There is certainly no immediate problem today with reference to undue bank-credit expansion. Outstanding bank loans today are less than they were at the beginning of the year.

So there is no urgency at the present time. I have suggested in my statement that I think the passing of a resolution—that was Senate bill 1559, which called for the creation of a National Monetary Commission—is very important. I have said that such a Commission should be set up and an extensive study made before any of these questions are determined. I have tried to point out here only a few of the high lights.

Mr. WOLCOTT. Should we give this Monetary Commission the authority to dictate to the Federal Reserve, the Open Market Committee, the point at which Governments should be supported?

Mr. ECCLES. The Monetary Commission was to be set up for the purpose of making a study, and would not, as I understand it, be given any authority.

Mr. WOLCOTT. I am not getting very far. I have been trying to centralize this authority somewhere—perhaps that is the wrong term—but I think we see here a need for coordinating these efforts; and whatever is set up, whether it is a monetary authority or a commission or whether it is a credit council, do you think that any such coordinating body should be given the authority to dictate to the Federal Reserve the point at which the Governments should be pegged?

Mr. ECCLES. No; I don't.

Mr. WOLCOTT. Who should have the authority?

Mr. ECCLES. I think the Federal Reserve should have it.

Mr. WOLCOTT. You are not in favor of transferring that authority to the Treasury?

Mr. ECCLES. No; I am not. As I have indicated, I think that the Federal Reserve itself needs some reorganization, and I do think that there should be a consolidation of the Federal supervisory agents.

Senator DOUGLAS. I can hardly keep still, because you are saying that the Federal Reserve Board should have the power to determine the price at which Federal securities are purchased, but previously you have said that the Treasury should be given the power over debt management.

Mr. ECCLES. What I meant to say, Senator, is that, whether it be the Board as now constituted or whether it be any other credit, monetary or credit organization, they should have the authority rather than there being a direct authority of the Treasury. They should have the authority to manage the open-market operations, in line with a policy that would have to be agreed upon with the Treasury.

Now they would be independent to the extent that they are able to advise the Treasury, to recommend to the Treasury, and hence, I think, have considerable influence upon the Treasury. I think that that much independence must and should be maintained; whereas if you put it in the Treasury directly, eliminating the Federal Reserve Board, you would not have any agency with any independence of expression on the subject.

Senator DOUGLAS. On the principle that a subordinate can hardly give independent advice to a superior who wants to be advised in a different direction?

Mr. ECCLES. Well, in a degree I think that is correct. And I don't know how you are going to get away from that. I think that the history of central banking throughout the world would indicate that they must be subordinate to treasuries, and particularly is that true now that the public debt is 60 percent of the entire debt.

Now, it was one thing prior to the First World War, and even during the Twenties, and even prior to the Second World War. But, with a public debt the size that the public debt now is and with the prospect of running into another deficit, it seems to me pretty impractical to say that there should be a body with sufficient independence that it can defeat the purposes of an administration that chooses to create public deficits.

Mr. WOLCOTT. Mr. Eccles, do you think the trend, the immediate trend, is toward further inflation, or reflation, or deflation, or are we on a level that will remain more or less static for some time?

Mr. ECCLES. Well, the statistics at the present time point to, I would say, some inflationary developments, and I say that for these reasons: Bank credit is beginning to expand a little. There is an excessively rapid growth in consumer credit on more and more favorable terms. There is a great growth in housing credit on very small down payments. There is a very rapid growth in State and municipal debt. There is a very substantial public deficit, of about $5,000,000,000 in this fiscal year. In addition, there is the payment to the veterans of close to $2,800,000,000 that will be disbursed the first 6 months of next year. There is the agricultural support policy of the Government, which, of course, tends to sustain the inflationary level in the field of agriculture. There is the present labor wage policy that is indicating a further increase in wages that must reflect itself, in many instances, in prices. There are the private corporate pension programs, which, I think, are a big mistake, that are equivalent to wage increases and that likewise tend to support or hold up prices.

That is just part of the picture. On the other hand I recognize the increased productivity of our machine, and I think that any inflationary development, unless it is followed up by larger budgets, Federal budgets, which I hope will not be the case, and larger Federal deficits, will be greatly moderated by the fact that supply may well overtake the demand all along the line. It has done so now in many fields, and prices are only being held up by Government action.

I think that our longer-range problem is not one of inflation. It is one of deflationary pressures. It is one not of inadequate production, not of capital for investment—of which I think there is plenty—but it is one of consumption—being able to buy what our machine can produce. That doesn't mean ability to buy through a continued expansion of consumer credit. I think we are going to be confronted with that problem before very long.

Mr. WOLCOTT. What do you think should be done in respect to supporting the Government-bond market in the face of this inflationary threat; what do you suggest should be done by way of letting the Government-bond market find its own level or pegging it at a higher or lower figure than they are selling for on the market at the present time?

Mr. ECCLES. I do not think that support of the Government-bond market will be required for some time to come. The long-term Governments are selling at very high premiums; and I, for one, would like to see those premiums reduced. The long-term rate, in my opinion, is too low and not too high. The rate on the long-term securities on the basis of which they are selling today is about 2¼. So there is quite a way to go before the decision will have to be made as to whether or not it is advisable, under the circumstances that exist, to hold the long-term Governments at 2½.

Mr. WOLCOTT. Would you recommend that the rediscount rate be changed at this time?

Mr. ECCLES. No; I do not.

Mr. WOLCOTT. Do you think the amount of reserve requirements should be increased, provided you have the authority to do it?

Mr. ECCLES. I do not.

Mr. WOLCOTT. What can Congress do to help stop inflation except balance the budget and cut Government expense?

Mr. ECCLES. I thought I made the point that I understood this was a discussion to determine what might be done to deal with a long-range program.

Mr. WOLCOTT. Anything that would deal with a long-range program would, of course, have an immediate psychological effect. The fact that Congress was considering limitations and standards, and so forth, which might result in stabilizing our economy on a long-range basis might have a psychological effect to prevent immediate inflation. That is what I am thinking of in asking that question.

Mr. ECCLES. Well, I am not too much concerned about the psychological effect. I think that is very temporary. I think it is the basic economic factors that are finally the determining factors.

Mr. WOLCOTT. Let me ask you, Do you think that sterilizing any part of the Government debt which is held by the banks, so that no more than a certain amount would be monetized, would be of any help?

Mr. ECCLES. I do. That was what we suggested in our special reserve program. That was exactly what it was. I think that would be very helpful if you should begin to get an inflationary development through bank credit expansion. You have to consider your fiscal situation in connection with this. If you are going to operate in a period of great business activity financed in part by Federal deficits. That creates an entirely different problem. It is pretty difficult to adopt a restrictive monetary policy in the banking system under conditions of a peacetime economy if the Federal Government is going to operate heavy Federal deficits.

Mr. WOLCOTT. Because of the importance of the holdings by insurance companies of Government debt, in the stabilizing effort would you recommend that the Federal Government be given more control over insurance reserves?

Mr. ECCLES. I don't think so. I think that you could sterilize pretty largely the effect of the sale of securities held by insurance companies by increasing bank reserves.

I do think howver, the study should take into account the operation of these huge insurance companies. They are very important factors in this whole field of money and credit. It may well be that certain Federal laws, certain controls, would be necessary. I am not prepared at this time to say. But I do think that you cannot ignore the effects of any such large pools of investment money in private hands.

Senator DOUGLAS. May I say that the Investment Subcommittee of our general committee is going into the question of the role of insurance companies and has scheduled about 3 days of hearings when these monetary, credit, and fiscal policy hearings are closed.

Mr. ECCLES. Yes. I just don't want to be put into the position of suggesting anything with reference to that because——

Mr. WOLCOTT. We are dealing with fiscal matters here. It is the influence of insurance holdings, or I can shorten it up by saying, on the value of the American dollar, that is what I was asking about, and whether there was any control you thought necessary over those holdings, which might embrace other large holders of Governments, in addition to insurance companies.

Mr. ECCLES. A heavy sale of Government securities added to the inflationary pressures last year.

Mr. WOLCOTT. You mentioned silver, you slid over it pretty fast, and for which I am thankful, but I wondered if you were in position now to perhaps recommend changes in the Silver Purchase Act.

Mr. ECCLES. Being from, I think, the No. 1 silver State in the Union, maybe I better pass that up.

Mr. WOLCOTT. Well, in the——

Mr. ECCLES. I would like to say, however, that I am just jesting, because I haven't passed it up, and my position on silver is well known. I recognize the program for what it is, a subsidy, but I see no reason why there may not be a silver subsidy as well as many other subsidies. When we take up the question of what to do with the farm and other subsidies, I think it might be well to take up the question of the silver subsidy.

Senator DOUGLAS. And you wouldn't give up the silver subsidy until every other subsidy is given up?

Mr. ECCLES. I wouldn't say that. I think there are a lot of subsidies that have more merit than the silver subsidy.

Mr. WOLCOTT. In the Banking Act of 1935 we legislated to force all banks to come into the Federal Reserve System in order to participate in the Federal Deposit Insurance Corporation. We let that authority lapse finally. Would you be in favor of restoring that requirement?

Mr. ECCLES. If the recommendations that I have suggested here be adopted it would not be necessary to require that all State banks be members, or all insured banks be members, of the Federal Reserve System. The important thing is that they maintain the same reserves that the member banks of the Reserve System do. Whether they are members or not, and have to buy stock, and have to comply with the other requirements, is not too important, and I would certainly be willing to waive that.

Mr. WOLCOTT. One other question. This $5,000,000,000 overdraft authority of the Treasury, I don't know whether you want to get into that or not, but that expires this next year. I think you sponsored that, didn't you?

Mr. ECCLES. That is right.

Mr. WOLCOTT. Do you think it should be continued?

Mr. ECCLES. I think it is desirable to continue it. I think it is a proper instrument, I think it is a useful instrument, in the case of debt management. It is often desirable to give the Treasury a substantial overdraft in order to avoid undue money market strains during tax payment periods. That authority has been helpful, and over the years that it has existed in the Reserve System I am sure that it has never been abused.

Mr. WOLCOTT. Thank you very much.

Senator DOUGLAS. Thank you very much, Mr. Eccles.

(Whereupon, the committee adjourned until 2:30 p. m.)

AFTERNOON SESSION

Senator DOUGLAS. Mr. Brown, we are very glad indeed to have you here. We appreciate your public spirit in coming from Chicago to testify on this subject.

STATEMENT OF E. E. BROWN, CHAIRMAN OF THE BOARD, FIRST NATIONAL BANK OF CHICAGO

Senator DOUGLAS. Mr. Brown, did you have a prepared statement which you would like to read?

Mr. BROWN. No, Senator; I have no prepared statement. The questionnaire of your committee offered such a wide variety of subjects that it seemed to me difficult to give a prepared statement which would cover the many points in it. I would like to express my views briefly on three points.

Senator DOUGLAS. We will be very glad to have you.

Mr. BROWN. After that I will be very glad to answer any questions which you or the other members of the committee may desire to submit.

These three points are:

(1) The relationship of the Federal Reserve Board to the Treasury and the national administration;

(2) The power that the Federal Reserve should have to fix the reserves of banks;

(3) The question as to what agency or agencies should examine and supervise banks.

As to the first, the relation of the Federal Reserve Board to the Treasury and the national administration: Originally the Federal Reserve Board was conceived as an independent body. World War I broke out before the system was really functioning. Under the necessity of financing the war the policies of the Board had to be subordinated to those of the administration and the Treasury in practice. After the war came the depression of 1921 and the Board policies continued in practice to be those of the administration during the period up to 1933. When the Banking Act of 1935 was adopted, which gave the Board additional powers, it was still the view of Congress that the Board should be independent.

There were many statements to the effect that the depression wouldn't have occurred if the Board had been an independent organization in the Hoover and Coolidge and Harding administrations, and that the depression was partly caused by the fact that it had been subservient to the administration. To make the Board more independent the Secretary of the Treasury and the Comptroller were removed as ex officio members. The Board, according to the debates in Congress, was to be a supreme court of finance; statements were made that it should be as free as the Supreme Court of political pressures; the members were to have long terms, staggered, and to receive salaries equal to those of Cabinet officers.

Then came deficit financing and World War II with its legacy of a tremendous Federal debt and the problems of its management.

The Federal Reserve Board could not, under such circumstances, have been politically independent at any stage of its history. I do not believe that at any time in the foreseeable future it or any central bank can really be independent of the administration in power. The Board, in the final analysis, must adapt its monetary policies to the policies of the administration, no matter how it may feel about their wisdom. It must bow to the judgment of the Secretary of the Treasury in matters affecting the handling of the public debt and the interest rates thereon.

Granted that the Federal Reserve Board must conform its policies to those of the administration and the Treasury, it does not mean that it should become a subordinate bureau of the Treasury, or some other branch of the administration, or that its members should hold office only at the pleasure of the President or be appointed for short terms, or that their judgment and ability are relatively unimportant.

Decisions and actions in the field of monetary policy affect the whole economy. It takes a high degree of ability, technical experience, and judgment to make them wisely and to appraise their effects in advance.

The giving of sound advice on monetary matters to an administration or to its Secretary of the Treasury that must make the ultimate decision, and skillful carrying out of the monetary policies designed to implement an over-all general policy, are much more probable by a continuing board, made up of men of stature and of long tenure in office, than by any subordinate bureau.

To make it possible to get men of proper caliber and public stature to serve on the Federal Reserve Board, terms should be long and the salaries of Board members high enough both to indicate the importance of the position and not to penalize qualified men without private means. The present salaries of the Board members do neither.

Senator DOUGLAS. Even with the increase of a thousand dollars?

Mr. BROWN. Even with the increase of a thousand dollars.

Senator DOUGLAS. Of course, I was in favor of raising the salaries of the Federal Reserve Board members to $22,500, but we had a great deal of opposition from the friends of the Federal Deposit Insurance Corporation, who said that if you raised the Federal Reserve Board members to $22,500 the FDIC salaries should go up, too, and that seemed to be out of keeping with the rather limited responsibility which that group has. Sometimes, Mr. Brown, I suspected that there were certain banks in the country which were using the principle of equality of salaries between the Federal Reserve and FDIC to keep down the salaries of Federal Reserve Board members. I am much reassured by this testimony of yours. But I had thought that some of your colleagues wanted to keep the salaries of the Federal Reserve Board down. That may have been an unjust suspicion on my part.

Mr. BROWN. I think there is probably some justification in it.

Senator DOUGLAS. In any event without going into the question of what others think, so far as you are concerned you would be for an appreciable further increase in the salaries of the Federal Reserve Board members?

Mr. BROWN. I would. Given a competent Federal Reserve Board, the administration and the Secretary of the Treasury, I think, could be counted on to pay attention to its advice in matters affecting the monetary field, though reserving to themselves the final decision.

The Board should be allowed large freedom in monetary methods to implement and carry out the administration's or Secretary's policy.

Conversely the Federal Board should, even if its views were not followed, carry out and administer or direct policy finally adapted as such to the best of its ability.

Members of the Board differing with the policy could and should resign, if they regarded it of sufficient importance, and fundamentally wrong.

That is another reason for getting strong men on the Board. If we get men of stature, of proper caliber, they will resign if their views are not followed on a fundamental matter. It acts as a great check on Treasury or administration action.

It seems to me so self-evident, under present conditions, and conditions that will exist as long as we live, that the Board, in the last analysis, has to follow the policy of the administration in power, not only as regards management of the public debt, but facilitating the export of capital to Europe and the rest of the world, or what will you, or making possible easy credit for agriculture, housing, even if they disbelieve in it. This to me is almost axiomatic, and I think a whale of a lot of the time of Congress is lost and the public is confused by talking of the Federal Reserve Board as a really independent judicial body which is immune from political pressure, or should be immune from political pressure.

The second question is, what powers the Federal Reserve should have over the reserves of banks. In the first place, I am opposed to giving the Federal Reserve any power over the reserves of nonmember banks. With 85 percent or so of the deposits of the country in member banks, it does not need control of reserves against the other 15 percent to effectively control the volume of credit.

I might say in passing that the reserve requirements of a large percentage of the remaining 15 percent are set by State boards which tend to follow the reserve policy of the Federal Reserve Board. The advantage of access to credit from the Federal Reserve Bank is important, so important that no really large bank can afford not to be a member bank, and most medium-sized banks, and many small ones, are members.

Too high reserve requirements make it impossible for a bank to make money.

The fact that a small- or medium-sized bank can give up its membership in the System if, in its opinion, excessive reserve requirements offset the advantages of the System membership is a healthy restraining influence on the Federal Reserve Board in setting requirements for its member banks.

I do not want to argue here the dual banking system. I believe in it chiefly because it affords a check against arbitrary and unreasonable action or legislation by either a State or the Federal Government.

A bank can shift from a State charter to a national, and a national bank can shift to a State charter.

To give the Federal Reserve Board authority over State nonmember banks would be a first step toward the breaking down of the dual system.

I can't forget that in times past we have had highly capricious and arbitrary comptrollers. More recently, many States have had to deal with capricious and unreasonable State banking authorities.

The greatest check on arbitrary actions by a State or national supervisory authority is the ability, when conditions become too bad, to shift from a State into the national system, or from the national into the State.

Senator DOUGLAS. Of course, they were Comptrollers of the Currency, not Reserve Board members as much, as I remember.

Mr. BROWN. They were Comptrollers of the Currency, yes. They were not Federal Reserve Board members.

As to the reserve requirements of member banks, I believe that the Federal Reserve Board should have power to vary them within a limit, but with a maximum limit fixed by law at a figure which will enable banks to make sufficient profit so that they can absorb losses, maintain and build up their capital structures, and pay reasonable dividends.

If this is not done, I doubt if our present system of privately owned chartered banks can survive.

I believe present maximum limits to be about as high as they are tolerable.

The market value of bank stock today is almost universally less than the liquidating value of banks, due, I believe, to a fear that future legislators and governmental policies will cut bank earnings.

Changes in bank reserves should only be made rarely and when general basic conditions have changed.

Credit control should ordinarily be exercised by open-market operations and changes in the rediscount rate.

With these instruments of credit control, the maximum reserve requirements which the law now authorizes, we give the board adequate powers to control credit.

The present fixing of reserves, by central Reserve, Reserve, city, and country bank classifications lack logic, but the banking system, over many years, has adjusted itself to the arrangement. Some other method might be more logical and work as well or better, but a change should not be made without a detailed study of its effects on various classes of banks and banks in different localities. No change should be made which would increase the over-all percentage of the maximum reserve to total deposits that would be required from member banks as a whole above the present over-all percentage.

It seems to me clear that vault cash should be counted as reserve.

The question as to what agency or agencies should examine and supervise banks is the third matter which I would like to comment on. The guiding principle in bank examinations and supervision should be objective, for the purpose of protecting the banks' depositors and seeing that the bank examined or supervised is obeying the law.

Bank examinations and supervision should not be used as instruments to carry out a monetary policy, contracting or expanding credit, or of directing credit in specific directions.

If supervision and examination are exercised for the purpose of carrying out monetary policy, the examinations will not be as efficient in determining the safety and soundness of the bank as if the examinations were purely objective and made for that purpose.

It has been argued by members of the Federal Reserve Board, and it was argued by Mr. Eccles this morning, that examinations and supervision should be used as instruments of general over-all credit control and direction. I think that is a highly dangerous doctrine. No body of men, even the Federal Reserve Board, is able, with sufficient certainty, to predict the course of the economy, and put pressure on banks by examination or supervision as to when to loan, when to refrain from loaning, when not to make certain classes of loans.

I know, in the case of my own bank in the depression, that nine-tenths of our losses came from loans made after the begining of 1930, in an effort to, as we thought, help turn the tide, keep the depression from going deeper. Our losses weren't on loans made at the height of the boom. We lost enough money as it was, but I tremble to think what we would have lost if we had had pressure from Mr. Hoover's Comptroller or bank examiners and we had been under pressure to go out and loan even more liberally in order to keep the economy of the country from going down.

Granting my argument that bank examinations should be objective, not made for the purpose of carrying out monetary policy, the primary examinations of banks should not be made by the Federal Reserve System; they should be made by the Comptroller in the case of national banks, by the State authority in the case of State banks.

Since the FDIC and the Federal Reserve Board are both Federal agencies, and they are not satisfied with taking the reports of the State banking departments, they should have the right, which they now exercise, of joining in the examinations of State banks. The Federal Reserve Board, I suppose, theoretically, should have the right to join in the examination of national banks, if it wanted to, although it is difficult to consider one Federal agency not taking the report of the other. I don't believe any economy would be effected by combining the Comptroller, FDIC, and the Federal Reserve examinations.

It takes about so many examiners to examine so many banks, and I think the present system works well enough.

If it should be decided to consolidate examinations, I think the logical thing would be to put all the examinations under the Comptroller of the Currency, as being the supervising authority with the longest record in examining and supervising banks. The Comptroller's office has been at it now for a long time.

Senator DOUGLAS. Would you have him examine the State banks which are members of the Federal Reserve and FDIC respectively?

Mr. BROWN. I think it would do no harm. I think the present system works well enough and should be left alone; but, if there is a consolidation of bank examinations, my first preference would be to have the Comptroller conduct the examining functions for both State member and FDIC State nonmember banks.

I think the present system works relatively well, and I do not think there is any considerable overlapping, and I think examination policies are sufficiently coordinated to work out well.

Senator DOUGLAS. I take it that the two reasons why you believe if consolidation were to be carried into effect it should be under the Comptroller of the Currency, are: (*a*) That the group of national-bank examiners have a longer record and you regard them on the whole as more experienced and competent than the examiners attached——

Mr. BROWN. They have a longer tradition of freedom from political influence and political pressure.

Senator DOUGLAS. They are in a department headed by a political appointee.

Mr. BROWN. It may be, but the Comptroller's office has been brought up under an enviable record of freedom from political and personal pressure. At times it has shown signs of deterioration, but it has always come back.

Senator DOUGLAS. And also you believe that bank examination should not be connected with credit policy.

Mr. BROWN. I am very strongly of that opinion.

Senator DOUGLAS. And, therefore, you want to have it divorced from an agency which is also concerned with credit policy?

Mr. BROWN. Yes; I think it is sound to do so. I would be glad to answer any questions on any other points of the questionnaire that I may be able to.

Senator DOUGLAS. Before I turn to the first part of your testimony, could you comment upon the proposal to have the FDIC put in the Treasury?

Mr. BROWN. I do not see any advantage to be gained by it. I do not know that it would do any harm. The FDIC—the greatest number of its members are State banks, and I think that the State banks would prefer an independent Federal agency rather than a Treasury agency, and I think that the FDIC would probably function better independently than as a Treasury bureau.

Senator DOUGLAS. Mr. Brown, I was struck with many parts of your testimony, but I was struck by the statement that you thought it was desirable that State banks, members of the Reserve System, should be able to get out of the Reserve System if the reserve and other requirements imposed by the Board became arbitrary and not in the general interest, so they could have an avenue of escape, and that this would operate as a restraining influence upon the Board itself.

Now, what puzzles me is who is to tell what is arbitrary and what is in the public interest? There is a natural desire, which should not be condemned, on the part of the banks to not have any more of their assets tied up in reserves than is absolutely necessary, and an increase in reserve requirements diminishes the potential loaning power of banks.

But suppose you are in a period of inflation, and it may be in the public interest to check the loaning power of banks and not let them go to the maximum. The Reserve Board raises the reserve requirements; but the member banks, which are State banks, those State banks which are members, perhaps I should say, feel that the provisions are arbitrary and get out of the System in order to have a higher earning power.

Now, that is protection for the individual bank, but is it a protection for either (*a*) the economy as a whole or (*b*) the banking system as a whole?

Mr. BROWN. I think it is, because, in the first place, giving up membership in the Federal Reserve System means giving up very valuable privileges of access to the credit facilities of the Federal Reserve. A bank is not going to give up such privileges lightly unless it thinks it is heavily penalized.

In the second place, if the statutory maximums are not too high, the banks will expect to see those statutory maximums exercised in a period of inflation and will stay in the System. I think the proof of the pudding is in the eating. We had very few banks go out of the System with the present maximum during the inflationary period of the war and the immediate period following the war.

Senator DOUGLAS. But the amount of Government securities held by the banks is so large that, if they turn those in and get reserves in the Federal Reserve System for them, it gives them a tremendous potential lending power, which would not be checked by maintenance of present reserve requirements.

Mr. BROWN. That is another question than that of the banks getting out of the System. I think you have got to realize that the present policy of the Open Market Committee and the Treasury, if you want to put it that way—or as I think it is fundamentally and in the last analysis a Treasury policy—of buying all Government bonds that are tendered, and in the past supporting all Government issues at par or above, has undoubtedly weakened the credit controls of the Federal Reserve System.

That applies to national banks, which cannot get out of the System without giving up their national charter and all member banks. On the other hand, if you raise reserve requirements sufficiently high, as I tried to point out in my statement, you make it impossible for the private banking system to survive by cutting down on its earnings. I think it is better to take the chance of too much bank credit than to get rid of the privately owned chartered banks and substitute a collection of Government loaning agencies in their place.

A great many economists and bankers think that reserve requirements should be fixed by law and that the Federal Reserve Board should have no power whatsoever to vary them. I personally think the Board should have the power to vary them—but I think the maximum limits at all times must be placed at a level which will enable the private banking system to survive. I think in a discussion of reserve requirements. Not enough attention has been paid to the necessity of enabling banks to make reasonable earnings which will maintain and gradually build up their capital accounts and enable them to pay sufficient dividends.

As I said before, 99 banks out of a 100 in this country could be liquidated and pay anywhere from 25 to 50 percent more than the present market value of their stock. That is a highly unhealthy condition.

Senator DOUGLAS. I have some difficulty remembering always what the present size limits are, but as I understand it, the maximum limit for the central Reserve cities on demand deposits is 26 percent, for Reserve cities 20 percent, and for the country banks 14 percent.

Mr. BROWN. Yes.

Senator DOUGLAS. And that this in practice results in an average maximum reserve ratio of approximately 20 percent. That is, that the deposits in the country banks, as I remember it, are approximately equal to the deposits in the central Reserve city banks.

Mr. BROWN. You are speaking of——

Senator DOUGLAS. Demand deposits.

Mr. BROWN. Time deposits?

Senator DOUGLAS. Demand deposits only.

Mr. BROWN. I thought the over-all percentage was slightly less, something like 18½ or 19 percent.

Senator DOUGLAS. It is a weighted average.

Mr. BROWN. The weighted average somewhat less.

Senator DOUGLAS. Not far from the 20 percent.

Mr. BROWN. I know in the original Federal Reserve Act as it stood up to 1935 it contained maximums of 13, 10, and 7; and the Federal Reserve Board had no power to vary Reserve requirements.

In the discussions of the Banking Act of 1935 there was a great deal of discussion as to what the maximum should be. Before the Federal Reserve System, central Reserve city banks had operated with reserve requirements of 25 percent, which had to be kept in cash. It was felt that they had demonstrated they could live with a reserve of 25 percent in that it was a figure on which they could live; 26 percent was fixed as a compromise that was not very far from the 25; and they just doubled the reserve requirements, that is, from 13 to 26 and from 10 to 20 and from 7 to 14.

Senator DOUGLAS. I think I heard you say that you favored a uniform reserve requirement based on the type of deposit rather than according to the size of the city.

Mr. BROWN. I am quite sure I did not say that. I said that the present system was illogical and that another system might work as well or better, but that the banks of the country operated on this Reserve city, and central Reserve city and country classifications since the passage of the Federal Reserve Act, and a change should not be made without a careful study of its effect on different classes of banks and banks in different parts of the country, and that if a change was made to some other system, such as the so-called Bopp plan, the total over-all maximum reserves which could be required by the System should not be higher percentagewise than the present reserve requirements.

Senator DOUGLAS. If the weighted average is 18½ or 19 percent, would a uniform requirement on ordinary demand deposits, say, of 18½ but allowing vault cash to count as part of the reserve—would that be onerous upon the banks?

Mr. BROWN. No; I do not think so and it probably would not make as great difference between banks in different classes of cities as you suggest. All these plans contemplate a higher rate on interbank deposits. They are largely centered in New York and Chicago. Demand deposits would carry a higher rate than time deposits, and banks of central Reserve and Reserve cities generally have a higher percentage of demand deposits compared to total deposits, including time, than country banks do, but no study has ever yet been made—or, at least, I have not seen it—as to how it would hit the country bank.

It might upset whole regions or various classes of banks, and such a change should not be made until a careful study has been made of its effect.

Senator DOUGLAS. Have you any rough estimate as to what percentage of demand deposits should be kept in vault cash, as good banking practice? Have you a rough guess?

Mr. BROWN. There is no such thing as any standard practice. A large bank can keep a much smaller percentage in vault cash than a small bank can. A bank in Chicago, which can get currency from the Federal Reserve Bank in 15 minutes, needs much less cash, vault cash, than a bank in some country town, that has not even got a railroad in it, in Wisconsin.

Senator DOUGLAS. Suppose you had a uniform requirement of 18 or 19 percent. That would only be 5 percent above the present requirement on demand deposits for the country banks, and if you allowed vault cash, the difference might either be negligible or nonexistent.

Mr. BROWN. I do not know that there would be any particular objection by adding in all present vault cash held with the present required reserves and counting that. The theory of counting vaulting cash a part of your reserves is that vault cash today is in practice Federal Reserve notes, and of Federal Reserve control over reserves in Federal Reserve notes held by banks is just as effective an over-all credit control as control over balances carried at the Federal Reserve banks.

Senator DOUGLAS. If you were to have a uniform rate of 18½ or 19 percent, accepting your figures as a weighted average, that would increase the earning power of banks in the central Reserve cities by lowering their reserves and would increase slightly the earning power of banks in Reserve cities.

Mr. BROWN. I am not so sure, because I have not seen the tabulations, that if reserve requirements on interbank deposits were to be very large and if the deposits in the two central Reserve cities had a disproportionate amount of interbank deposits, their total reserve requirements might work out about where they are now.

Senator DOUGLAS. These differential rates of reserves, I assume, grew up in the days when the call money market was so important in New York primarily?

Mr. BROWN. No. I think that they date back to the formation of the national banking system in 1863. There was not any call money market. Banks had to carry certain reserves. Country banks could carry part of their reserves in deposits with banks in Reserve cities, which were supposed to be money centers. Banks in the Reserve cities could carry part of their deposits in central Reserve cities, of which there were originally three—New York, Chicago, and St. Louis.

Because of this pyramiding of bank reserves the cities which held deposits of other banks were subject to more sudden withdrawals of their cash and, consequently, they were required to keep larger reserves.

Senator DOUGLAS. May I go back to what you have discussed in the first part of your testimony—namely, the question of pegging prices and yields on governmental obligations with Federal Reserve action.

Now, Mr. Burgess said he thought that the Federal Reserve System should not do this. What would be your position? I think you have indicated it.

Mr. BROWN. I indicated first that I think in the last analysis the Federal Reserve Board has to follow the policy laid down by the Secretary of the Treasury and the administration, so that the decision is in the final analysis the decision of the Secretary of the Treasury rather than the decision of the Federal Reserve Board.

As Mr. Eccles stated this morning, up to 1948 I was one of those who believed that the long-term 2½'s should be supported at par. I urged that both as a banker—as a member of a committee which Mr. Morganthau had during the war advising the Treasury regarding war financing, also as a member of the Federal Advisory Council. A good many statements were made by the Treasury that they intended to support the price of Government bonds at par in the foreseeable future. No promise was ever made to the banking system that they would always be supported.

Senator DOUGLAS. Mr. Harl testified last week that in his judgment a promise had been made.

Mr. BROWN. I am quite sure it was not. The language of the Secretary of the Treasury was generally pretty carefully chosen. The words used were generally "in the foreseeable future."

Since the middle or latter part of 1948 the price of the long-term 2½'s has advanced very considerably above par. The bank eligible 2½'s of the longest issue are today selling at 106 or 107. The ineligible long-term 2½'s are selling around 104. That is about 2¼ percent yield basis.

I think the Treasury could now announce that they intended at all times to support an orderly market, but that the "foreseeable future" had passed, if you want to put it that way, that under present conditions they did not feel they had obligations to support Government bonds at par at all times, that in the future they might very well do so but they were not obligated to do so. I do not think there is the slightest possibility if such an announcement were made today, that Government bonds of any issue would break below par.

Then I would have the Treasury or Federal Reserve Board or Open Market Committee, acting under the domination of the Treasury, maintain orderly markets. I would leave it to the future to determine that when the price got down to par or close to par on the long-term issues, whether they should not in effect step in and support the bonds at par without making any public statements that they would do so. I do not think there would be any lack of confidence. I think it would restore a great deal of flexibility to the Federal Reserve System and that in the long run it would help the Treasury in its problem of debt financing.

I want to state that I differed from a great many bankers on conditions as they existed up until about the middle of 1948. I looked at an announced policy of supporting the long-term $2\frac{1}{2}$'s at par as necessary and desirable.

Senator DOUGLAS. No support is needed now, is there?

Mr. BROWN. No support is needed now with the premiums. I know, in spite of Mr. Harl's statement, of no promises by the Government that they were always going to support long-term Government bonds at par. I think Mr. Eccles this morning indicated that he knew of no such promises. Mr. Burgess certainly stated in his testimony, as reported in the papers, and in his published statement, that he knew of no such promises by the Government. A good many people think they will be supported, yes, but I think now is the time for the Treasury to clarify it.

They did issue a sphinx-like statement between the Treasury and the Federal Reserve Board, which nobody could understand—and I think it was purposely drawn so that nobody could understand it—that they had changed their Government-support policy, and left everybody wondering whether they were promising to support bonds at par or whether it was an indication that they were edging away from the practice of doing it.

Senator DOUGLAS. Did I understand correctly that you thought the bonds should not be permitted to fall appreciably below par?

Mr. BROWN. I did not believe they should be allowed—I did not think they should be allowed to fall anywhere below par up to the summer of 1948.

Senator DOUGLAS. How about now?

Mr. BROWN. If I were running the Treasury or the Federal Reserve System as of now, I would announce I felt no obligations, and if the bonds should by any chance break to par, I would in practice support them at par, but I would not make any promise to do it. Perhaps it is fortunate for me as well as the country that I am not running the Treasury.

Senator DOUGLAS. Do you think that a slight increase in yields caused by a fall of 4 or 5 points in the price of Governments would have any real deterrent effect upon the amount of private credit loaned by banks? That would be a change of less than one-quarter of 1 percent in yield.

Mr. BROWN. I do not know so much about the credit extended by banks. I think it would have a great over-all effect on the long-term market. I think the municipalities and large corporations borrowing long-term money would be greatly influenced by a change of as much as a quarter of 1 percent in the interest rate.

Senator DOUGLAS. They would not borrow as much?

Mr. BROWN. They would not make improvements and capital expenditures or pay bonuses or what not if they had to pay a higher rate of interest and, therefore, a change in the interest rate would have a deflationary effect, if you want to call it such, on the total over-all expansion of credit.

Senator DOUGLAS. So you think that if we were to go into inflation, and if the Government bonds would still then sell above par, you think it might be a good means of checking inflation to allow the price of Governments——

Mr. BROWN. To drop to par on the long ones, and it would not worry me if some of the intermediates ones got to 99 or some such price in the process.

Senator DOUGLAS. You would not permit a run-away market with the price of Government bonds breaking to much lower limits?

Mr. BROWN. No; I think the Government has to maintain an orderly market in its bonds at all times. It cannot allow panicky conditions to get under way.

Senator DOUGLAS. Of course, there are some who say don't have the Government support the price at all; let the Reserve System get out and then let the price of bonds be determined by "market forces."

Mr. BROWN. Well, that cannot be worked that way. The Federal Reserve System holds so many Government bonds that it can determine the yield on them by the price it pays for them, the price it sells them. It can determine short-term rates, and short-term rates if they rise will have a somewhat depressing effect on long-term yields.

Senator DOUGLAS. In other words, the Federal Reserve System is part of the market, and if you take it out you will alter the market.

Mr. BROWN. Yes; and the Federal Reserve System or some of the spokesmen—I think Mr. Eccles said this morning we are out of the market on the long-term bonds. They cornered all the floating supply of long-term bonds, and now they will not sell them when the price is up.

If that happened on the Board of Trade in Chicago, that would be called cornering wheat or lard or something, but if it is done by the Federal Reserve Board or the Treasury it is a somewhat different thing.

If they wanted to sell some of their large holdings of ineligible long-term bonds, they could cause the price to go down a point or two, to my mind, to the benefit of the whole economy.

Senator DOUGLAS. We had a study made, Mr. Brown, on the requirements relating to the safety and soundness of banks, which requirements were imposed by the Federal Reserve System as a condition of membership of State banks in the Federal Reserve System. We got some 30 requirements, which I read to Mr. Harl last week, which are not required by FDIC itself.

Would there be any value of attaching these requirements dealing with safety and soundness to membership in the FDIC system rather than to membership in the Federal Reserve System and thus reaching a broader band of deposits in banks?

Mr. BROWN. I do not know what the requirements are, Senator. I probably should know.

Senator DOUGLAS. They are as follows:

1. Limitations on total loans to one borrower.
2. Regulations governing purchase of investment securities.
3. Prohibition against purchasing stocks.
4. Prohibition against engaging in underwriting of investment securities and stocks.
5. Restrictions on loans to executive officers.
6. Restrictions on dealings with directors.

7. Restrictions on interlocking directorates or other interlocking relations with other banks and with securities companies.

8. Prohibition against bank having less than 5 or more than 25 directors.

9. Provision authorizing supervisory authority to remove officers and directors for continued violations of law or continued unsafe or unsound practices.

10. Prohibition against affiliation with securities company.

11. Restriction on holding companies affiliates.

12. Restrictions on bank stock representing stock of other corporations.

13. Limitations on loans to affiliates.

14. Requirements of reports of affiliates and publication thereof.

15. Requirements for examination of affiliates.

16. Limitations on investment in bank premises.

17. Minimum capital requirements.

18. Minimum capital requirements for branches.

19. Prohibitions against loaning on or purchasing on stock.

20. Restrictions on withdrawal of capital and payment of unearned dividends.

21. Requirement that reserves specified in the Federal Reserve Act be maintained.

That is a debatable one.

22. Prohibition against making loans or paying dividends while reserves are deficient.

23. Requirement for specific number of condition reports annually and for publication thereof.

24. Requirements in connection with the par clearance collection system.

25. Prohibition against false certification of checks.

26. Limitations on acceptance powers.

27. Prohibition against acting as agent for nonbanking institutions in making loans to brokers and dealers in securities.

28. Limitations on loans to one borrower on stocks or bonds.

29. Limitations on aggregate loans to all borrowers on stocks or bonds.

30. Limitations on deposits with nonmember banks.

As I understand it, these are provisions relating to the soundness of the individual bank which are imposed on members of the Reserve System which are State banks.

Mr. Brown. I would not say many of them had much to do with soundness. They might have something to do with over-all governmental policy.

I think, if you tried to make all those conditions a condition for membership in the FDIC, a lot of banks would decide to get along without the FDIC membership, the small banks in particular.

Senator Douglas. On the other hand, under FDIC you assume a liability that the bank may fail, and that normally should carry with it some powers to protect you against the excessive danger that the liability may occur.

Mr. Brown. Yes; but I think most of those regulations that you read only incidentally deal with the soundness of a bank.

Senator DOUGLAS. Well, I should think a good many of them dealt——

Mr. BROWN. A good many do, but others deal with other matters of Federal policy.

Senator DOUGLAS. Restricting the power of the insiders to use the banks privately.

Mr. BROWN. A good many of them are in the nature of restrictions which are now imposed on national banks.

Senator DOUGLAS. Yes; I think they are, but not on State banks.

Mr. BROWN. State nonmember banks.

Senator DOUGLAS. Except insofar as the States specifically provide for them.

May I ask you a question or two on the gold and silver policy?

Mr. BROWN. Yes.

Senator DOUGLAS. There has been some talk of advocating the restoration of the unlimited convertibility of money or Federal Reserve notes into gold coin or gold bullion. Has the Federal Advisory Council taken any position on that subject?

Mr. BROWN. They have. All 12 members as recently as last week stated their belief that at this time convertibility of the currency to gold coin was neither feasible nor desirable. We felt that as an ultimate objective of monetary policy it was desirable and that studies should be made as to how it might be ultimately brought about.

We felt at the present time the unsettled condition of the world, the desire to hoard money, both at home and abroad, would make it highly undesirable to adopt such a policy at the present time.

We did recommend, or did feel—I will not say recommend—that Congrss should repeal the act of 1934, which gives the Secretary of the Treasury the power to buy or sell gold at home or abroad in any amount at any price he may see fit.

Senator DOUGLAS. It is a favorite subject of Congressman Wolcott.

Mr. WOLCOTT. There has been some doubt raised as to whether the Treasury has the authority to change the rate. It all stems back to what Mr. Brown referred to, the fact that they may do it, perhaps those provisions which are not completely offset by the provisions in the Bretton Woods Agreement to the contrary. The question seems to be as to whether the authority in the Gold Act to buy and sell supersedes or has been repealed by the Bretton Woods Act.

If there is a dispute there, it should be corrected.

Mr. BROWN. There seems to be some doubt about it. I think the opinion of most lawyers is that since the act adopting the Bretton Woods agreements contains the provision that the President or any person acting on behalf of the United States should not propose or consent to any change in the gold value of the dollar the Treasury has lost its authority.

Mr. WOLCOTT. I think perhaps Mr. Brown would agree with me that it was our intent to prohibit it, but whether we did or not seems to be in dispute.

Mr. BROWN. I think it was a clear intent to prohibit it, and I think it has probably been done, but there seems to be enough doubt about it to make it desirable to clean up the doubt. I believe Mr. Snyder in a press release stated that the price for purchases and sales of gold could not be varied without the consent of Congress, but even that statement of his is not final. The attitude of the Council—and it is my own attitude, incidentally—is that convertibility is not feasible nor desirable at the present time, but as an ultimate objective of monetary policy it is, and that the gold value of the dollar should not be changed, and it would be desirable, since uncertainty does exist because of this act of 1934 being still in force and effect, to repeal it or amend it so as to make it clear that the gold value of the dollar cannot be changed without the consent of Congress.

Senator DOUGLAS. What are the advantages, as you see them, in ultimate convertibility?

Mr. BROWN. I think the value of ultimate convertibility is that it tends to check the creeping decline in the purchasing power of the dollar. Nations devalue; they never increase the value of their currency, practically speaking.

Senator DOUGLAS. England did in 1924.

Mr. BROWN. England did temporarily, with unfortunate results. It went back to the gold standard; we went back to the gold standard after Civil War days; but if currency was convertible into gold, since gold has a commodity value, if you want to call it such, it would make it less likely that the dollar will keep on decreasing in purchasing power indefinitely.

I think also, granted somewhat normal circumstances, the feeling that a lot of people may want to get gold might have some effect on Congress in matters of deficit financing and expenditures. You are familiar with the arguments against it of Mr. Sproul and others, but I still believe on the whole that, granted a stable world, free of the fear of war, ultimate gold convertibility is desirable.

Senator DOUGLAS. That is on the ground that there are more rigid limits to the supply of gold than to the potentiality of man's foolishness?

Mr. BROWN. Exactly, and also the belief that the value of gold is determined by the cost of the marginal production, and if currency is convertible into gold the dollar as a measure of value would have more stability over a period of years than it otherwise would without convertibility.

Senator DOUGLAS. Of course, we had a very sharp rise in prices from 1896 to 1914 under the gold standard.

Mr. BROWN. That was due to the fact that South African production came in at that time. Probably the ability of the United States to go back to the gold standard after the Civil War was largely influenced by the gold production of the Virginia lode in Nevada at that time. I do not think the gold standard is by any manner of means an infallible standard. If you could work out Professor Fisher's stable dollar in a practical way, I think I would favor it. I do not see that it can very well be worked out, but I am very certain that the value of gold bullion or gold coin, which is the same thing, is more likely to be stable over a period of years than an arbitrary value set by political bodies or governments on their monetary standards.

Mr. WOLCOTT. Mr. Brown, if the United States and the other former gold countries went back on a gold convertible basis, what would you anticipate would happen to the international fund?

Mr. BROWN. I do not know that I quite got your question.

Mr. WOLCOTT. If we went back on the gold standard——

Mr. BROWN. You mean gold convertibility standard?

Mr. WOLCOTT. Yes; and all the other former gold convertible countries did likewise——

Mr. BROWN. At the present time?

Mr. WOLCOTT. No; finally when this can be brought about—what would be the future of the international fund?

Mr. BROWN. Oh, I think it would lapse into innocuous desuetude that probably would not be harmful.

Mr. WOLCOTT. What did you call it?

Mr. BROWN. Innocuous desuetude.

Senator DOUGLAS. That was launched into political language, I believe, by Grover Cleveland, so it has a very respectable lineage.

Mr. WOLCOTT. I think I know what it means now, with the context.

Mr. BROWN. Pardon me for not making myself clear.

Mr. WOLCOTT. It is excusable under the circumstances.

Senator DOUGLAS. Mr. Brown, what specific recommendations, if any, would you make to increase the effectiveness and independence of the Federal Reserve System? You propose to increase their salaries?

Mr. BROWN. I have already said I proposed an increase in salaries to attract men of greater stature. I do not know but that the Board could function as well or better with five members as against seven. To be one of a group of five is probably somewhat more attractive than to be one of a group of seven. I do not believe that membership of the Board should be more than seven. I think the present size of the Board and the terms of its members are effective. I do not think any change in the number or tenure of the Board would be of sufficient importance to make it desirable to make the change.

Senator DOUGLAS. Do you want to increase the statutory powers of the Board?

Mr. BROWN. No.

Senator DOUGLAS. Do you want to decrease the statutory powers of the Board?

Mr. BROWN. No. Believing as I do that in the last analysis the Board has to go along with the administration, I think its statutory powers are less important than the character of the Board and its members.

Senator DOUGLAS. What are the weaknesses of the Board or of the System, rather, as you see it?

Mr. BROWN. That is a hard question to answer. I would say the greatest weakness in the past has been that at all times it has not had men of proper stature on it. Please do not ask me to specify what times and what men.

I think I have known every member of the Board since it was formed in 1913, but I really think that in the long analysis of the Board, its greatest fault has been that either proper men have not been appointed to it or that men whom it was desired to appoint would not take the appointment.

Senator DOUGLAS. Do you see any advantage in Congress giving to the Treasury and to the Federal Reserve System more definite instructions concerning the operations of the Open Market Committee?

Mr. BROWN. No; I think that would be highly detrimental to the working of the System.

Senator DOUGLAS. And no instructions to the Secretary of the Treasury?

Mr. BROWN. No. The administration of government has to be worked out between men just as the organization of any large business has to be. Instructions and charts do not count as much as good will and intelligent cooperation.

Mr. WOLCOTT. May I ask a question in there?

Senator DOUGLAS. Yes.

Mr. WOLCOTT. Would you recommend that the make-up of the Open Market Committee be changed in any way?

Mr. BROWN. No; I think the present compromise is a good compromise.

Senator DOUGLAS. Well, you say that the Reserve Board must in the nature of the case be more or less subordinate to the Secretary of the Treasury as regards open-market operations, but does not the Secretary of the Treasury almost inevitably tend to have a prejudice in favor of low interest rates because that means a smaller burden of carrying the debt and makes the refunding problems less than otherwise would be the case?

Mr. BROWN. I do not think that is actually the case. The Secretary of the Treasury has to consider the burden of the interest charge in connection with the total budget, but I think he realizes that a proper rate structure will by promoting general prosperity of the country probably increase tax receipts more than the interest charge would be increased; and in my discussions with various Secretaries of the Treasury I have never seen any indication of such a consistent and hard-boiled attitude in favor of very low rates on their part.

Senator DOUGLAS. Do you want to comment upon the silver-purchase policy of the Government?

Mr. BROWN. I cannot make any better comment than the one Lord Keynes made at the time of Bretton Woods, and there was talk of using silver as a monetary base, the Government buying it. He said, "Why not buy Irish potatoes?" We are buying Irish potatoes and buying silver, and buying Irish potatoes is about the same degree of foolishness.

Senator DOUGLAS. Silver is not as perishable.

Mr. BROWN. If you want to subsidize both of them, all right. If you want to subsidize the potato producer in New Jersey or in Maine, or subsidize the silver producer, let them do it, but it should not be called monetary policy.

Senator DOUGLAS. I take it, then, that you are not enthusiastically in favor of the silver-purchase policy.

Mr. BROWN. I think it is just a subsidy and I think it is an entirely unjustified subsidy, even less justified than the subsidy to the potato growers.

Senator DOUGLAS. I have no more questions.

Mr. WOLCOTT. I do not know that I have, except the comment that I think we disposed of the silver question at Bretton Woods by a resolution that they study the problem.

I do not know whether Mr. Brown wants to do it—perhaps it has gone in the record—but should we not have in the record the advantages to banks of going in and staying in the Federal Reserve System that are not enjoyed generally by nonmember banks? I do not know if Mr. Brown wants to take the time to do that.

Mr. BROWN. Haven't some of the Federal Reserve banks published books on that? I am pretty busy and I do not have a staff of economists at my disposal.

Mr. WOLCOTT. That is why I put the question as I did. You probably would not want to give an offhand opinion without study. We can get it.

Senator DOUGLAS. If there is nothing further, thank you very much, sir.

(Whereupon, the committee adjourned at 4 p. m., to reconvene at 10 a. m., Wednesday, November 23, 1949.)

MONETARY; CREDIT, AND FISCAL POLICIES

WEDNESDAY, NOVEMBER 23, 1949

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON MONETARY, CREDIT, AND FISCAL POLICIES,
JOINT COMMITTEE OF THE ECONOMIC REPORT,
Washington, D. C.

The subcommittee met, pursuant to adjournment, at 10 a. m., in the caucus room, Senate Office Building, Senator Paul H. Douglas (chairman of the subcommittee) presiding.

Present: Senator Douglas (chairman of the subcommittee); Senator Flanders and Representative Wolcott.

Also present: Dr. Grover W. Ensley, acting staff director; and Dr. Lester V. Chandler, economist to the subcommittee.

Senator DOUGLAS. Ladies and gentlemen, I think perhaps it would be well if we opened the proceedings.

In general, we have tried, by submitting questionnaires to people in advance, to which they made detailed replies, to obviate the necessity for reading a prepared statement, and to enable us to plunge immediately into a discussion of the issues involved, but the Committee for Economic Development has been probing some of these issues for some years, and, since our questionnaire was addressed to individuals and did not cover organizations, we have asked Mr. J. Cameron Thomson and Mr. Beardsley Ruml, representing the Committee for Economic Development, to appear. We are going to waive our usual procedure and suggest that they read the statement which they have prepared; and, after that, we will move in to questions.

Mr. Thomson.

STATEMENT OF J. CAMERON THOMSON, PRESIDENT, NORTHWEST BANCORPORATION, MINNEAPOLIS, MINN., ACCOMPANIED BY BEARDSLEY RUML, VICE CHAIRMAN OF THE RESEARCH AND POLICY COMMITTEE, COMMITTEE FOR ECONOMIC DEVELOPMENT, NEW YORK CITY

Mr. THOMSON. This is a prepared statement. I believe that everybody has a copy. With one exception, I will confine my statement to this prepared statement.

I am J. Cameron Thomson, president of the Northwest Bancorporation, Minneapolis. In response to your invitation, I appear here as chairman of the monetary and fiscal policy subcommittee of the research and policy committee of the Committee for Economic Development.[1]

I shall present a statement describing the views of our research and policy committee on the questions before your subcommittee. Mr. Beardsley Ruml, of New York City, vice chairman of the research and policy committee, is here with me; and we shall both be available for questioning.

The Joint Committee on the Economic Report has before it one of the three or four great problems of our time—how to maintain high employment in a free dynamic society without serious inflation. A repetition of anything like the experience of the thirties would be more than an immediate economic catastrophe to the American people. It would set off a chain of disastrous consequences in political and social organization, domestically and internationally.

The idea that great economic instability is inevitable in a free society is one of the most dangerous ideas at large in the world today. The Committee for Economic Development was established in the belief that this idea is not only dangerous but false. The Employment Act of 1946, which is the charter of your committee, expresses the national belief that economic stability can be maintained by democratic methods in a free competitive economy. Having expressed this belief, it is now up to all of us to prove its truth. This requires, first of all, that we should actually avoid serious depression and great inflation. But this alone would not be enough. We should not be satisfied just to go on from day to day avoiding depression and inflation. We need institutions and policies that deservedly create confidence that our economy will continue to be stable.

We need a positive program for greater economic stability. Such a program cannot be simply drawn up by economists and enacted by

[1] The Committee for Economic Development is an organization of businessmen formed to study and report on the problems of achieving and maintaining a high level of employment and production within a free economy. Its research and policy committee issues from time to time statements of national policy containing recommendations for action which, in the committee's judgment, will contribute to maintaining productive employment and a rising standard of living. Following is a list of the members of the Committee for Economic Development research and policy committee:

COMMITTEE FOR ECONOMIC DEVELOPMENT RESEARCH AND POLICY COMMITTEE

Marion B. Folson, chairman, treasurer, Eastman Kodak Co., Rochester, N. Y.
Beardsley Ruml, vice chairman, New York, N. Y.
William Benton, chairman of the board, Encyclopaedia Britannica, Inc., and Muzak Corp., New York, N. Y.
John D. Biggers, president, Libbey-Owens-Ford Glass Co., Toledo, Ohio
James F. Brownlee, Long Meadow Road, Fairfield, Conn.
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S. Sloan Colt, president, Bankers Trust Co., New York, N. Y.
Gardner Cowles, president and publisher, Des Moines Register and Tribune, Des Moines, Iowa
Chester C. Davis, president, Federal Reserve Bank of St. Louis, St. Louis, Mo.
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Philip L. Graham, president and publisher, the Washington Post, Washington 4, D. C.
John M. Hancock, partner, Lehman Bros., New York, N. Y.
George L. Harrison, chairman of the board, New York Life Insurance Co., New York, N. Y.
Robert Heller, president, Robert Heller and Associates, Inc., Cleveland, Ohio.
Jay C. Hormel, chairman of the board, Geo. A. Hormel & Co., Austin, Minn.
Amory Houghton, chairman of the board, Corning Glass Works, Corning, N. Y.
Eric Johnston, president, Motion Picture Association of America, Inc., Washington, D. C.
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Meyer Kestnbaum, president, Hart, Schaffner & Marx, Chicago, Ill.
Fred Lazarus, Jr., president, Federated Department Stores, Inc., Cincinnati, Ohio.
Robert A. Lovett, partner, Brown Bros., Harriman & Co., New York, N. Y.
Fowler McCormick, chairman of the board, International Harvester Co., Chicago, Ill.
W. A. Patterson, president, United Air Lines, Chicago, Ill.
Philip D. Reed, chairman of the board, General Electric Co., New York, N. Y.
Harry Scherman, president, Book-of-the-Month Club, New York, N. Y.
H. Christian Sonne, president, Amiinck, Sonne & Co., New York, N. Y.
J. Cameron Thomson, president, Northwest Bancorporation, Minneapolis, Minn.
W. Walter Williams, president, Continental, Inc., Seattle, Wash.
Theodore O. Yntema, vice president in charge of finance, Ford Motor Co., Dearborn. Mich.

legislators. If the program is to be effective, it will have to grow out of a responsible discussion in which all viewpoints are represented. It will have to be understood and accepted by the American people. In the process of discussion, we shall have to avoid accepting ideas as true just because they are old or, equally dangerous, just because they are new. Moreover, we should recognize that reaching wise decisions can only be impeded by attempts to make it appear that the goal of economic stability is the private property of any group or party. We all share this objective in common. We have all made mistakes; we have all learned something; and we all have much to learn.

I know that the committee invited me down here to express the views of the CED on certain specific questions, and I hope that the remarks I have just made will not seem too far afield. But I am sure this subcommittee knows that it will not reach final answers to all the questions before it in the limited time it has available. Even if time were unlimited, there would always be new questions emerging as old ones were settled. The job upon which you and the Nation are engaged—the pursuit of greater stability—will be a continuing job. How well we do it will depend upon the effectiveness of the process by which we seek decisions. I hope that in your report to your colleagues and to the American people you will urge upon them the need for continuing, responsible participation in the development of policy.

THE IMPORTANCE OF MONETARY, FISCAL, AND DEBT POLICY

I should like to turn now to the area with which your subcommittee is chiefly concerned. I believe that the greatest opportunities in the Federal Government for contributing to economic stability lie in this area; namely, fiscal, monetary, and debt-management policy. Obviously, the Federal Government must have a policy, or at least must act, with respect to its budget, its debt, and the money supply. It is equally obvious that this action is going to affect the stability of the economy. And, when we face a $40,000,000,000 budget and $250,000,000,000 Federal debt, the effects of Federal action upon economic stability become of paramount importance.

Senator DOUGLAS. That is now a $44,000,000,000 figure?

Mr. THOMSON. That is right.

In emphasizing the importance of fiscal, monetary, and debt-management policy, I do not want to give the impression that nothing else needs to be done. On the contrary, public and private policy with respect to international economic affairs, prices and wages, agriculture, and many other matters have much to contribute in a rounded stabilization program. But it seems to me very unlikely that these other policies can make an effective contribution if fiscal, monetary, and debt policies are erratic or perverse from the standpoint of stability.

I want to draw a sharp distinction between fiscal, monetary, and debt-management policies on the one hand and direct controls on the other hand. By direct controls I mean such measures as Government price controls, wage controls, rationing, allocations, and controls over the direction of investment. Failure to distinguish between these two kinds of measures is responsible for much confusion in public discussion and could lead to serious error in public policy. Two kinds of confusion are common. One is to reject the attempt to achieve greater stability by fiscal, monetary, and debt-management policies by putting these policies in the same class with direct controls over the details of private economic activity. The other is to accept and justify all manner of direct controls by putting them in the same class with indirect financial measures for stability.

Senator DOUGLAS. I don't want to interrupt continually, but I have felt that the banking fraternity did not always understand the difference between these two types of controls and that they argue against the control of credit as though it were an infringement solely and exclusively upon private business.

Mr. THOMSON. I don't think that applied to the banking fraternity solely, but I admit it does apply to us sometimes.

Fiscal, monetary and debt policies are appropriate means for attacking the problem of instability in a free society. The problem of instability is essentially a problem of broad forces affecting the over-all magnitudes of the economy. The problem arises when millions of workers are simultaneously unemployed or when there is a general, although probably uneven, rise of most prices. The advantage of fiscal, monetary, and debt policies is that they allow the Government to influence the over-all forces, especially the level of aggregate demand, that determine the stability of the economy without necessarily involving the Government in detail control of the particulars of the economy. These over-all measures will, of course, affect different individuals and businesses differently. But the differences are determined by the market process, not by Government decisions. The Government does not have to make decisions that are with rare exceptions better left to the market—the price of shoes relative to the price of automobiles, whether the ABC company or the XYZ company should prosper, what kind of a job John Jones or Robert Smith should have.

Direct controls do involve Government decision about the particular interrelationships of the parts of the economy. One virtue claimed for them by their advocates is that they are selective. But adding together a very large number of selective controls is surely a clumsy, expensive, inefficient, and politically dangerous way to get the over-all effect needed to deal with the stability problem. While the market process is not perfect, any general substitution of Government decisions for it would result in serious loss of efficiency, progress, and stability.

But more than efficiency, progress and stability are at stake. Freedom is also at stake. Any widespread system of direct controls would necessarily involve widespread power of government to affect the economic fortunes of particular individuals, businesses, industries, and regions selectively; that is, discriminatingly. This power would have to be exercised by the Executive subject to only the most general statutory limitations. It would be the power to reward or punish, to coerce, by administrative action. The existence of such a power would ominously threaten the survival of our free society for so long as the free society might endure.

We hear the concepts of "freedom" and "statism" used so much and so loosely that we become callous and impatient with them. But on the specific problem of this subcommittee I am convinced that the importance of fiscal, monetary, and debt policy will not be sufficiently appreciated until we learn to make the distinction between power to coerce individuals and power to affect the general behavior of the economy. A precise line cannot be drawn between appropriate and inappropriate powers, yet we must recognize that there is a direction in which we should not move except in cases of clearest necessity and even then only with utmost caution.

Senator DOUGLAS. May I say that this is almost precisely the distinction which Mr. Williams, president of the Federal Reserve Bank of Philadelphia, drew between general controls exercised through the supply of money and credit affected by debt management on the one hand and direct controls exercised by the Government on the other.

THE UNITY OF FISCAL, MONETARY, AND DEBT-MANAGEMENT POLICIES

One of the things we have learned most definitely from CED's studies in the fiscal-money-debt field is that the three instruments are inseparable.

I might say that is one of the things we have learned. The first statement that CED made was on taxes. Then we made one on taxes and the budget and then one on fiscal, monetary, and debt-management policies. We are going to deal with tax policy in our statement in January; but the long-range statement will be on fiscal, monetary, and debt management as well. So we have been learning.

It will not be possible to work out a satisfactory policy that uses one of the three instruments alone. If you try to develop a stabilization program relying solely on fiscal policy, you will find that, while fiscal policy is very powerful, it is not sufficiently flexible to be effective alone in some circumstances and in other circumstances can be effective alone only at the sacrifice of other important objectives. If you try to develop a stabilization program relying solely on money and debt policy, you will find that, while the instrument is very flexible, it may not be sufficiently powerful for your purposes in some circumstances.

This means more than that the instruments must be used consistently. It means that the instruments should be combined in a program that achieves the desired net effect most efficiently by using the special capacities of each instrument. At some times this may involve having budget policy running counter to monetary-debt policy. For example, suppose that in some period not calling for inflationary action we are faced by a sudden, large, and temporary increase in Federal expenditures. To keep the budget from having an inflationary effect, it might be necessary to raise tax rates temporarily by a large amount. However, it would ordinarily be better not to raise tax rates in this way. Rather, we should follow more restrictive monetary and debt policies to offset the temporarily inflationary effects of the budget. This would not be inconsistent policy so long as the combined program avoids inflation and each part of the program does what it is best suited to do.

THE STABILIZING BUDGET POLICY

CED recognizes that it does not have the final answers to all the problems of an integrated money-budget-debt policy for economic stability. We think we have learned some important things. Also, we are encouraged by the fact that a consensus seems to be emerging among students of this subject and that the CED recommendations lie within the range of this consensus. However, we are aware of a number of unsettled problems and are planning to continue our work in this field.

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What I have to say this morning is in the nature of a progress report rather than a final report.

Senator DOUGLAS. The modesty with which you advance this program is very disarming, I may say.

Mr. THOMSON. I am very, very humble when I sit here representing CED on this very important subject.

I would like to read from our 1947 statement, Taxes and the Budget, page 20, a description of the three alternatives on budget policy. [Reading:]

There are three distinct alternatives in budgetary policy:

1. *The annually balanced budget policy.*—This policy attempts to keep Government revenues continuously equal to or in excess of Government expenditures, regardless of economic conditions.

2. *The managed compensatory budget policy.*—Under this policy, attempts would be made to adjust tax rates and expenditure programs as often as necessary and to the extent necessary to keep employment or the national income steady at a high level.

3. *The stabilizing budget policy.*—This policy is described herein, and advocated as the most practical method of achieving all the objectives of budgetary policy. Its basic principle is to set tax rates to balance the budget and provide a surplus at agreed high levels of employment and national income and thereafter to leave them alone unless there is some major change in national policy or condition of national life.

ANNUAL BUDGET BALANCING

The annual-balance policy cannot be made to work, and the effort to make it work accentuates inflations and depressions. With its inevitable break-down fiscal policy becomes a mere day-to-day expedient.

This program requires that, whenever a decrease in the national income is forecast, tax rates must be raised or expenditures cut, or both, to prevent a budget deficit. Whenever the forecast of higher national income promises larger surpluses, it not only permits but invites a cut in tax rates and a rise in expenditure programs. On the record, the program meant tax cuts in the prosperous twenties, and tax increases in the depressed thirties.

The implications of such a program are clear:

(*a*) Tax rates and expenditure programs will be changed at times and in directions most harmful to high employment and stable prices. When incomes are low and unemployment is widespread, tax rates must be raised and Government expenditures cut. In boom times the program welcomes tax reductions and new expenditures.

(*b*) Annual budget-balancing policy does not in the long run promote Government economy. The program allows a growth of public expenditures in boom times, without any increase of tax rates, even with a decrease in tax rates. The policy does not furnish steady pressure against the initiation of unnecessary expenditures; the pressure it does provide, to end entrenched expenditure programs in depressions, is certain to be ineffective.

(*c*) The system dissipates the potentially large surpluses of good times and strives vainly for balance in bad times. In a fluctuating economy this program will not result in debt reduction.

(*d*) To carry out the program requires a degree of accuracy in forecasting fluctuations in business activity that has not been achieved in the past and that is not possible now.

(*e*) The program involves irregular and unpredictable variations of tax rates, with unsettling effects upon business and personal planning.

THE MANAGED COMPENSATORY BUDGET POLICY

The theory of the managed compensatory budget is simple. Whenever employment is judged "about to be" below a high level, taxes should be cut and expenditures increased by the amount necessary to prevent the forecast from coming true. Whenever prices seem "about to be" above the proper level, tax rates must be raised and expenditures cut.

Dependence upon accurate forecasting of business fluctuations is even greater for the compensatory budget than for the annually balanced budget. If forecasting is inaccurate, the compensatory budget could easily increase fluctuations rather than moderate them.

Senator DOUGLAS. I suppose you could point in that connection to the failure of most of the forecasts in the fall of 1945, when the vast preponderance of forecasters estimated that there would be 8 to 10 to 12 million unemployed by the spring of 1946, and if we had followed that policy we would then have expended expenditures and reduced taxes and therefore have added enormously to the inflation which actually occurred?

Mr. THOMSON. That is a very definite example in recent times, Senator, yes. [Reading.]

Like the annually balanced budget system, the compensatory program encourages increased expenditure programs without higher tax rates at some stage of the business cycle. However, whereas the annually balanced budget plan opens the door to new spending in boom times, the compensatory plan opens the door in depression—actual or forecast. In either case the effect upon Government economy is likely to be the same—periods of rapid increases in spending, followed by futile efforts at retrenchment and a generally excessive upward drift of expenditures.

If the managed compensatory system is to make any progress toward reducing the debt, it must count upon creating large surpluses in prosperous periods by raising taxes and cutting expenditures. But expenditures resist downward change and taxes resist upward change. In the present state of economic forecasting, it will always be possible to make out a plausible case that depression is around the corner. Such a prediction will permit both unpleasant alternatives to be avoided, since under the managed compensatory theory the forecast of depression requires lower tax rates and higher expenditures. This system offers no realistic hope of debt reduction.

Under this plan, as under the annual-balance plan, tax rates are subject to frequent and unsettling changes.

Senator DOUGLAS. May I interrupt for a minute?

Mr. THOMSON. Yes.

Senator DOUGLAS. I don't want to introduce an excessively personal note, but when some of us felt that the budget for 1949–50 should be reduced, this argument was immediately advanced, that we were going to have a period of depression, and that therefore we should avoid reductions in expenditures. So here is another illustration of what you say.

Mr. THOMSON. I am glad to have your comments.

As I have said, budget, money and debt policy should be considered as a unitary program. However, for purposes of exposition I shall describe the elements of the program separately before telling how we think of these elements as fitting together. I shall start with budget policy.

The key to CED's budget policy, which we call the stabilizing budget policy, is in these two sentences:

Set tax rates to balance the budget and provide a surplus for debt retirement at an agreed high level of employment and national income. Having set these rates, leave them alone unless there is some major change in national policy or condition of national life.

I should point out at once that the budget we are talking about is the cash consolidated budget and the surplus is a surplus in that budget. I shall come back to this later.

CED suggested that tax rates should be set to yield a $3,000,000,000 cash surplus at high employment. However, in our thinking, this particular figure is less important than that there should be agreement upon a moderate surplus to be achieved at high employment.

This basic proposition has a number of far-reaching implications.

First, the size of the surplus would remain constant so long as the level of employment and national income remains constant. If we remain at high employment the surplus would remain at the agreed level.

Senator DOUGLAS. May I interrupt?

Mr. THOMSON. Yes.

Senator DOUGLAS. When you speak about the cash consolidated budget, you refer to total receipts and total expenditures by the Federal Government, including social-security receipts?

Mr. THOMSON. That is correct, Senator, and the social security and the trust funds are the main element that is not in the administrative budget.

Senator DOUGLAS. It is possible that this type of budget will not be as much out of balance for 1949–50 as the operating budget because I think there will be an excess of contributions for the old-age-annuity account of probably close to $2,000,000,000 with the increased rates which are going into effect, and while the unemployment-insurance account has been drawn down in the last 8 months if unemployment falls off we may have a cumulative surplus. It is probable that the budget wouldn't be quite in balance but there would be an excess of collections over disbursements in the social-security account, so that the deficit for 1949–50 for those items would not be probably more than $2,000,000,000.

Senator FLANDERS. Senator, won't you have to take into account the additional purchases of mortgages by "Fanny May" (FNMA) which go into the cash budget? They go into the regular budget, but we are talking about the cash budget.

Senator DOUGLAS. Would you include veterans' insurance disbursements?

Mr. THOMSON. Yes.

Senator DOUGLAS. If you make an allowance for that it would probably put the cash consolidated budget at about the same deficit as the operating budget.

Mr. THOMSON. That is right.

Mr. RUML. I think, Mr. Chairman, since the point has come up now with respect to these two budgets, I might say this: I think it is of the greatest importance, when we talk about inflation and deflation, that we talk about the impact of Federal Government by way of cash expenditures and receipts, rather than the other budget, which is perfectly valid for administrative control, but which really has nothing to do with inflation and deflation.

Let me give a somewhat dramatic case on the other side, namely, that the increase in the redemption value of series E bonds from year to year is counted as an expenditure in the administrative budget although no cash is distributed.

It is for that reason that in discussing fiscal policy we felt these issues of policy should be determined by the cash consolidated budget.

Mr. THOMSON. That is right. May I continue?

Second, the size of the surplus or deficit would vary with the national income. If the national income declines the tax base will decline and the yield of a stable set of tax rates will decline. This will cause a decline of the surplus or below some point an increase of the deficit. Also variation of the national income will cause some change in expenditures under stable expenditure programs. For example, unemployment compensation payments will automatically increase if unemployment rises. The amount of variation in the surplus or deficit with any given variation in national income will be determined by the variation of tax yields and expenditures under stable tax rates and expenditure programs.

Third, in order to carry out this policy once it is embarked upon, an increase of expenditure programs calls for a matching increase of tax rates, and a decrease of expenditure programs calls for a cut of tax rates. The distinction between actual expenditures and expenditure programs may need explanation. For example, the unemployment compensation system sets up an expenditure program providing that certain amounts of money shall be paid to certain classes of persons if they are unemployed for certain periods of time. Under that program actual expenditures will depend upon the actual amount and distribution of unemployment. Similarly, actual expenditures will vary even if programs are held stable in the case of farm price supports, veterans' readjustment benefits, and some other programs. A change in the program calls for a change in tax rates, but a change in expenditures if the program is unchanged does not call for a change in tax rates.

Two exceptions to the general basic proposition are so important that they must be considered integral parts of the policy. However, I shall come to them and reserve discussion of them after I have explained the advantages that we would expect to be realized from the policy in its general outlines.

1. The policy would contribute to the stability of the economy. It would cushion the cumulative process by which economic fluctuations build up into great depressions or inflations. When total expenditures for goods and services decline, total incomes earned in production of goods and services also decline, which causes a further decline of expenditures and so a further decline of incomes, and so on. A similar process works on the inflationary side. The stabilizing budget policy would insert a shock absorber in this cumulative process. When expenditures decline, part of the resulting decline of incomes will be absorbed by the Government budget. Tax yields will fall and as a consequence private incomes after tax will not fall so much. At the same time Government expenditures for unemployment compensation will rise and offset part of the decline in private incomes. The result is to reduce the decline in private incomes available for expenditure and so to dampen the cumulative process, making fluctuations smaller than they would otherwise be.

Senator Douglas. I notice that this is very carefully worded, and that all you claim for that process is that it would provide a shock absorber, that it would contribute to the stability and that it would cushion the cumulative process. In other words, the fluctuations would occur, but their magnitude would be diminished.

Mr. Thomson. That is right, Senator.

Mr. Wolcott. Mr. Chairman——

Senator Douglas. Yes, Mr. Wolcott.

Mr. Wolcott. In connection with stabilizing budget policy and compensatory budget policy, do you want to discuss what effect the result of this drive by retailers for a reduction in excise taxes might have on either one or both of those?

Mr. THOMSON. Would you like to have it discussed now or when we get through? I think Mr. Ruml is thoroughly familiar with it.

Mr. WOLCOTT. Perhaps we can put it on the shelf until you finish your statement.

Mr. RUML. I shall be very glad to discuss it at the proper time. That is not CED policy.

Mr. THOMSON. 2. The policy would contribute to economy in Government. No budget policy by itself can assure economy in Government. So far as our policy goes, it would permit an increase of Government expenditure programs whenever the Congress and the public are willing to raise tax rates to pay for them. But the fact that, if the recommended policy were followed, an increase of expenditure programs would call for higher tax rates would lead to more careful counting of the costs of higher expenditures.

Senator DOUGLAS. Perhaps I am anticipating a subject which is discussed later in your statement, but if you were in an especially severe depression wouldn't you approve of a stepping-up of expenditures?

Mr. THOMSON. That is covered a little later, and would be taken into account, Senator.

3. The policy would contribute to reduction of the debt out of Government surpluses over the long period, although not necessarily in every year. The policy would assure cumulative reduction of the debt if high employment is in fact maintained on the average. It seems to me very unlikely that any policy could in fact succeed in reducing the debt if our average level of activity is much below high employment, and I think that the attempt to reduce the debt under such conditions would be dangerous. But this is not to say what is sometimes said, that the future course of the national debt will be determined by events. Whether or not we succeed in reducing the debt will depend upon:

(*a*) Whether all public policies, plus private policies, plus events combined are such as to maintain at least reasonably high employment on the average, and

(*b*) Whether budget policy is such as to provide for debt reduction under conditions of reasonably high employment.

I will now come to the two important exceptions to our basic budgetary principle which I referred to earlier.

The first relates to the handling of extraordinarily large Government expenditures that are known to be temporary. It seems to us undesirable to raise tax rates sharply in order to finance such expenditures currently and then cut tax rates when the expenditure ceases. Therefore we suggested that it would be better not to match the temporary expenditure increase by a temporary tax increase and that any inflationary consequence of the expenditure should be offset by anti-inflationary debt and monetary policy. One of the questions that our committee wishes to examine further is the proper scope of this exception.

Senator DOUGLAS. Do you have any illustration of what might be an extraordinarily large governmental expenditure that is known to be temporary?

Mr. THOMPSON. We think this whole question of what are nonrecurring expenditures should be explored, and we intend to explore it in connection with the statement we will issue next year. The thing that bothers us at this time is that there seems to be so many regular nonrecurring expenditures.

Somewhere along the line we hope to deal with that subject more effectively than we have been able to so far.

The second important exception to our general principle relates to action to be taken in the event of an extreme depression or inflation. Under our general principle we would not cut tax rates in depression or raise tax rates in inflation in order to stabilize the economy. Instead, we would rely, so far as the budget alone is concerned, upon the stabilizing effect of automatic variations in revenue and expenditures from stable tax rates and expenditure programs. We believe that this stabilizing influence, if combined with appropriate measures in other fields—and I emphasize that—will certainly moderate fluctuations. We hope they will be sufficient to avoid more than moderate departures from high employment. But, of course, no one can guarantee that. We have to think about what we would do if, in the absence of appropriate policies, or in spite of them, we find ourselves in a severe depression or major inflation. In such conditions, extraordinary action should and will be taken. In our opinion an emergency congressional reduction or increase of tax rates would be one of the most effective and least dangerous courses.

Senator DOUGLAS. Mr. Thompson, may I interject there? What you are proposing, I take it, is to make the stabilized budget policy the standard, and to apply a portion of the managed compensatory budget for severe fluctuations insofar as that refers to taxes. It is a partial marriage of point 2 with point 3.

Mr. THOMSON. I don't think we would want to agree that we are adopting any part of that compensatory philosophy.

Senator DOUGLAS. What I mean is this, you say in a severe emergency that you would alter tax rates, presumably decreasing them in a period of depression, and increasing them in a period of severe inflation; so there is at least one element of the compensatory principle which you graft on to your stabilized budget.

Senator FLANDERS. Perhaps there is a secret liaison instead of a marriage.

Senator DOUGLAS. That could be as effective, but if it is put into effect it would be legitimatized; we want no illicit relationships.

Mr. RUML. I think there are two important distinctions. One is a real one; the other semantic. The "compensatory" term has a bad odor. Therefore we want to make a very large distinction between this policy and the compensatory. The chief distinction, Mr. Chairman, is on this point, that these actions on either the tax reduction or the expenditure side would take place after the fact, rather than in anticipation of the fact.

Senator DOUGLAS. After the depression has occurred?

Mr. RUML. That is right. Therefore, the element of forecasting is eliminated.

If you take the situation that existed in 1949, I think probably most people would have looked for more trouble by September than actually occurred, and would have taken actions in July that would have been very untimely in October.

Senator DOUGLAS. Would you apply the same modification in the field of expenditures, that after an appreciable depression has occurred you should expand expenditures?

Mr. THOMSON. We do suggest that, in the public works program later on.

Senator DOUGLAS. And reduce expenditures in a period of severe inflation after the inflation had occurred?

Mr. THOMSON. That is correct.

Senator DOUGLAS. I would say that you have affected a partial marriage between theory 2 and theory 3.

Senator FLANDERS. A trial marriage.

Mr. THOMSON. Since the question has come up recently I want to say a word about "automatic guides to policy." Neither the guides nor the policy recommended by CED is automatic. As we said 2 years ago in first presenting the stabilizing budget policy:

> The policy recommended here cannot be "adopted" and left to run without common sense and vigilance. Basically, we are presenting the principles that are important in making the decisions that must be made. The policy will not yield the results of which it is capable unless the principles are consistently followed and reasonably interpreted.

We have tried to describe our principles as specifically as possible, and to provide within the policy itself for the most important exceptions to the general principles. We do not think it an adequate policy to say that sound judgment must be used about the relevant facts, without saying what the relevant facts are and how they are to be taken account of. Any policy that is followed will have certain consequences, which may be called automatic. We choose our particular policy not because its consequences are automatic but because we believe its consequences are good.

MONEY-DEBT POLICY

I should like now to describe briefly the money-debt elements of the program and then turn to an appraisal of the whole program as a unit.

I think it may be useful to distinguish between two aspects of money-debt policy:

1. The contribution to stability that a sound financial structure can make by not itself initiating or aggravating fluctuations. This means that random changes in monetary reserves—say as a result of gold flows—should not initiate undesired expansion or contraction of the money supply. It means that fear about the soundness of financial institutions should not cause intense pressure for contraction. Business recession should not make the banking system so illiquid that the flow of credit is frozen and the money supply shrinks. The economy should not bear an excessive burden of private debt, especially short-term debt.

I think we tend to underestimate the importance of these factors, possibly because they are not dramatic. For instance, we tend to forget the simple fact that between 1929 and 1933 our money and banking systems were allowed to collapse. That collapse added materially to the severity of the depression. There is nothing more essential to avoiding another great depression than avoiding another financial collapse; and we have done something about this, as I shall point out in a moment.

2. In addition to this more or less neutral function there is a positive function of monetary-debt policy for stability. This means in times of recession, deliberate action by the monetary and debt authorities to increase the reserves of the banking system and the money holdings of the public, to increase the availability of credit and, in general, to make holding liquid assets less attractive and to make investment and consumption more attractive. With appropriate reversal of direction the same policy holds good for inflation.

We think of this positive stabilizing policy as coming into operation quickly in response to relatively moderate departures in either direction from high employment and price stability. It is one of the great virtues of monetary-debt policy, as compared with deliberate fiscal policy, that it can come into operation quickly. Monetary-debt policy does not involve cumbersome legislative or administrative procedures. Moreover, it can take some risks of being wrong because it can reverse itself quickly.

Our financial institutions are now much stronger than they were, say, 20 years ago. This is partly the result of legal changes in the Federal Reserve System and the establishment of deposit insurance. In part, our financial structure is more stable because of the change in the composition of bank assets from predominantly private loans to predominantly Government securities. Our private financial structure has been strengthened by the use of the amortized mortgage for home and farm financing and the growth of the term loan for business. Moreover, the total burden of private debt on the economy has been much reduced in relation to total incomes and total asset values.

We should remember that this relatively favorable private debt position is largely the product of the war and the accompanying inflation. It will not be maintained unless more favorable conditions for equity financing are created. The present tax structure and the fact that a large proportion of our current savings flow through financial institutions both restrain equity financing. This will not only make our economy more vulnerable to depression, it will make our economy less able to meet urgent needs for productive investment at home and abroad.

The tools and techniques for a positive, stabilizing monetary policy are well known and available. They include open-market operations, changes of reserve requirements, and changes of rediscount rates. The main requisite in this area is recognition that economic stability is the primary objective of monetary policy in association with fiscal and debt policy. I believe this proposition is recognized by the Federal Reserve. It and its implications need to be more fully understood by the public generally. One implication of the proposition is that monetary policy must concern itself first with the over-all state of the economy and should not allow responsibilities with respect to particular markets and particular prices to interfere with its over-all responsibility. Another implication is that monetary policy will involve risks, particularly the risk that action to restrain inflation may be followed by recession. This risk may be reduced by prompt and flexible action, but cannot be entirely eliminated. Failure of the public to understand this may tend to make the monetary authority unduly cautious.

More problems arise in connection with the debt aspect of the money-debt combination. Certain general features of a debt management policy for stability may be described. In times of inflation the Government should retire debt held by the banks, using for this purpose the budget surplus and the proceeds of borrowing from the public. In times of recession the Government should borrow from the banks to finance its budget deficit and to retire debt held by the public. But there are problems beyond this. One is how to devise the terms and selling methods of a Government bond that would more effectively attract savings when needed. The issue and redemption of such security would be a valuable additional stabilization instrument. Another problem, which will become acute in a year or two, is how to handle the refinancing of savings bonds as large amounts mature.

Of course, the best-known problem in this area is that a vigorously anti-inflationary monetary policy might lead to a major drop in the market prices of Government bonds, with possibly serious adverse consequences. I believe that this problem is likely to be less acute in the future than it was in 1947 and 1948. For one thing, recent events have reminded us that the Government bond market is not a one-way street. It can go up as well as down. Moreover, as time passes since the war-bond drives, holders of Government securities probably come to regard them more as permanent investments and become less concerned about market prices.

Senator Douglas. I suppose you are referring to the fact that in recent months the price of Government bonds has risen, and I believe they are now selling at a premium of around 4 points above par?

Mr. Thomson. That is right, Senator; yes.

These remarks are not intended to dispose of the problem, which may still remain or may recur, even if possibly in less acute form. Our committee has taken the position that the Federal Reserve, while it has a continuing responsibility for maintenance of an orderly bond market, should make its decision in terms of the effects of its action upon the whole economy. More specifically, "the Federal Reserve should feel free to reduce the support level unless it finds a superior alternative way of bringing about a monetary restriction if and when that is required by the objective of economic stability." General stability is the primary objective, and the objective of stability in the bond market should be reconciled to that, rather than the other way around.

Probably the most immediate question about this situation is whether it requires or justifies an increase of the powers of the Federal Reserve. Are there powers not now possessed by the Federal Reserve that would significantly add to its ability to reconcile the objectives of general stability and bond-market stability? Would the existence or exercise of these powers have other effects that would make them on balance undesirable? Chairman McCabe has presented to this subcommittee a clear and thoughtful statement of the case for additional powers. I think these questions require more consideration, and I would not be prepared to answer them definitely now. They would be appropriate questions for the National Commission to which I shall refer later.

THE COMBINED PROGRAM

What we are seeking in the whole program I have outlined is this: A combination of neutralizing, cushioning, and compensating influences achieved by a suitable division of responsibility among budget, money, and debt policies.

First, as a minimum and all the time we want the financial system to be at least neutral. That is, the financial system should not itself originate or intensify unstabilizing disturbances. We would get this effect with respect to the budget, under our policy, by the provision that the surplus should remain constant if the national income remains constant. We would also get this effect by maintaining, what we already essentially have, sound financial institutions that do not give rise to perverse movements of money and credit, that are not subject to panic and collapse, and that avoid an excessive burden of private debt.

So long as we have high employment and price stability, all we expect from our policy is neutrality.

Senator DOUGLAS. I notice that you use as your norm high employment. Now, when the stabilization bill was first introduced, the objective was stated as full employment. In the act as finally passed, the objective was to be maximum employment, production, and purchasing power.

Mr. THOMSON. Yes.

Senator DOUGLAS. I have a dictionary, but, as I remember those comparative terms, you have great, greater, greatest. I assume that maximum is "greatest," if I remember my Latin.

Now, your standard is, apparently, somewhat lower than maximum, somewhat lower than greatest, and I wonder what definite meaning you attach to the word "great."

Now, the advocates of full employment, as you remember, were willing to concede that in this country you could have, say, 3 to 4 percent unemployment caused by seasonal and transitional factors; somewhat higher in this country than in England, because of the greater fluctuations of the weather and more rapidly a fluctuating tempo; and it was said that, when unemployment is greater than 3 or 4 percent, then these compensatory or stabilizing devices should be called into play.

Now, apparently you do not contemplate as rigid a standard as 3 percent.

Mr. THOMSON. I think we started with the idea, Senator, that there would be seasonal and transitional unemployment, as classified, and that high employment would include employment of everyone in the labor force outside of those unemployed for seasonal or transitional reasons.

Senator DOUGLAS. I think the advocates of full employment would concede that. As I remember Mr. Beveridge's book, he said that we should not expect to eliminate seasonal and transitional unemployment. Let us say that the figure is somewhat higher for the United States than for Great Britain. Say it is 4 percent. Would you say that we should keep unemployment down to 4 percent, or would you allow a further figure above that?

Mr. THOMSON. Our estimates were based on 4-percent unemployment representing high employment.

Senator DOUGLAS. And, when unemployment exceeded 4 percent, then you thought there was a departure from the norm which we would try to maintain?

Mr. THOMSON. Yes. May I just read a paragraph here?

Senator DOUGLAS. Yes.

Mr. THOMSON. We did cover this. [Reading:]

These precise figures—

that is the 4 percent—

cannot be rigorously defended against other figures in the same neighborhood, and some adjustments may be indicated after the system has been in operation. However, the appropriate figures cannot be far away in either direction. Actual unemployment may, from time to time, lie below 4 percent, as it does now—

this was written in 1947—

it probably cannot be much below this figure without serious inflationary pressure. With 4-percent unemployment, most involuntary idleness is of the between-jobs variety.

That was our thinking at that time.

Senator DOUGLAS. When you say 4 percent, do you mean 4 percent of the total labor force or 4 percent of the nonagricultural working force?

Mr. THOMSON. Four percent of the total labor force.

Senator DOUGLAS. Which would be around 2.4 million?

Mr. THOMSON. That is correct.

Senator FLANDERS. For the record, I suggest that you tell us what the document is that you just read from.

Mr. THOMSON. That is from our 1947 statement called Taxes and the Budget, page 32.

Senator DOUGLAS. When with the present labor force unemployment rose above 2½ million, then you would want to have some of these stabilizing influences go into effect?

Mr. THOMSON. Yes. As a matter of fact, some are in effect now.

Senator DOUGLAS. Let me raise another query: How severe would unemployment have to be before you think your added compensatory feature should go into effect?

Mr. THOMSON. I don't believe that we have arrived at an answer to that. I don't think that it is anywhere near the present situation. We haven't arrived at a definite answer.

Senator DOUGLAS. The Congress has to do so, however.

Mr. THOMSON. That is right.

Senator DOUGLAS. Would you say 10 percent?

Mr. THOMSON. I think, Senator, that I would have to let the statement stand, that we never have taken a position. We will consider that further in connection with the statement next year.

Senator DOUGLAS. It would be very helpful, because frequently the Members of Congress feel that they are given an adjective but not given the definition of the adjective, and it is always a question as to whether the actual facts justify one policy or another.

Mr. THOMSON. That is right.

Senator FLANDERS. May I introduce here a statement of the Princeton conference which was held on September 16 and 18. Their recommendation was [reading]:

Congress should act in case of a decline in activity involving a genuine increase in unemployment of more than 1½ million persons above present levels. This would mean total unemployment of about 5,000,000 according to present methods of computation.

Senator DOUGLAS. Eight and one-third percent?

Senator FLANDERS. Yes; 8⅓ percent.

Mr. RUML. Mr. Chairman, it might be worth pointing out that, in case we gradually moved into a high level of unemployment such as you talk about, the measures in this program become extremely powerful all by themselves. What we do not know yet is how powerful they really are, and for that reason we don't know when the crisis action should be taken; but notice that unemployment insurance begins to pay out, tax receipts from withholding stop being paid, other things begin to happen that accelerate as the amount of unemployment increases. For that reason, without more experience than we have had today, it would be a little dangerous to say much more than that at some point you would take crisis action; when you would have to do that, we do not know.

Mr. Thomson. As I understand it, these communities that are supposed to be in distress are supposed to have 12-percent unemployment. They are using 12 percent as a yardstick now for trying to put Government orders into effect there. I suppose there must be a history or an experience back of that.

But in the event of departure in either direction from this target position we want more than neutrality. We want a strong cushioning influence to come into play to restrain the deflationary or inflationary movement. We would get this cushioning influence mainly from the variations in tax yields and in some expenditures under stable tax rates and expenditure programs. I have already described this factor, which the economists call built-in flexibility. We expect it to be a very powerful force, much more powerful than it could have been before the war, simply because of bigger budgets, greater use of income taxes, including the pay-as-you-go feature, and the unemployment-compensation system.

The purpose of the cushioning factor is not merely to moderate fluctuations, to make little depressions out of big ones, although that in itself is highly important. We expect the cushioning force to help retain the conditions under which such natural forces for stability as do exist can operate. That is, we want to prevent the natural forces that make for stability from being swamped by the cumulative process of instability.

So long as departure from high employment and price stability are small, our policy calls for no more than neutralizing plus cushioning measures. But if the departures are larger we want to do more. We want positive compensating action to get us back to the position of high employment and price stability. Under our policy this compensating action would be of two kinds and would come into play at two different levels. First, in case of moderate, even rather small, recessions or inflations, deliberate monetary and debt policy would be called for. The precise timing and amounts of action would be a question for the judgment of the monetary and debt authorities. We can only say in advance that it should be prompt and large.

There is, I know, considerable skepticism about the effectiveness of monetary policy, especially against depression. This feeling is partly derived from consideration of conditions in which a severe collapse has so impaired the outlook for future sales, incomes, and profits that no flooding of the economy with money and credit can stimulate investment and consumption. But it is the purpose of our whole program to prevent such conditions from developing. That is, we look to the other parts of the program to prevent conditions from getting so bad that monetary policy cannot work, and we look to monetary policy to make conditions better.

Finally, if the combination of neutralizing measures, cushioning measures, and compensating money-debt measures is not sufficient, if we run into an extreme depression or inflation, we would want to do more. We would call for positive compensating action in the budget to give a strong impetus back to high employment at stable prices. We would mainly rely on cutting tax rates in severe depression, because it is practical to do much more in a short time in this way rather than by increasing expenditures. However, we would not rule out such deliberate changes of public works or other expenditures as might be feasible.

That is a more definite answer to the question you put a while ago.

Senator DOUGLAS. You don't rule it out, but you don't say "No" and apparently you don't say "Yes."

Mr. THOMSON. I wouldn't think that. I would think that what we are saying is that it is a matter of information and of judgment as to when you do these things, with the emphasis on being able to do a better job, using present techniques, better understood, and with a policy.

Senator DOUGLAS. The argument in favor of increasing expenditures, you see, rather than reducing taxes in periods of depression is the contention that, if you reduce taxes, that will not result in a corresponding increase in private expenditures, due to hoarding, whereas the direct expenditure by the Government will translate itself into such an initial outlay.

Mr. THOMSON. You can get the effect by tax reduction and make it more effective quicker than you can by a public-works program.

Senator DOUGLAS. But the argument is that it will not translate itself into corresponding increases in either investment or in expenditure.

Senator FLANDERS. May I make an observation, Senator?

Senator DOUGLAS. Surely, Senator Flanders.

Senator FLANDERS. We had from the early 1930's through the thirties, what was, for the period, a very high compensatory spending by the Government, with no satisfactory result in increasing employment. As I remember, under that period, we increased our national debt about $15,000,000,000, which then looked very large indeed. At the same time, in making those expenditures, we went into war preparations with somewhere around 10,000,000 people unemployed.

It seems to me that there is another factor that was missing during that period, and that was a sympathetic state of mind on the part of the administration toward private business, toward private enterprise, toward profits, toward the whole structure of our enterprise system. That not only can but did negate these expenditures to a very large measure, and it seems to me that that factor must be kept in mind by governmental forces if the increases in expenditures are to become effective. Otherwise, the funds go right into unused liquid capital and remain stagnant and ineffective in their results.

Mr. RUML. Mr. Chairman, I think, to complete the record, that period was also characterized not only by increases in expenditures but also by increases in tax rates, which is, of course, just contrary to the type of program we are suggesting.

Senator DOUGLAS. That was only in the first 2 years, as I remember, 1933 and 1934, wasn't it?

Senator FLANDERS. The undistributed profits tax came in at that time.

Mr. RUML. In 1936 and 1939 there was an upward change in the corporate rate, I believe. I think there were more than two changes, Mr. Chairman.

Senator FLANDERS. The undistributed profits tax was one of those measures which, to my recollection, negated the other results, in that it put a penalty on a new investment and the plowing back of such profits as there were into business expansion and revival. So that while we had that one measure of increased taxation, it was increased taxation that worked unfavorably and, furthermore, in putting a damper on business enterprise, it was one of those features which tended to reduce the effect of increased governmental expenditures.

Senator DOUGLAS. I am sure that it is not our purpose to refight the battles of the New Deal, but I would say in reply to my very esteemed colleague that if the tax policy followed by the Roosevelt administration during this period was not precisely perfect, that does not prove that the expenditure policy was wrong.

Senator FLANDERS. In looking back to that period, what we are looking for is to gain from it some experience as to making increased governmental expenditures during a depression period.

Senator DOUGLAS. That is right. What I am saying is that it is possible that the tax policy may have dampened down the beneficial effect of an expenditure policy, and that if that is true you should lay the blame at the door of the tax policy rather than at the door of public works, PWA, and so forth.

Senator FLANDERS. I haven't argued against that.

Senator DOUGLAS. I understand. But you are a very subtle man. The implications were there, and I wanted to prevent the stream of opinion from moving in a direction contrary to what I, at least, believe to be the truth.

Mr. WOLCOTT. Mr. Chairman, perhaps this is as good a place as any to bring this up. As to compensatory actions on the part of the Federal Government to take up the slack, and so forth, I think we are all agreed that they are desirable. I wonder if Mr. Thomson or Mr. Ruml could clear up a point which has been bothering a great many people: The relative importance of public works as compared to private activities. Somewhere, at some time or other, I read or heard that a Government-created dollar of credit turns over in velocity with a ratio of about 2, or 2½, to 1, and that normally a privately created dollar of credit turns over at a ratio of about 10 to 1.

Mr. RUML. I think your judgment on that would be affected by one paramount fact, that is, the scale of income of the recipient of the dollar. Obviously, if a governmental dollar goes to the poor it will be spent rapidly by the recipient; if it goes to people who are better off, some part of it might be saved. If it goes to a corporation, some part might go into depreciation; some into withheld profits. I think you can't draw any general rule except perhaps to say this: That when there is a lack of confidence in governmental spending it tends to create an attitude of unrest and a feeling of lack of confidence.

I think that some of that has happened in the past because of the unconventional character of some of the things done.

Senator DOUGLAS. May I interject? I would say that lack of confidence in business conditions may impede private expenditure or investment. It was that lack of confidence in business conditions during the middle thirties which the Government strove to offset by an increase in public expenditures, which would not necessarily be forthcoming from funds in the possession of private business.

Senator FLANDERS. I could follow with my point of view on this, but I think it is understood, so it doesn't have to be reiterated.

Senator DOUGLAS. That is right. Then, I understand, the flag of truce has been put up on both sides.

Mr. RUML. Mr. Chairman, could I just pin a bright ribbon on the flag of truce?

In studying the public-works situation specifically, it has seemed to me—and this is a personal view which the CED has not adopted—that the objective in the public-works program can hardly be more than to stabilize the over-all construction picture; that if the public-works program tried to stabilize the whole economy the consequences would be to give a terrifically unstable character to that particular industry, creating public demand for labor and materials that would preclude private activity.

So that there is a limitation of that character on the usefulness of public works as such.

Mr. WOLCOTT. In that connection there is a formula, which we have heard about, that heavy-goods-industries expenditures and construction-industry expenditures are usually about 16 percent of the income in all the effort. Could the Government determine—that is, broadly—what the national income could be by providing always that this base be maintained?

Perhaps I am not on the right premise in taking at face value that 16 percent is the base, but, whatever it is, could the Government, through Government spending or reductions, and so forth, determine, within certain reasonable bounds, what our income would be, if the Government provided that base, if private industry was not providing it?

Mr. RUML. I think in aiming at it we would come closer to it than in the past. The record of 1931–32 is that when private building went off so also did State and municipal building. They all went off at the same time due to the general attitude with respect to building.

Senator DOUGLAS. A great change occurred in 1933, 1934, and 1935.

Mr. RUML. We made an enormous amount of progress, but did not quite hit the State and municipal level.

Senators FLANDERS. Mr. Chairman, I wonder if I might state the terms of this truce?

Senator DOUGLAS. Yes, Senator Flanders.

Senator FLANDERS. Are not we all interested in having the increase in Government expenditures in slow times as effective as possible in generating a general increase in business?

Senator DOUGLAS. Yes; certainly, that is correct.

Mr. WOLCOTT. Is there substance to the contention that we can, through Government expenditures in the heavy goods and construction lines provide, within reasonable bounds, for a level of national income?

Mr. RUML. I think not. I think it can only be a contributing factor. Certainly we can keep it from going in reverse.

Mr. WOLCOTT. It doesn't necessarily follow.

Mr. RUML. I think the amount of preliminary planning, the amount of work that will have to be ready, and all the rest of it, would involve such fantastic engineering operations that they might be out of date when the time came to exercise it; but a great deal more can be done than ever has been done, I think, along those lines.

Senator DOUGLAS. Then your preference for using a reduction in taxes at the time of a severe depression rather than an increase in expenditures is primarily based on the fact that you think public works would be slow to start; whereas the effect of a reduction in taxes would be immediate?

Mr. RUML. Primarily that. There is one collateral thought, however, that if the amount that would have to be spread is very large indeed, it probably is more consistent with our way of life to let individual consumers decide what they want rather than to have a central agency decide.

Senator DOUGLAS. So far as the first objection is concerned, if engineering plans are drawn in detail in advance, would that not reduce the time required?

Mr. RUML. Yes; it would very much. But you would have to be very careful to make sure if the plans were drawn 4 years ago that they are still up to date and there have been no technological changes.

Senator DOUGLAS. Congress just appropriated $100,000,000 for the detailed planning of a large series of works.

Mr. THOMSON. If I may make a couple of observations: (1) The CED has been in favor of the kind of advanced planning you speak of; (2) I do not know, Mr. Wolcott, the exact measure of the impact, but I do recall some studies along this line. If you conceive of public works being augmented, you have to deal with some 250,000 governmental units, and it has seemed to me that the effect on all these governmental units is going to be influenced by the level of business thinking, and it is not as easy as you might think to get either business or Government or smaller governmental units to go ahead and say that this is a time of low prices, this is the time we need employment, and we are going ahead.

There is one more point to be made here. I was trying to find the exact statement used in the 1946 Employment Act, but as I recall it, it says we are trying to promote economic stability within a framework of a free enterprise economy.

It seems to me the act says that if you have a choice between Government expenditure and incentives to make the free enterprise economy operate, that you give the preference to things that will create incentive. If there are no other questions I will continue my statement.

APPRAISAL OF THE COMBINED PROGRAM

The program I have outlined does not guarantee perfect stability. We do not think perfect stability can be guaranteed. And the small ups and downs, if kept small, serve a useful purpose. The number one economic problem of the United States is great fluctuations, not small fluctuations. We believe that this program, if accompanied by reasonable policy in other fields, would prevent great fluctuations. Perhaps it is more relevant to say that we have worked hard, and I believe objectively, on this problem and that this is the best we know at present. With more study and experience we, or the Nation, will certainly learn more.

One question that is sometimes asked about our policy is why we propose to wait until extreme conditions arrive before we take affirmative compensatory fiscal action. I hope I have made it perfectly clear that our policy proposes strong action to avoid, moderate, and combat depressions or inflations before they reach extreme dimensions. It is the purpose of the program to prevent severe depression or inflation. The provision for extraordinary budget action in extreme conditions is not the heart of our program. It is an exception, and if the rest of the program operates as we think it can, the exception would be rarely invoked. We provided the exception, not because we thought the rest of the program would fail, but because we could not guarantee that it would succeed.

Nevertheless, it is pertinent to ask whether what we call extraordinary budget measures should not be made the ordinary procedure. For example, instead of waiting for severe depression before cutting tax rates, shouldn't we cut tax rates when depression is forecast or at least in the case of an actual moderate recession? This is a question essentially involving judgments about two factors:

(*a*) The possibility of forecasting economic fluctuations reliably, and

(*b*) The possibility of quick action to change tax rates (or expenditure programs).

I don't think it is necessary to say more about forecasting than that we share what is now almost the universal opinion that forecasts of economic fluctuations are not sufficiently reliable to serve as a basis for public policy.

Senator FLANDERS. May I at this point again read a paragraph from the report of that group of economists which met at Princeton? It indicates a little difference in optimism as to the effect of the automatic flexibility, although you are not confining yourself to automatic flexibility at all. So perhaps this paragraph should be read in view of the fact that you are not relying completely on automatic flexibility. This paragraph reads:

> Automatic flexibility can slow down and perhaps halt a decline of activity or a rise of prices. It can give time for restorative forces to come into play, but it will not by itself pull activity back to a full employment level or restore prices to a preinflation level.

As I followed your testimony, it would seem as though you were not too far off from that, although you do, after all, limit the possibilities of the automatic flexibility and call for definite action particularly in the monetary and credit and debt control fields.

Mr. THOMSON. That is correct, Senator.

The more reasonable proposition is that we should take fiscal steps, say cut tax rates, in response to actual but moderate recession. This does not escape the forecasting problem unless the response takes effect much more quickly than the economic situation is likely to reverse itself for other reasons.

If we call for a cut of tax rates in a moderate recession and the economy is on its way to inflation by the time the tax cut takes effect, the result of the fiscal action is unstabilizing rather than stabilizing. The smaller the fluctuations are to which stabilization policy is to respond, the quicker-acting must be the response if it is to do any good.

Built-in flexibility can respond to very small fluctuation because its response is instantaneous. Monetary and debt policy can respond to moderate fluctuations because it can respond quite quickly, although not instantaneously.

But so far as we can see, the deliberate response of fiscal policy via changing tax rates or expenditure programs will be rather slow and should be confined to major fluctuations. However, it may not be impossible to devise ways to speed up the process of making fiscal decisions and putting them into effect; in that case it might be desirable to reconsider this conclusion.

It is possible that in the future the problem of maintaining high employment without inflation in a free economy may arise in a form rather different than the form it has taken in the past. In the past the main problem has been great instability in the total demand for output. It will certainly be essential to avoid such instability in the future. But it is conceivable that this, while it would have been sufficient in the past, will not be sufficient in the future.

Suppose that prices and wage rates are, or come to be, predominantly determined not by the market process but by the administrative decisions of business organizations, trade-unions, and government. And suppose that these decisions are made in a way that lead to continuous increase of prices and to increase of wage rates more rapidly than productivity rises.

It would then not be possible to maintain high employment without inflation, as it is uncertain whether high employment could be maintained even with inflation. We do not know whether this kind of problem exists now, or whether it will exist in the future. However, the possibility does suggest a reservation to the claims that should be made for any program of fiscal, monetary and debt policy.

THE CASH-CONSOLIDATED BUDGET

As I pointed out earlier, CED recommends that over-all budget policy should be decided in terms of the cash-consolidated budget. This committee is already familiar with the significance of the cash-consolidated budget. The President has regularly included in his annual economic reports, which this committee studies, a statement of Federal cash receipts from and payments to the public.

This statement is what we call the cash-consolidated budget. The Economic Report uses this budget, rather than the ordinary budget, because the cash-consolidated budget presents a better picture of the over-all effects of Federal finance upon the economy. It is therefore more useful in developing over-all economic policy.

But of course it is not solely the President and the Joint Committee on the Economic Report who are concerned with over-all economic policy. The President in his budget message, and your colleagues in the revenue and appropriation committees, are making over-all economic policy, as well as making policy about a lot of particular programs.

It is our suggestion that when total budget policy is considered—questions such as whether or not the budget is balanced, how big the surplus should be, what should be done to achieve the desired surplus—we should look at the cash-consolidated budget.

We are not suggesting that the present administrative budget should be abolished. We think that most of the business of the Government would continue to be done in terms of an administrative budget. But for certain important decisions the cash-consolidated budget would be used.

There is nothing wrong with having two budgets. What is wrong is not to have all the relevant information for making policy about a $40,000,000,000 budget—$44,000,000,000 now—even if that involves two budgets. The difference between the two budgets is not minor or technical. In fiscal 1949 there was a surplus of $1,000,000,000 in the cash-consolidated budget and a deficit of $1,800,000,000 in the administrative budget.

In our opinion one of the simplest and most useful things this subcommittee can do is to explain the facts of the cash-consolidated budget to its colleagues in the Congress.

SOME UNSETTLED QUESTIONS

I would leave an inadequate impression of the state of our current thinking if I did not refer to one of the problems that now troubles us and that we plan to consider during the next year. This problem arises from the fact that the present tax system in the United States is extremely heavy as well as badly constructed.

Continuation of the existing tax system would be a serious menace to the strength of the American economy and to the welfare of all the American people. I shall not elaborate upon this fact, which we have discussed in several policy statements, but merely raise some questions about its implications for fiscal policy.

While the ideas of proper fiscal policy now held in the United States differ in many respects, most of them, including ours, would agree that any substantial increase in Federal expenditures would call for higher taxes and that substantially lower taxes would have to wait for reduction of expenditures.

This leaves one route to tax reduction, namely, expenditure reduction. We believe that some steps along this road can be taken now. But we must recognize that substantial progress along this road, if achieved at all, may take a long time.

There are possibilities of reducing the adverse effects of the present tax system without reducing total revenues; these possibilities should be fully exploited. But there are obvious limitations, economic and political, to these possibilities that would not apply if revenue reduction could be permitted.

This raises the question whether we can devise a fiscal policy that will permit more rapid total tax reduction. Are we relying too heavily upon taxation in our present economic policies? Can we discover ways other than taxation to perform some part of the functions we now count upon high taxes to perform?

One important aspect of these questions is how far we may consider our present level of Federal expenditures as an abnormal and temporary reflection of the transition from war to peace, possibly justifying some temporary departure from normal fiscal policy.

We do not know the answers to these questions, and I hope I have succeeded in raising them in a way that does not imply an answer.

Senator FLANDERS. I think you have.

Mr. Wolcott. Mr. Chairman, may I clear this up?

As I understand from your statement, you are advocating that we put less stress upon our tax structure as a stabilizing influence, that taxes should be raised for purposes of carrying on the functions, extraordinary as well as ordinary, of the Federal Government, but should not be used purely for the sake of siphoning off purchasing power, et cetera, as we have so frequently done, excepting where that might be necessary, of course, to build up reserves against lower tax income in periods of depression.

Mr. Thomson. We suggest that question as one that very properly has to be considered, and it is a very proper question for the Monetary Commission, and we say we are going to study it next year. It is a very proper question.

Senator Douglas. I am a little puzzled by the meaning of the two following sentences in your statement:

> Are we relying too heavily upon taxation in our present economic policies? Can we discover ways other than taxation to perform some part of the functions we now count upon high taxes to perform?

I confess that leaves me completely mystified.

Mr. Thomson. I think I will ask Mr. Ruml to comment on this.

Mr. Ruml. During the war we knew that the sale of savings bonds to the public was an anti-inflationary measure, and as soon as the war ended we suddenly seemed to forget that the sale of savings bonds to the public is an alternative to taxation insofar as the immediate consequences of inflation are concerned.

We knew that some day the savings bonds would have to be paid out of taxation, but it would be over a period of time. Therefore, we operated our war program and financed it partly by taxes, partly by deflationary financing, and partly by inflationary financing.

Senator Douglas. In the form of bank-created deposits, which were used to take title to Government bonds? Is not that the inflationary type?

Mr. Ruml. That is right. Now, then—and here I want to make it perfectly clear that I am speaking only for myself and not for the Committee on Economic Development, and I will be quite concrete with the risk that concreteness brings—in my opinion it is worth thinking about these refunds to the veterans of life-insurance premiums as a nonrecurring expense and as part of the consequences of the war. It would seem to me that the inflationary consequences of that disbursement, which they certainly are, might be properly offset by similar net sales of savings bonds to the public rather than to cover them by taxation. That would be not a departure from our policy, but would be consistent with the second exception, namely, that our tax structure should not be distorted by what are obviously transitional and nonrecurring expenditures; and even though these are inflationary, there are other ways of countering them than by taxation.

Senator Douglas. You are not proposing that you use these bonds to have a permanent increase in the public debt, are you?

Mr. Ruml. The bonds, when they mature, will either be refunded or paid off. The point is that the people living and breathing in 1949–50 will not by themselves take up this expenditure. It will be like other war expenditures, spread over the period of the life of the bonds, or their refunding. It is, in other words, a national emergency not yet liquidated and not an ordinary expense of the National Government.

Senator FLANDERS. To put that concretely—you spoke of being concrete—does that justify that part of the deficit for the coming year?

Mr. RUML. My personal answer is that it does if it is financed by the sale of savings bonds to the public net, because that would be deflationary debt management and would have the equivalent effect of taxation, except for one important exception—namely, that the payment would be over the period of the life of the bonds and their refunding rather than out of the current year's income.

Senator DOUGLAS. I suppose there is one exception you would want to make to that—although perhaps you would not. The amount devoted to the purchase of these E bonds, the net addition to the total amount of savings, would this not be a diversion of at least a portion of savings that would otherwise be made for private purposes and placed in the bonds?

Mr. RUML. It almost certainly would be a diversion in part. In other words, you would have to allow some elbow room in the picture to get your complete effect. But, on the other hand, so also will there be some savings made out of these life insurance premiums, so that it is not all net expenditure either. All you can do is come to some practical judgment as to the consequence.

May I mention one other concrete example that occurs to me where this alternative principle might be used? That is in the question of the expenditures for Fanny May (FNMA) of taking over mortgages that presumably will be paid off someday. It seems to me quite discussable as to whether those should not be refunded by deflationary debt operations rather than be covered out of this year's taxes. Those are the types of considerations that give us a great deal of pause, which really make us have this humility that is referred to, because the consequences of these policy decisions are so vast in terms of what might happen to the tax structure.

Mr. WOLCOTT. Would you suggest, Mr. Ruml, that the insurance premiums be refunded in the form of interest-bearing nonnegotiable certificates, perhaps?

Mr. RUML. Yes.

Mr. WOLCOTT. On the chance that most of them would have been kept as savings and not immediately liquidated?

Mr. RUML. On the basis of our past experience, yes.

Mr. WOLCOTT. Such as the veterans' bonus certificates, I believe.

Mr. RUML. But I want to say again that these are strictly personal views, and I am very grateful to Mr. Thomson for having permitted me to make that statement, because I feel much happier about getting my views on the record.

Mr. THOMSON. I want to emphasize what Mr. Ruml said, and that is that the illustration of the way of handling it does represent one of the points of view that is discussed and is a proper subject for the Monetary Commission. My only personal views are that, one, we have not studied the question; two, we are concerned about the present situation of deficit financing at a time of high level employment; and, three, I would like to explore more carefully with more information than I have now as to the volume of these so-called nonrecurring expenditures that seem to be more or less current, before I make a decision; but it is one of the points that is raised and is a proper subject, in our opinion, for consideration by the Commission.

Senator FLANDERS. I would like to raise a question or two about Fanny May (FNMA). Now, the expenditures for purchasing these mortgages by the RFC would appear, would they not, in the cash budget?

Mr. RUML. Yes.

Senator FLANDERS. So that, appearing in that cash budget, they have the economic effects which you assign to the situation so far as the cash budget is concerned.

There is another type of double budget which is under consideration. This may perhaps lead to a triple budget. That is the investment budget. It seems to me that, if there is any case in which the investment budget is justified, "Fanny May" would be the case, because the investment is one which will result in the profit to the Government; the investment is justified from a strictly business basis. The degree of risk in it is small on the basis of past experience or any future expected experience.

So that, if we begin to talk about an investment budget, that is one of the items which I think, on a strictly business basis, might well appear in it. I do not want to raise the question of the investment budget and the expenditure budget at this time, but I do feel that it is perhaps the best case you can add to this as an example of a valid governmental investment, but it does have the economic effects that you attribute to the cash budget.

NATIONAL COMMISSION

Mr. THOMSON. There are, of course, a great many other questions that should be raised. I have, for example, not talked at all about organizational matters, such as the possibility of formalizing the cooperation between the Federal Reserve and the Treasury. I have not raised any of the questions that arise from the fact that the United States is part of a world economy and not a closed economy. We are talking about an area in which the questions still outnumber the answers.

This brings me to the recommendation on which I shall close. Last year our committee recommended the establishment of a temporary commission on national monetary and financial policy to make a comprehensive study of the possibilities of improving the structure and policies of monetary, budgetary, and related institutions. Similar suggestions were made by other groups.

We were very much encouraged by the establishment of this subcommittee, by the quality of its membership, and by the workmanlike way in which it has approached its task. We think the materials assembled by this subcommittee will be invaluable in pointing out the main questions and laying the basis for the comprehensive study we recommended.

Now that such a good start has been made, it would be folly not to follow it up. How long a thorough study would take, I don't know. Probably 2 or 3 years would not be an overestimate. In any case, as much time as is necessary should be allowed. We think the membership of the commission should extend outside of Congress.

These are people in the administration who have much to contribute, not as witnesses merely but as active collaborators. Also, outside the Government there are people whose wisdom and experience should be brought directly to bear on these problems. After all, my good friend Ralph Flanders could have made a major contribution to this study 3 years ago, when he was not yet a Senator. I might say, if you let Ralph retire, we will put him back on the committee. I don't think we can find another Ralph Flanders. But there may be three or four private citizens who together make nearly his equivalent. From a broader commission I think you would get not only somewhat better answers but also more attention paid to the answers, which is very important.

I think you for your courtesy in hearing me at such length on this difficult subject.

Senator FLANDERS. Mr. Chairman, may I rise to a point of personal privilege? I may say that I have looked upon my connection with the CED as a very valuable course of adult education, and I think that is about all that I can claim for it, and I do not think I am educated yet completely.

This process that the CED goes through is rather complicated and time consuming, and is, I think, the greatest project in adult education among both businessmen and economists that has been undertaken. All the credit I want to claim is that of having pursued that process of adult education assiduously over a period of years, but I do not think a diploma is yet ready for anybody.

Mr. THOMSON. I would like, if it is satisfactory, to give Mr. Ruml a chance to make any comments. He has been listening and may have comments.

Mr. RUML. I am afraid I have spoken a good deal. I would like to just briefly touch some of the high points in the report you have already read.

I would like to emphasize the fact that we distinguished between three different budget policies and accepted one and rejected the others.

Senator DOUGLAS. The others?

Mr. RUML. Yes.

Senator DOUGLAS. I think you took number three, but you also took a portion of number two.

Mr. RUML. I would not be so stubborn as to deny that in periods of depression the stabilized budget policy which we advocate has in it strong compensatory mechanisms, but there is a necessity for a distinction because the extreme position that was taken in the thirties as to the possibility of using Federal expenditures and perhaps taxes to even out the economy is quite a different measure from introducing built-in stabilizing influences that do not require either legislative or administrative discretion.

Particularly we reject the policy that requires an annual balancing of the budget, because we know that, if business falls off, the only way to balance the budget is to raise taxes, and the only thing you are going to do then is make it fall off more, and then you will have to raise taxes some more, and then in the end you will have to abandon the policy, and you might as well abandon it in the first place. It will save time and headaches.

I call attention to the exceptions again of the stabilizing budget policy. They are not exceptions; they are parts of the policy, actions for exceptional circumstances.

Senator DOUGLAS. Compensatory modifications of the policy.

Mr. RUML. One is and one is not. Yes; the first exception is how to behave under conditions of extreme deflation or inflation. The other is how to handle the extremely difficult problem of nonrecurring expenditures and also how to handle this new question that is now becoming so important, the question of investments that have an inflationary consequence. These things must be part of any over-all program. Let me leave that for a minute and refer to the administrative measures that are necessary to make any policy work, whatever policy you adopt.

First, on the side of the executive branch, my good friend Tom McCabe, in testifying before this committee, said that good friends would always be able to work together, and I am sure that is true. On the other hand, I think it is a good thing for them to have minutes of their meetings so that their successors can find what the causes for their actions were.

I therefore believe that some modification with recognition of contemporary events should be made of the short-lived Fiscal and Monetary Advisory Board that was created in 1938 and lasted, I think, for 4 weeks into 1939. The record of that Board is quite extraordinary in showing both the difficulties of getting cooperation among independent agencies and also the extraordinary power they have when they cooperate.

I believe it would be worth while to note that, and I spoke to Tom McCabe about it, and he said, "By all means take exception to my friendship plan, if you please," and so I do. I think something more formal than that is necessary in the executive branch.

In 1938 we brought together—I say "we" because I was working with Mr. Delano at that time in the National Resources Planning Board—the Secretary of the Treasury, the Director of the Budget, the Chairman of the Federal Reserve Board, and the Chairman of the National Resources Planning Board. The Resources Planning Board is now extinct; there are new agencies that have been set up. We note the actions of the National Advisory Committee and find it to be an extraordinary example of interagency cooperation.

Senator DOUGLAS. Do you favor the Hoover proposal for a National Commission on Monetary Policy composed of the chief officers of the Government to deal with such matters?

Mr. RUML. I think it would have to be broader than that, Mr. Chairman. I certainly would refer questions of debt management in principle and also questions of taxes in principle for recommendation.

Senator DOUGLAS. To the Council as a whole and not to the Secretary of the Treasury?

Mr. RUML. That would be the conception, not that they would have power of decision, but they would have power of discussion and coordination and reference to the President in case of a serious dispute. I do not know what should be recommended on that. That probably would be another study.

The other administrative measure would be that something needs to be done on the legislative side to see that there is brought together the over-all problem of expenditure and taxation and the consequences of actions in either area. The Congress has had before it recommendations along those lines.

I have nothing to add. I do not even know that I can do more than simply say that, in moving into a world where you have this vast debt and vast expenditure and vast taxation, with the consequences of policy in taxation on the lives of people, I really think that something more is needed to tie the activities of the legislative branch more in harmony each with the other, the executive branch more in harmony, and the channel of communication between the two.

I think that is all I have to say, Mr. Chairman.

Senator FLANDERS. Mr. Chairman, I had passed over my shoulder by some person unknown to me this little note, which I would like to read. I think it is in the interest of peace and harmony.

Is it correct to say that, if you remove action on the basis of forecasts from a compensatory budget policy and act only after an economic trend becomes clear, as recommended by the 15 university economists at Princeton, you approach the CED's proposal of a stabilized budget policy?

Mr. RUML. Yes; with one addition, which I am sure the author would have put in if he had recalled it, and that is that the program within the area of small fluctuations should have as an essential part some built-in flexibility. That would have to be part. That would be the essence. There must be some flexibility in the program that does not require administrative or legislative action.

Mr. THOMSON. I would like to indicate that what Mr. Ruml said about better procedure on the part of Congress is covered in our statement, Tax and Expenditure Policy for 1949, on page 13. That will give you a reference to it.

Senator FLANDERS. There was one point raised by the Princeton people, and that was the possibility of formula flexibility. That apparently has not been in the recommendations of the CED.

Mr. THOMSON. I think, Senator, that would be covered in our general statement that you cannot consider this as an automatic device, that it is something which has to be used with judgment and with all the facts before you. I take it that would provide for the flexibility they had in mind.

Mr. RUML. It is a little more serious than that, and we shall undoubtedly have to consider it, but for myself I have always felt it rather impractical that Congress or the Executive would delegate to some operating board or committee the type of powers that would be necessary for built-in flexibility, because, as this report indicates, these powers involve changing the withholding rate on the income tax.

It seems to me that hardly any formula could be set up that would cause you to refer that to an executive agency or even a board like the Federal Reserve Board. It will have to be studied. To say it is politically impractical really is no answer.

Mr. WOLCOTT. You have not forgotten my question on excise taxes, have you?

Mr. RUML. Again, I am not speaking for the CED. I am speaking for myself only.

I think that, to discuss excise taxes, it is absolutely necessary to define what we are talking about, because there are three areas of excise taxes that must be distinguished: No. 1 is the excise taxes as a whole, including gasoline, alcohol, and tobacco. I think that the situation from a public-revenue point of view on gasoline, tobacco, and alcohol is sufficiently distinct so that those taxes can be removed from consideration from the rest.

Senator DOUGLAS. Would you remove the taxes or merely separate them?

Mr. RUML. They should be considered separately. If you take all the rest, there is another distinction, and that is the excises we have used traditionally prior to the war as a means of getting revenue, and the excises and rates that were put on in 1941 and 1943.

Now, what I want to do next is to remove from consideration everything except the excises that were put on in 1941 and 1943 for wartime purposes, excluding gasoline, alcohol, and tobacco.

Senator FLANDERS. Did you give us an example of the second group you wish to exclude?

Mr. RUML. The second group that I wish to exclude—there was an excise tax, I believe, on automobiles prior to 1941. There was a tax on oleomargarine prior to 1941.

Senator FLANDERS. Will you please avoid discussing that?

Mr. RUML. That is why I hesitated.

Senator FLANDERS. Go directly to your third group now.

Mr. RUML. These taxes I am talking about have one thing in common. They were put on during the war for punitive purposes against certain particular types of consumption and types of production. They were put on there to save materials, to save labor, or because it was presumed that a good moral influence on the war would be had, such as the tax on admissions to cabarets, et cetera.

Now, then, it seems to me that this bundle of taxes should be repealed as being contrary to a nondiscriminatory tax position for peacetime.

It also seems to me that, after they are repealed, the revenue consequences of the repeal should be studied to see if anything needs to be done, because I have a feeling, having observed what has happened to the fur industry in New York and the jewelry industry in New England and the leather goods industry, et cetera, that the net loss of revenue will be much less than what would appear to be the gross loss.

In other words, there will be taxes on manufacturers' profits, taxes on retail profits, taxes on withholding taxes, on employees' income, a lessening on out-payments on unemployment insurance.

If I may go back, I think by taking these punitive taxes as a group they should be repealed as being contrary to a peacetime policy of taxation, and that after that is done the revenue effects should be appraised to see what, if anything, needs to be done to make up for loss of net revenue.

Mr. WOLCOTT. How would you fit that into our discussions with respect to a compensatory budget policy or stabilizing budget policy? Would you give consideration in these budgets to the renewal of them under certain circumstances?

Mr. RUML. I would consider this, sir, just as the community-property reform was considered. That is, the correction of an inequity which has prior consideration to revenue consideration. This thing should be done, because the employees of these industries and their families have done nothing wrong to justify the punitive action taken against them.

Having done that and having come to a figure that represents the net loss, I would then say: "Is this so large that we cannot absorb it? Must we find revenue from some other source? What should we then do about it?"

Mr. WOLCOTT. As I understand it, in respect to a consideration of a budget, whether under the compensatory system or stabilizing system, you eliminate these punitive taxes altogether?

Mr. RUML. Or even under the annual balanced budget. I think under any policy they have no place in a peacetime scheme of taxation.

Mr. WOLCOTT. Thank you.

Mr. THOMSON. I might add I was glad to have Mr. Ruml make that comment, because he has studied the subject so definitely, and he is expressing his viewpoint.

As chairman of the committee, the committee has in mind that they are going to bring out a tax-policy statement in January, and that one of the subjects we will deal with is this matter of excise-tax removal in part or in total, and we have said so far that our tax-policy statement for January will be considered in terms of the CED's previous policy statements.

So I am not saying at this time whether the committee will agree with Mr. Ruml or not, but we are working on it and we will have a statement in January that will deal with that subject.

Mr. WOLCOTT. I am glad to have these statements, and I will have to explain that they are somewhat personal and perhaps a little selfish on my part. However, I do not think my mail on the subject is any different from that which other Members of the Congress are receiving. I think perhaps I have more information now upon which to base an answer to the complaints against the baby-oil tax and the cosmetics tax, which come within that category.

Mr. RUML. I did make it clear that I was giving my personal views, did I not?

Mr. THOMSON. Yes; you did.

Senator DOUGLAS. If I may question you about your personal views for a minute, suppose it were to be found that by the reduction of these excise taxes you caused a very severe reduction in revenues and contributed to the governmental deficit in a period of high employment, and therefore added to inflationary pressures. Wouldn't you regret, as a citizen of the country, that you had offered this advice to the Congress and led them down a path which later turned out to have bad results?

Mr. RUML. No.

Senator DOUGLAS. And wouldn't we regret having been led down that path? I would.

Senator FLANDERS. I would not. I would rather get the taxes some other way than that way.

Mr. RUML. Mr. Chairman, I think that is the whole point of this business. If you have an unjust and inequitable tax, the thing to do is get rid of the tax and then decide what you are going to do to have an equitable system of revenue rather than perpetuate the wartime legacy that is unjust to towns, communities, and families, and has nothing to do with the current needs.

Today most of our unemployment, or a great part of it, is in these affected industries—it was last summer. There are no public works I know of that can give employment to fur workers and jewelry workers and leather workers and cosmeticians.

Senator FLANDERS. They would not make good cement mixers.

Senator DOUGLAS. May I raise a question? You mentioned the liquor industry. You say you would not favor reducing the taxes on liquor; but, as I remember it, the taxes on liquor were increased during the war. I was not here, but I believe they were trebled. And if you say that the imposition of these fresh taxes on the items that you mentioned was a war measure, which should be discontinued as soon as possible, would not the same line of reasoning lead you to a reduction in the very high liquor taxes? And it may be argued that distillery workers do not adapt themselves very readily to other occupations.

Senator FLANDERS. Are they not as well employed as they were before the war?

Senator DOUGLAS. I am asking Mr. Ruml whether he is going to remove the wartime increases on liquor as well as the fresher portion of the imposition of war taxes on leather goods, jewelry, and furs.

Mr. RUML. Mr. Chairman, I think I was quite precise in my original statement, not that I would not reduce the taxes; I would not consider them in this package, because of the——

Senator DOUGLAS. They are to have secondary treatment?

Mr. RUML. That is right, because of many secondary considerations of a moral, ethical, and perverse character.

Senator DOUGLAS. I think you have lingering traces of prohibition inside your moral consciousness.

Mr. WOLCOTT. If Mr. Ruml has the figures, it might be helpful for the record if we could have the amount of revenue which is being received from those three different categories.

Mr. RUML. I have three estimates which differ so widely that I trust none of them; and, if I might be excused, I can give you their orders of magnitude. It is some place between a gross of about $1,700,000,000 and $2,500,000,000. What is included, what is excluded, what estimates are made on the volume to occur in 1950, are all bases for variation, and all I can say is it is within that gross. What the net is, I do not really feel that I ought to even try to make an estimate.

We are going to try—not the CED, but another group—to make a study to see if we can present to the Congress in January or February an honest estimate on this extraordinarily difficult question as to what the net loss might be.

Mr. WOLCOTT. Can we assume the major part of that revenue comes from the first group of liquor, tobacco, and gasoline?

Mr. RUML. Excluding that altogether. This is only the package of the wartime rates and taxes excluding tobacco, gasoline, and liquor.

Mr. WOLCOTT. They vary between $1,700,000,000 and $2,500,000,000?

Mr. RUML. That is gross. What the net is, I do not know, but less than that.

Senator DOUGLAS. You may be able to throw away $1,750,000,000 or $2,500,000,000 in this free-hearted gesture; but, much as I would like to be a public benefactor to these industries, I find a certain reluctance in abandoning these sources of revenue until we know what other sources of revenue we could get.

If our aim is a balanced budget—and some of us are trying as best we can to get it balanced—to throw it out of kilter by a reduction of $1,700,000,000 or $2,500,000,000——

Mr. WOLCOTT. It would be offset somewhat by an increase in employment in those fields and an increase in production.

Mr. RUML. If I may say so, Mr. Chairman, I hope you will not decide an issue until after the estimates are in hand, and then you can see whether the estimates are good and what alternatives there are. There is an inequity here hanging over from wartime, which ought to be gotten rid of if we possibly can.

Senator DOUGLAS. I would agree, but I think we ought to count the cost before we take final action.

Mr. RUML. That is right.

Mr. THOMSON. I said the CED Committee is studying the question, and our idea is to make recommendations on that and other questions in line with our budgetary policies.

Senator DOUGLAS. We want to thank you for this very valuable presentation, which I think we have all enjoyed.

We will shortly be working on the budget for fiscal 1951. What concrete adjustments would you recommend in the light of this general policy which you have outlined?

Mr. THOMSON. That again I would have to defer and tell you we are working harder than we have usually worked to get a statement out in January dealing specifically with the 1950 situation, but we are not prepared to make our statement now.

Senator DOUGLAS. Would you like to make a personal statement?

Mr. THOMSON. I think not. I have a strong feeling that the chairman of the committee should not anticipate what a very good and capable committee is going to decide.

Senator DOUGLAS. What about the vice chairman?

Mr. RUML. In spite of the fact that I have been free in expressing my opinion on general matters, when it comes to something specific about budgets for fiscal 1951, and now it is almost the 1st of December and we will have that recommendation the first part of January, I think I am bound by courtesy to the committee to reserve what I have to say until the committee reports.

Senator DOUGLAS. We thank you very much for your appearance before the subcommittee and for your interesting contribution.

Mr. THOMSON. We thank you very much and hope we made some contribution.

(Whereupon a recess was had at 12:10 p. m., to reconvene at 2 p. m.)

AFTERNOON SESSION

Senator DOUGLAS. Ladies and gentlemen, I wonder if it would not be better if we came to order.

We had invited Mr. Emil Rieve, who is president of the Textile Workers Union of America, and vice president of the CIO, and administrative chairman of the CIO full employment committee, to testify this afternoon.

Mr. Rieve is unable to be present, but he has sent a statement which will be read by two of his representatives, Mr. Stanley H. Ruttenberg and Mr. Everett M. Kassalow, and we would like to have the statement read. I assume that you will be ready to entertain questions at appropriate points during the reading of the memorandum.

Mr. Kassalow, will you read the statement?

STATEMENTS OF EVERETT M. KASSALOW, EXECUTIVE SECRETARY, CIO FULL EMPLOYMENT COMMITTEE, CIO; AND STANLEY H. RUTTENBERG, DIRECTOR OF EDUCATION AND RESEARCH, CIO

Mr. Kassalow. I should like to say that Mr. Rieve was sorry he could not be here today. He has followed very closely the workings of the Employment Act and the activities of the joint committee, but he was detained in New York this afternoon. [Reading:]

I do not appear before this subcommittee in the role of a fiscal or monetary expert. Your subcommittee already has received statements, written and oral, from many Government officials who are certainly far more learned in the technical aspects of this subject than I or the CIO full employment committee of which I am a member.

Let me add, however, that this particular CIO committee was formed immediately after passage of the Employment Act of 1946 for the specific purpose of enabling CIO to develop policy and shape support to carry out the broad mandate established by this act. We are, therefore, extremely interested in the activities of the Joint Committee on the Economic Report, which, like our committee, is a kind of child of the Employment Act. Consequently, we welcome this opportunity to testify, if even only to present general views on fiscal and monetary policy.

Our own consideration of the Employment Act and the policies which can bring about its successful operation have convinced us that there is no more important single area for bold Government action than in the fields of credit, fiscal, and monetary policy.

As a nation we have come a long distance from the 1930's when a national debt of $25,000,000,000 or $30,000,000,000 and an annual deficit of $3,000,000,000 or $4,000,000,000 looked like a catastrophe. Economically speaking, we are living in a new climate. In the space of less than 12 years our national debt has grown 7 or 8 times over. Yet, in spite of a debt of $250,000,000,000, I don't believe there is much disagreement with the fact that as a nation we are stronger economically today than ever before.

As a nation we have learned that fiscal problems such as the size of the debt, taxes, and Federal budget surpluses or deficits cannot be considered as entities unto themselves. They can only be regarded intelligently in relationship to the Nation's total income in a given period as well as its prospects for economic growth and development.

I say that as a nation we have learned this, and let me add that we in the labor movement are frank to admit that much of the fiscal experience of the past decade has been eye opening and highly educational for us. We like to believe other groups have undergone similar education, and we hope the joint committee can do something about extending a broader understanding of Federal debt problems.

Consider, for example, that our national debt today of 250 billion dollars has an annual interest-carrying charge of 5½ billions. This interest charge is more than five times the 1939 level, but it shapes up against a current national income of 230 billion dollars compared to national income in 1939, to choose a so-called normal prewar peacetime year, of 72 billion dollars.

The level of current interest payments on the debt is referred to here because we think it is a matter too easily overlooked. In at least a limited sense, the real burden of the debt is the annual carrying charge.

Let me remark, aside, that we recognize that the size of the debt itself as well as the kinds of annual deficits it has involved creates other problems and is not an unmixed blessing, but we shall discuss budget balancing and related questions later in this testimony.

Getting back to the carrying charges, we cannot help but be struck by the fact that a more than fivefold increase in annual Federal interest payments doesn't seem too serious a load in the light of the 180-billion-dollar increase in national income over the same period. Even in real terms, national income is up over 100 percent. Obviously this great rise in income has raised the tax-bearing capacity of the Nation and thereby makes the carrying charge of 5½ billion dollars in interest much less of a burden than even the 1-billion-dollar charge was in the late thirties.

Senator DOUGLAS. May I interrupt? Five and a half billion is approximately 2⅓ percent of $230,000,000,000 of national income. A $1,000,000,000 interest charge upon a national income of $72,000,000,000 would be 1.4 percent. So I think you do well to point out that the increase in the carrying charge, as a percentage of the national income, has not increased as much as the gross amount of the debt would indicate; still it does seem to be an increase from 1.4 percent of the national income to around 2⅓ percent, which is an increase.

Mr. KASSALOW. I would agree that on a strict proportionality basis it was an increase, but we mentioned the fact that we think it must be seen in contact of prospects for growth.

Senator DOUGLAS. Yes.

Mr. KASSALOW. I wouldn't disagree with you on that point. [Reading:]

As to just where Federal fiscal policies fit into this great growth in income, while there were undoubtedly many economic influences at work, our own analysis convinces us that the wartime Federal spending was the initiating force that jarred the economy back into full operation and enabled the country to put its idle manpower and resources to work. The result was a record flow of both war and nonwar goods.

Moreover, the lasting favorable effects of these huge Federal expenditures have undoubtedly contributed to the high levels of postwar economic activity. Huge wartime-created accumulations of cash in the hands of both consumers and business provided an unprecedented peacetime demand for the products of farm and factory in 1946, 1947, 1948, and even in 1949.

It may well be that, when historians come to assess the role of Federal spending in the past decade, they will conclude that, with all its shortcomings and dangers, its major significance lay in the fact that it furnished the leverage which moved the economy off the dead center it had hit in the stagnant thirties. Once under way, the basic strength which was inherent in the system but had remained dormant for over a decade came into play.

Looking back, it seems particularly unfortunate that this spending, so far as many of the goods produced were concerned, had to be of so largely a wasteful, warlike character. Can anyone here conceive what our instruments of health, welfare, and education, to choose but three, might be today if the two-hundred-odd-billion-dollar debt had been poured into more useful channels?

Let me make one final comment on the positive side of this debt question. I don't pretend quite to understand all the mysteries of the Federal debt and budget deficits; perhaps, therefore, some member of this subcommittee can tell me why is it that when a private utility company floats a bond issue and uses the funds thus obtained to build a new power plant or a series of transmission lines, it is entered on the books as an asset; yet, when a Government agency, a TVA or the like, borrows money and does the same thing, it becomes an all-terrible public debt, with nothing good to be said for it.

Senator DOUGLAS. In other words, you would suggest having an operating budget and an investment budget to differentiate the amounts which are spent for current purposes from those which are used to build up capital investment?

Mr. KASSALOW. I believe that in an earlier period we made such a recommendation, but it strikes me that this is more than simply a technical problem or one of semantics; it is a matter of concept. It is unfortunate that the notion of varying types of Federal expenditures is not sufficiently differentiated in many people's minds.

Senator DOUGLAS. What you are saying is that some Federal expenditures are highly productive, even though they involve the operation of a deficit?

Mr. KASSALOW. Yes. I agree that the division of the budget into the two categories you suggested might serve a very educational purpose. [Reading:]

While I have here emphasized what might be called the positive aspects of Federal monetary, fiscal, and credit policy, types of spending that under certain conditions may help raise levels of national income and output, I hasten to add that we in CIO believe that the application, in reverse, of similar fiscal tools can also help check inflation and prevent wild booms. We believe, for example, that the Federal surpluses piled up in the years of 1947 and 1948 certainly reduced the force of inflation and lent additional stability to the economy.

The SEC Act, to cite another phase of Federal fiscal policy, has also been a healthy, restraining influence during the past 3 years.

Another critical phase of Federal fiscal policy is the tax field.

I might add, we didn't go into taxes very substantially because we didn't want to add to the length of the statement, but we would be glad to answer questions on that. That is a related fiscal policy. Mr. Ruttenberg is the secretary of the CIO's tax committee. [Reading:]

Indeed, in our judgment, one reason why Federal deflationary policies were not entirely successful in the immediate postwar years was because of some bad tax legislation that was passed. These bad tax changes—which we opposed, incidentally—helped bring on serious inflation and ultimately greased the skids for the current recession. If, for example, the excess-profits tax had been retained on the statute books, there is good reason to believe inflation would have been lessened. By the same token, the ill-timed, ill-staged income-tax bill of 1948 undoubtedly fed the fires of demand at the worst time.

But, if anything, these past mistakes only point up the general conclusion that proper Federal fiscal monetary and credit policies can help to stabilize the economy.

These types of Federal activity, incidentally, have special added attractions. For example, they fall clearly into the realm of accepted Government responsibility. Not even in this day and age of the attack on the welfare state would many question the Federal Government's right to use these policies, in keeping with its powers of regulating the value of money and credit under the Constitution.

Another compelling reason that leads us to put so much reliance on these policies is that they are exercised on a very broad general plane. They can help guide the general movement of the economy, but they do not, by and large, extend to individual industries and workers.

Thus, they fit into the accepted American tradition of leaving fundamental areas free for action by individual companies, unions, and consumers. Much of what is unique and dynamic in the American economy can continue to function and grow in the face of well-executed Federal fiscal and monetary action.

Senator DOUGLAS. May I interrupt? What you are saying now is substantially what the Committee for Economic Development said this morning and what the president of the Philadelphia Federal Reserve Bank, Mr. Williams, said last week—that the Federal Government should use, primarily, indirect controls to regulate the total quantity of money, credit, the general price level, and so forth, but that the matter of individual adjustment be left to competition and to the market rather than the exercise directly by the Government?

Mr. KASSALOW. Well, we will agree generally with that provision. As we indicate later on, we don't believe that fiscal policies are by any means sufficient. [Reading:]

For these reasons, we believe that this subcommittee would be well advised to give sympathetic consideration to proposals to strengthen these policies and the agencies exercising them.

For example, we are not prepared to say ourselves precisely what should be done about bringing the seven-thousand-odd commercial banks which are not members of the Federal Reserve System under the general jurisdiction of the central banking system. Whether membership in the System should be compulsory or whether the mere requirement that all banks must observe the reserve ratios established by the Federal Reserve System would be sufficient, we don't pretend to know. We sincerely hope, however, that this subcommittee will see fit to recommend either of these lines of action, whichever it judges best, to make our banking structure more rational.

Senator DOUGLAS. But you think that one or two others should be adopted, that others shouldn't be left as they are now?

Mr. KASSALOW. That is right. Those, as we understand it, have been the major proposals to accomplish that general end. [Reading:]

We think Congress' failure to renew the Federal Reserve Board's power over consumer credit was an appalling mistake. Clearly this was a FRB power that had justified its existence. Of course, there will be periods when it may not be necessary to exercise it, but this is one of those flexible fiscal powers that should be available for use when necessary.

Senator DOUGLAS. May I interrupt there? The continuance of regulations on consumer credit was attacked by some on the ground that it would be unfair to unduly restrict the ability of low-income groups to command durable consumer goods, who were able to borrow on mutually acceptable terms from the consumer-goods financing institutions. I gather that you do not agree with that criticism, and I think it would be informative for the sake of the record if you would state why you do not.

Mr. RUTTENBERG. Might I comment on that?

It is generally the people who have in the past shown no regard for the welfare of the low-income individuals who make the argument which you quote; it comes from people who oppose the extension of Regulation W. In other words, they show their tremendous interest in the welfare of the low-income people by saying we ought to permit them to become so indebted that they can't get out of it, and they might even lose the products they buy because they have gone into the consumer credit market to buy them.

We take the position, and the very strong position in which we have supported Regulation W from the beginning that it is a power and authority which ought to exist to be used in times of inflation to curtail expenditures of durable and hard goods production.

Senator DOUGLAS. Have you given any thought to the desirability of requiring concerns which sell on the installment plan to state what the interest rate is which they are charging on unpaid balances? There is a concealed rate, of course, in all installment purchasing, and frequently that concealed interest rate, I found in the past when I looked into the matter, was very high. Would you favor requiring, as one of the conditions of installment sale, a statement—not necessarily a regulation, but a statement—as to what the interest rate actually is which the person buying on the installment plan pays? And furthermore, to have that interest rate computed on the unpaid balance, which is what the purchaser owes?

Mr. RUTTENBERG. I think that is an excellent suggestion, and your committee, I think, could do considerable good service if during the course of your report you point out and analyze just this question of interest rates on consumer buying. Of course, it relates to the whole field of the Small Loans Act.

Senator DOUGLAS. Yes.

Mr. RUTTENBERG. Actually efforts have been made in past years to get the Congress to take some action in the field of small loans, and, of course, they haven't. But regulation over that whole field, or at least pointing up the problem in an educational way, will go farther toward accomplishing something useful than any other measure in this field of consumer loans.

The general charge is made that workers buy regardless of the situation. That is generally true. Sometimes it might be well to help them understand the problem they are getting into in terms of high interest rates they pay and in terms of what will happen to the products they buy if they default on payments.

Senator DOUGLAS. I know some years ago I looked into this matter and found in a great many cases of installment selling that the interest rate was never mentioned, and when the interest rate was mentioned it was commonly stated as a percentage of the original figure whereas it should have been at least twice the rate of interest on the unpaid balance.

Mr. RUTTENBERG. Of course, the interest rate is always figured on the original balance, not the unpaid balance.

Senator DOUGLAS. The proper analysis is on the unpaid balance, which is that which the purchaser owes the seller or the borrower owes the lender.

Mr. KASSALOW. Or, I suppose, the rate at which the lender refinances it.

Mr. RUTTENBERG. I think it might be well to suggest that another worthy service which your committee could perform would be an analysis of the existing Small Loans Act as it applies to this whole field of consumer lending.

Senator DOUGLAS. Thank you very much.

Mr. KASSALOW (reading):

These are details, however, and we prefer to rest this testimony on the broad needs for adequate Federal fiscal, monetary, and credit policy and actions.

No statement on fiscal and related policies can avoid the question of budget deficits and budget balancing, particularly at the present time, when the current budget deficit has been a subject of such great controversy.

I have earlier referred to the fact that we by no means see large deficits or a growing Federal debt as an unmixed blessing. Indeed, while we pointed out how Federal spending helped move the economy off dead center, we appreciate the fact that this kind of stimulation provided by liberal Federal fiscal, monetary, and credit policy can only be effective if it isn't a steady kind of dosage. No one would recommend the huge Federal spending of the forties as a steady diet.

Moreover, the growing burden of interest charges does raise some serious questions as to income redistribution. An internally held Federal debt—that is, one owned primarily (as is the status of our current national debt) by the people of this country—is not like an ordinary private debt. Broadly speaking, it is something we owe to ourselves and the interest payments on it don't constitute a real draining off of wealth from the Nation.

To the extent, however, that the debt is held by any particular economic group, it makes for an unfavorable flow of income to that part of the economy. Progressive taxation may mitigate this unfavorable flow of interest payments and income distribution, but the problem of trying to hold down the size of the debt in order to keep the level of interest payments as low as possible remains.

Then, too, we have always taken the position that waste in Government can no more be condoned than waste in private industry—and we realize there is plenty of it in both.

The principle of striving, as far as possible, for a balanced budget and a budget surplus, then, appeals to us as a sound economic canon.

Senator DOUGLAS. May I interrupt at that point? I am very glad, indeed, to have you make the statement—I think it is very important—namely, that you believe waste in Government should be reduced, and that the presumption in normal times is probably in favor of a balanced budget, with whatever meaning you attach to "normal."

If, for instance, it were developed that there were an excessive number of Federal employees, you would not regard it as an antilabor policy if their number were reduced?

Mr. KASSALOW. I think we could agree with that. If it were a demonstrable form of waste, no one could really defend it.

Senator DOUGLAS. If there were more people in Federal service than needed to perform the functions of the Federal service.

Mr. KASSALOW. Frankly, we would be doubtful that you could pose it on such a grandiose scale and decide that there were more people in the Federal service broadly than needed. I suppose that you could well attack it on the basis of this or that department, or this or that function.

Senator DOUGLAS. But, you see, Congress gets lost when they have to search out each individual unit, because of the hundreds and almost thousands of individual units. The question is, Isn't there a general presumption that there probably is an excessive number of persons in Government employ?

Mr. KASSALOW. If you will forgive a bit of levity, we are opposed to "5 percenters" or "10 percenters," on any kind of operation, but let me explain. I think that kind of broad cut which might be envisaged under a broad attack on this question of waste, if there is waste, is a regressive kind of action. I daresay that there are some departments where there is waste. While I don't know all of the details of Secretary Johnson's handling of the armed services, it would seem he found waste.

Senator DOUGLAS. He was trying to save $2,000,000,000 out of a $15,000,000,000 budget.

Is it your belief that there are no reductions which could be made in the civilian budget?

Mr. KASSALOW. I would say that when you get down to the situation where you are trying to impose a 5 or 10 percent cut on a budget say as small as the Labor Department, it is about as regressive as a 2-percent sales tax for the low-income person.

Senator DOUGLAS. Is it your assumption that there is no waste in the Labor Department?

Mr. RUTTENBERG. I think what Mr. Kassalow is saying is that he is using the Labor Department as an example.

Senator DOUGLAS. That is right.

Mr. RUTTENBERG. If you take the Federal Trade Commission, or the Department of Justice, the Antitrust Division, and try to cut 5 percent out of those Departments, which are now completely inadequately staffed to do a job, they will not be able to carry out their functions.

Senator DOUGLAS. Let the record show that I went on the floor of the Senate and advocated an increase in the appropriations for the Federal Trade Commission because I believed that they needed more people to perform their functions, and that I was in favor of an increase in the number of internal revenue tax agents to diminish evasions under the income-tax law.

Isn't there a presumption, however, that most governmental departments are somewhat overstaffed, some more than others—not every department, but nearly every department?

Mr. KASSALOW. There seems to be too many dangers in that broad approach.

Senator DOUGLAS. Have you ever worked for a Government department?

Mr. KASSALOW. Yes.

Senator DOUGLAS. Wasn't it your general judgment that there was excessive personnel?

Mr. KASSALOW. I worked for several Government departments.

Senator DOUGLAS. Then you have had quite a wide range of experience.

Mr. KASSALOW. I would say I really couldn't generalize on that point.

Senator DOUGLAS. You mean you can't tell on the whole?

Mr. KASSALOW. No, sir; because not in the case of each of the divisions that I worked for would I make the same judgment.

Senator DOUGLAS. But in totality, if you add them all up, Do you feel that there is?

Mr. KASSALOW. Do we think that there is a possibility of trimming some of the budget and eliminating some of the waste?

Senator DOUGLAS. Yes.

Mr. KASSALOW. I think we would agree with that.

Senator DOUGLAS. Reducing the number of personnel?

Mr. KASSALOW. Yes. The only fear we have is in a too broad attempt to get at that question.

Senator DOUGLAS. No one proposed, so far as I know, that a 5 percent cut be imposed on every unit, division, section, bureau, or even department. What we did propose was that within a given department a percentage figure cut be imposed and that either the members of the Appropriations Committee or the department itself apportion those cuts. But what we aimed at, at least what I aimed at, was a general reduction of some 6 percent in the number of governmental employees, an average over-all reduction, but distributed differently from department to department, and from unit to unit.

I had hoped from the statement that I was going to get reinforcement from you and now I feel my hopes are beginning to be a little bit dashed.

Mr. KASSALOW. I daresay the only hope we could give you is that we are in general sympathy with your position, and when specific appropriations are under question we would have our specific positions on them.

Senator DOUGLAS. When you start on specific appropriations you always hit somebody's pet bureau or department, and it is always said that that is not the place to make cuts, or the manner in which you are proposing it is not the proper manner, or that now is not the proper time. So that it is like sin, everybody is against it, as a general principle, but a great many seem to dally on the primrose path.

Mr. RUTTENBERG. Isn't it the duty of the Appropriations Committees, its subcommittees, to review the budgets of the various departments?

Senator DOUGLAS. Yes; but it is not completely staffed, and besides an appropriations committee needs the support of public opinion.

Mr. RUTTENBERG. But this proposal, as it looked to us when it was made during the past session of Congress, was that Congress was attempting to pass the buck to the Executive.

Senator DOUGLAS. I think you are confusing the last move that was made, after everything else had failed, with the previous attempts. The previous attempts had been to reduce specific appropriation bills. The last and final attempt was, having failed in all these efforts, we asked the Executive to do it.

In any event, I take it that the CIO is opposed to waste?

Mr. KASSALOW. They are against sin, too.

Senator DOUGLAS. We hope that we will get sympathetic and strong support when the specific proposals to reduce waste are brought forward. Have you thought of any possible ways of reducing waste?

Mr. KASSALOW. What about these pork-barrel projects which I think you made a speech about once?

Senator DOUGLAS. I feel very keenly about those. I would like to see them reduced by $300,000,000.

Mr. KASSALOW. And——

Senator DOUGLAS. A reduction in rivers and harbors.

Mr. KASSALOW. And the substitution therefore of a good conservation program?

Senator DOUGLAS. I would not say you should substitute another, an equivalent $300,000,000 for it. I think we need to reduce the total budget.

Mr. KASSALOW. One difficulty we have in focusing on this question is that the appropriations have been quite inadequate over the years. Such as those Mr. Ruttenberg mentioned, for the Federal Trade Commission, the Department of Labor, and to some extent Federal Security.

Senator DOUGLAS. I think the regulatory agencies, if they are rigorous, tend to be starved by Congress. If they are tame they probably can get all the money they legitimately want. But I wondered if you felt that the Labor Department and the Social Security Division have reached a 100 percent efficiency, so that you can effect no reduction in their personnel.

Mr. RUTTENBERG. You can always improve efficiency, in the Government, in an industrial plant, or wherever you go.

Senator DOUGLAS. You can get the same amount of work done with fewer people.

Mr. KASSALOW. We think fundamentally the things the Labor Department should be doing and is not doing, and the things the Federal Trade Commission should be doing and is not doing, could not be done merely by an increase in efficiency, whether it was 6 percent or 10 percent. That is not answering you directly but maybe gives some idea of the problem as we see it.

Senator DOUGLAS. We are getting into colloquy, but I have never seen how the protection of underpaid men, women, and children in factories depended upon the maintenance of an excessive number of highly marcelled stenographers in the Department of Labor.

Mr. RUTTENBERG. Take a look at the wage and hour enforcement branch. Take a look at that problem. They need far more people in that department as inspectors in the field to investigate violations of wages and hours, and unless they get more people the 75-cent minimum which the Congress passed will become totally ineffective.

Mr. KASSALOW. I think the estimate now is that a check is possible in about every 10 years in the ordinary establishment.

Mr. RUTTENBERG. They can make only 35,000 inspections every year with their present budget. You can't enforce wages and hours with that kind of personnel. You have got to increase it.

So that, obviously, where you take it away in certain areas, in other areas equally important personnel ought to be added.

Senator DOUGLAS. I take it the net result is that you do not believe the appropriations for the Department of Labor or the Social Security Administration should be cut, and economies should be made elsewhere?

Mr. RUTTENBERG. If we can be shown that economies can be made in the administration of the Federal Security Agency and the Department of Labor, the Antitrust Division, and others, we would be glad to accept them.

Senator DOUGLAS. As to the Antitrust Division and the Federal Trade Commission, I think those in the past have been understaffed. What is your feeling on the Post Office? Should the Post Office approximately pay its way?

Mr. RUTTENBERG. I think the current deficit is approximately $500,000,000——

Senator DOUGLAS. Approximately $550,000,000.

Mr. RUTTENBERG. The Congress doesn't seem to be willing to act on the rates which people must pay.

Senator DOUGLAS. I am trying to get your opinion on that. The Postmaster General estimates that the value of unpaid services performed by the Post Office Department to other governmental agencies is about $150,000,000 and he does not propose that those costs should be assumed by the private users of the system, but does propose that the other $400,000,000 be assumed. He estimates that it costs $247,000,000 to take second-class matter, newspapers, and magazines through the mail, for which the Federal Government only gets $40,000,000. There is, therefore, a subsidy of some $200,000,000 on second-class matter; it is $120,000,000 on third-class matter, unsealed advertising matter, in the main.

Do you think those rates should be increased?

Mr. RUTTENBERG. What is the franking privilege cost?

Senator DOUGLAS. For Members of Congress? That is included in the $150,000,000 of unpaid services to other Government departments, for which the Post Office Department grants that the private users should not pay.

But $150,000,000 from $550,000,000 leaves $400,000,000 as a subsidy of second-, third-, or fourth-class matter.

Have you given that subject any thought?

Mr. RUTTENBERG. We would have to say that we have really not given the subject a careful enough consideration to give any general opinion on it.

Senator DOUGLAS. If that deficit could be reduced, obviously the Government would be put in a sounder fiscal position.

Mr. RUTTENBERG. And probably that deficit could be used to develop a real sound welfare program which the Government ought to become engaged in doing.

Senator DOUGLAS. At least to reduce the deficit.

Do you think it would be a good contribution to sound budgeting if the newspapers and magazines of the country would voluntarily come forward with a request that the subsidies be discontinued and that their rates be increased to the point where they would pay for the cost of services rendered?

Mr. RUTTENBERG. Shall we answer that in the presence of all these newspapermen?

Senator DOUGLAS. Yes.

Mr. KASSALOW. If they voluntarily did it——

Senator DOUGLAS. If they did not voluntarily do it, then what would your answer be?

Mr. RUTTENBERG. We haven't given careful enough consideration to it. Thus far, the CIO has restricted its public utterances on this question merely to expressing opposition to proposals to eliminate the special mailing rates allowed for nonprofit publications. Such elimination, we have pointed out, would create special hardships, for example, for the labor press.

Senator DOUGLAS. Would you go ahead?

Mr. KASSALOW (reading):

> We do not believe, however, that this canon or principle can be applied to very rigid periods of time. No one seriously proposed that we try to balance the budget during the war, nor, looking back, would anyone say we were wrong in spending beyond the limits of a balanced budget to care for the hungry and homeless millions of Americans during the depression of the thirties.
>
> We were quite impressed with Budget Director Frank Pace's formulation of this problem in his recent statement to the committee when he noted that "budget surpluses cannot ordinarily be achieved in a declining national economy. Rather, the way to achieve such surpluses is to preserve the types of budgetary and other policies which will increase national income and taxpaying capacity * * * the fundamental fiscal consideration should be the long-run outlook for expenditures, receipts, and public debt. The policies contemplated in the budget of any given year, therefore, should be judged primarily in terms of their impact on the budget and the public debt over a period of years rather than in terms of their interior effects."
>
> Balancing the budget, then, as we see it, gets to be a kind of offshoot of the business cycle. When times are good and full employment and high levels of national income prevail, every effort should be made to pile up Federal surpluses and pay off part of the debt. When unemployment rises, however, and national income drops, the Federal Government must use its fiscal powers to help stabilize the economy, including, if necessary, spending for programs which may result in budget deficits for a while.

Senator DOUGLAS. May I ask a question: How much must unemployment rise before the Government should, in your judgement, use such a policy?

Mr. KASSALOW. This question was recently put to Mr. Rieve, and I think you might be interested in his answer, because, after all, his judgment is more of a critical importance, and I think it reflects CIO leadership. He said his feeling was that to him it was just about untenable to talk about normal hard-core unemployment; as far as he was concerned, unemployment at a level of 1 percent of the labor force might not appear to be a very serious problem, but he would not want to be in that 1 percent category; that he was interested in a policy which continually strove for employment, suitable employment for all those able, willing, and seeking work, as stipulated in the Employment Act of 1946.

If you want to get our current judgment, we certainly don't believe that 4- or 5-percent unemployment is a frictional figure, or an irreducible minimum of unemployment.

Senator DOUGLAS. Let's see. Of course, there is some unemployment created by seasonal fluctuations which exist even at the top of a business boom, and there is other unemployment caused by the waning of some industries and localities. So that even at the peak you have, I suppose, 3- or 4-percent unemployment. Would you use Government deficits to try to put that 3 to 4 percent back to work?

Mr. KASSALOW. I can answer you indirectly. We would never be satisfied with unemployment at 3 or 4 percent, but we did not advocate deficit spending in 1947 and 1948, for example, when unemployment was running about 3 percent of the labor force.

Senator DOUGLAS. That is, you would try to reduce it in other ways, by better employment services, and so forth?

Mr. KASSALOW. Yes.

Senator DOUGLASS. But if unemployment rose above 3 or 4 percent?

Mr. KASSALOW. It isn't strictly a matter of Federal spending, because I don't think Federal fiscal action reduces itself to that, or our program, or the things we believe are necessary for full employment, don't get down to just Federal spending, either. But let me read on. We will discuss the current budget, and maybe that anticipates your question.

Senator DOUGLAS. Well, I would like to go back, if I may, to your statement. Personally, I think you are quite correct in saying that we couldn't probably have balanced the budget during the war, and that we shouldn't have balanced the budget during the thirties.

I agree with you.

Have you, however, heard of Dr. Pavlov's discovery of the conditioned reflex?

That may seem to be a tangential question which has no bearing, but I think it does.

You may remember Dr. Pavlov took his dogs and offered them steaks and rang a bell at the same time. The dogs would see the steaks and hear the bell and their saliva would flow at a very lively rate. Then after a while Dr. Pavlov took the steaks away and rang the bell and the saliva continued to flow for a time, but the dogs then became confused and finally were sent to the equivalent of an animal psychiatrist. I wonder if this same moral couldn't be drawn in this particular instance. Is it not possible to fall into a frame of mind which welcomed deficits in order to avert the misery of the depression and to help us get out of a depression, and which accepted deficits and high spending as a necessary consequence of the war; and that, when the depression is removed and the war is nonexistent, for the emotional and intellectual saliva of men to continue to flow in the presence of deficits, irrespective of the purpose for which they are incurred?

You will forgive me for this fanciful story; but, since this is supposed to be, in part, a physiological matter, I wondered if you would make any comment upon it?

Mr. KASSALOW. I think part of the answer to your question lies in one's notion of what a recession or depression is. I think we probably both would agree, for example, that at a level of 7 or 8 million unemployment was something which warranted serious Federal action, whether fiscal or otherwise. We believe that at a level of 3½ or 4 million it is also a rather serious economic problem.

Senator DOUGLAS. At a level of one and a half or two?

Mr. KASSALOW. We might not recommend the same things at the level of 1½ to 2 that we would recommend should be done at a level of

3½ to 4. I don't believe that it is strictly a matter of deficits or surpluses. There are certain programs which we believe should not be sacrificed at any stage of the cycle, and if it happens that those programs will entail deficits we go ahead with them, because we think that in the long run they might add to the productive strength of the country, and it so happens we think that the current budget discussion entails those kinds of considerations.

I would agree that there is the danger of getting into that rut. We would hope, however, that we have a kind of good watchdog on the Hill in the form of the Appropriations Committee, and I know it usually gives us a good deal of trouble on our programs. I hope they are not responding to any bells. I don't think they have been up to now.

Senator DOUGLAS. Assuming that you regard certain expenditures as necessary, couldn't those be met in normal times by taxes, so that you don't have a deficit, in normal times—whatever the definition of "normal" may be?

Mr. RUTTENBERG. We think so. That is why during all of the Eightieth Congress, and in that attempt of Congressman Knutson of Minnesota to impose his tax cut, we opposed it, and we supported the President when he vetoed the measure, and supported the Congress when they upheld the veto; and finally, when they did override his veto and put into effect in 1948 a tax-reduction bill, we criticized it wholeheartedly, because, we said, in times of high national income it was no time at all to begin cutting taxes. We also had the same thing to say in 1946 when the Congress was considering the elimination of the excess-profits tax as well as the reduction in certain individual-income taxes by about 5 percent.

So that we feel very strongly on that question.

Mr. KASSALOW. We go on in the statement to indicate that we don't think that all sources of revenue have been tapped even at this point of a recession.

Senator DOUGLAS. Will you proceed?

Mr. RUTTENBERG. We also make a strong point in that if we could really develop the full-employment economy with an ever-increasing national income our tax structure could remain stable and still produce much higher levels.

Senator DOUGLAS. Because of an increase in income?

Mr. RUTTENBERG. Yes. If the Government followed the proper policies to establish a full-employment economy.

Senator DOUGLAS. Will you go ahead?

Mr. KASSALOW (reading):

> Applying this standard, we feel the President in his midyear report was on sound grounds in resisting cuts in essential Federal programs. For so long as the private economy is failing to provide useful employment for all those able, willing, and seeking work, budget cutting doesn't make sense, socially or economically. Particularly is this true when cuts are aimed at programs which in the long run will add to our productive power.
>
> Again, let me emphasize that in taking this position we are not suggesting a discontinuation of sincere efforts to eliminate actual waste; but this is a different proposition from merely striving to balance the budget at any cost.
>
> It is well to remember the one thing no country can afford is wasted manpower and idle resources. Those, too, are real deficit threats to national economic development.
>
> So far as the current situation is concerned, however, we are not prepared to say that nothing can be done about increasing Federal revenue and scaling down the prospective deficit. We pleaded in 1945 against the premature lifting

of the corporate excess-profits tax. The staggering profits of the giant-size corporations in each of the past 4 years has convinced us we were correct. We still believe the enactment of an excess-profits tax, especially in a form which would exempt the smaller-size company, is desirable, and would help take up the slack in revenue?

As an organization, we strongly disapprove the iniquitous income-tax law of 1948. We still feel it was a mistake. While it may be difficult to reverse all of this ill-advised action, at the very least we feel such features of the law as the provision for split returns should be revised to enable the Government to recapture some of the lost revenue.

But, again, these are detailed considerations; and, as we understand it, this committee is primarily interested in the broad aspects of fiscal, monetary, and credit policy.

Before I conclude, let me set the record clear. As I have indicated, we place considerable hope in fiscal and related aspects of Government economic policy. Part of this hope stems from the fact that as a Nation over the past 16 years we have adopted other policy measures which lend great basic support to the Nation's economy.

The social-security system, the minimum wage, the farm-support program, the securities and bank-deposit legislation, the public-housing law, these and other phases of national economic policy help create an environment in which the tasks of fiscal policy are reduced. As a consequence, the prospects for successful fiscal-policy operations are enhanced.

But the lesson shouldn't be lost. Fiscal policy can be a major tool for full employment, economic growth, and stability. By no means, however, is it sufficient in itself. Additional measures are needed, such as broadening and improving of social security, additional housing legislation, resource and public-works development, and Federal aid to education, to name but a few. Necessary adjustments in wage, price, profit relationships, looking toward a fairer distribution of income, also should not be minimized.

There are, of course, no conflicts between these policies and a vigorous Federal fiscal program designed to help stabilize the economy. Indeed, sound fiscal policy complements the other measures I have briefly mentioned here.

Let me thank you again for this opportunity of appearing. The CIO strongly supports the work currently being done by the Joint Committee on the Economic Report. Hearings and studies such as these have a real function in the effective execution of the Employment Act of 1946.

Senator DOUGLAS. Mr. Wolcott?

Mr. WOLCOTT. No questions.

Senator DOUGLAS. I have no more questions. Thank you very much.

Mr. Ruttenberg, did you want to submit a supplementary statement?

Mr. RUTTENBERG. No.

Senator DOUGLAS. Thank you very much.

Is Mr. Warren here? It was understood that Mr. Warren, of Moorestown, N. J., was to testify.

We will recess for 10 minutes to find out Mr. Warren's whereabouts and convene again at 3:10.

(Short recess taken.)

Senator DOUGLAS. Mr. Warren, we appreciate very much your readiness to come down and testify before our committee, and we are very glad, indeed, to have you. Would you care to make a general statement, and then perhaps there might be a few questions that I would like to ask you on the basis of your statement.

STATEMENT OF ULYSSES GRANT WARREN, A. S. RIECKE & CO., INVESTMENTS, PHILADELPHIA, PA.

Mr. WARREN. Mr. Chairman, I am very glad I did finally get here. I am sorry that my train was late because I should have gotten here much earlier.

The only general statement that I would have at the present time, in addition to what I have here in the memorandum, is the fact that while I have been in the investment-banking business all my business life, since 1931, I do not consider myself a high-powered economist, but I think I would qualify as an expert in the investment-securities field.

Senator DOUGLAS. We are very glad to welcome you, indeed. Would you go ahead.

Mr. WARREN. Yes, sir. As I see it, gentlemen, over the recent years the impact of the monetary and fiscal policies of the Federal Government upon the private-investment problem has been manifold in its aspects. When I refer to the monetary and fiscal policies of the Federal Government, I mean its easy-money policy and its deficit financing. And when I refer to the private-investment problem I mean the investment-securities markets.

I believe the low interest rates occasioned by this easy-money policy have enabled many corporations—utilities, rails, and industrials—successfully to refund many hundreds of millions of high coupon bonds with long-term low-interest bonds. This cheap borrowed money helps these corporations to render their services or manufacture their products at a lower cost. This also applies to the Federal, State, county, and municipal governmental agency services. This refunding market thus created proved to be a stimulant to the underwriting phase of the investment-securities business.

Also, this change in interest rates has driven a lot of money out of the high-grade market into the semi-investment and speculative markets, from high-grade bonds, preferreds, and commons into lower-grade bonds, preferreds, and commons. Unfortunately, this has hurt a lot of people, some elderly and retired, who bought high-grade securities with good dollars. They now find that they have had these securities taken away from them by call and replaced with securities of comparable quality but yielding fewer dollars which in turn are not worth as much as they were when they invested them originally. In other words, their income consists of fewer and smaller dollars. Their standard of living in some cases has been reduced, and they are worried and mad.

Senator DOUGLAS. You mean angry?

Mr. WARREN. Yes, sir; angry; that is right.

This would appear to be an unfortunate corollary to what some people term a redistribution of wealth.

Also, the higher taxes attending the afore-mentioned fiscal policies combined with the capital-gains aspects of the present tax laws has tended to increase the speculative activity of those persons in high-tax brackets because of the premium placed on long-term capital gains as compared with income. This speculative capital is not of necessity venture capital.

Speaking of venture capital, I don't believe that the monetary and fiscal policies of the Government have had any slowing effect as yet on new money coming into the market. That kind of money is primarily interested in capital gains rather than income. I believe that the slowing effects of current corporate taxes are more than offset by the stimulating effect of the increased activity in our economic life.

Finally, if we are after a continually expanding economy, with all its implications of a higher standard of living for more people, increased personal and corporate incomes, increased tax revenues, et cetera, that is fine so long as our economy continues to expand in proper relation to our debt; but, when the economy starts to contract or deflate, then where are we with a Federal debt the size of ours that continues to grow? I am not an alarmist, but I am curious—just what will we do if a first-class depression hits us?

That may not be very much, but it about covers the field in which I would be qualified to talk, gentlemen; and perhaps I overran that field a little bit.

Senator DOUGLAS. What distinction would you draw between speculative capital and venture capital, which you refer to in your memorandum?

Mr. WARREN. I would draw this distinction: Venture capital is of necessity speculative capital, but all speculative capital is not necessarily venture capital.

For instance, there are a great many speculative securities in the market today, all outstanding. A person can speculate in securities of that sort with speculative capital, but it has not added any money to the venture-capital field, to the venture-capital market.

Senator DOUGLAS. You refer to venture capital as new capital poured into enterprises?

Mr. WARREN. That is right.

Senator DOUGLAS. And either into new enterprises or to expand old enterprises and invested in the form of common stock rather than in the form of bonds?

Mr. WARREN. Not necessarily. There are a great many speculative bonds as well as common stocks. The distinction I would make is this:

You take a man who is in a high tax bracket. He may speculate in common stocks because of the long-term capital gains. He might not want to go into any new ventures at all. He might be riding the market rather than be interested in any particular field of operation.

Senator DOUGLAS. I am interested in your statement that you do not think venture capital has been slowed up by monetary and fiscal policies of the Government.

Mr. WARREN. That is right.

Senator DOUGLAS. We keep hearing complaints that venture capital is being dried up because of the amount of new stock issues or, rather, the amount of capital obtained by new security issues is very low.

As I remember the figures, the SEC approved something less than a billion dollars' worth of new capital last year.

Mr. WARREN. It could be.

Senator DOUGLAS. And that the major portion of expansion is being financed overwhelmingly out of corporate profits. I believe about half of corporate profits, as I remember it, were reinvested, and that is furnishing the major proportion of capital expansion.

Mr. WARREN. That is still venture capital, only it is coming out of the corporations directly rather than being paid out in the form of dividends and coming back into the market.

Senator DOUGLAS. So you do not think it serious that new stock and bond issues are at a low point?

Mr. WARREN. No; I do not think that that was exactly the point that I had in mind. What I mean to say is this, Senator: You hear a lot of complaint about the fiscal policy of the Federal Government slowing down venture capital. That is a popular complaint, particularly if you are not running the thing. I do believe, myself, that the fiscal policy of the Federal Government has slowed down venture capital, new money.

Senator DOUGLAS. You point to reinvestment of corporate profits inside the concern before distribution.

Mr. WARREN. That is right, and I do not see exactly how any change in the fiscal policy of the Federal Government would stimulate more venture capital. Temporarily there might be brought out some more new issues with a lot of newspaper publicity about we are going to have less taxes, et cetera, but the over-all effect over a period of 5 years, I do not think would be changed a bit now. I do not think it would.

Senator DOUGLAS. Do you have any recommendations to make on fiscal policy of the Government?

Mr. WARREN. No, sir; I do not, except to say that the people who have determined or do determine the fiscal policy of the Government are bound to be criticized, but I think the folks, generally speaking, the grass-roots folks, are betting on the fellows who are carrying the ball. There may be criticism, and any criticism would get a lot of publicity, but I do not think a lot of folks back home feel particularly that they can do a better job than is being done.

They may be Republicans, as I am. However, as I said, I am betting on the fellows who are carrying the ball.

Senator DOUGLAS. Do you think interest rates should be raised?

Mr. WARREN. A raising of interest rates would certainly help your big commercial banks. It certainly would not help to refund any of the Federal Government's credit. That is a matter of judgment, of opinion. I do not think I want to say whether I think they should be raised or not.

Senator DOUGLAS. The raising of the interest rate would probably diminish the demand for investment capital, would it not, because the lower the interest rate the more ventures become profitable and, therefore, the greater the demand for investment capital; the higher the interest rate the less demand for investment capital; is that right?

Mr. WARREN. I do not think that would follow. If you increase your interest rates—I see what you mean—there would be less demand, you say, for venture capital.

Senator DOUGLAS. That is right. Not necessarily less supply, but less demand.

Mr. WARREN. Yes; it would not be as attractive. Six-percent money is not as attractive as 3 percent.

Senator DOUGLAS. It would be attractive at 3½ percent or 4 percent or 4½ percent interest, but would not be as attractive if the interest rate went up to 5, 5½, or 6.

Mr. WARREN. Yes; I agree with that.

Senator DOUGLAS. And that, therefore, low interest rates stimulate investment at least on the demand side. It stimulates the demand for investments.

Mr. WARREN. Yes; I would agree with that.

Senator DOUGLAS. And I presume that what we want in society is for the workers to have an increasing amount of capital for each worker to work with, and that raises the productivity of labor and diminishes the marginal productivity of capital. Therefore, is not a high wage rate and low interest something to be welcomed?

Mr. WARREN. The thing to be welcomed is to do the largest amount of good for the largest number of people, yes, that is right; and the largest number of people would welcome reduced interest rates with an ever-expanding economy, more jobs, and the largest number of people would welcome that, so long as it can be done soundly and not to the point where our Federal debt would get away from us.

Senator DOUGLAS. That did not involve the question of Federal debt. It involved the question of wage rates and interest rates, and I was saying that on the whole the increase in the quantity of capital per worker should lower interest rates and raise the wage rates, other things being equal, and the prices being steady.

Mr. WARREN. Yes.

Senator DOUGLAS. I think we are all worried a bit about that worry of yours of what would happen if we were to have a depression. We hope we will not have one.

Mr. WARREN. We all have problems, we have always had problems, and this is one of them. I heard a remark the other night by a very capable man about the fact that in the 1880's we had a Federal debt of a billion dollars, and a lot of very capable people threw up their hands, said it was terrible, the country was going to the dogs, and we would never get over it.

Senator DOUGLAS. The interest charges now on the public debt are $5,500,000,000 on a national income of 220 to 230 billion dollars a year; that amounts to about 2⅓ percent of national income; whereas, the 1939 interest charge of a billion out of a net national income of around $72,000,000,000 would be about 1.4 percent. So that while the charges have increased, they have not increased to the catastrophic figures that some prophets of alarm would have us believe.

Mr. WARREN. That is right. The only point is if we had missed something and our economy should start to deflate, then we have got to look for those revenues to service that debt, and maybe to put more in there to stimulate things up again. That is the potential problem.

Senator DOUGLAS. Would you feel happier on the whole if over a long period the size of the debt were reduced? That is assuming no war, which we hope will not occur.

Mr. WARREN. Yes, indeed. I think everybody would be happier. I think a great many people are becoming better informed in matters of this sort.

Senator DOUGLAS. And, therefore, over a long period of time you would prefer to have the governmental receipts, say over 10 or 15 years, exceed expenditures, so there would be a surplus to be devoted to the retirement of the debt as a long-run policy?

Mr. WARREN. That is right, sir.

Senator DOUGLAS. Therefore, you think there is a presumption in favor of not only balanced budgets, but of surplus budgets, other things being equal?

Mr. WARREN. Yes; at this point in particular.

Senator DOUGLAS. I have no more questions. I want to thank you for coming down, and I appreciate it very much.

Mr. WARREN. Thank you, sir.

(Whereupon, at 3:50 o'clock p. m., the joint committee adjourned.)

MONETARY, CREDIT, AND FISCAL POLICIES

THURSDAY, DECEMBER 1, 1949

Congress of the United States,
Subcommittee on Monetary, Credit, and Fiscal Policies,
Joint Committee on the Economic Report,
Washington, D. C.

The subcommittee met, pursuant to adjournment, at 10 a. m. in the caucus room, Senate Office Building, Senator Paul H. Douglas (chairman of the subcommittee) presiding.

Present: Senators Douglas (chairman of the subcommittee) and Flanders, and Representatives Wolcott and Buchanan.

Also present: Dr. Grover W. Ensley, acting staff director; and Dr. Lester V. Chandler, economist to the subcommittee.

Senator Douglas. Ladies and gentlemen, I think we should come to order.

We invited Mr. James G. Patton, president of the National Farmers Union, to testify before our subcommittee. Mr. Patton is otherwise engaged, but Mr. Russell Smith, who is the legislative secretary of the National Farmers' Union, is testifying.

I assume you are testifying as an individual primarily, and not specifically for the Farmers Union, or are you testifying also for the Farmers Union?

Mr. Smith. It is difficult to separate the two. I will try to indicate, Senator.

Senator Douglas. Thank you very much. Will you proceed?

STATEMENT OF RUSSELL SMITH, LEGISLATIVE SECRETARY, NATIONAL FARMERS UNION, WASHINGTON, D. C.

Mr. Smith. My name is Russell Smith, and I am legislative secretary of the National Farmers Union located in Washington.

The National Farmers' Union is particularly interested, so far as immediate action by this subcommittee is concerned, in that part of its instructions from the joint committee which called for recommendations "on the problem of coordinating monetary, credit, and fiscal policies with general economic policy." Our special interest in this phase of the subcommittee's work is due to the fact that we believe there is a compelling reason for the establishment of such coordination and moreover that it is likely to be possible to obtain specific action in this field now.

At this point, Mr. Chairman, since the rest of this statement is generalization and not particularly responsive to the questions originally asked by this subcommittee, I should like to read a letter written November 19 by our president, Mr. Patton, to Chairman Hise, of the

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Reconstruction Finance Corporation, in which he comments on Mr. Hise's reply to your questionnaire. I think perhaps it may fill some of the gaps in my statement.

Senator DOUGLAS. Go ahead.

Mr. SMITH. Mr. Patton wrote Chairman Hise as follows:

You have the thanks of the National Farmers' Union and of all those who sincerely believe in the successful functioning of a truly free system of business and enterprise for the reply you have made to the subcommittee of the Joint Congressional Committee on the Economic Report, which is now investigating monetary, credit, and fiscal policies of the Government. The words of truth and wisdom which you conveyed to the committee were, of course, the more important and significant because, as newspaper reports have pointed out, Chairman McCabe, of the Federal Reserve Board, chose to ignore the real problems of credit in relation to the stimulation of small- and medium-sized business enterprises and ventures.

I am taking the liberty of sending a copy of this letter to Congressman Wright Patman, chairman of the House Small Business Committee, with the suggestion that when his committee resumes hearings it would be desirable, if feasible, to include in the scope of those hearings some inquiries into the efficacy of the private banking system in the provision of adequate credit.

This of course is a crucial problem in a free enterprise system. Unless small business entrepreneurs are able to obtain with relative freedom, and at relatively low interest rates, and on easy conditions, the capital required both for the initiation of new ventures and the progressive modernization of plant, then obviously the present tendency toward concentration of control of American industry will be accelerated. There appears to be no doubt whatever about this tendency towards concentration. The Federal Trade Commission last year showed, in a very able study, not only that larger enterprises are steadily swallowing up smaller ones, but that this process is proceeding at a faster and faster tempo.

Moreover, it should be noted that the weakness of the private banking system in this field is a weakness of the economy as a whole. In addition to the encouragement it gives to the growth of monopolistic controls, the failure to provide adequate credit for smaller enterprises automatically tends to diminish the total amount of investment in plant replacement, in modernization, and in construction expenditures. In turn, this failure to achieve the total annual investment which otherwise would be possible tends to put a brake upon economic expansion. Most economists feel that there is a vital and direct connection between the annual flow of investment funds of this character and the general health and activity of the economy. Thus when the credit system, for the picayune reasons you have so ably outlined to the committee, fails to fulfill its responsibilities, it not only does a disservice to small enterprisers but it threatens the continuation of generally prosperous economic conditions.

Further, I agree wholly with your view that it would be idle for Congress to authorize the Federal Reserve banks to lend up to $500,000,000 to private business since the Reserve Board itself would have little or nothing to do with the making of the loans. Under Mr. McCabe's proposal, the same private banks which now refuse to make such loans, simply would be asked to make them. This would of course be the height of futility. Most banks now have sufficient funds, reserves, and margins to make such loans to small business. The difficulty is that they will not make them. Perhaps their reasons for not making them may be wholly sound from the exclusively banker point of view. Nevertheless, from the general welfare point of view these reasons are not valid at all, and the failure to make such loans constitutes a genuine threat to continued prosperity. Again, let me congratulate you on your intelligent and forthright presentation to the joint committee and to assure you that the National Farmers Union will support your views in any way it can.

That is the end of Mr. Patton's letter, Mr. Chairman. I will return to my own statement.

The emphasis that I put in the first paragraph on coordination does not mean, however, that we necessarily regard that phase of the subcommittee's work as of major importance in the context of the inquiry as a whole. Indeed, we are inclined to believe that the report on monetary policy, and on the "machinery for monetary policy formulation and execution" may well be of greater and almost crucial importance in the long run.

Rather than attempt to make detailed suggestions to the subcommittee in any of these fields, we believe that we can be of more use if we present the general views of our membership in the fields with which the subcommittee is concerned. There are three or four major premises upon which our policies with respect to monetary policy and program have been formulated. Among these fundamentals is the conviction that much of the debate now being conducted over the so-called "welfare state" is being conducted in a vacuum. No one of whatever party or persuasion really wishes to curtail human liberties in this country simply in the interest of individual security. To set up such black and white alternatives is to set up a straw man.

What happens when such a pinch comes as came to business in 1929 to 1932? Business, of course, turns to the Government for help, just as farmers and other groups turned to the Government for help when their individual efforts or their efforts through organizations of individuals prove unable to cope with circumstances. Obviously, if we should have another and greater depression or panic, it will be of no avail for businessmen to meet and urge each other to do something about the situation. This is what they did, with the encouragement of Government, in the earlier period to which I have referred. By the very nature of a competitive system, it is impossible for individual businessmen or for that matter even highly organized groups of businessmen to end a depression by their own unaided effort. Obligations to stockholders, for example, must remain paramount to the general interest, or else the management of the industries concerned would be defaulting upon its primary responsibility. Thus, we think it is idle to condemn Government efforts on behalf of the welfare of groups of citizens simply out of vague fear that somehow the machinery to produce such benefits will fall into unworthy hands. Rather, we think that the positive note should be sounded and that we should emphasize the critical necessity of maintaining truly popular and representative government in a full health and vigor in the United States. To us, the question of exactly what governmental instruments are used as a means of economic improvement are of no great consequence beside the question of democratically functioning government at national, State, and local levels. If we guard that citadel of liberty, we feel the economic mechanics, whatever they are, will turn out all right.

Another major element in our concern with the subcommittee's work is our interest in the maintenance of maximum employment as a primary means of dealing with fiscal and credit policies. At our last convention the National Farmers Union adopted a program containing the following statement of policy on this subject:

> We, the members of the National Farmers Union, declare that the public interest in full employment is superior to the private interest of corporations in high profits. We further declare that there is a public responsibility to create a permanent, stable prosperity in the United States.
>
> This responsibility must be expressed in behalf of all people by the Federal Government.
>
> We call for full-employment legislation that will be effective. It must provide for public investment and enterprise, if and when private enterprise fails to expand our basic industries year by year. It must provide for continuous

analysis of our economy, of the type which is now being rendered by the Council of Economic Advisers to the President. But, in order to prevent a break-down of our economic life, it must also provide for definite planning and mandatory action by Congress, following the recommendations of the Council of Economic Advisers.

The significance of this statement to the subcommittee's work, of course, is that a drastic decline in employment and economic activity will render almost insuperable the questions with which this subcommittee is dealing. It is not enough simply to compare present national budgets with prewar national budgets and call for economy without regard to the size of the public debt and the carrying charges of that debt, the expansion of national income that has incurred in the same period, and the immense increase in production upon which that national income is based. In such a context as that, there appears to be no question that a Government budget in the range of those of the last several years is almost unavoidable. This is not to say that the budget should not be balanced nor is it to say that national expenditures should be set at any given figure. The point is, however, that a drastic reduction in expenditures probably would mean a decrease in business activity which, in turn, would lead to lower collections from taxes and a reduction in revenues below the point actually desired by Congress. If this should then be followed by additional reductions, only careful management could prevent such a course from progressing into a genuine and serious economic decline. We are inclined to believe, therefore, that the subcommittee should concern itself more with the allocations made to different types of expenditures from present budgets and to the impact of taxation upon individual incomes and upon business activity rather than to what we believe would be futile attempts to return to national budgets far below present levels.

Finally, we should like to make the point that the Federal system is affected as much by credit and fiscal policies as it is by taxation and expenditure policies. It is our view that a large field for coordination exists in the relationship between State and Federal Governments, and the relationship of each in turn to capital sources and taxing policies. At present, the existence of very large financial concentrations makes it extremely difficult for individual State governments to function in the manner contemplated under the Constitution. Just as in the field of regulation it became essential for the Federal Government to take over functions once exercised by the States, so now the existence of huge capital aggregations, individually more wealthy than many States, makes it very difficult to restore to the States that sovereign dignity which they enjoyed at the time of the ratification of the Constitution. We are unable to advance at this time proposals for remedying this condition. We do feel, however, that a special study needs to be made of the whole field of State-Federal relationships, including those involved in Federal-aid legislation of all kinds, and that Congress ought to work toward a definition of the proper spheres of the Federal and State Governments in all of these politico-economic areas.

Thank you.

Senator DOUGLAS. Thank you, Mr. Smith, very much.

Reading from the resolution of the National Farmers Union, you state that your organization believes that there should be definite planning and mandatory action by Congress following the recommendations of the Council of Economic Advisers.

What mandatory action did you or your organization have in mind?

Mr. SMITH. Well, the basis for that phrase lies in the history of our interest in the legislation which created this committee and the Council.

We advanced back in 1944, during the debate over reconversion legislation, a proposal that an authorization bill be adopted whereby Congress would undertake to provide appropriations for investment purposes sufficient to meet the gap which might occur between existing construction and investment expenditure and that level needed to maintain the maximum of full employment.

Senator DOUGLAS. You were looking forward to a large volume of postwar unemployment, then?

Mr. SMITH. That was correct. That is, at the time when 6,000,000 boys were coming back and everybody expected 8,000,000 unemployed by midwinter, and so forth.

Senator DOUGLAS. Virtually every economic group around Washington—with the exception, as Mr. Flanders reminded us the other day, of the CED, and an economist over at the Social Security Board—made those prophecies and urged a big volume of public works to offset this expected decline, and urged that the action be taken speedily.

Now, had that been done, in view of the fact that no unemployment developed, would that not have resulted in inflation and a still further upward movement of prices because you would have been injecting into the economy a large volume of purchasing power to absorb the unemployed who were not there?

Mr. SMITH. I think that is absolutely true.

I should say this, Senator, that we were not aiming at the public works in that proposal. The proposal was to stimulate with the use of governmental funds private investments primarily.

Senator DOUGLAS. The economic effect, however, as you correctly say, would have been the same, because you would have been injecting additional funds to absorb unemployed who were not there.

Mr. SMITH. There is no question, if you had proceeded to do so, that would have been the effect. However, we did not recommend doing it unless that condition occurred.

Senator DOUGLAS. Does not that indicate a danger of moving on the basis of forecasts?

Mr. SMITH. It does, indeed. It is a very hazardous occupation, as most economists, it seems, have been finding out. However, it probably is necessary to make some assumptions, just as Congress must make some assumptions at the beginning of the year regarding, well, how much money it is going to spend on administration, for instance.

Senator DOUGLAS. And we had recommendations in February and in March from two members of the Council of Economic Advisers that the problem then was inflation, and that the Congress should take steps to check inflation. Now, if we had followed their advice and had tried to check inflation and restricted credit in some lines, would not that have resulted in still further intensifying the recession?

Mr. SMITH. That I am unable to answer, because that would be retroactive forecasting, Senator.

Senator DOUGLAS. The forecast was given to us in February at a public hearing of this committee by Mr. Keyserling.

Mr. SMITH. Yes; I heard him.

Senator DOUGLAS. He testified that the danger was inflation, and that Congress should take steps to check inflation.

Now, checking inflation naturally means restricting the increase in prices and sending prices down. If we had done that, since prices were already moving down and continued to move down for some months, would not that have had a further deflationary influence? You see my point. We feel the forecasters' fingers have been burned pretty badly on two crucial occasions, and we are naturally a little bit reluctant to launch out upon this unknown sea which may get us in danger in view of the failure of forecasts to come true.

Mr. SMITH. I think this should be said: I cannot speak to the specific point, but at any given stage, of course, in an economic phase, there are usually some deflationary and some inflationary factors at work. It is the balancing out that determines which is predominant.

Senator DOUGLAS. Mr. Keyserling wanted expansion in steel, while restricting the movement in other directions.

Mr. SMITH. Right.

Senator DOUGLAS. But the general impression he gave was that inflationary forces were stronger than the deflationary forces in the economy as a whole; and, therefore, he asked for a series of controls over most of the economy, designed to restrict prices from going up—the major portion of prices—though in steel he wanted expansion.

Mr. SMITH. Well, I think the mistake is often made of regarding economics as an exact science of some kind, whereas actually it involves human beings at all levels; and, therefore, is much like politics.

Senator DOUGLAS. I suppose you would quote Mr. Justice Holmes to me.

Mr. SMITH. I would if I could, sir.

Senator DOUGLAS. Well, you remember this passage:

> Every year, if not every day, we have to wager our salvation upon some prophecy based upon imperfect knowledge.

Mr. SMITH. As always, beautiful.

Senator DOUGLAS. Should not one be a bit careful about wagering one's entire salvation upon prophecies which in the past have not had a very high record of correctness?

Mr. SMITH. One certainly should; yes.

Senator DOUGLAS. So, would you favor the Government moving on the basis of forecasts of what is going to happen or on the basis of what is happening; that is, should it go on the present facts, or should it proceed on an estimate of what the future facts may be? There is a big difference there.

Mr. SMITH. Well, I think there is an area of flexibility, Senator, in which the Government can be prepared to move more rapidly than it would be otherwise.

Senator DOUGLAS. Yes. But should it move on the basis of forecasts or should it move simply on the basis of conditions?

You see, we had the CED in here last week, and they were emphasizing you should move not on the basis of forecasts but on the basis of actual conditions.

Mr. SMITH. Let me give you an agricultural example.

Senator DOUGLAS. Go ahead.

Mr. SMITH. It may establish my point of view.

There is an in-between between the two alternatives you have presented.

I assume you must have farm price-support programs which are considerably affected by the volume of carry-over of given commodities. If you wait until you have accumulated a large enough stock pile, surplus, or carry-over, or whatever you want to call it, to depress prices before you act either to expand consumption or to limit production, then you will have a very serious decline in prices. Therefore, the only effective way you can deal with the price problem is to make some assumptions about what you want and try to achieve that much production and that much consumption.

Senator DOUGLAS. Did you read the testimony of the CED? I do not suppose you have.

Mr. SMITH. I read a newspaper account of it.

Senator DOUGLAS. They drew a distinction between what they term "built-in stability" and compensatory fiscal policy.

Built-in stability, I take it, would include farm price-support programs developed in advance and unemployment-insurance programs developed in advance, so that if unemployment were to develop then the schedule of benefits would provide for the payment of a larger total sum in benefits than was received in contributions and a drawing down of the fund, and hence an injection of monetary purchasing power into the pockets of the urban unemployed. Similarly, a farm price-support program would either wholly protect or protect in part, depending upon the type of farm bill you have, the farmers from reductions in income.

Now, Senator Flanders will correct me if I am wrong, but it is my impression they are not opposed to that type of built-in stability in which the rates would be fixed in advance and which would go into effect automatically when business conditions turned for the worse.

But the second part, namely, either the addition of further expenditures for additional purposes, or the appropriation of additional sums for all purposes—such as expansion of public works, or a new hospital program, or what not—or the taking off of taxes, that those should be held in reserve until after a very appreciable volume of unemployment had occurred. They did not rule that out. On questioning we found they did not rule it out.

Senator FLANDERS. I think it also would not rule out being prepared for that emergency.

Senator DOUGLAS. It looks to me as though perhaps the points you have just been mentioning would be in the CED program of what they term "built-in stability."

Mr. SMITH. I thought it was a brilliantly done statement, and I found myself in a great deal of sympathy with it.

Senator DOUGLAS. Then let me ask this.

Mr. SMITH. May I return, before we leave the point, to one thing that occurs to me with respect to this original proposal of ours for an underwriting of investment.

Senator DOUGLAS. All right; certainly.

Mr. SMITH. I should say that we realized at the time, and have realized, I suppose, more fully since, that it is really impossible for one Congress to commit another one to, say, an appropriation. This

Congress cannot commit the Eighty-second to appropriating money for whatever purpose. Therefore, this mandatory action phrase and the attempt to write into law a continuing level of any kind is more or less futile, except as an expression of what one Congress thought about it.

Senator DOUGLAS. Surely.

Now do you want to have some questions on this guaranteeing or making of loans to private business by governmental agencies?

Mr. SMITH. I will be glad to do what I can.

Senator DOUGLAS. I think anyone who studies the credit situation carefully becomes convinced that, as you say, small enterprise has difficulty in getting the credit for either beginning or expanding its operations.

Some people lay the blame for this to the tax laws—to the 38-percent tax on corporate profits—which diminishes the possibility of growth out of profits.

Others say that the banks, or perhaps I should say the saving institutions, are themselves becoming so large that they do not like to deal with small business and that they therefore deal with large business.

And it is probably true that purchase of machinery, where the obsolescence rate is high, requires credit which is too long for commercial banks, and too short for security issues, and so forth, and that this falls between two stools.

My own feeling is that there is a deficiency in the credit machinery, but I am worried, very frankly, by direct loans by Government institutions because of the danger of political pressure and corruption, either open or concealed. And I wondered if you had any comments on that. Is it possible to get the first without exposing yourself to the danger of the second?

Mr. SMITH. Well, if you must make a choice, Senator, I am not sure that you are required to make that clear-cut a choice, but if you are, in the end you must stake the whole thing on the success of politics, democratic politics, despite the corruption that inevitably will occur in such a situation as you have described, and has occurred in many other situations, local, State, and national. Nevertheless, if our political system is not going to be healthy and vigorous enough to manage this kind of an economic dilemma, then it will fail. And I think you must face it sooner or later.

Senator DOUGLAS. Let me raise this question: Systems like individuals can be more virtuous if they are exposed to less temptation. Is that not true? And they tend to be less virtuous if they are exposed to more temptation. And does not the temptation to make direct loans, or the making of direct loans, put added temptation upon the officials who make them?

Mr. SMITH. I assume so. I assume that it probably would be harder to resist stealing a hundred thousand dollars than to resist one hundred. But I do not think you bolster up an essentially weak character by removing temptation from him.

Senator DOUGLAS. Well, I have never thought you should increase temptation in order to strengthen character. I have never thought the moral world is one where you should heap on temptation in order to develop spiritual athletes.

Mr. SMITH. Usually, however, a little practice in any sport helps you.

Senator DOUGLAS. That is true.

There is enough temptation, however, in life for us to exercise our moral muscles. The question is whether we should heap it on.

Mr. SMITH. I think I am in agreement.

Senator DOUGLAS. What do you think of Senator Fulbright's proposal that officials of the RFC who make loans to private companies should be debarred for a period of years from entering private employment connected with the companies to whom the loans have been made? Senator Fulbright has brought forth a number of cases where officials in the RFC approved loans to private companies, and then after a period of time resigned from the RFC and became officials at high salaries of the companies which received the loans.

There may be no connection whatsoever between the two, and the officials of the RFC insist there is no connection. And I am not passing judgment on that. But is it not a dangerous situation to have that occur?

Mr. SMITH. Certainly it is. I am in thorough agreement with Senator Fulbright.

Senator DOUGLAS. And I assume your organization has gone into the workings of the banks of cooperatives in agriculture, that is, you know a good deal about the workings of the banks for the cooperatives in agriculture?

Mr. SMITH. Yes; we do. I do not individually but the organization does.

Senator DOUGLAS. The Government furnishes those banks with capital, but the directors are primarily chosen by the farm groups themselves; is that not true?

Mr. SMITH. Yes.

Senator DOUGLAS. And then when Government capital is paid off, they are cooperative banks. Is that not true?

Mr. SMITH. Yes, sir.

Senator DOUGLAS. Furnishing capital to the cooperative marketing agencies.

Well, might such a development as this be applied to small business, in which the Government could furnish capital to banks primarily cooperative in nature, set them up, not manage them, but with the responsibility upon the group to manage, then when the Government loan is paid off, the bank is owned by the group in question?

Mr. SMITH. I think it is an excellent suggestion, with a couple of provisos. One is that the model of the banks for cooperatives should be followed pretty closely, in that the people who manage it should manage it in the interests of the borrowers. In other words, you do not turn over what is essentially a cooperative to a private banker. They are performing two different functions entirely. The cooperative is not engaged in earning money for a group of original stockholders, it is engaged in operating for the purpose of providing capital to people engaged in an enterprise. That is really the sole purpose of being.

In order to do that, they must be people who not only passively accept the responsibility of trying to make loans to small business—I mean of making loans to small business—but actively get out and try to develop the possibilities of such loans.

Senator DOUGLAS. We have a very delicate problem of balance there, it seems to me. On the one hand, I think it is true that small business needs more credit. On the other hand, it is a good rule that no man is a safe judge in his own case. And if you have the borrowers as a group determining policies of lending, you may have a lot of unsafe ventures from the standpoint of management and have large capital losses.

I confess I do not know the answer to that, but there is a very real problem there.

Mr. SMITH. Well, the experience of the banks for cooperatives has been long and pretty successful, and I think that experience would provide some of the answers.

Senator DOUGLAS. May I turn briefly to the paragraph in your statement dealing with fiscal policy.

You are not saying, are you, that there should be no reduction in the present national budget?

Mr. SMITH. No, sir; I am not saying that.

Senator DOUGLAS. And you hint that some items in the Federal budget might perhaps be appreciably reduced?

Mr. SMITH. Well, of course, the most obvious spelling out is in relation to military and foreign aid expenditures, which, in turn, are conditioned on factors that are highly noneconomic at the moment.

Senator DOUGLAS. The President, as I understand it—and I believe it is common knowledge from the hearings before the Vinson Committee in the House—requested the military to give approximately the same amount of security for 1950 and 1951 for $2,000,000,000 less. And it was originally contemplated that the Marshall plan expenditures would diminish each year.

Now, in the civilian budget, can you see any economies that could be made?

Mr. SMITH. None of any great consequence, Senator.

Senator DOUGLAS. You do not think there is an excessive number of governmental employees?

Mr. SMITH. I think you could make some savings by adoption of, say, the Hoover Commission reorganization proposals, yes. As a significant reduction, I do not think it would make a great deal of difference.

Senator DOUGLAS. What do you regard as a significant reduction?

Mr. SMITH. I would say anywhere from between 5 billion and 10 billion dollars.

Senator DOUGLAS. I believe there is one Senator who has proposed a reduction, and one political figure who has proposed a reduction, of that magnitude, but I do not know of anyone else who has made such a proposal.

Mr. SMITH. I know it has not been proposed, but that is what I consider significant.

Senator DOUGLAS. Suppose you could save five or six hundred million dollars on governmental personnel, would that seem to you a significant figure?

Mr. SMITH. I think it would be very careful if in so doing you did not wreck some valuable programs.

Senator DOUGLAS. Merely squeeze out the water.

Mr. SMITH. If there is water there, yes, that would be fine.

Senator DOUGLAS. What would you think of doing away with the postal deficit?

Mr. SMITH. I would not approve of that.

Senator DOUGLAS. Why not?

Mr. SMITH. I think it is not supposed to balance its own budget. I think it performs a service that is invaluable to the people as a whole. It ought to be subsidized.

Senator DOUGLAS. How much? It is being subsidized $550,000,000 a year, approximately, now.

Mr. SMITH. I cannot answer that. I think perhaps you could make some substantial savings, for instance, by removing the air mail subsidies from the private plane lines, and that kind of thing.

Senator DOUGLAS. Where would you subsidize in the Post Office?

Postmaster General Donaldson estimates there is about $150,000,000 worth of unpaid services which the Post Office furnishes to other Government departments, about $73,000,000 on franked mail, of which only $1,100,000 is taken up by Congress; about $50,000,000 in the form of rental space and janitorial service given to other Government departments in the post-office buildings throughout the country; and then the remainder in air-mail subsidies. So he estimates that there is about $150,000,000 of unpaid services given to other governmental agencies that he does not propose should be made a charge upon private users of the mail.

But, according to Postmaster General Donaldson, the other $400,000,000 consists of subsidies on second-, third-, and fourth-class mail.

He says in the case of second-class mail that the cost of carrying newspapers and magazines through the mails amounts to $247,000,000, for which the Government collects only $40,000,000, a subsidy of around $200,000,000; that the subsidies on third-class matter—unsealed advertising circulars primarily—is about $120,000,000; and on parcel post about $80,000,000.

Do I understand you to say that you think those subsidies should be continued?

Mr. SMITH. Well, I think any subsidies that are necessary to provide the present comprehensive and excellent mail service for individuals ought to be continued.

Senator DOUGLAS. I simply mean the service could be provided but people would pay the cost.

Mr. SMITH. I mean at as cheap a rate as possible. I think free communication of all kinds, including the carriage of magazines and newspapers, is an essential characteristic of this country.

Senator DOUGLAS. Newspapers and magazines are educational.

Mr. SMITH. Yes, sir.

Senator DOUGLAS. That may be true, but is the advertising contained in them primarily educational in its design?

Mr. SMITH. Senator, I am unable to answer that.

Senator DOUGLAS. Well, that is a very important question because newspapers and magazines are not merely carriers of information, but they are also carriers of advertising. And you will find that the great national weeklies, as you well know, have a tremendous income from advertising. Now, should the advertising be subsidized?

Mr. SMITH. Well, Senator, advertising also seems to be a very large component of our national life and essential to continued prosperity in the minds of many businessmen.

Now, as to such publications as, for instance, the Luce group of publications, whether they ought to be levied on to pay part of the cost of distribution——

Senator DOUGLAS. You would not single them out by name. You would not say there should be a subsidy to every one but the Luce group?

Mr. SMITH. I assume you cannot do that. Therefore, I would not. I would go ahead and let Mr. Luce profit by the necessity of subsidizing him in order to subsidize the distribution of the others, the smaller ones.

Senator DOUGLAS. So you would not really do anything to reduce the postal deficit?

Mr. SMITH. Very little.

Senator DOUGLAS. How do you feel on rivers and harbors?

Mr. SMITH. I think much could be done there. I think there is still a great deal of pork barrel left in that angle of appropriations.

Senator DOUGLAS. I hope you can help some of us in the coming session of Congress.

Mr. SMITH. We will try.

Senator FLANDERS. I have two or three questions, Mr. Smith.

You spoke of the absorption of small companies by large companies as proceeding at the present time on a faster tempo. Have you any definite information, any statistical analysis of that, which would substantiate that statement?

Mr. SMITH. Well, only the Trade Commission report of last year. That is the last thing I know of.

Senator FLANDERS. And it indicated that it was proceeding at a more rapid rate?

Mr. SMITH. Oh, yes; quite marked.

Senator FLANDERS. Now, in the letter you wrote, which I got by ear rather than by eye, you suggested that credit could be available for replacement and modernization. I wonder if that is in itself a good principle, except in special cases. Traditionally that has been done out of pockets. It is difficult to do it out of pockets now.

I wonder if there is not an underlying difficulty for which credit is not, perhaps, the best way to meet the problem.

Mr. SMITH. I think you have to approach any problem of this kind in the aggregate, Senator Flanders, and there will be, unquestionably, individual cases where what you say is true. Perhaps it is an inefficient establishment which ought to go under anyway. But looking at it in the large, I think the two points made here are still valid.

One is, from the general welfare point of view, that the more small businesses you have which are modernizing their plants, the more stability you have throughout the economy.

In other words, you are not staking general prosperity on the expenditures of a few large organizations. If you have thousands of small businesses that are modernizing, you then have an annual flow of investment capital just like the flow in a blood stream in the body. It continues and spreads throughout the country.

The other point is on the monopoly side. If small businesses are not able to modernize as fast as big businesses, then obviously they are going to keep progressively falling behind and cannot compete.

So I think the modernization thing is essential if you are going to tackle this problem.

Senator FLANDERS. I can agree with you in everything you have been saying, that is, with regard to the importance of small business so far as our whole economy is concerned and the desirability of keeping up to date in their equipment, and so forth. But I am a little bit troubled about the fact that it seems necessary for them to do it on credit and the difficulties they fall into in doing it out of earning.

Now, we have a notched provision in our tax laws on corporate profits which relieves the first $25,000 of profits of a large measure of taxation.

Mr. SMITH. Yes, sir.

Senator FLANDERS. And then between $25,000 and $50,000 we catch up on it again. In other words, from $25,000 to $50,000, the business of that size is pretty heavily penalized in taxes.

Mr. SMITH. Yes, sir.

Senator FLANDERS. It seems to me the fundamental difficulty comes from our high rate of taxation that requires the small business of a certain size to go to the dubious procedure of making its further improvements by credit. And that brings us back to the question of the incidence of taxation on businesses. This seems to me to be the fundamental question, and the provision of credit is the dubious remedy which we find, which seems to be made necessary by the high incidence of taxation.

I think we ought to be giving some attention to seeing what can be done about the incidence of taxation on business expansion and on the improvement of business operations. I would rather give more attention to that and less to a simple way of lending the money, which seems to be the present thought in that area.

In the paragraph that you have just read, you suggest that we can decrease our appropriations so greatly as to hinder employment and hinder business. Would you not feel a little differently with regard to restraining increases? Can we not say, at least, that we must restrain any increases in appropriations?

Along with that goes the continuous increase in Government employment. Should not that be restrained? Can we not at least set a ceiling on these things? The Congress has not done it. The Congress has made provisions in their appropriations for the continuous expansion in Government employment, for continuous expansion in governmental expenditures. I think you would at least agree we ought to keep a lid on the thing.

Mr. SMITH. Yes, sir; I can agree with that. I cannot quite see, in so uncertain a world as the one we live in, permanent validity of arriving at ceilings. At least the contingencies are so many that I think it would be extremely difficult.

Senator FLANDERS. It is difficult. I think we have all found that out.

With regard to possible large-scale reductions in Government expenditures, we have the President's desire to cut $2,000,000,000 off of the military expenditures, and we have a prospective reduction of $1,000,000,000 in the Marshall plan.

Mr. SMITH. Yes, sir.

Senator FLANDERS. That brings us to $3,000,000,000. And with the possibilities of the Hoover suggestions and the rivers and harbors——

Senator DOUGLAS. And the post office.

Senator FLANDERS (continuing). And the post office. It would seem to me as though we might get another billion, and that brings us up to $4,000,000,000, and then we are beginning to get somewhere.

Senator DOUGLAS. That is right.

Senator FLANDERS. It seems to me we should be aiming for at least a reduction of that amount and be suspicious of any increase.

Senator DOUGLAS. Now wait a minute. I want to demur there, because we want some money for housing, both of us.

Senator FLANDERS. Yes, we do.

Senator DOUGLAS. And I want some money for education and for health. Therefore, I would like to save more than $4,000,000,000 out of existing items so that we can expand in these other directions.

Senator FLANDERS. We are going to have, I suppose, when Mr. Pace appears before us—at least, I certainly hope so—some discussion of the question of investment budget of the Government as distinguished from the cost of current operations. I think there we can admit some validity to those types of governmental investment which definitely return an income, such as, for instance, "Fanny May" (FNMA), which is an investment that appears safe in the business sense. It is an investment in the business sense. I think we must be a little bit dubious about investments that are not investments in the business sense.

And furthermore, do we not still have to question even the effect of the inflationary pressure of these business investments? We still have to take those into account.

Senator DOUGLAS. Surely.

Senator FLANDERS. And I hope, Mr. Chairman, we can bring those matters out in Mr. Pace's testimony later.

The only thing, Mr. Smith, in your testimony which gives me concern is the shifting of the method of supporting small business and of bringing about a proper amount of business investment through credit rather than through some readjustment, reorganization, of our tax laws so as to give some tax benefit to funds reinvested as distinguished from funds distributed or held as liquid reserves.

I hope that some means can be found to do that, Mr. Chairman.

Mr. SMITH. I would say, Senator Flanders, we have favored that kind of tax policy for some years. For instance, the redistribution of profits tax, or whatever it was called, that Mr. Roosevelt requested about 6 years ago. We favored that.

I think you should remember, though, that such a change in the tax law will not meet all these problems of small business by any means. If you encourage them, for instance, to expand or modernize out of profit, you encourage them, of course, to raise prices in order to do so. I doubt if you can cut taxes enough to enable them to do it without raising prices. And then in turn they run the risk of loss of volume of sales. They are at a disadvantage already in competing with larger units.

So I do not know that you are going to get at the root of the problem simply by a tax bill.

Senator FLANDERS. I may say that President Roosevelt's tax on undistributed profits seemed to me to be exceedingly faulty in that it made no distinction between profits which were held as liquid and those which were reinvested, and put the same policy on reinvestment at a time when investment would very much have assisted in recovery.

Mr. SMITH. Yes, sir; but we have been for the principle of encouraging the reinvestment phase. That is what I was driving at.

Senator DOUGLAS. Mr. Wolcott.

Mr. WOLCOTT. Mr. Smith, do you believe it is basically the obligation of the Government to stabilize our economy?

Mr. SMITH. Well, I believe it is the basic responsibility if the Government wants to be successful. Put it that way, Mr. Wolcott.

I do not think it is a sacred obligation exactly even for the Government to continue to exist. But I think the present world is so complex that Government is no longer going to be able permanently to evade the responsibility.

Mr. WOLCOTT. Well, does that carry with it any thinking on your part, or on the part of the Farmers Union, that we should go to the extreme of a managed economy if our other efforts fail?

Mr. SMITH. No, sir; if I understand what the words "managed economy" mean.

Mr. WOLCOTT. I mean by it, managed by the Government.

Mr. SMITH. No sir. What we envision is a Government that will take sufficiently strong action when it is needed in order to protect itself as a Government of the kind that we want. In other words, it is not going to be so weak on the economic side that it will fall politically.

Mr. WOLCOTT. I was a little disappointed, frankly, sir, that Senator Douglas, when he patted Senator Flanders on the back, and said that "We want housing," apparently spoke in the singular.

Senator DOUGLAS. I did not believe I should speak for anyone else without authorization.

Mr. WOLCOTT. He did not include me in that category.

Senator DOUGLAS. I will be delighted to welcome you, Congressman. This is not an exclusive society in any way. We will be delighted to have you in it. We could not have a better companion.

Mr. WOLCOTT. I might say that we would be glad to welcome you into the fold of those who desire housing, because we have been trying to get housing now—adequate housing—since 1937.

Senator DOUGLAS. The ways of God are mysterious.

Mr. WOLCOTT. I think I should be credited on your side with having voted for the first public-housing bill that was presented in 1937. I have had to apologize for it since then.

Of course, we all want housing. And we in the Midwest, who are dependent somewhat upon shipping for a livelihood, want rivers and harbors. And, if we did not spend a certain amount of money for dredging the channels in the Great Lakes, it would seriously affect our entire economy, because almost 90 percent of the iron ore that is used in our steel industry comes down through those channels.

Mr. SMITH. That is just the "pork" that I want to get out, Mr. Wolcott.

Mr. WOLCOTT. I presume, then, that you would include in that, perhaps, the harbors of refuge along the Great Lakes?

Mr. SMITH. No, sir. As a matter of fact, what we would do about the Great Lakes is put the St. Lawrence seaway bill through.

Mr. WOLCOTT. We may be in agreement with respect to that.

Senator FLANDERS. May I remark, Mr. Chairman, that I have a recollection on that one element, I think it is on the river and harbor bill, which was within the State of Illinois, you objected to and were voting against. Am I right in that recollection?

Senator DOUGLAS. I think you give me more credit than I probably deserve. I said since I wanted a 40-percent cut in appropriations that I would be perfectly willing to have the Illinois appropriations for rivers and harbors cut 40 percent also.

Senator FLANDERS. That is it.

Senator DOUGLAS. I did not single out any particular project which should be eliminated completely. So, I think you give me credit for probably more virtue than I have.

Senator FLANDERS. You still retain 40 percent of virtue to your credit.

Senator DOUGLAS. I would say I am perfectly ready to reduce appropriations to my State in the same percentage the country is cut as a whole.

Mr. WOLCOTT. Then, it should be our objective to find the pork in all of these projects—housing as well as rivers and harbors, and flood control, and social security, and all of the expenditures of the Government.

We are in agreement that they should be continued, but we should try to find what constitutes the pork and what constitutes whatever is the opposite of pork in that field. I do no know what it is.

Mr. SMITH. We might differ on what constituted pork; but, in general, that is right; yes.

Mr. WOLCOTT. You made a very interesting remark earlier in your statement to the effect that one Congress could not bind a succeeding Congress in respect to appropriations. May I suggest to you, Mr. Smith, how that is done in Congress? It is done through the very interesting process of authorizing contractual obligations. It has been done for a good many years with respect to building of highways, which I think we will all agree is very essential as a basis for economic expansion and stability. It has been done in respect to rivers and harbors; it has been done in respect to flood control; it has been to the extent of almost $16,000,000,000 in respect to housing.

Of course, you would not say that succeeding Congresses would not have to meet those contractual obligations concerning which the Government could, without its consent, be sued; would you?

Mr. SMITH. Well, I think the statement still holds in general, sir.

Mr. WOLCOTT. As a general statement.

Mr. SMITH. That any Congress can refuse to appropriate money to carry out the contracts.

Mr. WOLCOTT. Any Congress, of course, can repudiate the national debt.

Mr. SMITH. Yes, sir.

Mr. WOLCOTT. Any Congress can repudiate any note issues which are outstanding.

Mr. SMITH. Yes.

Mr. WOLCOTT. But, of course, if any Congress did that, then we would have seen probably the last days of the American Government as we know it now. All confidence in Government would fail. And when that fails, of course, the American system of government will fail.

So, in effect, and in fact, if we want to preserve the American Government where it is, or as we hope it might be, then, of course, no Congress can ever repudiate the contracts which are made with American people by any other Congress; can they?

Mr. SMITH. Well, I suppose not. At least, as a practical matter, they probably could not.

Mr. WOLCOTT. What I am leading up to is this: We are confronted here with an objective which we all agree is desirable, and that is to prevent these ups and downs in our economic life, depressions and booms. That is why we were set up.

And what I am trying to bring out here and have you confirm, if you think you can, is the fact that we can lay out, set up a long-range program and give better than reasonable assurance to the people that the program is going to be effectuated and surely never repudiated by a succeeding Congress. Do you not think that we can? Under our system of government, under our Constitution, do you not think we can set up a long-range program which might help?

Mr. SMITH. Yes, sir; I do.

Mr. WOLCOTT. To prevent these ups and downs in our economy?

Mr. SMITH. I think the very existence of this committee, for one thing, is proof that you can make progress in that direction, and the existence of the Council, for that matter. I think it should be remembered, of course, that both the committee and the Council are relatively new instruments, and I should think that over, say, a decade they would both be much more effective; but I think the country can feel much safer about the next downswing in the cycle as a result of what has been done already.

Mr. WOLCOTT. What would you suggest we could do (*a*) to prevent a depression, and (*b*) to further inflation?

Mr. SMITH. Mr. Wolcott, either question almost overwhelms me in the time that is left this morning.

Mr. WOLCOTT. Frankly, we are rather confused about it ourselves, we have not come to an agreement on the question, or we would not be having these hearings. Do you have any definite legislation in mind that might help the situation?

Mr. SMITH. No; I do not think that at the moment there is any acute necessity for this committee or for Congress to attempt to rush through something to stop a possible future depression. It seems to me it is incredible to expect any major decline in economic activity in the next year, and I would not make so bold as to attempt to ad lib a cure for depressions here this morning. I think, within that year, certainly a great deal of progress ought to be made toward reaching what agreement can be reached by a sufficient majority to adopt something to strengthen the defense against it when it does come, because they always come unexpectedly. They build up before you can get ready for them, unless you do something.

Mr. WOLCOTT. You do believe, Mr. Smith—that is, I assume you believe—that a strong economy and strong American dollar is absolutely essential if we are going to meet our obligations, to give any degree of social security to the American people?

Mr. SMITH. Yes, sir.

Mr. WOLCOTT. Of course, it follows from that that we should not fall into the same pit that Great Britain apparently has by promising the American people more security than our economy will stand.

Mr. SMITH. Well, I cannot agree with your assumption about the British people, Mr. Wolcott. Otherwise, I agree with your statement.

Mr. WOLCOTT. Are we in disagreement that the Labor Party program in Great Britain, in respect to the attempts to meet its promises of social security, has some bearing upon the condition that Great Britain finds herself in today economically?

Mr. SMITH. I am afraid we are in disagreement. I think there is very little connection.

Mr. WOLCOTT. That answer amazes me and rather knocks me off my feet, because I think it is generally thought that there is some affiliation between the social-security program and, broadly speaking, the socialistic tendencies in Great Britain incident to the Labor Party platform, which influences, if it is not directly responsible for, the economic condition in England today.

Mr. SMITH. No, sir. My point of view is that if Mr. Churchill came back to power, or if he had stayed in power, he would have been forced to do almost exactly what the present Government of Great Britain has done. He would simply have called them by different names.

Mr. WOLCOTT. Of course, we can conjecture what he would have done; but the point is, perhaps, there is this difference: That people should be given all of the security—social and otherwise—that the economy of the country can stand, but no more, because if you go beyond that point then you do not assure them of the security; do you?

Mr. SMITH. That is correct.

Mr. WOLCOTT. Perhaps therein lies the difference, just to conjecture, between the Labor Party in England and Mr. Churchill's party. Mr. Churchill perhaps would have given them security, but commensurate with the ability of the British people to pay for that security.

Mr. SMITH. I can agree with you on the principle but not on the result of this application.

Mr. WOLCOTT. Why I bring this up is: Shouldn't we perhaps survey our economic situation incident to a long-range program to try to find out where we are going economically, taking into consideration our resources, our natural ability to constantly expand, and then fit the expenses of government—social security, housing, anything else we might want to take up—into that picture, rather than to make promises to the people, providing for these reforms, and then trying in every way we can to get the money to make good on the promises?

Mr. SMITH. I agree with you. I think there are perhaps other things equally important in laying out such a program.

I think, for instance, that it is possible to make generalizations about where the governmental functions step in with relation to the economy and the dangers that we risk of being converted into fascism, say, as a result of the Government's intervention.

I think you can define types of activity of the Government in relation to private business and why it should do such and such a thing at such and such a time. I think you can also pretty well define the kind of social activity that the Government engages in.

Well, take the social-security system. There is nothing more far-reaching, I suppose, in this country in that it touches all citizens or most citizens. At the same time, I do not know that the Social Security Board has ever threatened the individual liberties of Americans. You can define types of bureaucratic or administrative activity in relation to benefits and procedure parallel with the suggestion you have made, which is to define the load, I think, the financial load in relation to the Government's ability to carry it or the Nation's ability to carry it, but I think there are several parallel lines of inquiry.

Mr. WOLCOTT. I want to make myself clear. I do not think we have gone so far at the present time in many of these fields, especially social security, as to endanger our form of government. We probably can go further than we have in the field of social security without endangering it, but the point is how far? We should go as far as we can in that field, even beyond what we have now, but at the same time keep within the bounds of reason in respect to our economy and what we can afford.

I do not like to put the Government or its people into the same condition that you or I might be in if we went to our insurance man and contracted for an annuity starting 5 years from now at $25,000 a year without any assurance that in the meantime we would be able to pay enough into the insurance fund to justify that income to us following that period.

We might be able to raise the first payment—I could not; but perhaps you could—however, we might be able to get together the first payment, but there would be a series of payments leading up to the security which is our objective.

Now the Government is in no different position in that respect from an individual. So the point is, What planning can we do for a program which would positively give us the security for which we contract? Isn't that what our objective should be?

Mr. SMITH. I think that is a very good way of putting it. Yes, sir.

Senator FLANDERS. Mr. Chairman, I would like to make a general observation of which I am reminded by this colloquy which has been taking place.

I am concerned with the possibility that the total load of taxation in this country may lead us into the necessity for looking to Government loans for the expansion of industry or its continuous improvement, for modernization, and all the rest of it. It seems to me we are concerned with the total tax burden and with the probability that, if that exceeds some unknown percentage of total production of the country, the ability to finance expansion and improvement by private means may dry up, and it is that which has given me concern in the document you read.

It seems to me that the provision of these things which used to be done out of the earnings of private corporations, provisioned by governmental credit, and the apparent necessity for it, the difficulty of doing it in any other way, may be indications of the fact that the total tax burden is too high.

That has been a matter for some discussion among economists. An Australian economist by the name of Colin Clark set, as a result of his studies, a total of 25 percent of the total production of the country going into taxes as perhaps a limiting value beyond which it became necessary to provide business funds out of Government loans rather than by private profits. So I sort of picked up your proposal of using Government credit for business expansion and improvement as perhaps some evidence that we were approaching that limit in this country. That I think, really needs to give us concern.

I have gotten various figures as to the total load of Federal, State, and local taxation, but any figures I have been able to get from different sources seem to indicate that we are around or about that 25 percent at the present moment; and, if we are, and if that is the figure, it seems to me that we should look with a great deal of interest and concern at what seems to be the necessity for going to the Government for what have hitherto been private business expenditures.

Mr. SMITH. May I comment?

Senator FLANDERS. I hope you will.

Mr. SMITH. I think it is a very valid point, that there is a limit somewhere, but I think in the first place Dr. Clark lays himself open to my objection to economists in general when he fixes a mathematical formula and then applies it to human conditions.

I do not think it works that way, but, aside from that, the fact remains that we are still in an expanding economy, that our productive plant is such that we should reasonably expect a continuing increase in national income for a long time to come, so that the tax burden must be considered in relation, I think, to that, as well as to current levels, and what looks now to be the dangerous mark in the tax load may 10 years from now represent a considerably smaller proportion of the gross national product.

Senator FLANDERS. What we are concerned with is the means of increasing that total national production and whether or not from now on it can continue to be done by private enterprise or whether that prospective increase has to be by Government funds. That is what concerns us.

Mr. SMITH. Well, yes; except there is this qualification, too, Senator: There is no proposal in here—we have never made one—for simply making Government loans in order to be making Government loans. There is always some acute necessity involved when you turn to that channel for stimulation of investment.

In other words, it is almost like a declaration of war. If you are facing another 1929, you see, or you enter it, the likelihood is it will be worse; the economy is more highly geared and closely meshed than it was then; production is bigger; it is a more urban country; the whole thing is likely to turn down faster and go farther.

Therefore, you may be against the proposition of entering on courses like this as a national defense measure really against an invisible enemy. I think the point needs to be stressed over and over again that this is an entirely different matter from simple construction of public works or from additions to social security or other welfare expenditures of the Government and that kind of thing, if I make myself clear.

Senator FLANDERS. I think you have made yourself clear, but without resolving my deep concern.

Mr. SMITH. I am sorry.

Senator DOUGLAS. Thank you very much.

Mr. SMITH. Thank you very much, Mr. Chairman.

Senator DOUGLAS. We are very happy to welcome Mr. Allan B. Kline, president of the American Farm Bureau Federation.

STATEMENT OF ALLAN B. KLINE, PRESIDENT, AMERICAN FARM BUREAU FEDERATION

Mr. KLINE. Mr. Chairman and members of the committee, first I wish to express our appreciation and pleasure at the very fact of this committee and its investigation at this time of these most important elements in the national economy. This paper is directed toward a discussion of monetary, credit, and fiscal policies and with especial reference to the point at which we find ourselves in the movement of the general price level, graphically shown in the first page of a statistical appendix which follows my statement.

There we find that we have had a number of great inflations in this country, each of them greater than the former one——

Senator DOUGLAS. And each apparently caused by war?

Mr. KLINE. That is right; and we find ourselves, furthermore, a very small way down from the peak of the inflation. And look at what has happened to the general price level. If we follow the historical pattern, we would be just ahead of a very great national dilemma. Furthermore, there are in the picture a number of entirely unprecedented elements.

For instance, the current national budget has no counterpart in this country or in any other country. The same applies to the national debt. There is every reason for the Congress of the United States to seriously undertake the responsibility of maintaining a more stable general price level. Furthermore, that responsibility does belong to the Congress without any question. It is constitutionally placed with the Congress.

Proceeding, then, with the formal presentation of the paper, the American Farm Bureau Federation believes that aggressive steps should be taken in the monetary, credit, and fiscal policy fields in order to add greater stability to the general economy and to the general price level. We are happy to see this committee established to give consideration to the problems in these important areas. Our organization has given special study in the past to many of the policy questions raised in the questionnaire submitted by your committee, and since 1946 we have constantly been urging for action in these areas. I should like to quote from the resolutions adopted at our last year's annual convention:

> We reiterate our position on methods of stabilizing the general price level. We urge Congress to establish a bipartisan joint congressional monetary study commission, charged with the responsibility of making studies and submitting recommendations to the Congress on means of bringing greater stability to the value of money. The commission should have sufficient funds to employ competent technical personnel.
>
> We will continue to solicit the cooperation of other groups in dealing with this basic problem. It is our belief that monetary and fiscal policies should be reviewed in the light of changes resulting from the war. A monetary study commission would bring about a better understanding of the problem.
>
> In the program for bringing about a more stable general price level, consideration should be given to the following: The control of money, credit, and fiscal policies of the Federal Government should be coordinated under one authority, with members appointed by the President and confirmed by the Senate. The policies of this authority should be regulated as far as feasible for formulas, based upon an established index, which would direct the authority to take action when the index reached certain levels, in order to stabilize the purchasing power of the dollar.
>
> The proper agency of government should be given responsibility for maintaining the supply of money and credit appropriate to the production needs of the Nation and for bringing about greater stability in the general price level. The proper authority should be provided for influencing more effectively the expansion and contraction of credit. More use should be made of additional selective-service controls. It should be the policy to prevent the contraction of money and bank credit during periods of depression and undue expansion during periods of prosperity.
>
> When inflation threatens, reserve requirements for banks should be raised, with appropriate adjustments in the bank holdings eligible to be counted as reserves. Steps should be taken to prevent further shift of non-bank-held negotiable Federal bonds to the banking system, because such a move makes possible an additional credit expansion.

Due to the magnitude of the national debt and the tax load, management of fiscal policies will have a greater effect on prices and production than in the past. The national debt should be so handled as to make the maximum contribution to economic and price stability rather than to finance the debt at a minimum cost. A long-time Federal tax policy should be adopted which will contribute to a more stable general price level and to an expanding domestic economy.

Government expenditures and construction should tend to counterbalance fluctuations in private business and employment. Public expenditures for deferrable public works should be eliminated during prosperous periods. A shelf of essential public works should be maintained, to be activated during business recessions. The national debt should be reduced rapidly in periods of good business activity, while during periods of depression it may be necessary to resort to deficit financing.

The proposed monetary authority should have the power to change the gold content of the dollar within the prescribed limits of the International Monetary Organization.

This Nation should cooperate with the various international agencies to bring about international stability of prices, the orderly adjustment of exchange rates, and expanded foreign trade. Where necessary, we should adjust our domestic policies and cooperate with international organizations designed to stimulate the exchange of goods and services among the nations of the world upon a self-perpetuating and sound financial basis.

I should now like to elaborate on these proposals and discuss them in relation to the major questions submitted by your committee. In order to conserve time, I have taken the liberty of grouping the questions into several main categories. Likewise, I have omitted a discussion of certain technical questions to which we have not had opportunity to give special study up to this time.

At the outset I should like to emphasize that in making these proposals we are not for a cheap-money program. We want a sound monetary system which maintains the purchasing power of the American dollar. Neither are we asking that authority in new areas be granted the Federal Government. The control of monetary, credit, and fiscal policy now rests in the hands of the Federal Government, as is prescribed by the Constitution. The problem is not one of delegating additional authority to the Federal Government in new areas, but rather one of reshaping and coordinating the policies in the field in which Government policy now largely prevails so that they will more definitely contribute to a more stable price level.

Senator DOUGLAS. I take it when you speak of the Federal Government already having constitutional powers to control monetary, credit, and fiscal policy that you refer, among other things, to article 1, section 8, which gives Congress the power, as I remember it, "to coin money" and "regulate the value thereof"?

Mr. KLINE. That is right.

Senator DOUGLAS. Some of the bankers have questioned whether that gives the Federal Government power over credit.

Mr. KLINE. There is, of course, a very considerable body of legislation which does give certain Federal authorities considerable power over credit, so that the principle is well established in public law.

Senator DOUGLAS. And, therefore, in opposition to the point of view of some of the banking fraternity, you would say the Federal Government already has power to regulate the value of money and that money in our modern system includes credit, and that in regulating the value the Federal Government can regulate the total volume of credit as well as of money? And that this is not the sole province of the private banking system, as some have contended?

Mr. KLINE. I would say "Yes"; but I note that the question has become rather involved now with several "ands" in it.

There is no question but that the volume and value of money are affected by credit policy. There is no question whatever.

Senator DOUGLAS. And that the Federal Government has——

Mr. KLINE. Very real responsibility in that respect.

Senator DOUGLAS. The right to control the total volume of credit in order to regulate the value of money.

Mr. KLINE. I should say it this way: That the Federal Government has a very great responsibility in this area in order to maintain a more stable general price level. You will note all through this paper that we direct our whole discussion to this matter of a more stable general price level. This is not because we like controls. It is precisely for the opposite reason.

It is because of a belief that a free-enterprise system, based primarily on the use of the market place and use of money must have a more stable general price level; and it was for that reason that I called the attention of the committee in the beginning to the chart on the movement of the general price level, which is the other end, of course, of the value of the dollar, and the point at which we find ourselves currently.

It seems to us that anyone interested in the maintenance of a really progressive free-enterprise system in America must now recognize the grave responsibility resting on this Congress for public policy with regard to the general price level.

If I may proceed, then, during each war in which this Nation has been engaged, prices have risen. Following each war period they have fallen (appendix I). Each succeeding war has resulted in a higher peak. Many in this generation have experienced two great wars and one great depression during which time the price level has fluctuated violently.

From 1914 to 1920 the general price level more than doubled. By 1932 it had fallen to less than the 1914 level. By 1948 it had risen two and one-half times. At the present time it is down some 11 percent from the 1948 monthly peak.

Nearly every American citizen is asking the question: Must we have the decline in prices that has followed the other wars, with the accompanying business stagnation and unemployment or must we have more inflation? The inequities, the dislocations in our economy, and the human suffering which these changes in the general price level have caused, are familiar to all of us. A more stable price level in the years ahead is one of the essentials of a free enterprise, a progressive, prosperous America. We must gear our monetary, credit, and fiscal policies to a greater extent toward this objective.

The problems growing out of these changes in value of the dollar have resulted in many demands upon the Federal Government by various groups for specific programs to protect them against these injustices. With these specific programs have come, of necessity, many direct controls on agriculture and business. Nearly every group, including farmers, businessmen, and laborers, objects to these controls but wants economic security against the great swings in prices and their associated problems. Greater stability of the price level offers the only opportunity for greater economic security without the programs which require specific and direct controls on each farm or firm. Monetary, credit, and fiscal policies which affect the general stability of prices have the advantage of being indirect and impersonal.

Farmers are particularly vulnerable to changes in the price level. When prices in general decline, prices of farm and other raw products decline furthest and most rapidly. Prices of commodities used in farm production fall more slowly, resulting in a price disadvantage for agriculture. If prices in general continue at a low level, prices for farm products and items used by the farmer in production are slow to come into adjustment again.

With farming a business of slow turn-over and narrow margins, such price disparities place agriculture in a serious financial condition. When prices rise, the reverse is true, except that prices come into adjustment much more quickly.

The reason for the very great interest of the American Farm Bureau Federation at the moment in this particular proposition is again the point at which we find ourselves on the general price-level chart, just a little below the peak of the greatest inflation we have ever experienced. The evidence with regard to farm prices is already in the record. They are extraordinarily flexible. Corn sold a year ago last spring in the heart of the Corn Belt at $2.55 a bushel, and a very great deal of corn changed hands a year ago this fall at $1 a bushel in the Corn Belt.

On the other hand, the cost of tractors or fencing or lumber or freight or trucking did not fall. As a matter of fact, in many cases it rose.

Thus, we take the position that one of the major guideposts and objectives of monetary and credit policies should be the maintenance of a more stable general price level and reasonably high levels of business activity and employment. This is more important than carrying the national debt at the lowest cost, desirable as that may be.

It is fully recognized that the monetary and credit policies carried on by the Federal Reserve System cannot alone achieve a more stable level of prices, yet they are an important factor and they should be geared toward that objective. The effectiveness of the Federal Reserve in controlling credit expansion and contraction has been materially decreased with the rise of the Federal debt, and in turn the loss of the opportunity of the Federal Reserve to vary discount rates significantly.

With so large a share of the Federal debt now held by the banking system, one of the most feasible ways of regaining their power appears to be to increase the Federal Reserve authority to vary member bank reserve requirements. The basic problem is the restoration of the Federal Reserve powers over credit expansion and contraction.

If, in order to accomplish this objective, it is necessary for the Federal Reserve to control the reserve requirements of the nonmember banks, such authority should be delegated to the Federal Reserve. Over-all bank credit expansion and contraction must be controlled in the interest of the entire economy, rather than left to the decisions of the more than 14,000 banks in this country. While inflation is possible without an increase in the money supply, and while monetary policy alone may not—in fact, cannot—be able to counteract a depression, it is a most important factor in either situation.

If the Federal Reserve is to regain its proper control over credit, it is doubtful if it should continue indefinitely to support the Federal bond market at present rates. It is recognized that with the national debt at present levels, serious considerations are involved in the support policy. Nevertheless, these considerations should not supersede the fundamental objective of a more stable economy and more stable prices. Here we again mean the general price level and not the price of some particular commodity.

Further study should be given to selective credit controls. The use of such controls by the Federal Reserve in the securities and installment loan fields were a factor in the immediate postwar years in avoiding overactivity in these areas. They are tools which offer possibilities for avoiding the overexpansion of credit in certain areas in times of rising prices. In turn, they may be relaxed in times of low business activity and declining prices to serve as strengthening factors in the economy and in the demand.

Congress has given a large number of Federal corporations and agencies independent responsibilities for making credit available to private borrowers. In some instances direct loans are made and in others the loans are insured or guaranteed. While each of these corporations or agencies has been set up to meet some special need, taken together they become an important factor affecting the availability and cost of credit and the over-all credit supply.

In fact, in certain instances this may have been the major objective. Because of this, there should be a mechanism for coordinating their policies with the other Federal groups responsible for over-all credit policy.

A Federal tax policy should be adopted which will contribute to a more stable price level and to an expanding domestic economy. This means that tax revenues should rise relative to Government expenditures in inflation, and fall in depression. The maintenance of a stable tax rate would partially accomplish this objective.

When employment, production, and prices rise, tax revenues would also rise; when employment, production, and prices drop, tax revenues would also drop. Certainly the maintenance of a stable rate would be a marked improvement over our past policy, when we increased the rates in periods of low business activity, and decreased them in boom times.

Flexibility should be introduced into governmental expenditures. During booms or periods when demand is excessive, governmental expenditures should be reduced to the minimum (appendixes II and III). The volume of new Federal construction should be limited. Federal grants to State and local governments for noncritical public works should be eliminated during such periods.

Local communities also should be discouraged from undertaking unnecessary expenditures when demand is excessive. When business activity and demand are low, governmental expenditures should be increased. A shelf of essential public works should be created which may be developed when demand is deficient.

Such demand may be stimulated by Federal financing and investment, and through financial inducements to State and local governments. Projects, so far as possible, should be of the self-liquidating type and should contribute to national welfare. Rural electrification and rural roads are examples of this type of project.

It is likewise important that projects be selected which interfere as little as possible with private enterprise. Otherwise the unsettling effects on private enterprise may restrict investments in private fields and offset Government spending and Government projects.

The national debt should be so handled as to make the maximum contribution to economic and price stability, rather than to finance the debt at a minimum cost. Billions of dollars of Federal debt mature or are presented for redemptions each year. Different methods of refinancing have different effects on the total expenditures of the Nation by varying the interest rate and significant consequences on economic stability.

Refinancing the debt by borrowing from the public and paying off Government obligations held by the banks is deflationary, while, on the other hand, a policy of paying off the Federal debt held by the public by refinancing through the banking system is inflationary. The policy followed at any particular moment should be synchronized with the over-all credit policies for the Nation and in accordance with employment, business activity, and price. This means the general price level. The national debt should be reduced rapidly in periods of good business activity, while during periods of depression it may be necessary to resort to deficit financing. However, the over-all long-run policy should be one of reducing the national debt.

We strongly urge that studies be made and that steps be taken which will bring about greater coordination in our monetary, credit, and fiscal policies. Consideration should be given to the activities of the Treasury, the Federal Reserve, and all corporations and agencies which make or guarantee domestic and foreign loans, so far as their activities affect the over-all credit supply and demand for goods and services of this Nation.

It should be the announced objective of these corporations and agencies to maintain the general price level, production, and employment within certain limits, so far as possible. Definite criteria should be established at which action must be taken.

If we are to have a free and prospering economy, of which a free, prospering agriculture is an integral part, we need desperately to work out and effectuate the means to a more stable price level. This can and must be done.

I would like to comment now very briefly on the statistical analysis appended.

(The statistical analysis referred to is as follows:)

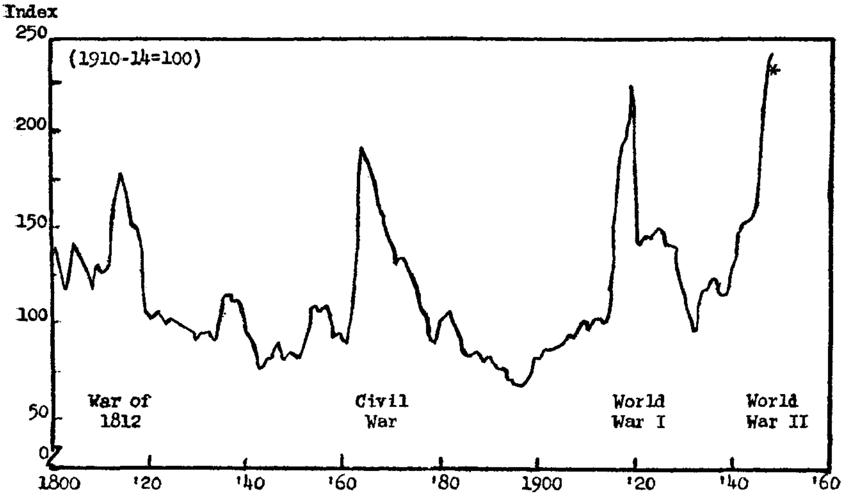
APPENDIX I.—*Wholesale prices of all commodities in the United States since 1800*

[1910-14=100]

Year	Price index	Year	Price index	Year	Price index	Year	Price index	Year	Price index	Year	Price index
1800	129	1830	91	1869	151	1890	82	1920	225	1932	95
1810	131	1840	95	1870	135	1900	82	1921	142	1939	113
1811	126	1850	84	1871	130	1910	103	1922	141	1940	115
1812	131	1860	93	1872	136	1911	95	1923	147	1941	127
1813	162	1861	89	1873	133	1912	101	1924	143	1942	144
1814	182	1862	104	1874	126	1913	102	1925	151	1943	151
1815	170	1863	133	1875	118	1914	99	1926	146	1944	152
1816	151	1864	193	1876	110	1915	102	1927	139	1945	155
1917	151	1865	185	1877	106	1916	125	1928	141	1946	177
1818	147	1866	174	1878	91	1917	172	1929	139	1947	222
1819	125	1867	162	1879	90	1918	192	1930	126	1948	241
1820	106	1868	158	1880	100	1919	202	1931	107	1949	[1] 222

[1] Index of 222 for Oct. 15, 1949.

Source: Warren and Pearson, Cornell University, for data prior to 1890; U. S. Department of Labor, Bureau of Labor Statistics, for data from 1890 to date.



APPENDIX II.—*Relation of changes in indebtedness to national income and prices*

	Annual increase or decrease in indebtedness	National income	Wholesale prices	Farm prices	Unemployment
1910		$34, 000, 000, 000	$103, 000, 000, 000	$102, 000, 000, 000	553, 000
1911		33, 000, 000, 000	95, 000, 000, 000	94, 000, 000, 000	1, 571, 000
1912		35, 000, 000, 000	101, 000, 000, 000	99, 000, 000, 000	920, 000
1913		39, 000, 000, 000	102, 000, 000, 000	102, 000, 000, 000	1, 018, 000
1914		37, 000, 000, 000	99, 000, 000, 000	101, 000, 000, 000	2, 214, 000
1915		39, 000, 000, 000	102, 000, 000, 000	99, 000, 000, 000	2, 355, 000
1916		46, 000, 000, 000	125, 000, 000, 000	118, 000, 000, 000	187, 000
1917	$12, 300, 000, 000	55, 000, 000, 000	172, 000, 000, 000	175, 000, 000, 000	−1, 933, 000
1918	23, 000, 000, 000	60, 000, 000, 000	192, 000, 000, 000	204, 000, 000, 000	−3, 099, 000
1919	10, 600, 000, 000	68, 000, 000, 000	202, 000, 000, 000	215, 000, 000, 000	−870, 000
1920	7, 400, 000, 000	69, 000, 000, 000	225, 000, 000, 000	211, 000, 000, 000	558, 000
1921	400, 000, 000	52, 000, 000, 000	142, 000, 000, 000	124, 000, 000, 000	4, 754, 000
1922	4, 200, 000, 000	60, 000, 000, 000	141, 000, 000, 000	132, 000, 000, 000	2, 917, 000
1923	6, 400, 000, 000	70, 000, 000, 000	147, 000, 000, 000	143, 000, 000, 000	749, 000
1924	6, 700, 000, 000	69, 000, 000, 000	143, 000, 000, 000	143, 000, 000, 000	2, 034, 000
1925	9, 600, 000, 000	74, 000, 000, 000	151, 000, 000, 000	156, 000, 000, 000	817, 000
1926	6, 300, 000, 000	77, 000, 000, 000	146, 000, 000, 000	146, 000, 000, 000	464, 000
1927	8, 500, 000, 000	76, 000, 000, 000	139, 000, 000, 000	142, 000, 000, 000	1, 620, 000
1928	8, 700, 000, 000	79, 000, 000, 000	141, 000, 000, 000	151, 000, 000, 000	1, 857, 000
1929	4, 900, 000, 000	87, 000, 000, 000	139, 000, 000, 000	149, 000, 000, 000	429, 000
1930	300, 000, 000	75, 000, 000, 000	126, 000, 000, 000	128, 000, 000, 000	2, 896, 000
1931	−8, 800, 000, 000	59, 000, 000, 000	107, 000, 000, 000	90, 000, 000, 000	7, 037, 000
1932	−6, 900, 000, 000	42, 000, 000, 000	95, 000, 000, 000	68, 000, 000, 000	11, 385, 000
1933	−6, 000, 000, 000	40, 000, 000, 000	96, 000, 000, 000	72, 000, 000, 000	11, 842, 000
1934	2, 900, 000, 000	49, 000, 000, 000	109, 000, 000, 000	90, 000, 000, 000	9, 761, 000
1935	3, 300, 000, 000	57, 000, 000, 000	117, 000, 000, 000	109, 000, 000, 000	9, 092, 000
1936	5, 500, 000, 000	65, 000, 000, 000	118, 000, 000, 000	114, 000, 000, 000	7, 386, 000
1937	1, 900, 000, 000	74, 000, 000, 000	126, 000, 000, 000	122, 000, 000, 000	6, 403, 000
1938	−2, 400, 000, 000	67, 000, 000, 000	115, 000, 000, 000	97, 000, 000, 000	9, 796, 000
1939	3, 600, 000, 000	73, 000, 000, 000	113, 000, 000, 000	95, 000, 000, 000	8, 786, 000
1940	6, 400, 000, 000	81, 000, 000, 000	115, 000, 000, 000	100, 000, 000, 000	7, 607, 000
1941	21, 700, 000, 000	104, 000, 000, 000	127, 000, 000, 000	124, 000, 000, 000	3, 276, 000
1942	48, 000, 000, 000	137, 000, 000, 000	144, 000, 000, 000	159, 000, 000, 000	−617, 000
1943	53, 700, 000, 000	168, 000, 000, 000	151, 000, 000, 000	192, 000, 000, 000	−6, 360, 000
1944	57, 300, 000, 000	182, 000, 000, 000	152, 000, 000, 000	195, 000, 000, 000	−6, 894, 000
1945	35, 600, 000, 000	182, 000, 000, 000	154, 000, 000, 000	202, 000, 000, 000	−4, 909, 000
1946	−8, 500, 000, 000	179, 000, 000, 000	177, 000, 000, 000	233, 000, 000, 000	
1947	16, 400, 000, 000	203, 000, 000, 000	222, 000, 000, 000	278, 000, 000, 000	
1948	14, 300, 000, 000	224, 000, 000, 000	241, 000, 000, 000	287, 000, 000, 000	

Source: Annual increase or decrease in indebtedness from U. S. Department of Commerce, Bureau of Foreign and Domestic Commerce; National income, Bureau of Foreign and Domestic Commerce, Prices, U. S. Department of Agriculture, Bureau of Agricultural Economins, Unemployment, The Economic Almanac, National Industrial Conference Board.

APPENDIX III.—*Outstanding net public and private debt, end of year 1916–48* [1]

[Billions of dollars]

Year	Total public and private	Public: Total public	Public: Federal Government and Federal agency	Public: State and local government	Private: Total private	Private: Long-term: Total long term	Private: Long-term: Corporate	Private: Long-term: Farm mortgage	Private: Long-term: Urban real-estate mortgage	Private: Short term and nonmortgage
1916	82.1	5.6	1.2	4.4	76.5	43.4	29.1	5.8	8.5	33.1
1917	94.4	12.0	7.3	4.7	82.4	45.6	29.7	6.5	9.4	36.8
1918	117.4	25.9	20.9	5.0	91.5	47.1	30.2	7.1	9.8	44.4
1919	128.0	30.8	25.6	5.2	97.2	49.7	31.0	8.4	10.3	47.5
1920	135.4	29.6	23.7	5.9	105.8	54.7	32.6	10.2	11.9	51.1
1921	135.8	29.6	23.1	6.5	106.2	57.5	33.8	10.7	13.0	48.7
1922	140.0	30.5	22.8	7.7	109.5	59.5	34.4	10.8	14.3	50.0
1923	146.4	30.0	21.8	8.2	116.4	63.5	36.2	10.7	16.6	52.9
1924	153.1	30.0	21.0	9.0	123.1	67.3	38.5	9.9	18.9	55.8
1925	162.7	30.3	20.3	10.0	132.4	71.0	39.7	9.7	21.6	61.4
1926	169.0	29.9	19.2	10.7	139.1	75.8	41.7	9.7	24.4	63.3
1927	177.5	29.7	18.2	11.5	147.8	81.5	44.4	9.8	27.3	66.3
1928	186.2	29.8	17.5	12.3	156.4	86.0	46.1	9.8	30.1	70.4
1929	191.1	29.7	16.5	13.2	161.5	88.6	47.3	9.6	31.7	72.9
1930	191.4	30.6	16.5	14.1	160.8	93.2	51.1	9.4	32.7	67.7
1931	182.6	34.0	18.5	15.5	148.6	91.1	50.3	9.1	31.7	57.5
1932	175.7	37.9	21.3	16.6	137.8	87.8	49.2	8.5	30.1	49.9
1933	169.7	41.0	24.3	16.7	128.8	83.2	47.9	7.7	27.6	45.7
1934	172.6	46.3	30.4	15.9	126.3	79.0	44.6	7.6	26.8	47.3
1935	175.9	50.5	34.4	16.0	125.4	77.1	43.6	7.4	26.1	48.3
1936	181.4	53.9	37.7	16.2	127.5	75.4	42.5	7.2	25.7	52.0
1937	183.3	55.3	39.2	16.1	128.0	76.2	43.5	7.0	25.7	51.8
1938	180.9	56.5	40.5	16.0	124.4	77.5	44.8	6.8	25.9	46.8
1939	184.5	58.9	42.6	16.3	125.6	77.3	44.4	6.6	26.3	48.3
1940	190.9	61.3	44.8	16.5	129.6	77.4	43.7	6.5	27.2	52.2
1941	212.6	72.6	56.3	16.3	139.9	78.4	43.6	6.4	28.4	61.5
1942	260.6	117.5	101.7	15.8	143.1	76.6	42.7	6.0	27.9	66.6
1943	314.3	169.3	154.4	14.9	144.9	73.6	41.0	5.4	27.2	71.4
1944	371.6	226.0	211.9	14.1	145.7	71.7	39.8	4.9	27.0	73.9
1945	407.2	266.5	252.7	13.7	140.7	70.8	38.3	4.7	27.8	70.0
1946	398.7	243.3	229.7	13.6	155.4	79.5	41.3	4.8	33.4	75.9
1947	415.1	237.7	223.3	14.4	177.4	89.6	44.8	4.9	39.9	87.9
1948	429.4	232.7	216.5	16.2	196.7	101.1	49.6	5.1	46.4	95.6

[1] Components will not necessarily add to totals because of rounding.

Source: Survey of Current Business, Bureau of Foreign and Domestic Commerce, U. S. Department of Commerce, October 1949.

The first and most important part, bearing on the situation in which we are and the very grave necessity that we so manage our affairs in this field that the historical pattern is not repeated, is emphasized in the figures, and in the graph based upon the figures, of appendix I. Again we find ourselves at a point where if the historical forces are allowed to do what they have done every preceding time subsequent to such an inflation, not only agriculture will have a very bad time, but also the very areas of freedom which we think so much of and which are so essential to the expansion of a system in which private initiative can get just rewards without a dominating Federal influence affecting particular prices, specific commodities. If we are to avoid the historical pattern of postwar adjustments in the general price level, we are going to have to handle these affairs better than we have in the past. That is just in the record.

Appendix II shows some correlation and especially shows what has happened to farm prices compared to wholesale prices and national income. You will note in the next to the last column in this table that farm prices were 68 in 1932, wholesale prices 95, farm prices in 1947 were 278, wholesale prices were 222. That shows the more violent fluctuations in farm prices.

The result is the fact that as an Iowa hog grower I have sold hogs from $2.90 to $31.50 at those two points; whereas, if farm prices had merely followed the general price level, I would have sold hogs within a range of $7.80 or so and $17.

This is a characteristic of farm prices. It is in the record and it is a well-known fact.

Farm costs, however, move up more slowly but stay up when farm prices fall.

Now, we have another table (appendix III) on outstanding public and private debt. It shows a number of correlations and a very considerable increase in the total indebtedness in the country, not unrelated, of course, to the total money supply. Where we were discussing budget, the important point there is the question of the cash income and the cash outlay in any particular year.

The real incidence that we are interested in is the effect on the general price level. Again, I want to make the point here that this paper, this presentation, this whole argument is an incisive one directed toward a particular problem, the problem of a more stable general price level.

I should like again to emphasize that while we are fully aware that some controls are necessary to effectuate that end, we are for it precisely to avoid an extraordinary expansion of controls directed toward particular businesses, specific prices, specific price relationships. As a matter of fact, this whole proposal has as its aim the development of enough stability in the value of the dollar itself, which is the fundamental thing in the market place, and a free-enterprise system, so that we can make the adjustments on a private-enterprise and individual-initiative basis.

Further, I would like to make this one comment. We are not prepared here to lay out specifically the things which we think should be done. We are delighted that this committee is undertaking a real study of the proposition.

In preparing this report, or rather previous to it, we had a special committee of our board of directors, which was in operation for a couple of years; and in the course of that time we employed special talent in our research department to work on this problem and related problems. They reviewed some 55 books on the subject, they contacted all the outstanding authorities and students on the subject in our colleges and universities—I suppose "all" is too much of a word, because someone we did not contact might consider himself an authority, but we picked those whom we thought to be outstanding authorities.

We also had joint meetings with the technical staffs of the Federal Reserve Board, the Treasury, of business groups such as the CED, and outstanding bankers in the country. I present that only because this is not a funny-money business, this is not something proposed offhand and lightly. This is a serious attempt on the part of a great farm group to discern what it is that is in the public interest and that will protect the magnificent heritage of free enterprise in America, and we have arrived at the firm conclusion that we simply must so manage our affairs in the area of the management of the public debt and collection and spending of public funds, those activities of the Federal Government which influence the contraction and expansion of credit and allied fields, that we have a more stable general price level recognizing that the dollar itself and the free market is a fundamental part of any free-enterprise system.

That is all, Mr. Chairman.

Senator DOUGLAS. I have begun the questioning heretofore, and I am afraid that I have taken more time than I should have; so we will reverse the rule this time and ask Congressman Buchanan to lead off.

Mr. BUCHANAN. Relative to selective credit controls, you say you are not prepared at this time to make any specific recommendation as to where this study might lead and what legislative recommendations might come out of it. But are you prepared to say at this time in just what agency the controls should be?

Mr. KLINE. I would much prefer to make the generalization at this time, and to await studies of this committee, or anyone else who may study the subject, for a definite decision with regard to it. We have some experience which ought to be taken into consideration, of course.

Mr. BUCHANAN. You feel that after a study of this character something more specific than has been delved into in the past, so far as legislative proposals are concerned, may work more effectively in a flexible economy such as ours?

Mr. KLINE. Yes, indeed, and it is on the record that this price level has gone up and down violently. It is for that reason that we hope such legislation can be had and it is for that reason that we are convinced that the study ought to be made by a congressional committee, a joint committee, because the responsibility is that of Congress. Then we would have some people inside the Congress who had themselves done everything possible to understand what the problem is and on whose judgment the Congress could depend more directly than they would be inclined to depend on the judgment of some outside commission.

Mr. BUCHANAN. That is all.

Senator DOUGLAS. Senator Flanders?

Senator FLANDERS. It seems to me Mr. Kline, that you have laid out an excellent set of agenda for the proposed Monetary Commission and I think your testimony gives evidence of the painstaking way in which you have gone at the problem which you have described for us.

I find very little that I can question in the whole document. I do raise one question. In the next to the last paragraph of the resolutions adopted at your convention last year [reading]:

> The proposed monetary authority should have the power to change the gold content of the dollar within the prescribed limits of the International Monetary Organization.

I go back there to the experiments in the change of the gold content of the dollar made in the thirties, which did not seem to result in the effects that had been hoped for. I raise no question with regard to submitting a proposal of that sort to the Monetary Commission, but I do raise some question as to your recommending it as one of the things to be done.

Mr. KLINE. Well, Mr. Flanders, this was in the resolution of our group last year, and the committee concluded its study a year prior to that, if I am not mistaken. I am of the opinion currently that while they might still think this authority should be there, they would have very serious reservations about using it at the moment. Currently the American dollar is the foundation of international exchange, it is the point of stability in the matter of international balances. It is sought after all over the world. The value of domestic currencies in other countries is counted against the value of the dollar.

I think that it would be a very great element of instability if at the moment countries of the world thought we might change the price of gold.

Senator FLANDERS. I am glad to hear you make that suggestion and protect the idea that was expressed in that paragraph.

There is one other thought that came to me, and that is the question as to whether it would be possible to have any very great decrease in the general price level without a severe depression. If you take the total business profits after taxes—I say "after taxes" because the Government has to have the taxes, so that we cannot allow in times of prosperity, at least, the taxes from profits to sink below the current level very much—we find that the number of billions of dollars left is a comparatively small amount of the total product of the country and that represents, does it not, the minimum amount of drop in the price level we can have without destroying available profits entirely?

In other words, the price level cannot go much lower than that without requiring reductions in wages. Aren't we pegged at that comparatively high level if we are to continue a high level of employment and production?

Mr. KLINE. I think, Senator Flanders, that the answer just has to be "Yes." Then, without relating it to the specific circumstances here, it is always true that the most important factor, that is, the seemingly controlling factor—while there are a great many others I would not discount here—in a depression is this movement of the general price level. You could not possibly have a depression with an upward movement of the general price level. Likewise, if you have a considerable downward movement of the general price level, a depression just comes.

That emphasizes the necessity of managing our affairs in such a way at this time that we avoid what would seem to me inevitable if you just look at the chart for the past 120 years.

Senator FLANDERS. As representing agriculture, you are concerned not merely with the ups and downs of the general price level, but also the ups and downs of agricultural price levels as a part of that general price level?

Mr. KLINE. Yes, indeed.

Senator FLANDERS. Ideally, under present conditions would you not hope that that curve of prices would level off at some point below the peak rather than level off—that is, on the basis of the suggestion I have just made—as it has in the past or go down to a period materially below?

I am remembering, for instance, the severe difficulties of agriculture between the two world wars due to some conditions which do not now exist. That is, the excessive burden of debt on agriculture, which is not as great now as it was then. But one would expect that the best we can do and the proper thing for us to do is to level off at a comparatively high level.

Mr. KLINE. I would agree with that. I think the most fortuitous thing we could hope for would be a relatively stable price level not too far below the peak. I think no one expects that you could level off with a more or less stable economy without taking up some of the very great maladjustments which took place during the inflation by a little decline in the general price level.

Senator FLANDERS. I have no other questions.

Senator DOUGLAS. Mr. Wolcott?

Mr. WOLCOTT. I wonder if Mr. Kline would want to reconcile his figures in the third column of appendix III with the Treasury releases on the public debt.

Mr. KLINE. This is not public debt, Mr. Wolcott. You have some credit items against them.

Mr. WOLCOTT. As I understand, in 1948, according to your figures, the net public debt was 216 and a fraction billion dollars.

Mr. KLINE. This is from Survey of Current Business, United States Department of Commerce. I think it is a well-known fact that the Federal debt is two-hundred-and-fifty-odd billion dollars. The difference is that the figures in the table I have submitted are net figures all the way through.

Mr. WOLCOTT. How do you arrive at the net debt?

Mr. KLINE. I am not sure how this was figured, and I would have no objection, certainly, to putting another column in here which had that in it. I am not able to give you the statistical reconciliation that you ask for.

Senator DOUGLAS. Is it possible that the figure of net public debt may not include the public debt held by trust funds?

Mr. KLINE. This is a net figure, I know. That is the only thing I can tell you about it.

Mr. WOLCOTT. That would seem to include contingent debt; it is headed "Federal Government and Federal agencies." Most of the Federal agency debt is contingent debt, I believe.

That is what rather confused me, that the net debt of the Federal Government and the Federal agencies would not be perhaps more than that.

Anyway, the figures here are all on a net basis and are relative.

Mr. KLINE. Yes; and the very great point is that we have this extraordinary debt; and, as all you gentlemen know, it is not unrelated to the fact that we have a whale of a lot of money in this country and that we have an extraordinary basis for the expansion of credit. So that we have a number of relatively volatile factors in this whole monetary and fiscal field.

It has been previously a combination of those factors and the instability from the very rapid rise and high level of the general price level which has gotten us into difficulty after the inflation, and the very fact of this extraordinary debt, to which you call attention, and its concomitants—that suggests the utmost necessity on the part of the Congress of studying the problem and avoiding the difficulties.

One thing that impressed us was not the very great difference of opinion as we met with these people who were students of the subject and authorities on the subject, not that they differed on specific points as they did with regard to which was more important, the volume or the velocity of movement of money, but the very wide area of agreement in which they were all agreed on a point as to whether it was inflationary or whether it was deflationary, as to whether certain activity of the Federal Government with regard to debt was inflationary or deflationary, and what management procedures would be essential to counteract either a decline or an incline in the price level.

That still leaves a very great area of uncertainty as to when to apply measures. This is a delicate business, as you know. Yet we have to accept this responsibility. We have to look at the chart and decide that after this inflation we must make up our minds to do better than we ever did before, use the tools available, the knowledge which we have, the experience which we have, and determine that we are going to level this price level off at the most advantageous point, not a perfectly stable price level, but a fluctuating price level consistent with the free-enterprise system and one where we do not allow it to just destroy the whole system by going down under the table or out through the roof.

Senator DOUGLAS. I do not want to anticipate the reply which Mr. Kline will make to the question of Congressman Wolcott, but I hold in my hand the Federal Reserve Bulletin for August, and on page 972 the bulletin lists the total public debt held by United States Government agencies and trust funds as approximately 37½ billion dollars. That, added to the 216½ billion dollars of net debt which Mr. Kline has given, reaches the total of 254 billion dollars, which is probably the gross, and it checks with the figure on gross debt, so that I think the figures are consistent.

Mr. KLINE. Thank you.

Mr. WOLCOTT. Possibly Mr. Kline should give consideration to whether the title of the column might not be corrected.

That will indicate that the debt is not included. I think we have been thinking generally that the farm-mortgage debt has been declining, and I notice that according to your figures here, it has been going up since 1945 from $4,700,000,000 to $5,100,000,000. Is that a reflection of the down trend in agricultural prices?

Mr. KLINE. There are probably a great many factors in it. First, I should note that, compared to the value of farm real estate, that is a very minor readjustment in mortgage debt, that as a percentage of total value we still are very low compared to the prewar figures, because of the increase in the unit value of the real estate itself.

Mr. WOLCOTT. But the surprising part of it is that it is going back up. I did not know that.

Mr. KLINE. This would be an offhand answer, but there are a great many young people—men coming out of the Army and that sort of thing—who, when they start farming, borrow money, and when they buy a farm a great many of them obviously cannot pay for it, so there are mortgages involved. I would not be able to give——

Mr. BUCHANAN. Likewise, mechanized equipment purchased on these new farms.

Mr. WOLCOTT. This is farm mortgage. This is the mortgage on the real estate.

Mr. KLINE. That is right.

Mr. BUCHANAN. They might still get money to purchase farm equipment using real estate as a base. That would be in the picture also.

Mr. WOLCOTT. That is not usually done, is it? They usually buy it on a chattel mortgage.

Mr. KLINE. That is right.

Mr. WOLCOTT. What you have said with respect to the new farmers borrowing might be the answer, because it is correlated here with the dates in which the servicemen were coming back on to the farms, perhaps.

Mr. KLINE. I can speak from experience. That is the way I started.

Mr. WOLCOTT. As you see, it is down from the high of ten billion eight in 1922. Now, have you any figures to indicate how many farms there were—I mean family sized farms—in 1922 as compared to the family sized farms in 1948?

Mr. KLINE. No. That is a very simple figure, and I could get it for you. I would not be able to answer offhand.

Mr. WOLCOTT. I wonder if it would not be interesting in analyzing these figures if we had the number of family sized farms, so that we could determine, percentagewise, the decline in mortgage indebtedness per farm.

Mr. KLINE. "Family sized farm" is a tricky term.

Mr. WOLCOTT. I gathered from former testimony that the Farm Bureau Federation had given before other committees that they had agreed upon what to them seemed to be a definition of a family sized farm.

Mr. KLINE. Yes. I doubt that one could get statistics on mortgage indebtedness which were on this more or less ephemeral basis. Agriculture itself has the roughest possible division; it has commercial agriculture, of which the great majority is family sized farms; and then there is a great national problem of underemployment on farms in the United States, where a vast number, about half as listed in the census, would show a gross income of less than a thousand dollars a year before expenses are paid.

There would not be much mortgage indebtedness down there, yet those would be all family sized farms. There is a very great problem there of opportunity primarily.

Mr. WOLCOTT. It would be in the same relation taking into consideration 1922 and 1948 figures.

Mr. KLINE. It might be. I will see whether we can get significant figures there or not.

Mr. WOLCOTT. With the chairman's permission, if they are available, I think it might be helpful.

(The information referred to above is as follows:)

Number of farms, by size of farm, for the United States, 1920 to 1945

Size group	Number of farms					
	1945	1940	1935	1930	1925	1920
Total	5,859,169	6,096,799	6,812,350	6,288,648	6,371,640	6,448,343
Under 10 acres	594,561	506,402	570,831	358,504	378,535	288,772
Under 3	98,966	35,977	35,573	43,007	15,151	20,350
3 to 9	495,595	470,425	535,258	315,497	363,384	268,422
10 to 29	945,608	1,012,971	1,241,431	(1)	(1)	(1)
10 to 19	(1)	559,254	683,452	559,617	588,049	507,763
20 to 29	(1)	453,717	557,979	(1)	(1)	(1)
20 to 49	(1)	1,221,006	1,440,143	1,440,388	1,450,643	1,503,732
30 to 49	708,796	767,289	882,164	(1)	(1)	(1)
50 to 99	1,157,320	1,291,048	1,444,007	1,374,965	1,421,078	1,474,745
50 to 69	472,415	510,305	581,352	(1)	(1)	(1)
70 to 99	684,905	780,743	862,655	(1)	(1)	(1)
100 to 174	(1)	1,278,617	1,404,297	1,342,927	1,383,777	1,449,630
100 to 179	1,199,809	1,309,741	1,438,017	(1)	(1)	(1)
100 to 139	633,851	688,163	754,076	(1)	(1)	(1)
140 to 179	565,958	621,578	683,941	(1)	(1)	(1)
175 to 259	(1)	517,460	540,267	520,593	503,417	530,800
180 to 259	493,215	486,336	506,547	(1)	(1)	(1)
180 to 219	282,839	279,577	294,309	(1)	(1)	(1)
220 to 259	210,376	206,759	212,238	(1)	(1)	(1)
260 to 499	473,184	458,787	473,239	451,338	438,961	475,677
260 to 379	331,727	324,084	338,478	(1)	(1)	(1)
380 to 499	141,457	134,703	134,761	(1)	(1)	(1)
500 to 999	173,777	163,694	167,452	159,696	143,852	149,819
500 to 699	105,515	100,702	106,377	(1)	(1)	(1)
700 to 999	68,262	62,992	61,075	(1)	(1)	(1)
1,000 and over	112,899	100,531	88,662	80,620	63,328	67,405
1,000 to 4,999	96,733	87,465	77,825	71,321	55,873	60,019
5,000 and over	16,166	13,066	10,837	9,299	7,455	7,386
5,000 to 9,999	9,014	7,595	6,208	5,266	(1)	(1)
10,000 and over	7,152	5,471	4,629	4,033	(1)	(1)

[1] Not available.

Farm mortgage debt outstanding, Jan. 1, 1910–49

Year:	Total farm mortgage debt (thousand dollars)	Year—Continued	Total farm mortgage debt (thousand dollars)
1910	3,207,863	1931	9,398,088
1911	3,522,121	1932	9,093,983
1912	3,929,758	1933	8,466,418
1913	4,347,679	1934	7,685,203
1914	4,707,358	1935	7,584,459
1915	4,990,785	1936	7,422,701
1916	5,256,425	1937	7,153,963
1917	5,825,851	1938	6,954,884
1918	6,536,860	1939	6,779,318
1919	7,137,365	1940	6,586,399
1920	8,448,772	1941	6,491,435
1921	10,221,126	1942	6,372,277
1922	10,702,257	1943	5,950,975
1923	10,785,621	1944	5,389,080
1924	10,664,919	1945	4,932,942
1925	9,912,650	1946	4,681,720
1926	9,713,213	1947	4,777,355
1927	9,658,422	1948	4,881,744
1928	9,756,957	1949	5,108,183
1929	9,756,559	Percentage change, 1923–49	−52.6
1930	9,630,768		

Senator DOUGLAS. Mr. Kline, I think your statement is extremely able. There are a few questions which I should like to ask. We had some testimony by eminent bankers that they did not want the

Federal Reserve Board given too great powers to raise reserve requirements, because that might be used to reduce the earning power of banks. They were opposed to giving the Reserve Board the power to control the reserve requirements of the nonmember banks and wanted to have State banks always have the power to withdraw from the Federal Reserve System and, therefore, be exempted from the reserve requirements of the Federal Reserve System, because they thought that would impose a check on any possible tendency of the Federal Reserve System to raise the reserve requirements to such a point as to reduce the earning powers of the commercial banks.

What would you say to that?

Mr. KLINE. There are several things involved in the question you raise. In the first place here, the statement taken on its face value might seem to indicate that the American Farm Bureau was in favor of the Federal Reserve Board through the banks or in any way whatever, in favor of the Federal Reserve System having considerable more authority over individual loans by individual banks than we have any idea they should have. We think the banks should have the greatest possible authority to pass on loans.

Senator DOUGLAS. I did not infer that at all. I thought you were inferring only the control of the general supply of bank credit.

Mr. KLINE. That is right, and in that respect we believe that the guiding consideration must be the ability to maintain a more stable general price level. In the past credit has tended, by the method through which it was extended and through the means by which it was contracted, to make inflations go higher and depression go deeper. There was an illustration in my own community in 1932.

The banks, not from choice but from necessity, forced the liquidation of loans wherever they could do it at exactly the wrong time.

Senator DOUGLAS. You mean because of the policies of bank examination?

Mr. KLINE. Policies of bank examination, and the inability of the private banker at that time to keep what he knew was a good loan whenever prices were anything like normal, on his books, because after all the depositor wanted his money, and it was not the banker's money. It was the depositor's money. A reasonable control, so that we would not have to do that sort of thing would be far better, I think, for the bankers themselves.

As a matter of fact, there were about 24,000 banks in 1929 and they ended up with some 40 percent fewer in 1933. So it was not good for the banker either.

Yet, he was unable to leave out a perfectly sound loan, so that the contraction of credit destroyed the productive capacity of the community. This is designed to try to operate in the opposite direction by being able to prevent the undue expansion of credit by controlling reserves.

You will note that with regard to the nonmember banks we said, "If it is necessary." I believe that some 80 percent——

Senator DOUGLAS. Eighty-five percent.

Mr. KLINE. Of the money and funds involved is in member banks now.

Speaking now as a farm group, we would think the over-all interest ought to guide and that the over-all thing is to so operate credit that it gives us a more stable general price level rather than push depressions downward and inflations upward.

Senator DOUGLAS. You would say it is a question of fact as to whether the ability of State banks to withdraw from the Federal Reserve System and thereby going under the lower reserve requirements of the States, does prevent the Federal Reserve System from raising reserve requirements at times when it be needed, and that if it can be demonstrated that this does not check the power of the Federal Reserve System, you see no reason for giving such additional powers, but if it does check the ability of the Federal Reserve System, then you say that logically the Federal Reserve System should be given the power to impose uniform reserve requirements for the banking system as a whole?

Mr. KLINE. That is quite right.

Senator DOUGLAS. That is a very important statement and I, personally think a very statesmanlike one.

I notice that further down in your statement you refer to selective credit controls. Do you believe that the Federal Reserve System should be given permanent power over consumer credit, over the terms of consumer credit?

Mr. KLINE. We would just not be prepared to make a specific answer on that question.

Senator DOUGLAS. Do you think that the Federal Reserve System on the whole, in the period from 1945 to June 30, 1949, exercised its powers wisely in this respect?

Mr. KLINE. On the whole, I would not criticize it. I know there was a great deal of criticism of it, but at that time we had a great deal of suppressed inflation, a vast amount of purchasing ability, which could be used. Anything which could prevent it from crowding prices up by expanding demand seemed to us to be a good idea at that time.

Senator DOUGLAS. If it had not been for this, the demand for durable consumer goods would have been so great, backed up by consumer credit, that it might have caused prices to rise still further and, in your judgment, would have caused prices to rise still further?

Mr. KLINE. We think so.

Senator DOUGLAS. Perhaps this was covered in Congressman Buchanan's question; I am not certain, but do you suggest a mechanism for coordinating the credit policies of the lending agencies of the Government with other Federal groups? How would you do that?

Mr. KLINE. Our committee recommended a monetary authority. I realize that this is a contentious subject and would raise the question of the supremacy in certain fields of the Treasury as against the Federal Reserve Board, as against the possibility of setting up an over-all coordinating agency.

We are yet convinced that while this is a difficult problem, it ought to be done, that there is enough of the capacity to expand or to contract so that a really wise Federal policy might be so operated against by certain other Federal agencies that we would unnecessarily complicate our own problem of a more general stable price level or in getting a more general stable price level.

Senator DOUGLAS. Would that authority be of an advisory nature or would it have mandatory powers? I take it you would prefer to have it have mandatory powers and operate under what you term a formula fixed by legislation.

Mr. KLINE. Just as an individual, I do not think advisory powers would be very effective. If this thing is to be operated, we are going to have to overcome some very powerful tendencies. Again referring to this general price level chart, I think as an economic chart it is the most important thing historically we have. That seems to suggest that I think this is a most important field, which I do. This is the place where we must operate effectively if we make the rest of the private-enterprise system work.

It seems to me, therefore, that we have to have an adequate authority, otherwise it will not work because these tendencies go in the opposite direction. Historically you can look at the chart and see what the tendencies produce. After a very great inflation they produce a very great deflation.

Senator DOUGLAS. You have a very interesting suggestion in your memorandum on refinancing. I wonder if you would be willing to expand that a bit.

Mr. KLINE. Refinancing the Government debt?

Senator DOUGLAS. That is right. You would say, therefore, that in a period of expanding prices you should borrow from the public and pay off governmental obligations held by the banks?

Mr. KLINE. Right.

Senator DOUGLAS. And that in a period of falling prices you should refinance by borrowing from the banks and pay off the debt held by the public?

Mr. KLINE. Quite right. That would suggest if the wholesale price level seemed to have a long trend downward, we probably should not appropriate too much money for the Treasury to sell E bonds, for instance.

Senator DOUGLAS. I was going to come to that, as to whether you would favor an E-bond campaign in a period of falling prices and falling employment.

Mr. KLINE. The answer is very simple. It is "No."

Senator DOUGLAS. Then you are not enthusiastic, to put it mildly, about the policy of the Treasury during the first part of 1949?

Mr. KLINE. I was answering the question. I am sorry you asked the question. I think the answer is rather obvious.

Senator DOUGLAS. I am always given to asking embarrassing questions, for I believe it is much better to get all these things out on the table than to move by innuendo and inference—not that you are doing so, but it is always better to get them directly stated.

Mr. WOLCOTT. I suggest that he goes on in his statement to suggest that the reason he advocates a refunding operation, which would take the E bonds from private holders and put the obligation in the banks, is because of the inflation that might be incident to banks holding them instead of private individuals holding them; is that right?

Mr. KLINE. Yes.

Mr. WOLCOTT. That explains why he is against the sale of E bonds to individuals in times of depression.

Senator DOUGLAS. That is right.

Mr. WOLCOTT. But in times of inflation, I assume you would be in favor of selling something similar to E bonds to the private holders; is that right?

Mr. KLINE. By all means. This is the very simplest area of the management of the public debt. The immediate influence, of course, of selling E bonds to people is to take money out of their pockets so as not to create a demand. It is a delayed demand. It seems to me we ought to at least be able to do these simplest things so that they fitted into a national program for a more stable general price level.

Senator DOUGLAS. We have kept you probably too long, Mr. Kline, but I cannot help asking another question.

When we had the representative of the Comptroller of the Currency here, who manages the examinations of the national banks, and when we had the Chairman of the Board of Directors of the Federal Deposit Insurance Corporation, who manages the examinations of the State banks in the insurance system, but not in the Reserve System, I asked them questions as to whether bank examination should not be somewhat influenced by the purpose of maintaining stability in the banking and economic system as a whole; and, as I think the record will show, both replies were "No," that the purpose of bank examination was solely to determine the integrity of the individual bank without regard to the system as a whole. They argued that if you had individually stable banks you would then have a stable system. To this I inquired whether it wasn't necessary to have a stable system in order to have stable banks.

I wondered if you would care to make any comment.

Mr. KLINE. That is a fairly technical question, Senator, to ask a farmer.

Senator DOUGLAS. You seem to find your way around pretty well on these issues.

Mr. KLINE. It would seem to me to be preferable to have relatively stable rules for the examination of banks simply from the standpoint of confidence and good business practice.

On the other hand, in the depths of the depression it was the rules of examination which ruined many banks, which if you had merely taken your word "integrity" of the individual bank, it was a perfectly sound bank unless the whole structure of the United States was going to fall.

The insurance companies had to beg leave not to make cash payments, which were in the contracts. Great institutions of all sorts found that they had gotten obligations which at the then existing price level they simply could not make good on. It would have seemed to be wise then to have made revisions in the rules for examination of banks under that very great stress.

But again I come back just as a farmer, who would rather have a technical opinion and certainly would want to get a great many technical opinions before passing judgment on them, after asking questions and cross-examining, and so forth, that in general the rules for the examination of banks ought to be as uniform as possible.

I would not give much weight to my answer on that question. I am not equipped for it.

Senator DOUGLAS. Not merely uniform between banks but uniform between periods—that is, that the same rules should be followed during a period of depression as during a period of prosperity.

The issue really turns upon "to what degree will you follow market values or normal values." That is really what the issue turns upon.

Mr. KLINE. Well, it would seem to me that there ought to be some consideration given to normal value. Again this is a technical question, and it has many implications which would not occur to me as I look at it incidentally.

Senator DOUGLAS. I have no more questions.

Mr. BUCHANAN. I have nothing further.

Senator DOUGLAS. Mr. Wolcott?

Mr. WOLCOTT. No more questions.

Senator FLANDERS. I have nothing further.

Senator DOUGLAS. Thank you very much.

Mr. KLINE. Thank you.

Senator DOUGLAS. We will meet again at 2 o'clock this afternoon and hear Mr. William J. Grede, president of Grede Foundries, Inc., and a director of the National Association of Manufacturers.

(Whereupon, at 12:45 o'clock the hearing was adjourned until 2 p. m. of the same day.)

AFTERNOON SESSION

Senator DOUGLAS. Ladies and gentlemen, we will come to order.

The witness this afternoon is Mr. William J. Grede, chairman of the Federal Debt Management Committee of the National Association of Manufacturers. Mr. Grede, we will be very glad indeed to have you come forward.

STATEMENT OF WILLIAM J. GREDE, CHAIRMAN, FEDERAL DEBT MANAGEMENT COMMITTEE, NATIONAL ASSOCIATION OF MANUFACTURERS; ACCOMPANIED BY JOSEPH DUBE, COMMITTEE EXECUTIVE OF THE FEDERAL DEBT MANAGEMENT COMMITTEE; AND DR. HARLEY L. LUTZ, TAX CONSULTANT, NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. GREDE. Mr. Chairman, as I come before the committee today, I do want to express my appreciation on behalf of the NAM and myself, personally, for this privilege to present to you some of the findings of our committee and some of our opinions on this very important subject.

My name is William J. Grede. I am president of Grede Foundries, Inc., of Milwaukee, Wis. I am a businessman and class B director of the Federal Reserve Bank of Chicago. In the National Association of Manufacturers, I am a director and regional vice president, and during 1949 I have been chairman of its Committee on Management of the Federal Debt. I have with me Mr. Joseph Dube, committee executive of the Federal Debt Management Committee, and Dr. Harley L. Lutz, professor emeritus of public finance, Princeton University, and NAM tax consultant.

Mr. Davidson, whom I planned to have with me, is ill and could not be here.

The questionnaire, that was issued by the Joint Committee on the Economic Report in August 1949, contains 20 questions. They can be grouped, broadly, into (1) those which deal with matters of monetary and banking policy; and (2) those which deal with general fiscal policy. As chairman of the NAM Committee on Federal Debt Management my primary concern will be to deal with certain issues involved in a sound policy of debt management as these have been developed in the studies of my committee. It is clear, however, that wise management of the public debt cannot be achieved apart from wise and sound management of the broader aspects of the Government's finances. As an introduction, therefore, I shall comment on these broader aspects, and in so doing, I shall draw upon the positions taken by other NAM committees in the Government finance field.

An appropriate starting point for my introductory remarks is provided by question 17 in the joint committee's list. This question is long, with many parts. It covers the whole water front of taxing, spending, budget surpluses and deficits, and the objectives to be sought through fiscal manipulation.

The position of this association, expressed through recommendations of its committees in the Government finance area and approved by its board of directors, is that deficit financing should not occur in peacetime. Recognizing, however, the great support for deficits as a conscious policy of Government in recent years, and the widespread belief that they are the most readily available and effective means of countering deflationary movements, Dr. Lutz was commissioned to undertake a special study in the premises last winter. Copy of this work, entitled "Public Spending and the Private Economy," and published as our 1949 Economic Division Series No. 6, has been filed with this committee. More recently, the association's board of directors has approved a report of its government spending committee entitled "A Recommended Federal Budget for the Fiscal Year 1951," copy of which also is filed with this committee. Dr. Lutz's analysis is summarized in this report as follows:

The principal purpose of this study was to examine the relationship of public spending to the situation of the private economy as indicated by the volume of gross national product. The data compiled by the Department of Commerce from 1929 to date were used as the basis. The following conclusions were drawn:

1. *Little or no demonstrable influence of spending upon product is apparent while the spending comprises only a small part of the total; but such spending does have prompt and definite effects when it is on a massive scale*

The decade of the 1930's was the proving period for the proposition that a moderate level of deficit spending has little or no demonstrable effect. During this decade Government purchases of goods and services constituted from 10 to 15 percent of gross national product. The advocates of deficit spending for prosperity recognized at the time that this was too little to produce decisive results, and they were right. Gross national product, even in 1940, was not yet back to the 1929 level, and millions of persons were still unemployed. The spending for national defense and war, 1940–45, was the proving period for the second part of the above conclusion. Total Government purchases rose from 13.9 percent of gross national product in 1940 to 46 percent in 1943 and 45.9 percent in 1944. As the war progressed and the spending rose, Government dominated the economy. The effects were reflected in a rise of gross national product from 100.5 billion dollars in 1940 to 213.4 billion dollars in 1945.

2. *Once strong inflationary forces have been set in motion and the Government has provided, by its financing measures, an ample supply of inflationary energy, the movement tends to continue under its own power despite the cessation of Government operations on a large scale*

The postwar years have provided the proving period for this conclusion. Government purchases dropped rapidly after 1945 and in 1948 they were 13.8 percent of gross national product, or within the range established in the 1930's. But gross national product continued to rise, reaching 255.9 billion dollars in 1948.

The course of events in the most recent months for which data are available is enlightening. The seasonally adjusted annual rate of gross national product in the fourth quarter of 1948 was 265.6 billion dollars, and in the second quarter of 1949 it had declined to a rate of 250.5 billion dollars. Government purchases of goods and services were at an annual rate of 39.5 billion dollars in the fourth quarter of 1948 and 42.4 billion dollars in the second quarter of 1949. The increase of Government spending did not halt the decline.

This result sustains the conclusion based upon the longer experience of the 1930's to the effect that a moderate level of public spending, in relation to the total gross national product, is not likely to have much influence on it. The current business recession began as a state of mind, that is, people began to realize that prices were too high and that the purchase of some things could be deferred. The annual rate of consumer expenditures in the fourth quarter of 1948 was $181,000,000,000, and it was down to an annual rate of $175,000,000,000 in the second quarter of 1949. This decline was not caused by lack of purchasing power, for even in the second quarter of 1949 the disposable income of individuals (personal income after tax and nontax liabilities) was $193,000,000,000. When a state of mind adverse to spending exists, a little "teaser" increase of public spending will not suffice to change it. A massive jolt is required, such as was given by the huge war deficits. * * *

The evidence contained in the record of gross national product and its components from 1929 to the present time throws doubt upon the doctrine that manipulation of the fiscal powers is capable of holding the economy in balance on a continuous upward course. According to this doctrine there should be strong, aggressive injection of inflation to correct any signs of depression, and the record indicates that the doses injected would have to be large to produce substantial effect. Then, as the inflation gets under way and shows signs of going too far, there should be, according to the doctrine, strong, aggressive taxation in order to draw off the surplus purchasing power that is producing the inflation. It will be remembered that a major objection to the tax reduction of 1948 was that it would contribute to the inflation by leaving more money in the hands of the people.

At present there is a toying with this idea of compensatory spending for this is what the deliberate resort to a deficit in face of a mild recession means. Complete application of the idea of whipsawing the economy between inflation and taxation has been characterized in the document mentioned above as follows:

"The effect upon the economy of an alternation between the furious rate of spending that would be required at one time to curb depression tendencies and the confiscatory rate of taxation that would be required at another time to eliminate the inflation resulting from the previous spending cure for depression can be likened only to life on the moon. There, for 2 weeks, the temperature stands at something like 150° to 200° F., and for the next 2 weeks at something like 100° below zero. In the kind of fantastic alternation between extreme stimulation and extreme repression that would be required if Government were to undertake the economic stabilization of the economy enterprise would have no better chance of survival, to say nothing of growth, than life as we know it would have on the surface of the moon."

In short, we believe that it is possible and desirable to keep the Federal budget in annual balance except under conditions of war or grave national disaster. In this we find support from a document already submitted to this Joint Committee by the National Planning Association Conference of University Economists, dated at Princeton, N. J., September 16 to 18, 1949. This document takes a position in opposition to the annually balanced budget and then proceeds to state such powerful reasons for annual balance that we accept these reasons as strong support of our own positions. The following is quoted from the report of these economists:

Annual budget balancing is, thus, both difficult in practice and unsound in principle. But one great merit it does have: It provides a yardstick by which legislators and people can scrutinize each activity of Government, testing it both for efficiency of operation and for its worth-whileness in terms of cost. Every Government program undertaken has to be paid for in a clear and unequivocal sense. The Legislature and the Executive are required to justify additional taxes equal to the cost of any new program. This is a principle every citizen can understand. If dropping the principle of annual budget balancing were to mean dropping all restraints to unwise and inefficient expenditure, grave damage would be done to our economic and political system.

Were expenditures divorced entirely from the need for taxation, political opposition to extension of the Government's expenditure programs would largely disappear. The scale on which the public sector absorbs resources would grow beyond what was really desired by the people as a whole; sooner or later the country would find itself in a state of chronic inflation. Such inflation is a sign of weak government and comes from eagerness to spend without willingness to tax. Accordingly, other habits of thought and action must be set forward to insure the standards of judgment and the self-discipline of Government's activities and to do better what the principle of annual budget policy attempted—though imperfectly—to accomplish.

Here is a perfectly clear statement of what is likely to happen when Government spends without taxing. The suggestion offered in the final sentence of the above excerpt that new attitudes must be introduced is sheer, wishful thinking. The Nation could be completely bankrupt before the citizens could be indoctrinated with these new attitudes, particularly since the indoctrination would have to swim upstream against the powerful current of getting something for nothing through spending without taxing.

From the most recent report of the NAM Federal tax committee, approved by the board of directors on October 25, 1949, the following statements on general tax policy are taken:

The development of sound, consistent tax policy requires constant concern for the needs of government, and also for the conditions essential to the maintenance of healthy economic growth. The record of our national expansion indicates that the two most fundamental factors in this expansion have been capital formation and a consumption level adequate to absorb the products of a growing industrial system. It is self-evident that these basic factors cannot have full and free play unless the people have income sufficient, after taxes, for the requisite consumption and capital formation objectives. When government's exactions are too great, the ability of the citizens to consume and to save for investment is encroached upon. Although the income taken in taxes is counted as part of gross national product, and is a source of income for public employees and others, such public diversion and use of private income *is not as invigorating* for the economy as would be its use by those who have worked, or saved and invested, to get it. It is demoralizing to effort and initiative to be obliged to surrender a substantial portion of one's income to be spent as determined by the whim or decree of someone else. This bad effect is likely to be intensified as government branches out beyond the services which are generally recognized and accepted to be essential to national security and internal stability into areas of less general acceptability and of less definite general advantage. Since government spending is in such large measure directed into consumption channels, it can never be an adequate substitue for those private uses of income which result in capital formation.

From these propositions there follows the first principle of taxation, which is that it must be moderate. All taxation is burdensome, which is a summary way of saying what has been explained at greater length above. Some taxation is obviously necessary, and it remains to effect the best possible adjustment of an obligatory burden. Moderation in taxation means two things: first, the total take must not encroach too heavily on the capacity of the people to consume and to save; and, second, the rates of tax must not cut too deeply into income at any point. The levy of extreme or punitive taxes, whether on incomes directly, or on commodities, business, or other objects, is an introduction of moral judgments which inevitably interferes with the primary purposes of distributing the necessary burden of taxation in such manner as to involve the least hindrance to the operation of the productive forces.

A corollary of the principle of moderation is that there must be no waste in the application of public funds, for otherwise it would soon be necessary to collect more revenue and in time the tax burden would pass the bounds of moderation.

This means that public spending must be strictly controlled and every possible waste eliminated. The Nation can never be rich enough to afford public spending for unnecessary activities or in a wasteful manner.

To conclude this section of my statement, I would like to say as a representative of American business, that we want to see full employment, high-level production, and better incomes for all. It is our conviction that these objectives will be most surely attained and maintained if the burden of government is reduced. This is essential to the avoidance of unbalanced budgets and the use of public credit as a device for postponing taxation to the future.

I turn now to the recommendations of the NAM Federal debt management committee. A complete copy of the report of the committee is filed with the Joint Committee on the Economic Report as a separate document. Here I propose to state and comment briefly on the several recommendations.

1. There should be a return to the historic policy of the retirement of debt as promptly as possible after the emergency giving rise to its issue has passed. Deficit financing is inconsistent with this policy and therefore deliberate resort to it in peacetime must be avoided.

It has been historic policy in this country to retire debt as promptly as possible after the emergency giving rise to its existence has passed. Huge, and at times seemingly uncontrollable, public debts have been incurred after five major wars in the past. However, following the Revolutionary War, the War of 1812, the Civil War, and World War I, there was an energetic and effective effort by the Government to repay the amount it had borrowed.

The cost of World War II dwarfed that of the others. It was about 10 times as great as that of World War I. With the addition of the postwar sale of 18.9 billion dollars of Victory loan securities, the debt reached a total of $278,000,000,000 by February 1946.

Proceeds from the sale of the Victory loan securities, which boosted Treasury cash balances to $26,000,000,000, made possible most of the subsequent debt reduction. The only substantial reduction effected from a budgetary surplus was a cut of $6,000,000,000 in the fiscal year from July 1, 1947, to June 30, 1948. Recently, the debt has started to rise again.

This departure from traditional policy could be acutely dangerous. Many hold that it is unimportant because increasing national wealth can be expected to render the debt burden less onerous for posterity to bear. However, European history is marked with the dire results of such weak financial policies.

The heavy debt burden is with us. Its dangers will increase in growing proportion if deficit financing is permitted in reoccurring periods. There can be no justification for continued resort to this method of financing during peacetime.

2. The Federal Open Market Committee should resume its responsibility granted by law in carrying on open market operations and be freed in this connection from Treasury domination.

A primary responsibility of the Federal Reserve authorities is to exercise powers granted it to help mitigate the effects of inflation and deflation. To direct the authorities in exercising this responsibility, the Federal Reserve Act provides that:

The time, character, and volume of all Federal Open Market Committee purchases and sales of Government obligations should be governed with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country.

Actually, under present arrangements, the Federal Reserve has been relegated to a position of serving as an instrument of Treasury policy. The Hoover Commission Task Force on Regulator Commissions found that—

Treasury fiscal policy has largely dominated Federal Reserve monetary policy * * *

It is noted that the Federal Reserve is by law completely independent of the Treasury, but added that—

as a practical matter, on virtually every major issue where Federal Reserve-Treasury differences have arisen, the Federal Reserve has gone along with the Treasury * * *

This condition is a result of Treasury bias in favor of too-easy money rates dictated by the desire to maintain low service charges on the debt. The economic dangers of subordinating to such a Treasury policy the Federal Reserve's power to regulate the volume of credit and its interest cost are discussed later. The immediately important point is that the logical conclusion of a further shifting in this relationship between the Federal Reserve and the Treasury is the destruction of the Federal Reserve System in all practical aspects of its present operations.

Close and continuous cooperation between the Federal Reserve and the Treasury is essential. It is also possible of achievement under the letter and spirit of the Federal Reserve Act. On the other hand, if the Federal Reserve's prerogatives under that law to formulate and execute credit policy are to be completely usurped by the Treasury, the Government will become lender and, at the same time, borrower, and, as such, control interest rates on its own borrowing.

Most important reasons for this changing relationship are the growing degree of Federal Government intervention in business and finance and the growth of the public debt. These reasons may be valid in nations lacking a developed monetary and banking system, or embracing a state of socialism. However, they should not be permitted further development here, for their byproduct certainly is in fundamental conflict with the principles of a free-enterprise system.

The use of spending and borrowing as a chief weapon against economic instability will promote Federal Government intervention in business and finance. This leads to the possibility of ultimate control through domination of the central banking system.

The solution of this problem is a return to sound policies of Government finance and debt management. A major step in this direction would be for the Federal Open Market Committee to resume the responsibility granted to it by law in carrying on open market operations.

As a matter of fact, there is reason for going further. Instead of the Federal Reserve authorities being subordinated, the Treasury should give greater heed to their advice with regard to the terms and forms of security offerings. In the final analysis, this group represents an outstanding repository of financial knowledge and experience and would exercise its influence against decisions sacrificing sound fiscal policy for considerations of expediency.

3. Future financing policies should be shaped toward the establishment of a free money market which shall itself resolve the terms of security offerings.

4. In order to help promote a free market and avoid future difficulties of debt management, there should be—

(*a*) Refinancing of all debt into properly spaced maturities, with particular emphasis on reduction of the amount due within 1 year to a minimum.

(*b*) Adjustment of policies relating to the issuance of savings and redemption bonds so as to recreate as much liberty as possible in the management of the marketable public debt.

(*c*) Avoidance of restrictions in regard to marketable obligations, such as the issuance of bank-restricted bonds.

The Federal Reserve System's statutory function of formulating and executing policy to regulate the volume of credit and its interest cost is seriously impaired when Government bond prices are "pegged" at a definite level. Such a policy has been pursued during and since the war for the purpose of maintaining low interest rates on new security offerings.

In mid-1949, the Federal Open Market Committee issued a statement which implied that flexibility, up and down, will be permitted in the interest-yield curve on Government obligations. However, a qualification in that statement reserving the right to maintain the continued "confidence of investors in Government bonds" leaves the market "pegging" policy open to arbitrary resumption.

The weight on the budget of interest charges is secondary to the importance of the interest rate on the Nation's entire economy. It influences every phase of commerce and industry. It is income, as well as expense.

Of direct concern here is its effect on the ability of the Federal Reserve Board to fulfill a primary responsibility—that of utilizing the interest rate to curb credit expansion during boom times and to try to encourage the use of credit when business is depressed.

At one time, the action of the Federal Reserve Board on the rediscount rate could exercise an important influence in mitigating boom conditions. The rate had been regarded as a type of brake when the inflationary speed became too great.

However, when the Federal Open Market Committee occupies the role of residual buyer of Government securities at a pegged price, the effect of this device as an instrument of credit control is lost. From the viewpoint of the Federal Reserve Board's power to help mitigate depressions, it is generally accepted that the interest rate is not a controlling factor. The area of decision lies within the incentive to borrow. A mere decline in interest rates will not impel an individual or business to incur debt, if other incentives are lacking.

However, if one subscribed to the theory that lowered interest rates will help stimulate credit demand, there is question as to whether the present low level leaves sufficient margin to achieve such results. The rate cannot be pushed below a certain minimum if there is to be any inducement left for the lender, and postwar policies have permitted only a nominal rise from the record low rates artificially attained during the war years.

Thus, whatever business stimulus might have been achieved by making the interest rate more attractive as a cost of investment has been limited by the low rate maintained throughout the boom period. Furthermore, if inflationary pressures should suddenly expand, continuation of this policy could see such pressures burst beyond control of the Federal Reserve altogether.

Wider distribution of debt maturities is needed.

The Treasury's position will become increasingly difficult if it continues to refinance medium and long-term securities with floating debt (due within 1 year) and demand obligations. This has been consistent policy since the Victory loan of November 1945—its last long-term offering.

Here again, savings in interest charges on the debt are the understandable but not justifiable determination. Apparently of secondary consideration are the questions of maintaining the Treasury's operating flexibility, limiting the inflationary potential of the banking system where the predominant part of short-term debt goes, and the fact that continued refunding with demand and short-term debt will by 1952 produce so radical a state of imbalance within the debt structure that marketable bonds will constitute not much over 25 percent of the total.

As of June 30, 1949, $146,000,000,000, representing 58 percent of the total debt, was due to mature within 1 year, or was subject to redemption on demand.

The Treasury has stated that it will vary its refinancing pattern to the extent of offering one issue of 2- or 3-year notes later this month. If some such departure from the short-term refinancing bias is not undertaken, and assuming that the debt total remains unchanged, the debt composition by the close of 1952 will be approximately as follows:

Now this morning the press announced the Treasury's refinancing, and they have issued some 4-year bonds, and this figure will change by the amount of those issued.

But at the time this report was prepared the floating debt and demand issues were $184,000,000,000. That figure would now, with the new Treasury financing, become $179,000,000,000.

Obligations due in more than 1 year, that $68,000,000,000 would become $73,000,000,000.

So great an amount of floating and demand debt could place the Treasury in a seriously embarrassing situation if it presented a large scale refunding problem at a time when the money authorities were seeking to employ a restrictive credit policy or had not had opportunity adequately to prepare for the operation. In such an event the Treasury would find it necessary to sell short-terms to the banks which would pay for them by expanding their bank deposits.

Short-term Government obligations do fulfill a certain need on the part of banks and other investors for highly liquid assets. However, the overwhelming majority of sound bankers and economists have voiced the opinion that the amount now outstanding is dangerously large. It is tremendous by any past comparison.

Since it is likely that only a minor portion of the Federal debt will be retired for many years, only two alternatives present themselves as a means of absorbing a sizable portion of outstanding short-terms: One is through the heavier sales of savings bonds and the other is through refinancing into longer-term obligations.

An objection to stepping up sales of savings bonds is that they obviously comprise the greater and most vulnerable part of the demand debt. These issues represent a tremendous potential cash demand on the Treasury which could become a reality.

From another point of view, they have failed to fulfill their purpose of compartmentalizing an important portion of the debt in the hands of small investors. This proclaimed feature—the need of diverting high wartime personal income from consumer-goods channels—and the desire to obtain as great a degree of permanency of ownership as possible for a part of the debt were the chief reasons for creating a fixed-interest, nonmarketable, but redeemable, security.

There is wastefulness in high-pressure campaigns to sell small-denomination savings bonds which do not stay sold much longer than the required minimum holding period. This has been the experience for the period from 1941 through 1948.

During this period, purchases of $25 bonds retained only 39 percent of their holdings. The percentage of retention grows sharply up to buyers of $10,000 issues who retained 90 percent of their purchases. This indicates that an attractive interest rate will find ready buyers for marketable Governments among the larger long-term investors.

As important as their contribution to the state of imbalance in the debt structure is the nonmarketable, but redeemable, feature of savings bonds. This cannot help but freeze the interest-rate curve. If the desired state of flexibility, up and down, were reestablished in interest rates and long-terms were to offer income in excess of the going rate on savings bonds, it is obvious that wholesale switching would occur.

The other alternative—a longer-term bond issue—has been opposed on the grounds that it will increase service charges. Such an increase in the budget would be a nominal price for the taxpayer if it served to create greater public awareness of the debt burden and the increase in that burden caused by deficit financing. In any event, it is conservative fiscal policy to space maturities of the debt so as to avoid any possibility of even temporary embarrassment, regardless of the added interest charges involved.

There is considerable room in the debt-maturity calendar for medium- and long-term financing. First calls from 1953 through 1959 total 20 billion dollars, of which 8.7 billion dollars occur in the latter year. From 1960 to 1967, the final year in which there exists a first call, the total is 45 billion dollars.

No hard and fast pronouncement on interest rates and other terms and covenants of future financing can be predetermined. However, if Treasury policy were adapted to the more conservative consideration of spacing maturities properly, the terms necessary to meet market conditions prevailing at the time can readily be ascertained.

Another phase of Treasury financing which has been unwise and unprofitable has been the attempt to "tailor" the debt to the needs of the economy. This has been done by resort to various restrictions upon security issues, illustrated by the bank-restricted bonds and the Treasury investment series. The hoped-for lodgment of the debt with different classes of permanent investors has not thereby been accomplished.

Arbitrary debt compartmentalization is no substitute for investors' judgment. In a free money market, the debt will compartmentalize itself.

That concludes the report of the debt management committee.

By way of conclusion, I would like to make some rather specific observations on the current situation. We in NAM are deeply concerned about the fiscal crisis that confronts the Nation. In this crisis there are the following elements:

1. The inability, or unwillingness, to balance the budget under conditions of near record-breaking business activity.

This situation has arisen from the failure to control Federal spending, and the evidence pointing to this conclusion is the fact that in the fiscal year 1948 the Government spent for all purposes 33,917 million dollars, aside from tax refunds. We have submitted a budget projection for the fiscal year 1951 which indicates an adequate level of Federal support costing 33.6 billion dollars aside from certain contingencies in the Housing Act and the Government corporations. We submit that there is no good case for a budget in 1951 in excess of this total.

2. The increase of public debt that deficits will involve, and the further deterioration of our monetary standard that a prolonged continuance of debt increase will surely produce.

The gradual rise of the debt may not induce, at any given time, a violent inflationary response. We have produced evidence to show that moderate doses of inflation are not likely to produce such a result. But the steady, indefinite increase of debt will in time create an inflationary potential which could be touched off by any of a number of circumstances. And further, it can lead eventually to a debt total so large that the only relief will be a further devaluation of the currency standard. The current declarations against devaluation are binding only on those who make them. They do not commit a future Congress, Secretary of the Treasury, or President. Nowhere in history is there convincing evidence of indefinite firmness on monetary standards in face of mounting debt.

3. The deficits and the rising debt are likely to lead to continued Treasury insistence upon debt management policies which we have criticized as unsound and dangerous in our main statement.

We refer, in particular, to the further expansion of short-term and demand debt, and the arbitrary restriction of interest cost on such debt by the price-pegging of long-term issues. In a free market the direct cost of deficit financing would be promptly exposed for all to see in the budgeted charges for interest.

4. The defeatist attitude of high Government officials, as revealed in their statements to this committee, is particularly alarming. The implication of this attitude is that nothing can be done about it.

We reject his doctrine. We hold that something can be done, which is to reduce the spending. We hold that it is the duty of the Joint Committee on the Economic Report to emphasize a reduction of Federal spending as the one essential step toward sound, controllable financial policy, and to spell out to the Congress and the Nation in full detail the consequences of accepting a defeatist, do-nothing-about-it attitude.

5. We do not agree that an increase of taxation would be the proper step to take to achieve budget balance.

Total Government receipts (Federal, State, and local) are now approximately one-quarter of net national product. A further increase of taxes in the magnitude to cover a deficit now estimated at some 5.5 billion dollars for the present fiscal year would raise this proportion significantly. Such an increase would cut heavily into the ability of the people to consume, to save and add to the capital fund, and hence would tend to defeat its own purpose by diminishing the flow of income from which all taxes are derived.

6. Finally, we do not agree that the test of spending in excess of receipts can properly be said to be the "welfare of the people."

This means that deficit spending promotes the public welfare. Since there will always be, next year and the year after down through time, some other project that is claimed to contribute to the public welfare, this doctrine means that there can never be an end of the deficits, once they are thoroughly established and justified on the basis of the general welfare.

The outcome will not be more, but less, welfare. If continuous deficits and debt increase were really the way to greater well-being, then the most heavily debt-ridden countries today should be the most prosperous. We know, on the contrary, that they are the most miserable, the most in need of our aid. If there is any lesson to be drawn from the financial history of nations, it is that a prolonged, inordinate exploitation of the public credit can lead only to the misery and despair of private and public bankruptcy. We can avoid this disaster, but only by putting our national finances on the sound and stable basis of paying as we go, and agreeing to pay only as much as we can afford without the imposition of a crushing tax burden.

Thank you.

Senator DOUGLAS. Mr. Wolcott, do you have any questions?

Mr. WOLCOTT. No.

Senator DOUGLAS. Mr. Grede, in your statement you refer with approval to the statement of the economists who met at Princeton and made a report to our committee. But I gather that you do not approve of another of their statements which appears on page 436 of the committee print on Monetary, Credit, and Fiscal Policies and which I shall take the liberty of reading to you, if I may. It is about the middle of the page, the paragraph beginning with "Compared to the full span of the business cycle—" and the statement reads:

> Compared to the full span of the business cycle, a year is a short period of time. To insist upon a balance in every single year is certainly undesirable and to attain it is probably impossible. To attempt to raise tax rates every time there is a decrease in national income will only result in discouraging private consumption and investment at a time when these are most in need of expansion; on the other hand, to try to eliminate a tax surplus by cutting tax rates or expanding Government activities would serve to increase inflationary pressures at a time when they are already acute.

In general, I take it you are saying that with the exception of wars, the budget should at least be balanced during peacetime, virtually every year of peacetime?

Mr. GREDE. That is correct, except in case of war.

Senator DOUGLAS. As opposed to deficit spending under virtually all conditions.

Now when business falls off and there is a decrease in national income that results in a decrease in national governmental revenues, since the same tax rates would yield less, do you think you can reduce expenditures rapidly enough to keep the budget in balance?

Mr. GREDE. Well, I do not think that you can in every year catch up with a rapid change in the situation. But as the Government projects its budget it should certainly to the best of its ability make the budget balance.

Senator DOUGLAS. Even in depression periods?

Mr. GREDE. Even in depression periods.

Senator DOUGLAS. Then that would mean the Government should spend less and should reduce its expenditures, in periods of depression. Its revenues will naturally shrink in periods of depression. Therefore it should reduce its expenditures or raise taxes. It must do one or the other.

Mr. GREDE. I think the Government must reduce its expenditures as its income reduces.

Senator DOUGLAS. Then that would mean in the present situation we would reduce the military expenditures in a period of depression.

You see, the military expenditures, as you probably know, for the armed services, are about 15 billion dollars, to which should be added 1.5 billion dollars for the rearmament of Europe, and 1 billion dollars for atomic energy; so we roughly have 71.5 billion dollars as a direct outlay for military expenses, or 40 percent of the present Federal budget for those services; roughly.

Then we have 5.5 billion dollars economic aid to Europe, and for the occupation costs of Germany and Japan. So we come to a total of around 23 billion dollars for military and economic preparation against future wars, or over half the Federal budget goes for these purposes.

Now you are saying if we have a depression we should contract expenditures. The biggest source of expenditures are these direct military and economic expenditures against a possibility of war. And I am trying to find out if what you are recommending is that we should cut on these items if we have a depression.

Mr. GREDE. Let me answer it this way: Of course, if there is a war or a threat of war, we are faced with an emergency.

Senator DOUGLAS. Yes. What we are proceeding on is not that there is war but that there is a cold war, and that if we relax our military preparations the Russians may move. Therefore, to deter the Russians from moving, we are carrying out a program of rather costly national defense, plus economic aid to the countries of western Europe.

And suppose we would have a depression, would you advocate cutting national defense and reducing aid to Europe?

Mr. GREDE. I would not advocate cutting national defense beyond what the leadership in our Government thinks a dangerous point.

Senator DOUGLAS. But you are giving advice to the leadership of Government that they should balance the budget in a period of depression. Suppose they accept it. Suppose we say this document is what we will go by, and the depression comes, and they say, "The NAM has submitted this statement, and in order to balance the budget we have to reduce expenditures; in order to reduce expenditures we have to cut the Army, Navy, and the Air Force, and stop economic aid to Europe."

Mr. GREDE. Let me answer that.

Senator DOUGLAS. Surely, go ahead.

Mr. GREDE. We think there is room for economy without any impairment of the military preparations in the present budget. Now when you talk about economic aid to Europe, I think certainly that the economic aid to Europe——

Senator DOUGLAS. In other words, you would not cut the 17.5 billion dollars devoted to military purposes. That is the 15.5 billion dollars or say 15 billion dollars, because the President has cut it back to about 15 billion dollars for the armed services, plus the billion and a half for military aid to the western Allies, plus a billion on atomic energy, which is really a military expenditure at present. So you have roughly 17.5 billion dollars for all those purely military purposes. I am trying to find out what section you would contract were we to be sufficiently unfortunate as to have a depression.

Mr. GREDE. Well, in the specific budget we have recommended for 1951——

Senator DOUGLAS. Is that in this booklet, Why Deficit Spending?

Mr. GREDE. Yes. Just after the preamble, right before page 1, there is a proposed Federal budget for 1951.

Senator DOUGLAS. You say that your budget proposal would amply provide for defense expenditures, veterans' care, foreign commitments, and so forth, but I would like to see the items.

Now $17,500,000,000 as I say, are the present expenditures. Veterans' care amounts to $6,000,000,000, making $23,500,000,000 foreign commitments at the present rate $5,500,000,000; that makes $29,000,000,000, plus 5½ billion dollars for interest on the public debt. I do not know where you would make your economies. That is the point.

Mr. GREDE. Now, I would like to ask Dr. Lutz, who has worked with this tax-spending committee, to comment on the exact details of this budget.

Senator DOUGLAS. Mr. Lutz.

Mr. LUTZ. Mr. Chairman, if I could go back a moment to what you quoted from the report of the economists who met at Princeton?

Senator DOUGLAS. Surely.

Mr. LUTZ. I think they are basing their argument on the present size and style of Federal budget. And as long as we are going to spend at the rate of $43,000,000,000 to $45,000,000,000 a year, it is perfectly obvious there is not anything like as much room for flexibility or adjustment as there would be in a considerably reduced budget of the sort that we are talking about.

Senator DOUGLAS. I am with you in wanting to reduce the Federal budget. But I have very, very serious doubts you can cut it by $10,000,000,000 as you suggest. My efforts are more modest—$4,400,000,000. If we could get the budget down to $39,000,000,000, I would be very happy.

Mr. LUTZ. I would too.

Senator DOUGLAS. And I am startled by this figure of $33,600,000,000 because I just do not see how you can make it.

Mr. LUTZ. Let me explain to you that is not a prediction. This is merely a statement of what the job could be done for.

Senator DOUGLAS. I doubt whether we could do it for $33,600,000,000. I would not only be happy if we came down to $39,000,000,000. But I would feel that the Congress and the administration had done just about all that could be done—possibly a little more.

I do not quite see how you can get this $33,600,000,000 in view of the military costs, in view of the economic commitments, in view of veterans' benefits. And mind you, if we have a depression, veterans will be in greater need and will make greater application for care.

Mr. LUTZ. Well, a brief explanation is provided in the text which follows the table in our booklet, Why Deficit Spending? If you wish, I will be glad to make some brief comments on various items in this over-all table here, assuming that that would be any advantage or enlightenment.

Senator DOUGLAS. Yes; I will be very glad to have you.

Mr. LUTZ. Well, these recommended figures were compiled after reading the reports of the Appropriation Committees for this year, and reading a good deal of the testimony built up in the hearings before the various Subcommittees on Appropriations.

And if we begin with veterans' care, the first point that was developed in a great deal of the testimony submitted last spring to the Appropriations Committees was to the effect that the load for readjustment benefits was going to taper off very substantially.

Senator DOUGLAS. As a matter of fact, it has increased.

Mr. LUTZ. That may be true today, but the Veterans' Administration people who testified last spring told a different story. As a matter of fact, Mr. Chairman, they never tell the same story twice.

Senator DOUGLAS. As a matter of fact, as a result of the recession, apparently a much larger number of veterans went back to school, so that the claims by the veterans actually increased instead of diminishing. I am sure that is correct.

Mr. LUTZ. About all we could go by in compiling this projection was the record made by the Veterans' Administration themselves.

Senator DOUGLAS. I think you ought to season it with other material.

Mr. LUTZ. All right. I do not know where you can go for other material to season the story on veterans' benefits except from the testimony of the Veterans' Administration people themselves.

At any rate that $4,500,000,000 is projected on the assumption that the readjustment benefits will very substantially decline by the fiscal year 1951. They are now; this is for fiscal 1950.

Senator DOUGLAS. And the table is for fiscal 1951?

Mr. LUTZ. We are talking about fiscal 1951, at which time a great many of them will have exhausted their privileges of going to college and will have exhausted their "52–20" privileges. And of course we had to assume further that there would be no congressional action to extend those arrangements so as to give them a longer lease of life on unemployment or educational benefits and so on.

The next item is "Interest," and it is explained in the footnote. It is broken down by a percentage distribution between the interest on the war debt and nonwar debt interest.

And we were able to utilize the President's latest estimate—well, that does not enter in 1951. It was for this current year—that there would be a nonrecurring increase of $200,000,000 because of the change of bookkeeping. But that does not carry into 1951.

We are assuming there that the present figure of about $5,500,000,000 would still be the total. The remainder of that is included in that item of "Civil functions" under the "Framework of government" as the cost of the civil or nonwar part of the debt.

Now with respect to the Military Establishment, which is lumped together there for the Army, Navy, and Air Force, the procedure was this: I took the 1950 appropriations, deducted the contract authorizations to the Navy and the Air Force—as I recall the Army had no contract authorizations in 1950. I then applied a 10-percent reduction, having in mind that the Congress itself had debated but at the last moment did not succeed in adopting either a 5-percent directive or a 10-percent directive to the administration on the reduction of appropriation bills. But assuming that in view of all that has been said about the possibilities of economy, both by the Hoover Commission and by Secretary of Defense Johnson, I assume that it would be reasonable to anticipate a 10-percent shrinkage there without any impairment in the Military Establishment.

Then after putting back the contract authorization, we get the over-all figure there of about $11,500,000,000.

Atomic Energy Commission had a total appropriation of $702,000,000 for 1950.

Senator DOUGLAS. Plus some contract authorizations, too.

Mr. LUTZ. Contract authorizations, to be sure. And in that $700,000,000 was $300,000,000 or more for liquidation of previous contracts.

Their testimony—well, in the first place you may recall the Appropriations Committee said their showing was very unsatisfactory. They do not produce enough evidence for anybody to know what the story is on what they are doing. But a good deal of what they are proposing to spend this year was for the completion of what I would call civil works—town sites, housing, street sewers, and other accommodations for the populations at their centers of operation.

And there was every indication that I could gather that that part of their expenditure was drawing to a close. At any rate, it does not seem reasonable that they should continue for an indefinite period of time to build more houses and provide more municipal facilities of every sort for their population. Sooner or later they must bring that to a close. They will reach a maximum there that will not be justified any longer.

So the $600,000,000 for 1951 represented what seemed to me a reasonable projection for the Commission—reasonable unless they are by some emergency required to go all out in doubling their output of atomic bombs, or something of that sort.

The stock-piling figure is merely a rounding off of the 1950 appropriation. We get different stories on the goal there.

For a long time it was said to be $3,000,000,000 over a 5-year period, which my figure would come pretty close to fitting into.

Now it is said to have been raised closer to $4,000,000,000. I do not know what the story is there, but I do remember that Senator Thomas made some statements to the effect that $100,000,000 was all they needed to spend in a year. He did not get very much acceptance of that idea, but at any rate, you do have two extreme points of view there.

For ECA and related purposes I proceeded on the assumption that when we say it is going to be terminated in 1952, we mean it, and unless we are going to let Mr. Hoffman off from what he said in his statement to the Senate committee, that he wanted what he was asking for this year but next year he was not going to ask for anything like as much—obviously, if we are going to chop it off in 1 year beyond 1951, we have to begin to whittle it to the vanishing point somewhere.

Army occupation costs at $500,000,000 may be high. This was done about the time that the West German Government was first established and the first elections were held there. I am just a little doubtful about how much longer we can justify keeping any sort of a military force in a country which has a government which is supposed to run its own affairs.

Senator DOUGLAS. You think the preponderance of opinion is for withdrawing the Army from Germany?

Mr. LUTZ. Yes; it seems the more responsibility and authority we delegate to the German Government itself——

Senator DOUGLAS. What about the danger that the Russians might move in if that were to happen?

Mr. LUTZ. In the first place, I do not think they will; and in the second place, $500,000,000 would not stop them.

Senator DOUGLAS. It is not that the American troops in Germany would be able to defeat the Russian Army, but that the presence of the American troops in Germany deters Russia from attacking, because Russia knows if she were to attack the troops we have there, it would involve us in war and the defense of our troops. They are, therefore, merely the shield, so to speak, for the Nation as a whole.

Mr. LUTZ. That raises a very interesting question: How many troops do we need to keep in Germany in order to create the situation that if the Russians come and fire on even one company of American soldiers it involves us in war, instead of spending a billion dollars to keep enough troops there so that we have a bigger reason for war?

Senator DOUGLAS. What about the case of Japan? Would you withdraw from Japan?

Mr. LUTZ. Japan is probably a somewhat different situation. I am not qualified in any sense to talk about the intricacies of General MacArthur's program or its bearing in this whole picture. We might include Southern Korea there, as a matter of fact, also, but at any rate——

Senator DOUGLAS. I notice that you are proposing to discontinue the appropriations under the North Atlantic Arms Pact.

Mr. LUTZ. Senator, the figure we show there for 1950 is only the cash part of it. We have a tabulation later on in which we have put down all of the contract authorizations.

Senator DOUGLAS. It comes to roughly $1,300,000,000.

Mr. LUTZ. Yes.

Senator DOUGLAS. Plus the amount for Greece and Turkey, a total of $1,500,000,000, but I notice there is no corresponding item in your list for 1951.

Mr. LUTZ. I have not seen any statement myself, although there may have been some made, to the effect that this was anything but a one-shot operation. Now, if it is an indefinite undertaking, if it is going to run on for years and years, then I will agree there should have been something shown for 1951; but I have seen nothing to the effect that we were ever going to do anything more than this one-shot job of it.

Senator FLANDERS. May I remark, Mr. Chairman, that most of these things of this sort have been one-shot operations.

Mr. LUTZ. A foot-in-the-door operation, Senator.

Senator FLANDERS. Of all the things we have done in connection with bolstering up Europe, that was not a one-shot operation and never advertised as such, that was the Marshall plan.

Mr. LUTZ. I understand that, and it is a 4-year proposition.

Senator FLANDERS. Everything else was advertised as one shot to cure the patient.

Senator DOUGLAS. I do not want to get into a discussion on the North Atlantic Pact with my good friend here, but let me say I think virtually everyone who voted in favor of the pact understood we were not going to reequip the European armies with $1,300,000,000, and there would probably be a continuing charge in the interest of national security. To the degree that it is, your figure would have to be raised; is that right?

Mr. LUTZ. That is true to the degree that we have failed to take account of it; and, as Senator Flanders so well said, we had to go merely by the advertised intentions without trying to read somebodys' mind.

Senator DOUGLAS. Wait a minute; I must protest. I do not think it was ever stated that this was going to be a one-appropriation matter and no more. It was merely said that that was all that the administration was asking for this year, and it was for future Congresses to decide what they would do later; but I have always felt that once you start this business you cannot pull out.

Mr. WOLCOTT. You mean we are going to have this forever?

Senator DOUGLAS. I do not say forever, but I say a budget for 1951 which puts zero dollars for this purpose is not particularly realistic so far as that item is concerned.

Senator FLANDERS. I think your record is clear on that, Senator, and that you will not have to take back your words.

Senator DOUGLAS. I do not think anyone else will, either. I did not read all the testimony with minute care, but I never found any statement that there were to be no further requests. Quite the contrary. The general implication was that this was the beginning.

Mr. WOLCOTT. Is it intended to stop when the threat of Communist expansion geographically stops?

Senator DOUGLAS. Was it the intention to stop it?

Mr. WOLCOTT. Yes.

Senator DOUGLAS. It was the intention to equip the armies of western Europe so that, if the Russians did attack, they would be in a better military position to resist and, being in a position to resist, would have a greater will to resist.

Mr. WOLCOTT. I understand that, but I am talking about the other terminal point. What was the intention in respect to cutting it off? Is it when the danger of communism has become so little that we do not think we have to protect ourserves against it?

Senator DOUGLAS. As an experienced practitioner of public affairs, you know that you cannot legislate for the indefinite future.

Senator FLANDERS. That was stated by one of the witnesses this morning.

Senator DOUGLAS. Yes, sir.

Mr. WOLCOTT. That runs right along with our expenditures in the Military Establishment, because I dare say that a large percentage of the defense expenditures now are predicated upon the threat of expansion of communism or Russian aggression in the world. So could the same thing not be said in respect to the maintenance or expansion of our Military Establishment? Then, as the threat of communism lessens, the expenditures we would be called upon for both the Military Establishment and the Atlantic Pact would decrease almost proportionately.

Senator DOUGLAS. I quite agree, and it would be not only a tremendous emotional relief but a tremendous economic relief to the Nation if that fear could disappear; but I do not want to have us proceed on the ground that the danger is nonexistent and exercise the fear if the danger is there. We have to face realities.

Mr. LUTZ. Shall I proceed?

Senator DOUGLAS. Yes.

Mr. LUTZ. The grouping of the nonmilitary functions into those main categories called civil functions shows a total of appropriated funds for 1950 of 7.9. I have not in this document given the details by which the $6,740,000,000 was arrived at, but it represents, roughly, something like a 10-percent or a little more across-the-board reduction. Again my justification for that approach was in the futile attempt made in the Congress to adjust the 1950 appropriations by some such across-the-board action.

Senator DOUGLAS. I am a little bit surprised that you give the total appropriation for fiscal 1949–50 as $40,500,000,000. The Office of the President, I believe, announced that the appropriations by the Congress amounted to 43.5 billions.

Mr. LUTZ. That is right. And over on page 5 there is a reconciliation between the totals in the regular appropriation acts and the other items which appeared in the President's October review of the budget, by which we get the 43.5—the table in the right-hand column.

Senator DOUGLAS. Are you cutting the budget by seven billion from 40.5 or from 43.5? If you are cutting it by seven billion, then you are not cutting it to 33.5; you are cutting it to 36.5.

Mr. LUTZ. I am cutting it to 33.5 or 6. I am talking about expenditures in that——

Senator DOUGLAS. You say deficiency appropriations should not be allowed to continue for fiscal 1951.

Mr. LUTZ. I think one of the sources of our trouble is the misuse, and I will even go so far as to say abuse, of deficiency appropriations. I think another source of our trouble is what I regard as the misuse of the contract authorizations.

On page 4 look at the record. This comes from the October review also. In 1949 actual cash to liquidate previous contract authorizations was 1 billion 2, but in 1949 you gave new authorizations of 2 billion 2. Now, in 1950 according to the October estimate you had to appropriate $3 billion to liquidate prior contract authorizations of 1949 and previous years and at the same time authorize 4.9 billion dollars, which is a fourfold increase from the cash to liquidate in 1949. That is a snowballing operation that can ruin your fiscal soundness if you do not stop it.

The deficiency situation is just as bad. I do not think there is any large amount of excuse for it all. Granted there are occasional instances in which the appropriations have not been sufficient; but I think, after you have authorized a certain sum for an agency, it is up to the President and the Budget Bureau to require them to distribute their expenditures for those operations over the year so that they live within the money appropriated instead of coming in in the spring of the next year for another appropriation.

Mr. WOLCOTT. May I comment there. First, how does this work out in percentages?

Mr. LUTZ. I did not understand your question.

Mr. WOLCOTT. What is that percentage cut? I could figure it out with arithmetic, but I cannot resist the opportunity to call attention to the fact that the House cut the budget estimate a little over 18 percent, and the Senate somewhat less than that.

Mr. LUTZ. At the bottom of page 5 you will find the comparison.

Mr. WOLCOTT. I was wondering what percentage you were recommending that it be cut now.

Mr. LUTZ. You say you cut 18 percent. I do not know how ours would figure out.

Mr. WOLCOTT. Around 30 percent.

Mr. LUTZ. Yes.

Senator DOUGLAS. The general cut from the appropriations is $7,000,000,000, which comes to around 17½ percent.

Mr. LUTZ. And on the basis of——

Mr. WOLCOTT. That is not much over the cut the House actually made last year. According to my figures here, the House did actually cut about 18 percent off budget estimates last year.

Mr. LUTZ. You mean by that we are not so unrealistic as it would appear?

Mr. WOLCOTT. I do not think you are much more unrealistic than the House was last year.

Mr. LUTZ. On the Housing Act of 1949 you gentlemen of the Congress will recall there was an optional amount on advice of the Council of Economic Advisers that could be dropped in any given year that they thought would be most helpful. I could not say at this time whether it would be the present fiscal year or the next one or the year after that, but whenever they bring in those recommendations. I think they would total in the neighborhood of $400,000,000.

Senator FLANDERS. There is also the reverse to that in that maximum allowable should not be expended in times when labor and materials were short.

Mr. LUTZ. Yes. As I recall, my $237,000,000 there represents a compilation of the maxima in all of those various grants and advances, and so on; and you are quite right that conceivably it would not run to that much.

Finally, on the Government corporations it is a pure guess. I do not know. It might be another billion dollars. It depends altogether on the farm price and on various other things, and the President pulled one on us that we had no idea of in throwing in another billion dollars in his October review for RFC mortgage purchases.

If that figure holds, then we have got to allow for that.

Senator FLANDERS. May I ask whether you make any distinction in your thinking between a thing that is as close to a business investment as RFC mortgages on the one hand and some of the so-called investments which do not carry with them a definite return as do the RFC purchases of mortgages?

Mr. LUTZ. You are asking me now to get off on this proposed double budget, the capital budget versus current budget.

Senator FLANDERS. I threw the switch; you do not have to pull the plug.

Mr. LUTZ. I have no use for it. I think it would become the device for all sorts of financial skullduggery if ever you in the Congress accept the device which was used in many European countries and has been shown there as to be the means of befuddling and beclouding and completely concealing a lot of stuff which they did not want brought too far into the open; and, with all due regard to the present gentlemen who must make up the budgets and vote on them, I think the same temptation is very likely to be present here.

As the chairman said this morning, what is the function of temptation? Is it to strengthen character or do something else? I would hate to see their characters molded by exposing them to this much additional temptation.

Senator DOUGLAS. Mr. Grede, I started to question you on fiscal policy and then we got off on a discussion of the present budget. I am not sure who threw the switch on me.

Mr. WOLCOTT. I think I did, and I apologize.

Senator DOUGLAS. In any event, I found myself down a sidetrack and off the main line.

I want to come back and ask you: Suppose you did get the budget down to whatever figure you think is proper and then we were to have a depression and revenues went way down. What would you do?

Mr. GREDE. Well, we are starting out here with a peacetime budget in which you now have a deficit, and I think I would have to be realistic about a situation in which a sudden emergency develops, in which an unexpected depression develops, in which income drastically declines. I am concerned that we would have some deficit in such a year.

Senator DOUGLAS. So that your phrase, "You should never have a deficit," becomes, "Well, you should hardly ever have a deficit," or as in the words of Gilbert and Sullivan, "What? Never?" "Well, hardly ever."

Mr. GREDE. That might be an amendment, but my point is here we are in a rather active peacetime year, budgeting a deficit. Now, how are we ever going to meet the emergency of a depression?

Senator DOUGLAS. Now, I am quite in agreement with you on the need of reducing expenditures to get an approximate budget balance for a year of at least moderate prosperity, which 1950–51 at present seems probable to be. But I am now going beyond that point to raise the query: Suppose we get the budget down to the level that we accept in view of the military danger and other needs of the people, and so forth, but you get a depression and then revenues fall off, and what you say is that for the first year you will inevitably have a deficit because of the time lag, so to speak. But then what about the next year? Suppose the depression continues. Would you reduce expenditures the second year of the depression or increase taxes or both?

Mr. GREDE. Well, I think that you may have to do some of both. I think that, of course, if you have an emergency, if you have a war threat where the military expenditures must be maintained——

Senator DOUGLAS. I am not speaking of a war. That is a situation, the external so far as war is concerned does not alter from where it is now, let us say.

Mr. GREDE. But you are concerned about a threat. You are concerned about maintaining the national defense at a certain level; and, of course, your desire to maintain it at that level is for defense. In other words, for a war or threat of war and as an emergency arises I can appreciate that we must maintain our defenses.

Senator DOUGLAS. You would say, do not cut military expenditures. That would mean that the sole cut would fall on the 23 or 24 percent of the budget used for welfare purposes at the very time when unemployment is increasing and the welfare needs of the people are greater than before.

Now, is that where I think your position leads you to?

Mr. GREDE. I do not think so, Senator. In the first place, I did not say, do not cut military expenditures. I think all Government expenditures should be reviewed.

Senator DOUGLAS. Let us say we have been able to cut the budget down to the point where all the waste is out, and let us say we brought it into balance then. We have done our housekeeping. After we have done that, a depression breaks out and Government revenues fall and you say, "Well, it is probably true that revenues will fall initially more rapidly than we can reduce expenditures, so there is a deficit." You say that we will accept that as a temporary evil. My next question is, What about the second year if the depression continues? What would you do then?

Mr. GREDE. I think that the difficulty we had in the past——

Senator DOUGLAS. I am talking about the future. Go ahead.

Mr. GREDE. I think that we must realistically face the future and realize that we cannot spend more money than we have.

Senator DOUGLAS. Even in a depression year? That is, we cannot create additional monetary purchasing power in a depression or should not?

Mr. GREDE. If we were budgeting—the budget should provide at least some surplus for debt retirement—if we were engaged in peacetime budgeting with some surplus for retirement and if we got our Federal debt to a reasonable limit——

Senator DOUGLAS. What is that? What is a reasonable limit of the Federal debt?

Mr. GREDE. I am not prepared to say just what is a reasonable limit.

Senator DOUGLAS. How much have you got to reduce it?

Mr. GREDE. We must reduce the debt.

Senator DOUGLAS. How much? Now, you plan expenditures of $34,000,000,000 a year, and at what rate should we be reducing it? As you well know, this is a huge debt we have got on our hands.

Mr. GREDE. I would think that in a year such as we are now experiencing, for instance in this 1951 budget, while there is no provision in this budget for debt reduction, I would think there ought to be some debt reduction in a budget for 1951.

Senator DOUGLAS. $2,500,000,000, 1 percent of the debt?

Mr. GREDE. I would think yes.

Senator DOUGLAS. So this rises now to $36,000,000,000 with debt reduction included, if that is included as an item of expenditure.

Senator FLANDERS. Mr. Chairman, I think you asked Mr. Grede two questions. One was whether he would increase expenditures, decrease expenditures, or what he would do about expenditures; and the other was would he raise taxes. I would like to hear the answer to that second question, as to whether you would raise taxes in a period of depression.

Mr. GREDE. I would think that would be related to the tax level at the moment. We are talking about raising them from a certain point. I think the taxes now are very dangerously high in comparison with our gross national product.

Senator DOUGLAS. If you provide a $2,500,000,000 debt reduction, it seems to me that these current expenditures, which even you propose, would require approximately the same level of taxes as now.

Senator FLANDERS. I would think so.

Senator DOUGLAS. Approximately the same level as now. So that if we were then to go into a depression, what would you say? Raise them still more in order to balance the budget?

Mr. GREDE. I think we have to face the situation in relation to what the economy will stand, and if the situation calls for increased taxes in a depression in order to maintain necessary expenditures, I would think we ought to raise taxes. I think we should pay our bills pretty much as we go along.

Now, I am realistic enough to realize that there is some difficulty in a year-to-year balanced budget because of the time lag and unpredictable situations, but I think that we as a Nation must realize that we cannot go on forever adding to our debt.

Senator DOUGLAS. I quite agree with you on that. I do not want to have us add to our debt in a period of prosperity nor in periods which only depart to some slight degree from so-called normal. But you go much further than that. You say in a period of depression you should not add to the debt appreciably.

Mr. GREDE. In a period of depression, if you had some allowance in your budget for debt reduction, you might waive that. You would have to face your expenditures in relation to what the economy will stand.

Senator FLANDERS. Mr. Chairman, I would like to ask the witness whether he feels that raising taxes during a period of depression would have any effect whatever either in deepening or in decreasing the depression.

Mr. GREDE. It would depend a great deal on where the tax level was when you started.

Senator FLANDERS. Where would you put it so it would have no impact on the depression? Where would you put the increased taxes? On what part of the economy would you place the taxes, an increase in taxes during a depression?

Mr. GREDE. I think that question also would be related a little bit to what the tax structure was at the moment. I think that the tax analysis should be on the basis that will produce the revenue.

Senator FLANDERS. Would you feel that increasing personal taxation would help get out of a depression?

Mr. GREDE. That again would depend on where the level of personal taxation was at the time or the point from which you are going to increase it. I think if we are in a depression, and the personal taxation level will stand an increase in relation to what it is at the moment, it should be increased.

Senator DOUGLAS. Mr. Grede, I have to break in. Aren't you proposing this: That at a time when business and people are less able to pay taxes that you will make them pay more taxes, a larger proportion of their income?

Senator FLANDERS. That is the question.

Senator DOUGLAS. I think that is what you are saying.

Mr. GREDE. That is if the entire increase in tax comes from personal income taxes.

Senator FLANDERS. Or from business.

Mr. GREDE. Or from business income taxes, that is correct. I think the entire tax structure at the moment would require some study to see where the tax should be collected with the least effect on the economy, but I must reiterate that it seems to me we must reach the point where we face the necessity for keeping our expenditures and adjusting our taxes to the point where we do not continually add to our deficit.

Senator FLANDERS. We are all agreed.

Senator DOUGLAS. We are agreed, but our problem is a depression that we are putting up to you.

Mr. LUTZ. Could I interject a further thought?

Senator DOUGLAS. Surely.

Mr. LUTZ. I think most people have been conditioned by the type of Federal tax structure that we have had for so long to the conclusion that you have just been expressing. I would answer Senator Flanders by saying, first of all, while there is yet time it would be an excellent step to redistribute the balance of your taxation and put more of it on the type of tax that is most nearly resistant, most fully resistant to depression conditions.

Senator DOUGLAS. What is that?

Mr. LUTZ. Consumption taxes.

Senator DOUGLAS. Sales taxes?

Mr. LUTZ. Excise taxes, whatever you call them.

Senator DOUGLAS. Which fall more heavily on the poor than upon the well-to-do.

Mr. LUTZ. Not necessarily.

Senator DOUGLAS. In the first place, they are allegedly proportional; and in the second place, you do away with the principle of progression.

Mr. LUTZ. That, I think, would be a consummation most devoutly to be wished.

Senator DOUGLAS. And in the second place, I think you will find they are actually regressive, because expenditures for services generally are not taxed; savings are not taxed; rentals generally are not taxed; so that a 3 percent sales tax will take a larger proportion of the income of the poor than of the well-to-do.

That hits them harder now than at the period when they are suffering from unemployment.

Mr. LUTZ. If they are unemployed and have no income, they cannot pay excise taxes.

Senator DOUGLAS. You mean since they will not have bread, let them eat cake?

Mr. LUTZ. All right. But it is still true they would not have a tax to pay if they did not have a job.

Senator DOUGLAS. Or income tax either.

Mr. LUTZ. Or income tax. But the fact is that when we are getting 75 percent of the total Federal revenues from income taxes and with the known instability of the income tax——

Senator DOUGLAS. Mr. Lutz, you are a distinguished economist. All taxes come out of income.

Mr. LUTZ. All taxes come out of income, of course, but when you consider the record, I think you will find that tax is based directly upon incomes, particularly the type and size of income consisting largely of profits, and you as a distinguished economist——

Senator DOUGLAS. We are bandying compliments back and forth.

Mr. LUTZ. Will admit that profits are the most volatile element in the whole economy. They go up fastest when business is good and they melt away fastest when business recedes. So that I don't care what our ethical views on the subject are, the fact is that when you are relying to the extent of 75 percent of your Federal revenues on individual and corporate income taxes, you have there a possibility of serious instability in the face of a recession.

I think we ought to have a higher proportion of our Federal revenues from a type of tax that will not expand as rapidly in good times or will not melt away as rapidly in bad times, and that is a tax based on the use of income rather than on its acquisition. I do not care what you call it.

Senator FLANDERS. Are you saying this in somewhat different words—that we should tax more heavily the expenses people have to make because they have to live? Is that what you are saying?

Mr. LUTZ. I am not saying that at all.

Senator DOUGLAS. I think he is.

Senator FLANDERS. It seems to me he is.

Mr. LUTZ. Well, the last thing that people will do, and they will melt down their savings to do it, is to spend on various sorts of consumption, and that does not simply mean food and necessities. It means means liquor and tobacco and mink coats, and all of the other things that enter into the enormous pattern of consumption.

Senator DOUGLAS. The fur industry has just been interviewing a number of Senators.

Mr. LUTZ. Yes.

Senator DOUGLAS. And they claim that a slight increase in the price of fur coats throws the demand for fur coats completely off, and that it is not one of these hard irreducible commodities that everyone has to have, but that it is highly volatile, too.

Mr. LUTZ. They are complaining about the 20-percent fur tax, but the fur auctions opened 20 percent higher this fall than last fall.

But let me proceed. I was reading a couple of days ago a report of the Ways and Means Committee in connection with the revenue bill of 1943, and they pointed out even then that our proportion of Federal revenue from excise taxes was very low. I think they said only about 18 percent. They cited Canada with a much higher percentage. They cited Great Britain with something like 43 percent of total national revenues from indirect taxes.

Now, it is a fact—you asked about what you can do in a depression—it is a fact that in the early 1930's the British did increase their taxes as they went into a slump, not as intense and serious as ours, because they had had some difficulties in the 1920's that started them on the downward path, but, at any rate, they had a very definite recession, if you would not call it a depression.

They did increase their taxes, and over that whole period from 1930 to 1937 their total deficits were of the magnitude of 70 or 80 million pounds, as I recall it, for the whole period in which we were engaging in deficits very much larger than that. But even our revenue situation would not have been as bad in the earlier 1930's and we should not have been as far short of meeting the necessary expenditures if we had had a better distribution between depression-resistant taxes and the kind of taxes that are highly——

Senator DOUGLAS. What you favor is a reduction in personal income and corporate taxes and the imposition of consumption taxes?

Mr. LUTZ. I am saying I think our Federal finances would be in much better condition to go into a depression without the danger of heavy deficits if we had a better balance between consumption and income taxes. In Canada at the present time the relation is pretty close to 50–50.

Senator DOUGLAS. What are you going to do about the unemployed?

Mr. LUTZ. Now, you raise a question there that will get us off on another sidetrack if we do not watch out.

Senator DOUGLAS. Thus far it is I who have been detoured and not you.

Mr. LUTZ. Well, I cannot talk about the amount of unemployment in a depression unless we can get into it the whole question of the wage structure. You are bound to have a great many more people unemployed and unemployed much sooner as long as you have got the rigidities in your wage structure.

Senator DOUGLAS. You would say the remedy for unemployment is a wage cut?

Mr. LUTZ. I think that is one remedy because, if prices come down and profits begin to melt and you cannot get anybody to work except at $6 an hour, he is going to be unemployed if you cannot afford to hire him at $6 an hour.

Senator DOUGLAS. Does that not diminish the demand of business for bank loans and, therefore, decrease the money demand for goods by the same amount by which it is decreasing costs, so that there is no net expansive effect?

Mr. LUTZ. I do not know what would reduce the demand for bank loans more quickly than to turn off all your employees and stop production; and, if you have to do that because you cannot sell your goods for enough to pay the present rigid wage rates, you are in the soup one way or the other.

Mr. GREDE. Senator, related to your question about what to do when we have a depression and this discussion of an excise tax, I think it crystallizes my thinking a little bit to this point: That the reason I hesitate to recommend that there be definitely an increase in the tax rate, income-tax rate, in a depression and its effect on the economy is related to this thing that Dr. Lutz has been talking about.

If in a depression we run into some deficits where the Government's revenue must be increased, where the rate of taxes somewhere along the line must be increased to meet the revenue requirements, I think a study of the whole tax structure must be made. I think the bills ought to be paid.

Now, then, if the effect of an increased income tax would actually seriously adversely affect the economy, then certainly an excise tax such as Dr. Lutz is talking about might be applied without that adverse effect on the economy.

Senator DOUGLAS. That would directly draw down the consumption of people. They would be able to consume a smaller quantity of food, clothing, and incidentals because they would be paying taxes and, therefore, the actual demand for goods would be reduced.

Mr. LUTZ. No.

Mr. GREDE. Not necessarily, and maybe not as much as if the income tax were increased.

I am not a tax expert, but that is a matter that would have to be studied. My concern is, however, that the tax structure be so developed that we can pay the bills.

Senator DOUGLAS. But suppose you had a tax structure which conformed to your theory and which had a lot of excise taxes in it, and was primarily based on consumption taxes, and then you have a depression and receipts fall off more rapidly than expenditures. As I understand it, you would say to increase taxes.

If you increased the excise taxes, would that not have an adverse effect on business because it would diminish the amount which people had available to spend?

Mr. LUTZ. No.

Mr. GREDE. I have some concern——

Senator DOUGLAS. Have you found the secret of the philosopers' stone, that you can take away from people and yet they will have the same amount that they had?

Mr. LUTZ Senator, we are off on another sidetrack, I am afraid.

Senator DOUGLAS. No; I think I am on the beam this time.

Mr. LUTZ. Let us test it.

Mr. WOLCOTT. May I ask a question here?

Senator DOUGLAS. I had better look out for some fast footwork coming in from the side.

Mr. WOLCOTT. I just want to know for my own information as to whether they are including tariffs as excise taxes.

Mr. LUTZ. That is a somewhat academic question. The tariff is a political matter, not an economic one primarily at all.

Mr. WOLCOTT. I mean in the category of excise taxes.

Mr. LUTZ. Yes; it is in the general category of excise taxes.

Senator DOUGLAS. You would include increased tariffs?

Mr. WOLCOTT. It might be the proper thing to do.

Mr. LUTZ. No; I am not doing that. Let me come back, if I may, to your beam?

Senator DOUGLAS. You do not favor increasing tariffs?

I want to make clear that discrepancy between you and the Congressman on this point, and I want to clinch that before it is lost sight of. You are not in favor of an increase in tariffs?

Mr. LUTZ. No; I would reduce tariffs pretty generally, if I could.

Senator DOUGLAS. Shake hands.

Mr. WOLCOTT. Just a minute now. I have to get my 2 cents in. If the depression here in the United States was brought on primarily or greatly influenced by a dumping of foreign goods into the American market, resulting in unemployment and a reduction in national income——

Senator DOUGLAS. When was this?

Mr. WOLCOTT. I said, if a depression is brought on by dumping of foreign goods into the American market, then you would not be averse to raising the excises to prevent that and protect the American workingman's income, and at the same time the income of the United States, would you?

Senator DOUGLAS. I think it would be proper to ask my esteemed colleague: When has a depression been brought on by a dumping of goods into the American market?

Mr. WOLCOTT. Well, now, wait a minute. The New England States are today enjoying, if I may use the term, a minor depression.

Mr. LUTZ. One watch company is in trouble, and all the others are doing all right.

Mr. WOLCOTT. The same is true in textiles and leather as well as in watches. It is spotty all over the United States. My own home town was affected to the extent that about 3 months ago it was put on the critical list. Fortunately, it has been taken off because of the upturn, but I do not think that you can argue successfully to any New Englander that there is not a direct affiliation between some of the depressions which we have had and the excessively large import of foreign goods, and you and I both have New England backgrounds, Mr. Chairman.

Senator DOUGLAS. I should not answer the question for the witness.

Mr. LUTZ. I was going to say, Senator, that if foreign countries had attained a level of economic recovery which enabled them to dump—and I use the word "dump" advisedly—large quantities of their product into the United States, we should at once get rid of the Marshall plan, and we could get rid of all foreign aid and everything else. At least, we would save out of our budget a good many billions of dollars that now have to go to help them get into a position where they can start dumping.

Mr. WOLCOTT. May I suggest in that particular that western Europe increased its production 100 percent in 1948 over 1947, and it is reasonable to presume that in 1949 they are going way up above a hundred percent on their production, so they have got to find markets for that increased production.

Senator DOUGLAS. You do not mean they doubled their output, do you?

Mr. WOLCOTT. They doubled their production in 1948 over 1947. It was forty-some-odd percent of normal in 1947; it was 87 percent of normal in 1948; and, because of the strides that they are making, it is reasonable to assume that they are going to produce more than normal in 1949. Of course, there is a backlog of demand, a big backlog; but there is going to come a time when, because of the encouragement which has been given to foreign production, they have got to find new markets the same as we have.

I am not arguing the tariff question, but I am putting in the "if," that if they are going to start dumping into a free market you would not hesitate to increase the excises incident to those imports, would you?

Mr. LUTZ. Dumping as such is not a particularly respectable form of foreign trade; and if you have got a genuine case of willfully intent expressed through what I understand the word "dumping" to mean, then I think probably you have a case.

Mr. WOLCOTT. Let's say an excessively large volume of imports incident to tremendously large production abroad.

Mr. LUTZ. As I say, when they get that prosperous, then we may have a different slant on it.

Mr. Chairman, before I forget it I am reminded that I should say for the record that in anything I have said about tariffs I am speaking individually and not for NAM.

Mr. GREDE. That goes for both of us. As you get us off on sidetracks and subjects NAM has not made a complete study of——

Senator DOUGLAS. This is a country of great diversity of opinion, and it is well that it should be so, but I have been struck by the difference between the budgetary position which you are taking and that which the Committee on Economic Development laid before us the other morning, because they advocated a program of what they termed built-in stability which during a period of depression without altering expenditures or tax rates, would result in a deficit, which they said in a period of depression exercised a stabilizing influence. They even went further and said that when unemployment rose above 5,000,000, or roughly 8⅓ percent of the nonagricultural working force, that they would favor additional extraordinary expenditures or tax reductions to lend further stability to the economy.

Now you are taking a diametrically opposite point of view, and yet the CED is composed of businessmen and you are composed of businessmen.

Mr. LUTZ. Some businessmen support both the CED and the NAM.

Senator DOUGLAS. That may protect the public record, but what does it do to Senators and Congressmen who in good faith are trying to find out what the policy should be when we get one organization advocating one policy and another organization advocating diametrically a different policy?

Mr. LUTZ. Did they go on to demonstrate as to how they would persuade the Congress to retire during the boom periods the debt which you have incurred by these extraordinary measures during the depression, or does it contemplate an indefinite expansion of the debt?

Senator DOUGLAS. I do not think it involves that.

Senator FLANDERS. Definitely it does not involve that.

Mr. LUTZ. I studied the CED thing, and that is one of the weak links in it I have not been able to convince myself on, because you have had a test of it this last year. We whittled the debt down to some $252,000,000,000; and, while 1949 was not quite as good a year as 1948, certainly it is one of our record-breaking years of big activity, and yet the Congress was not able to keep the spending down to a point where you could retire some more of the debt.

Senator FLANDERS. Lay that to the Congress and not CED. I think we have to take the responsibility for that.

Mr. LUTZ. That is my point.

Senator DOUGLAS. I personally do not assume any responsibility for that.

Senator FLANDERS. You did your best, and I almost did my best.

Mr. WOLCOTT. May we have sort of a gentleman's agreement that anything which has been said on the tariff question by either the witnesses or members of the committee does not necessarily reflect their political attitude.

Mr. GREDE. Again speaking for myself and not for NAM, this statement that I read is the result of a study by an NAM committee, but again relating to your question about what to do in a depression, I am so concerned that we realistically face the necessity for paying our bills. Now, the question of tariffs, as to whether to raise it as an excise tax, if you are going to have a cold war, let it be a tariff war or some other war, that is beside the revenue part of the tax question.

I believe that it depends upon what the Government's financial position is at the moment of the depression about which you inquire as to whether an increase in the deficit or an increase in taxes would have the most serious effect on the economy.

Now, they both will have an impact, and it is possible, in my conception, that at the moment an increase in the deficit might have a more serious effect on the economy than an increase in taxes. That is related to what the deficit is at the moment or what the debt is at the moment. It is related to what the taxes are at the moment. It seems to me that, if we realistically face the necessity in the depression year that you inquire about, we have to review the question in the light of the existing condition at the moment, and whether to increase the income taxes, the personal and corporation taxes, or whether to levy an excise tax or whether to make a deficit will be related at the moment to what impact that will have on the economy. But we must develop a philosophy that our bills have to be paid.

Senator DOUGLAS. What if it means that the people starve?

Mr. LUTZ. Nobody has starved yet.

Senator DOUGLAS. Oh, indeed.

Mr. GREDE. We never have let the people starve—never have and never will.

Senator DOUGLAS. That in the presence of unemployment will call for increased expenditures. You cannot take care of the unemployed and cut expenditures at the same time.

Mr. LUTZ. Can we come back to the main question there?

Senator DOUGLAS. I think this is essential.

Mr. LUTZ. This is on that point. We started it a while ago and then I think we got into one of our other detours.

Senator DOUGLAS. You mean the tariff? That was done artfully.

Mr. LUTZ. Mr. Chairman, the point I wanted to make is to remind you of the transfer nature of taxation. Suppose you did increase taxes in a depression. What will the Government do with the money? It will spend it. While it is true each individual taxpayer has to pay more and has personally less to spend, since we assume that the problem of the Government is to spend it, the over-all purchasing power in the community will not be affected.

Senator DOUGLAS. It is a transfer of purchasing power.

Mr. LUTZ. Yes; and if the taxpayer spends less, the Government spends more, and there is the same volume of demand for goods and services.

Senator DOUGLAS. But, Dr. Lutz, if you provide for the added expenses caused by the unemployed and whatnot through a bond issue financed through the creation of credit, you create additional monetary purchasing power, which is then put into increased personal incomes and which, therefore, buoys up demand and production.

Mr. LUTZ. Quite true. Yes; I would not question that, especially if you float your bonds through the banks. If you try to sell your bonds to the public, you have another transfer process, but a bank loan in a depression undoubtedly increases the total of purchasing power.

Senator DOUGLAS. And, therefore, increases the total demand and, therefore, increases the total of production and, therefore, increases the national income.

Mr. LUTZ. Wait a minute. It will not necessarily permanently increase the total production. To increase total production you have to have more capital investment.

Senator DOUGLAS. You can have fuller utilization of existing capital, a large part of which is idle because of unemployment.

Mr. LUTZ. You could have some temporary increase there, I will admit.

Now, if you have a sure-fire formula to prove that the debt issued in the depression years will be picked up in the good years, you have a much better case for deficit financing in lean years, but if you want to know what the other kind of story is, look at the history of the French franc. Before World War I, it was worth 20 cents. What is it worth now? It is hardly worth printing. Largely because they never did anything about the steady increase of their debt. They simply had to let the franc go.

Now, I am very strongly of the opinion personally that we will always find other good things to do with the surplus when you get one in good times than to pay off the debt, and I think while it is a good thing for the time being and it looks nice and we are taking care of people in need, we must do that—I will come to that in a minute—your ultimate danger is that the doller will go exactly as the French franc did. It will take it longer because we are bigger and stronger than France, but ultimately if you let the debt keep growing and never do anything about it, you are facing precisely what the French are up against today.

Senator FLANDERS. I wonder if Dr. Lutz is not saying that if under present conditions of high production and pretty nearly full employment, it is not full employment since we have a considerable number of unemployed, enough to give us a little worry. If we behave ourselves properly at this time, are you not saying that you would have less concern about deficit financing in hard times? Is that what you are saying?

Mr. LUTZ. That is right. If you could have given me a demonstration this year——

Senator FLANDERS. If that is what you are saying, I can agree with you 100 percent.

Mr. LUTZ. That is in effect what I am saying, that the evidence before us is that you will not do that in your boom periods, and this is pretty close to a boom period, and if we cannot and will not hold the spending within the revenues at a time like this, there is never any chance to catch up on this steadily increasing debt.

Mr. GREDE. And it is related to what the debt is when you engage in a deficit financing for the depression.

Senator DOUGLAS. Well, I have always felt that there was a moral obligation upon those who advocated deficit financing in a period of depression, of whom I have been one for 20 years, to similarly advocate the accumulation of a surplus in a period of prosperity and a retirement of at least a portion of the depression-incurred debt at that time.

It may well be that some of the advocates of deficit financing have not observed sufficient self-restraint in a period of substantially full employment. If that is so, I hope that there may be proper repentance, a changing of ways, and evidence of sound fiscal policy, so that if we were to be sufficiently unfortunate as to have a depression, we would not be inhibited by the policy now being advocated.

Do you have any more questions?

Senator FLANDERS. No.

Senator DOUGLAS. Mr. Wolcott?

Mr. WOLCOTT. No questions.

Senator DOUGLAS. I have no more questions. Thank you very much.

Mr. LUTZ. Thank you, sir.

(Whereupon, at 4:20 p. m., a recess was taken until 10 a. m., Friday, December 2, 1949.)

MONETARY, CREDIT, AND FISCAL POLICIES

FRIDAY, DECEMBER 2, 1949

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON MONETARY, CREDIT, AND FISCAL POLICIES,
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The subcommittee met, pursuant to adjournment, at 10 a. m., in the caucus room, Senate Office Building, Senator Paul H. Douglas (chairman of the subcommittee) presiding.

Present: Senators Douglas and Flanders, and Representative Wolcott.

Also present: Dr. Grover W. Ensley, acting staff director; and Dr. Lester V. Chandler, economist to the subcommittee.

Senator DOUGLAS. The committee will please come to order.

Mr. Snyder, we are glad you have come this morning and we are grateful for the reply which you made earlier in the autumn to our questionnaire. That reply and the others have been very helpful to us. We had thought that these replies would shorten the hearings and enable us to get down to more informal discussion more speedily. I understand that you, however, have a supplementary statement that you would like to read this morning.

Secretary SNYDER. Yes, Mr. Chairman.

Senator DOUGLAS. We will be very happy to have you do that.

Secretary SNYDER. Do I have permission to read the statement into the record?

Senator DOUGLAS. Yes, go right ahead.

STATEMENT OF HON. JOHN SNYDER, SECRETARY OF THE TREASURY; ACCOMPANIED BY WILLIAM McC. MARTIN, JR., ASSISTANT SECRETARY; EDWARD F. BARTELT, FISCAL ASSISTANT SECRETARY; GEORGE C. HAAS, DIRECTOR OF THE TECHNICAL STAFF; SIDNEY G. TICKTON, ASSISTANT DIRECTOR OF THE TECHNICAL STAFF; THOMAS J. LYNCH, GENERAL COUNSEL; C. R. McNEILL, OFFICE OF THE GENERAL COUNSEL; AND J. L. ROBERTSON, FIRST DEPUTY COMPTROLLER OF THE CURRENCY, DEPARTMENT OF THE TREASURY

Secretary SNYDER. Mr. Chairman and members of the subcommittee of the Joint Committee on the Economic Report, I am pleased to have the opportunity of appearing before you today to discuss questions on the monetary, credit, and fiscal policies of the United States Government. I should like at this time to take a few minutes to talk about some of the current factors in the outlook for Treasury financing and debt-management policies in the light of the budget estimates that have been released since I sent my answers to your questionnaire to the committee. In discussing some of the figures, I shall refer occasionally to a booklet of charts which we have prepared, and which I have given to members of the committee.[1]

The budget position is a matter of first importance. The new budget estimates show a deficit of 5.5 billion dollars for the present fiscal year. Expenditures are estimated at 43.5 billion dollars and receipts at 38 billion dollars, as is shown in chart 1 in the booklet. It seems to me, however, that in times as prosperous as these we should have a balanced budget. National income today is close to the highest level in our history; and, by every standard of sound Government finance, the time to have a balanced budget is now.

This is the position I have taken consistently since I became Secretary of the Treasury in June 1946. In the statement which I made at that time, I said:

> * * * It is the responsibility of the Government to reduce its expenditures in every possible way, to maintain adequate tax rates during this transition period, and to achieve a balanced budget—or better—for 1947.

It was, therefore, a source of great satisfaction to me to be able—as Secretary of the Treasury—to announce at the end of the fiscal year 1947 that the Federal Government had operated with a budget surplus. In the following fiscal year, which ended on June 30, 1948, we again had a budget surplus—it amounted to 8.4 billion dollars and was, in fact, the largest budget surplus in the history of the United States Government.

In the past 3 years, I have restated the urgent need for an excess of receipts over expenditures on many occasions—notably when the Congress was considering tax-reduction measures in 1947 and 1948.

Furthermore, President Truman has repeatedly urged the necessity of reducing the public debt under the circumstances which have existed since the end of the war. In his message to the Congress on April 2, 1948, in which he returned, without approval, the tax-reduction bill, H. R. 4790, he stated:

> * * * I repeat what I have so often said before—if we do not reduce the public debt by substantial amounts during a prosperous period such as the present, there is little prospect that it will ever be materially reduced.

You will recall that it was this tax-reduction measure which the Congress passed over the President's veto, and which resulted in a loss of revenues to the Federal Government amounting to approximately $5,000,000,000 annually. It is largely as a result of the enactment of this legislation that we had a budget deficit of 1.8 billion dollars in the fiscal year which ended last June 30, and that we have a prospective budget deficit of 5.5 billion dollars in the current fiscal year.

About 3 billion dollars of the deficit for the fiscal year 1950 has already occurred. It has been financed principally by increases in the weekly Treasury bill offerings and by increased sales of Treasury savings notes. The total amount of Treasury bills outstanding rose approximately 800 million dollars between August 4 and September 8 as a result of six successive offerings in excess of the amounts matur-

[1] The charts referred to follow Secretary Snyder's statement.

ing. The amount of Treasury savings notes outstanding has increased by over 2½ billion dollars since the end of June.

The Treasury cash balance is currently running between $4,000,000,000 and $5,000,000,000. Without any further new financing, the balance should remain near this level for the next 4 months, as shown in chart 2. If everything works out exactly as calculated in present estimates, the balance would run down to approximately $3,000,000,000 by next April 30.

There are always, however, a number of variables which could have an important influence on the picture. There is the possibility that revenues might vary from the amount shown in the budget estimates. We knew, for example, at the time the revenue estimates were made, that it was very difficult to gage the full effect of strikes on incomes and corporate profits. It still is not possible to do so. There is bound to be considerable range in expenditure estimates for such programs as farm-price supports, RFC mortgage purchases, and various types of payments to veterans. These considerations are important in our estimate of cash-balance levels.

The picture of how the various Government operations affect the cash balance is one that I have before me daily as I consider debt-management decisions and policies. We revise our appraisals constantly as new information comes in. It looks at this time as though we will have to do some additional new-money financing later in this fiscal year.

There are three main sources which we might tap for new borrowing. These are nonbank institutional investors such as insurance companies, mutual savings banks, and savings and loan associations; other private nonbank investors, including individuals and pension funds; and the commercial banks of the country. We keep close watch at all times on the position of the various investor classes which comprise the market for Government securities.

In addition to the problem of new borrowing, the Treasury will find itself faced next year, as it has been in each of the postwar years, with a large refunding task. Approximately $1,000,000,000 of Treasury bills mature each week; there will be a number of issues of certificates of indebtedness and notes maturing, totaling about $33,000,000,000; and there will be four Treasury bonds amounting to about $11,000,000,000 which mature or are callable next year. This is shown in chart 3. The budget deficit makes it clear that there will not be any reduction during the fiscal year 1950 on these maturities, except for tail ends of maturing securities not turned in for refunding. There will not be any official budget estimates for the fiscal year 1951, of course, until the President's budget message is released in January. The total of maturing or callable marketable securities in the calendar year 1950 is approximately $56,000,000,000; and, on net balance, it appears that nearly the entire amount will be refunded into securities maturing in the future.

Two-thirds of the securities which mature in 1950 are held by the commercial banking system. A significant portion of the remainder is held by industrial, commercial, and mercantile corporations. The ownership of maturing issues as well as the ownership of the remainder of the public debt is, of course, one of the considerations which we must take into account in making our debt-management decisions.

The debt is broadly distributed and we want to keep it that way. The present widespread ownership is, to a large extent, the result of the Treasury's policy of fitting its security offerings to the needs of various investor classes. This first became of special importance during the war period when one of the major objectives was to sell as great a portion as possible of the large wartime offerings to nonbank investors. It has had increasing importance in the postwar period, when we wished to maintain a large nonbank holding of Government securities, especially among individuals, under varying circumstances of business reconversion and then expansion.

A central consideration in fitting Government securities to the needs of different classes of investors has been setting the appropriate maturities for each class. Industrial, commercial, and mercantile corporations, for example, have been sold short-term securities primarily, since their purchases are generally made with reserves which they may want to have readily convertible. The same type of consideration was kept in mind in fitting Government security offerings to the needs of other classes of investors. The net results of this policy can be observed by an analysis of the portfolios of the leading investor classes. Information on this account appears in chart 4, which shows changes in the estimated average number of years of maturity of the Government-security portfolios of three important investor groups—life insurance companies, mutual savings banks, and commercial banks.

Life insurance companies and mutual savings banks are, of course, generally longer-term investors. During the war, insurance companies acquired a large volume of Governments, and it was the Treasury's policy to sell them longer-term securities. The results are evident. The average length of Government securities held by life insurance companies increased from about 10 years in 1941 to about 16 years in 1945. Since then there has been a gradual decline and at the present time the figure is 14 years.

The picture with respect to mutual savings banks differs somewhat from that of the life insurance companies. The average length of the Government-security holdings of these banks increased during the war finance period from 9 years to 14 years and has declined subsequently to 12 years. Savings banks also were sold longer-term securities, but their investment needs resulted in the acquisition of more medium-term securities than were acquired by life insurance companies.

Because there have been no new offerings of long-term marketable securities since the end of 1945, the average length of the outstanding marketable Federal debt has been automatically shortened during this period. Investors who are primarily bondholders have this reflected in their investment portfolios to a greater degree, of course, than do investors who hold primarily short-term debt. The average length of the holdings of life insurance companies and of mutual savings banks would have declined more sharply since 1945, therefore, if these institutions had not bought long-term issues in the market and sold shorter-term issues. They offset thereby, to some extent, the automatic shortening of their portfolios.

Commercial banks have been offered principally short-term securities throughout the war finance period and as a part of our postwar program. This has been a major factor in keeping their portfolios short on the average. The average length to first call or maturity date of the Government security holdings of commercial banks has declined from 7 years in June 1941 to about 3 years at the present time.

There is considerable variation among banks throughout the country in the maturities of the Governments which they hold. Estimates of the average number of years to maturity of Governments held by commercial banks, by Federal Reserve districts, are shown in chart 5. Longer-term securities are more generally held in the eastern areas, with the exception of New York City, than in the western areas. There are three districts in which the average length of Governments held is less than 2½ years; and, as you can see from the chart, these areas are in the western part of the country. The shortest average length, 2 years, is found in the Kansas City Federal Reserve District; while the longest average length, 4¾ years, is in the New York district, excluding New York City. In this connection, it is interesting to note that as we go farther west commercial banks also have more loans in proportion to their capital.

I have gone into these matters at some length to indicate how the present maturity distribution of the public debt developed. Our objective has been a smoothly functioning economy, and securities have been issued to the various investor classes to suit their needs and the requirements of the economy.

In handling the new money and refunding operations that are in prospect for next year, the interest cost of the debt to taxpayers must also be one of the considerations in our debt-management program. The interest cost of the debt comprises over 13 percent of the Federal budget for the fiscal year 1950. The total annual cost is likely to grow, even without any increase in the debt, because the rate of interest on savings bonds increases as they approach maturity and because an increasingly large proportion of the debt represents the accumulation of trust funds invested at an average interest rate which is higher than the present average rate on the total debt.

Even a relatively small increase in the average interest rate on the debt would add a substantial amount to the total annual interest cost. It is estimated that the interest on the debt will amount to 5.7 billion dollars in the calendar year 1949. About 1¼ billion dollars would be added to this amount if the average interest rate were one-half of 1 percent higher.

Senator DOUGLAS. The average interest rate, I take it, is about 2¼ to 2⅓ percent, is that right?

Secretary SNYDER. It is running 2.2 right now on the average. The annual interest cost would be more than $5,000,000,000 larger if the average interest rate were equal to the average borrowing cost of World War I, which was approximately 4¼ percent. The annual saving in the taxpayers' money as a result of the present level of interest rates is an important factor in the budget picture of the Federal Government.

The distribution throughout the economy of the interest on the public debt is, of course, determined by the ownership of the debt. The next chart, which is chart 6, shows interest on the Federal debt, by class of recipient, from 1946 through 1949.

It seems to me that the outstanding fact in this connection is the increase during this period in the interest on the Federal debt going to individuals. Their share during the current calendar year is one-third of the estimated 5.7-billion-dollar total. It rose from 1.4 billion dollars in 1946 to an estimated 1.9 billion dollars in the current year.

The share received by Government investment accounts also rose during this period, while interest payments to other nonbank investors declined slightly. The share received by commercial banks also declined. This was largely due to the Treasury's policy of concentrating debt reduction in the holdings of commercial banks.

Senator DOUGLAS. That is in the years in which you had a surplus?

Secretary SNYDER. That is correct, and also by using the cash balance we had at the end of the war. The receipts from the sale of nonmarketable issues were also available to retire bank-held debt.

Another way of looking at the interest cost of the debt is to consider the burden which it represents when compared with the gross national product of the country, from which it must be paid. The public debt is nearly 10 times as large as it was at the World War I peak in August 1919, as is shown in chart 7. But, because we were able to finance the Second World War at a borrowing cost about one-half as great as the average borrowing cost of World War I, the interest cost of the public debt today is only 5 times, rather than 10 times, as large as it was in 1919. This does not, however, mean an interest burden 5 times as great. For, in the meantime, our gross national product has risen from less than $80,000,000,000 in 1919 to an estimated annual rate above $250,000,000,000 at the present time. We have a tremendously increased product out of which to pay the interest on the debt, and the present interest cost is only 2.3 percent of gross national product. This compares with 1.4 percent in 1919.

One of the important refunding matters which will come before the Treasury in 1950, and in greater volume in 1951, 1952, and subsequent years, will involve the Government-security holdings of individuals. These holdings amounted to 69½ billion dollars on October 31, 1949, up from 65 billion dollars on December 31, 1945, and from 10½ billion dollars before the war, as shown in chart 8.

Ownership of Government securities by millions of individuals is good for the country as well as for those individuals. It gives the people of the country an increased interest in the affairs of their Government and causes them to participate more actively in those affairs. We have continued to promote the sale of savings bonds in order to encourage thrift. Thrift has played a vital part in the building of our Nation, and today it is as important to our well-being as it has ever been in the past. At the end of October, 48½ billion dollars of savings bonds of all series were held by individuals. Savings bonds comprised 70 percent of their total holdings of Government securities. Holdings of E bonds alone—the bond which is designed to meet the needs of small investors—amounted to 33½ billion dollars.

The savings bonds held by individuals at the present time are distributed broadly throughout the country. In chart 9 the United States is divided into geographical areas to show that the 48½ billion dollars of savings bonds outstanding in the hands of individuals are distributed approximately as follows: 16½ billion dollars held in the northeastern area of the country; 10 billion dollars held in the States of Michigan, Illinois, Indiana, and Ohio; 6 billion dollars held in the southern part of the United States; 6 billion dollars held in the seven States which are the farthest west; and 10 billion dollars held in the large block of Central States which is bounded, roughly, by the Mississippi on the east, the Rocky Mountains on the west, and stretches from Canada to Mexico. These savings bonds comprise a tremendous amount of assets in the hands of individuals. The 48½-billion-dollar total seems particularly significant if we recall that at the bottom of the depression in 1933 national income in the country was only 39½ billion dollars. Across the Nation people now have a cushion of reserves to fall back upon that is greater than the total income in the Nation in that year.

You may remember that during the latter years of the war there was considerable speculation as to the probable redemption experience with series E bonds as soon as the war had ended. The opinion was freely expressed that the large quantities of bonds which were being sold under the pressure of patriotism and intensive wartime selling methods would be redeemed speedily as soon as the war was ended. Instead, as I have noted, we have continued to sell savings bonds and to increase the total amount outstanding. Redemption experience with series E bonds is, in fact, more favorable than the postwar rate of turn-over in other forms of savings. Chart 10 shows the annual rate of savings-account withdrawals and savings-bond redemptions from 1943 to date, expressed as a percentage of total amounts outstanding. The rate of redemption of series E bonds has been substantially lower than the rate of withdrawals from savings accounts. Furthermore, since the end of the war savings-bond redemptions as a percentage of the amount outstanding have followed a downward trend, while the rate of turn-over of other forms of savings has followed an upward trend.

We have not, however, encouraged the sale of savings bonds at the expense of other types of savings. From December 31, 1945, through October 31, 1949, the increases in practically all other forms of individuals' savings were substantially greater relatively than the increase in savings-bond holdings.

It might be interesting at this point to give you the changes in some other types of savings as compared with savings bonds.

Savings bonds increased, between December 31, 1945, and October 31, 1949, 13 percent; savings accounts in commercial banks increased 15 percent; in mutual savings banks, 25 percent; in savings and loan associations, 60 percent; in postal savings, 10 percent; insurance increased 30 percent; and checking accounts, 10 percent. Currency holdings decreased 10 percent.

I think those are interesting to show that the savings-bond program has not been built up at the expense of other types of savings.

I have been talking about some of the technical matters that will have to be considered in connection with Treasury borrowing and refunding. Uppermost in our minds in making all of our policy decisions is the fact that the foremost responsibility of the Secretary of the Treasury is to maintain confidence in the credit of the United States. One hundred and fifty years ago, the main financial problem of our newly born Nation was to establish that credit. Confidence in our Government's financial soundness was successfully established; and it has been the responsibility of Secretaries of the Treasury for a century and a half to maintain it.

But never before has this responsibility been so great as since the end of World War II. The public debt increased more than fivefold during the war. It represents more than half of all of the debt of the country, public and private. It comprises a substantial proportion of the assets of the leading investor classes; and the decisions which are made with respect to it are of immediate and vital significance to each and every one of us.

The primary concern of the Secretary of the Treasury in formulating debt-management policies is to promote sound economic conditions in the country. Because the debt is so great, because it is such a large proportion of the total debt of the country, and because it is interwoven in the financial structure of the country, the policies and decisions made in the Treasury Department are of tremendous importance and significance to the economic and financial welfare of the Nation.

Figures on the total debt of the country—public and private—are shown in chart 11. At the end of 1939, the debt of the Federal Government amounted to $47,500,000,000 and accounted for 23 percent of the total debt of the entire country. At the present time, the public debt amounts to $257,000,000,000 and comprises 51 percent of all debt.

The estimated distribution of the ownership of the debt on October 31 of this year is shown in chart 12. Nonbank investors held $172,000,000,000 of Government securities—two-thirds of the $257,000,000,000 of Federal debt outstanding on that date. It is particularly significant that the holdings of individuals are so large. They totaled $69,500,000,000, as I mentioned earlier. Insurance companies held $20,500,000,000 of Government securities. Mutual savings bank holdings totaled $11,500,000,000. Government investment accounts, principally Government trust funds which are required by law to be invested in Government securities, held $39,500,000,000 of the public debt. The holdings of "other" nonbank investors—which include State and local governments, corporations, pension funds, and charitable institutions—were $31,000,000,000.

One-third of the debt—$85,000,000,000—was held by the commercial banking system. Commercial banks held $67,500,000,000; and the remainder, $17,500,000,000, was held by the 12 Federal Reserve banks.

These figures are large, in dollar terms; and they are also a substantial proportion of the assets of the various investor classes, as shown in chart 13. In the case of commercial banks, for example, holdings of Governments are equal to 56 percent of earning assets—a large percentage, but a sharp decline from February 28, 1946, when Government securities comprised over 70 percent of the earning assets of these institutions.

Nonbank investors—both financial and nonfinancial— also have a large share of their assets invested in Government securities. On October 31, mutual savings bank holdings of Governments represented 54 percent of their total assets; life-insurance companies had 27 percent of total assets invested in Government securities; and other insurance companies—fire, marine, and casualty—had 47 percent. Nonfinancial corporations had 13 percent of their current assets in this form. And, when we turn to individuals, we find that Government securities accounted for 34 percent of their liquid assets—that is, their combined holdings of Government securities, savings and checking accounts, and currency—which approximated $200,000,000,000 on October 31.

These figures are unmistakable evidence that the decisions which are made with respect to the public debt affect every segment of our economy. They indicate the compelling necessity for considering not only the effect of our decisions upon the financial structure of the Government itself, but their effect on the financial and economic structure of the whole country.

It is for this reason that Treasury and Federal Reserve authorities have cooperated to keep the market for Government securities stable during the postwar period. Under the circumstances which existed, stability in the Government bond market has been of tremendous importance to the country. It contributed to the underlying strength of the country's financial system and eased reconversion, not only for the Government, but also for industrial and business enterprises.

This is in marked contrast to the situation after World War I, when prices of Government securities were permitted to decline sharply—with disastrous results. Investors suffered serious financial losses. And the decline contributed importantly to the business collapse that occurred in the early post-World War I period. These things happened at a time when the public debt was a much less powerful element in the economy than it is at the present time. It seemed obvious to us that widely fluctuating Government bond prices would have even more serious repercussions after World War II.

It is now 4 years since Victory Loan 2½'s were issued. Chart 14 shows the price history of the Victory Loan 2½'s after World War II, as compared with the price history of the Fourth Liberty Loan 4¼'s during the corresponding period after World War I. At the end of the fourth year, Victory Loan 2½'s are above par; at the end of a similar period, Fourth Liberty Loan 4¼'s were in the vicinity of par. But the price movements within the two periods differed radically. Victory Loan 2½'s have always been above par. The Fourth Liberty Loan 4¼'s dropped substantially below par, reaching a low of about 82½. From this point, they had a long climb back before reaching par.

In the short-term area of the Government security market, we also had to consider the possible effect of our actions on the financial markets. When interest rates on short-term Government securities were raised, beginning in mid-1947, they were raised gradually in order not to disrupt these markets. When they were reduced, the change was small for the same reason.

In the 4 years since VJ-Day, the United States has achieved a record level of prosperity. There can be no doubt that world-wide confidence in the financial soundness of the Government of the United States played a prominent role in achieving this prosperity.

I have gone into some of the current matters of public debt management with you in some detail in order to round out the entire picture for your committee. Many of the answers to the questions submitted by your committee to me and to other Government officials and agencies touched on some of the points that I have mentioned; but I felt that it would make for better understanding of the problems and considerations involved, if I summarized the current situation as it looks from my position as Secretary of the Treasury.

Senator DOUGLAS. Thank you very much, Mr. Secretary. Might we have your permission to include this list of charts in the printed record of the hearings?

Secretary SNYDER. I would be pleased to have you do so.

(The charts above referred to are as follows:)

CHARTS ACCOMPANYING THE STATEMENT BY SECRETARY OF THE TREASURY SNYDER BEFORE THE SUBCOMMITTEE ON MONETARY, CREDIT, AND FISCAL POLICY OF THE JOINT COMMITTEE ON THE ECONOMIC REPORT DECEMBER 2, 1949

CHART 1

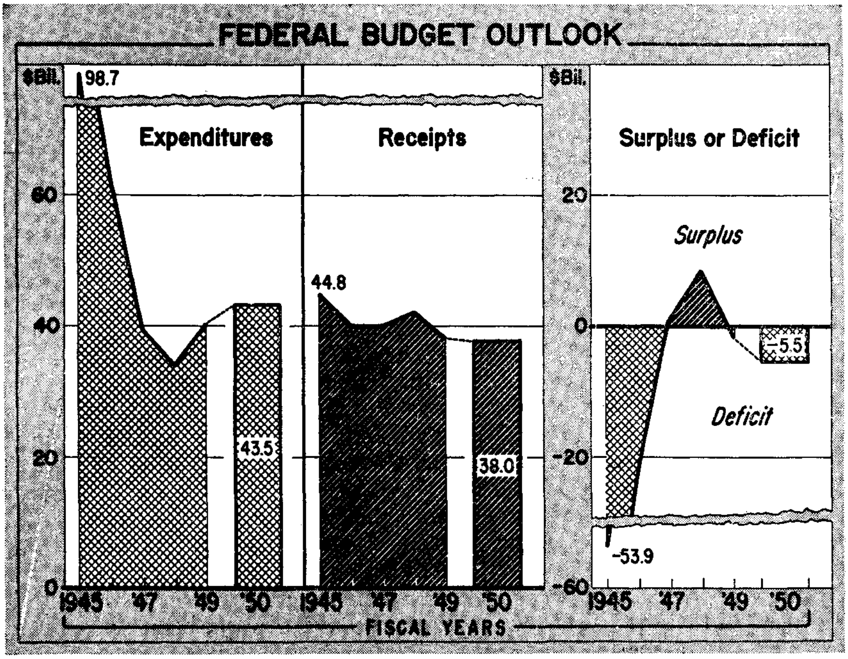


CHART 2

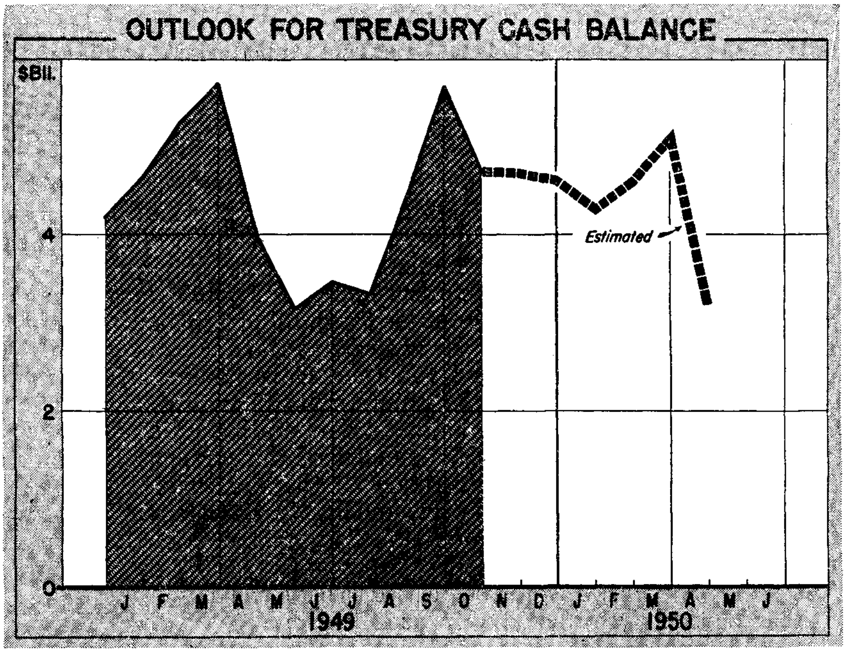


CHART 3

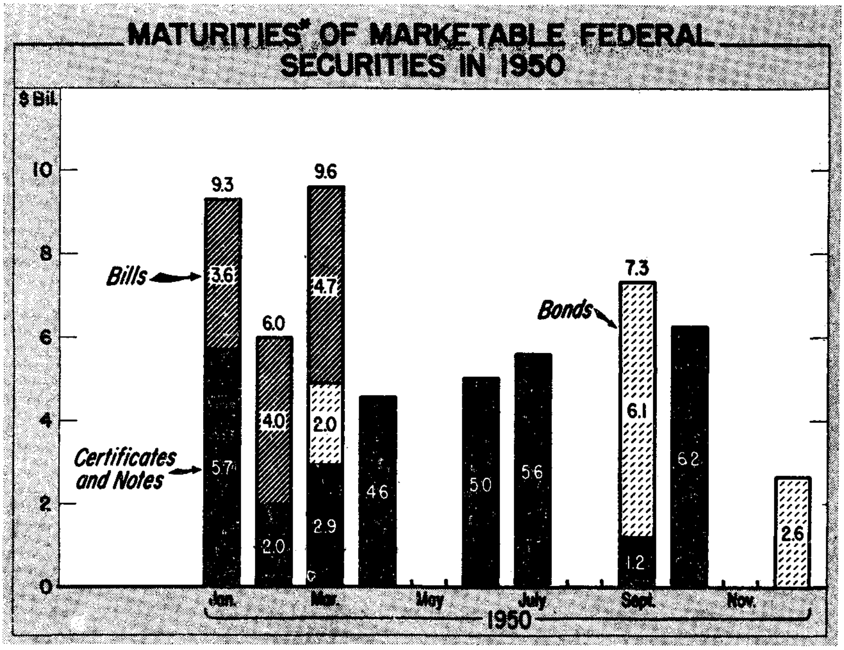


CHART 4

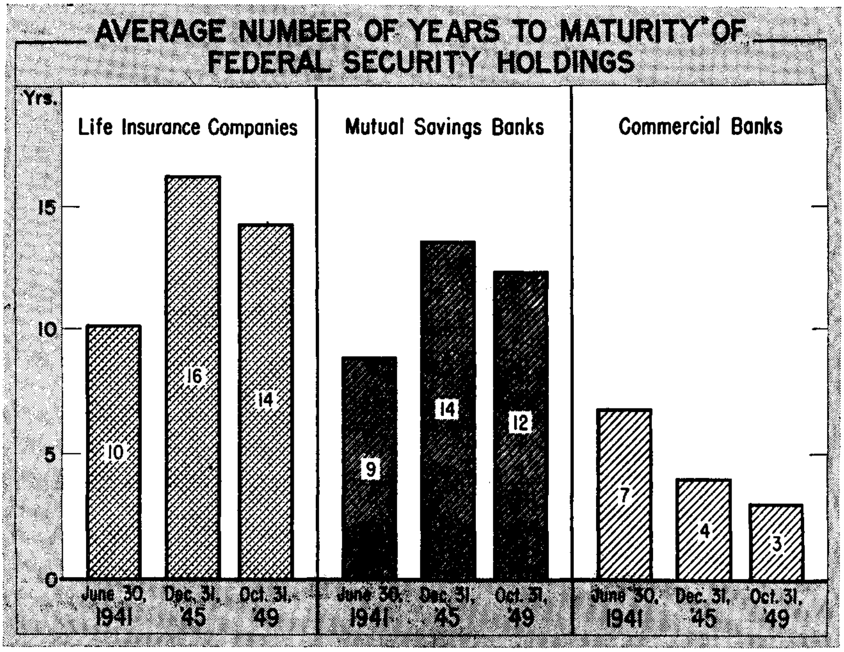


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CHART 5

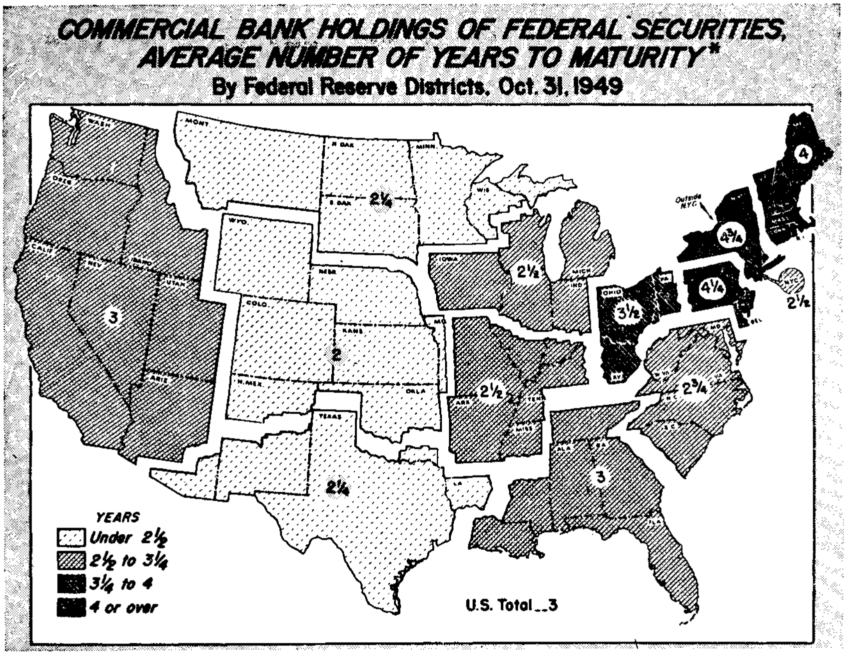
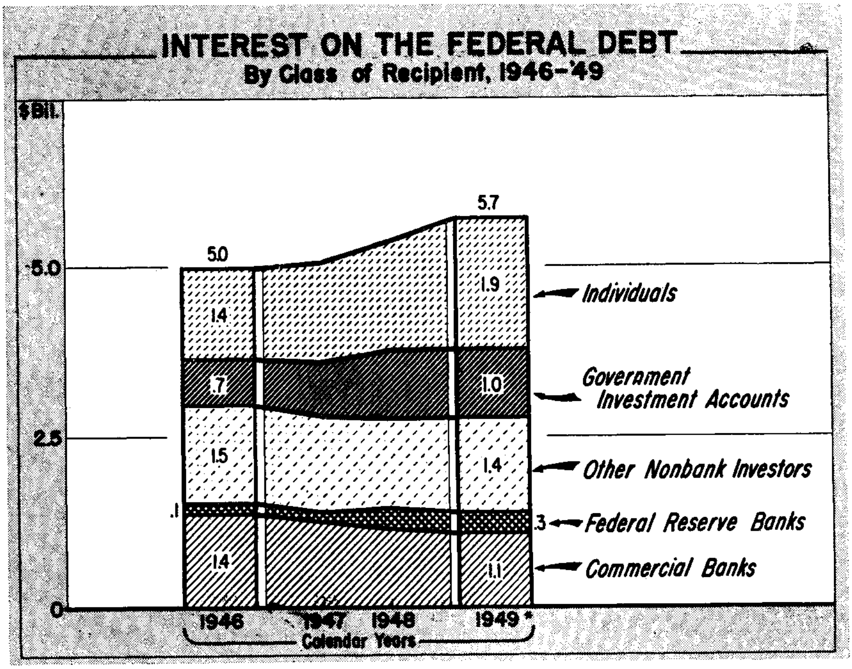


CHART 6



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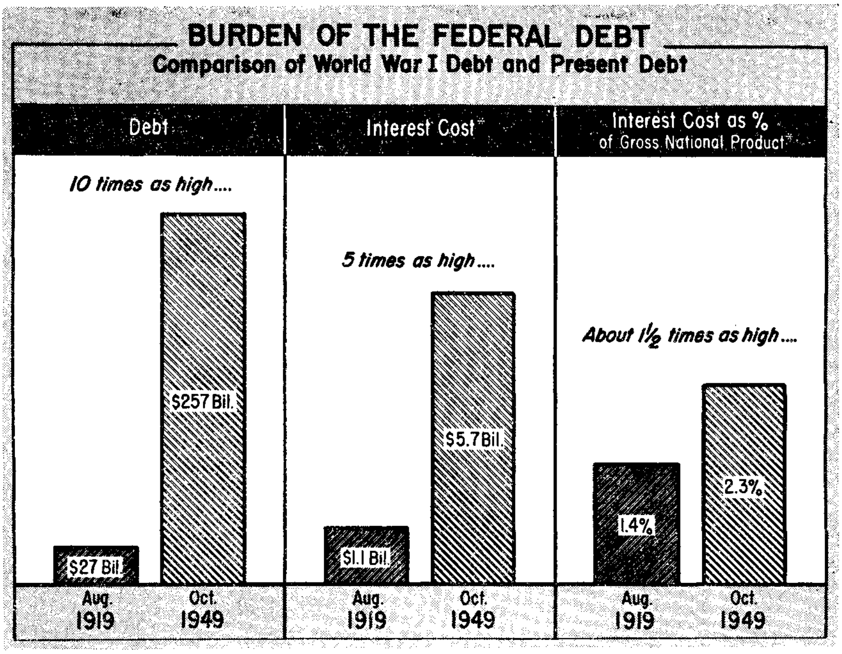


CHART 8

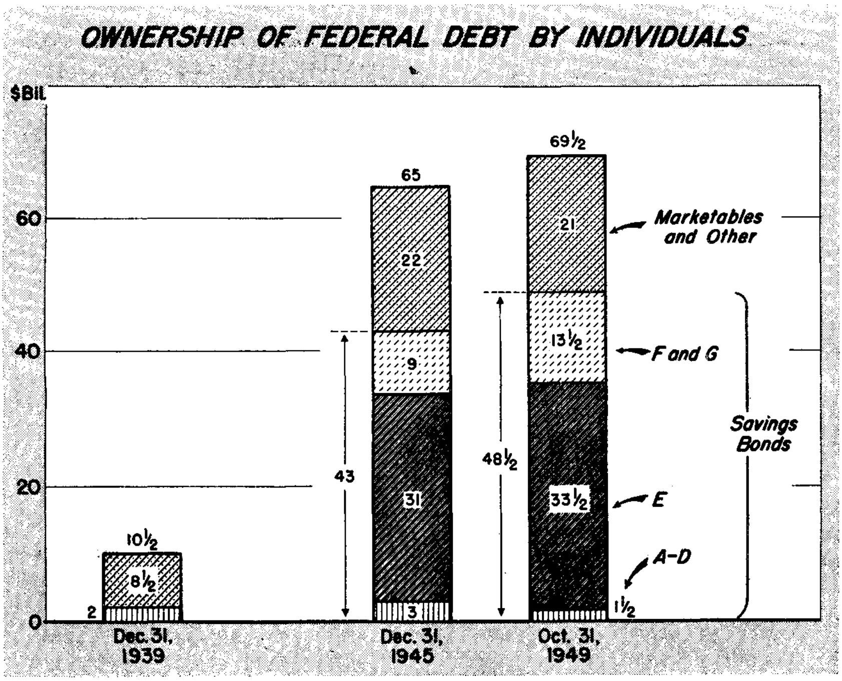


CHART 9

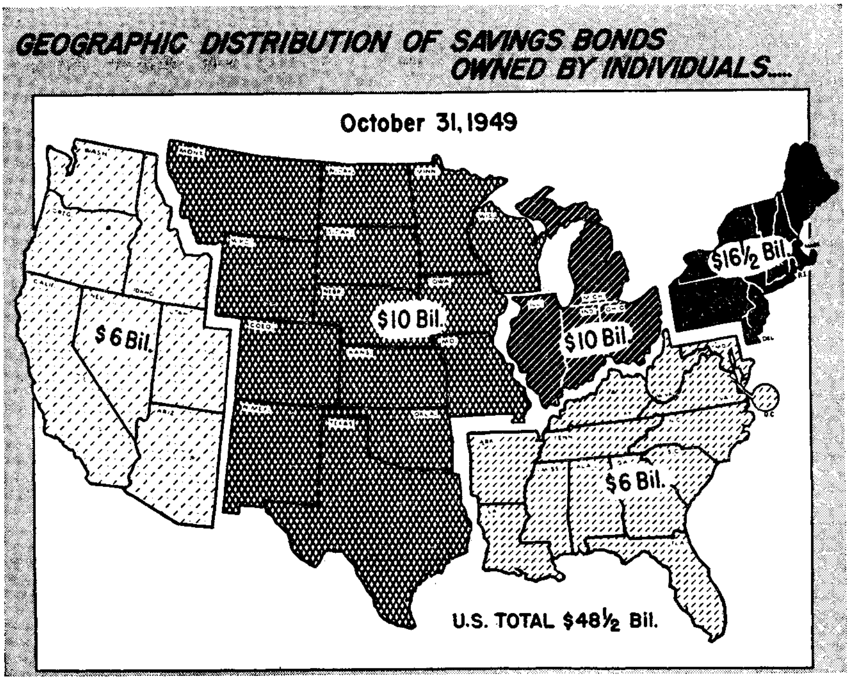


CHART 10

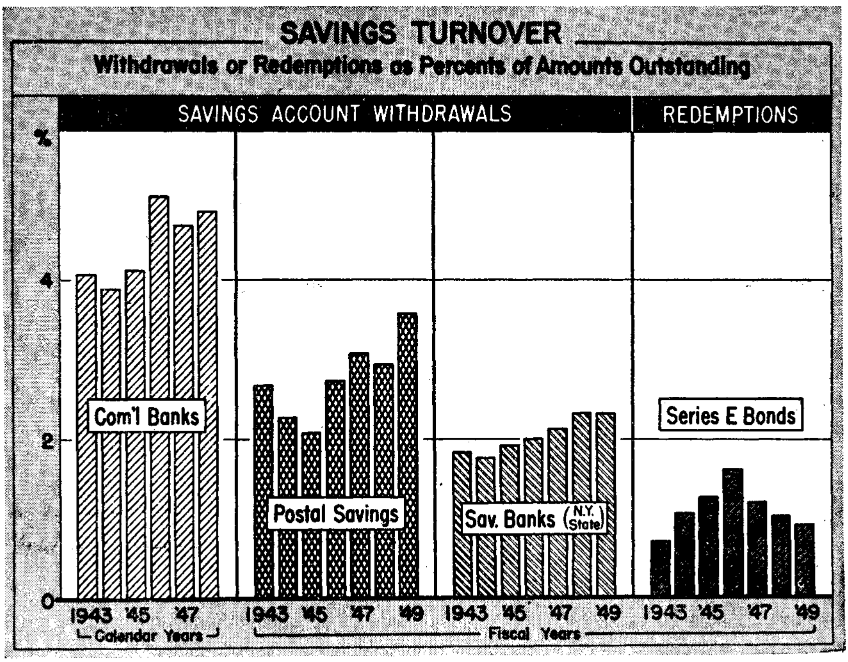


CHART 11

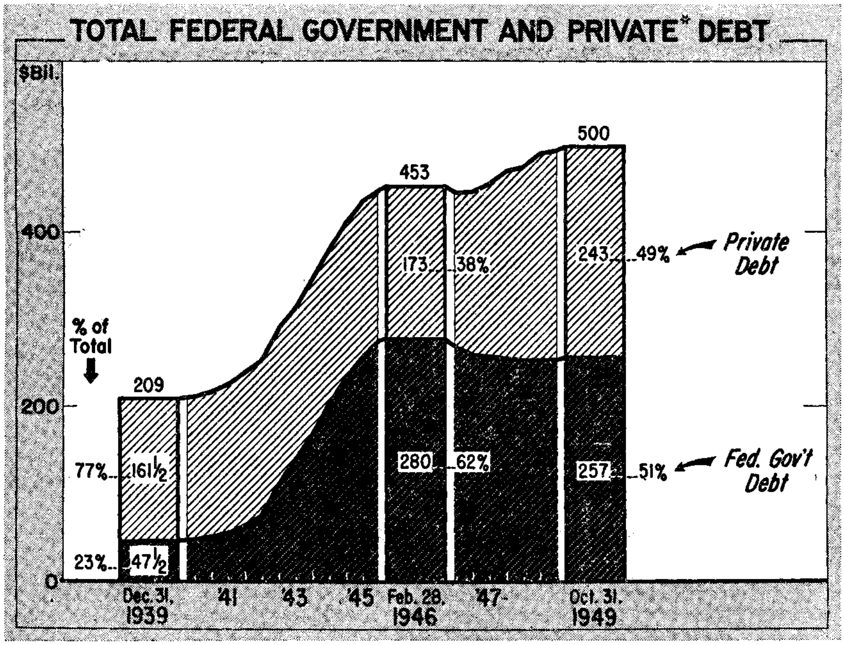


CHART 12

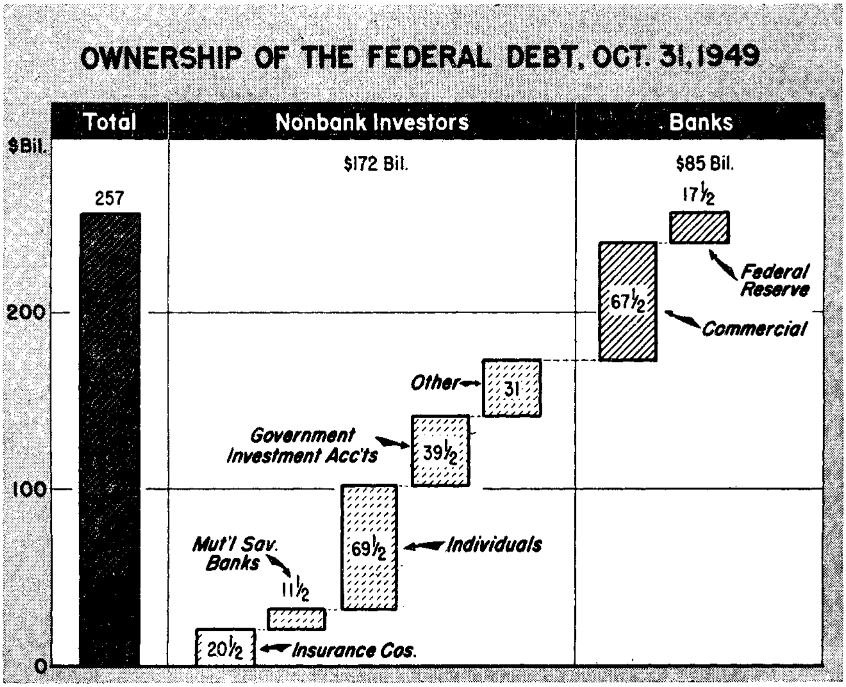


CHART 13

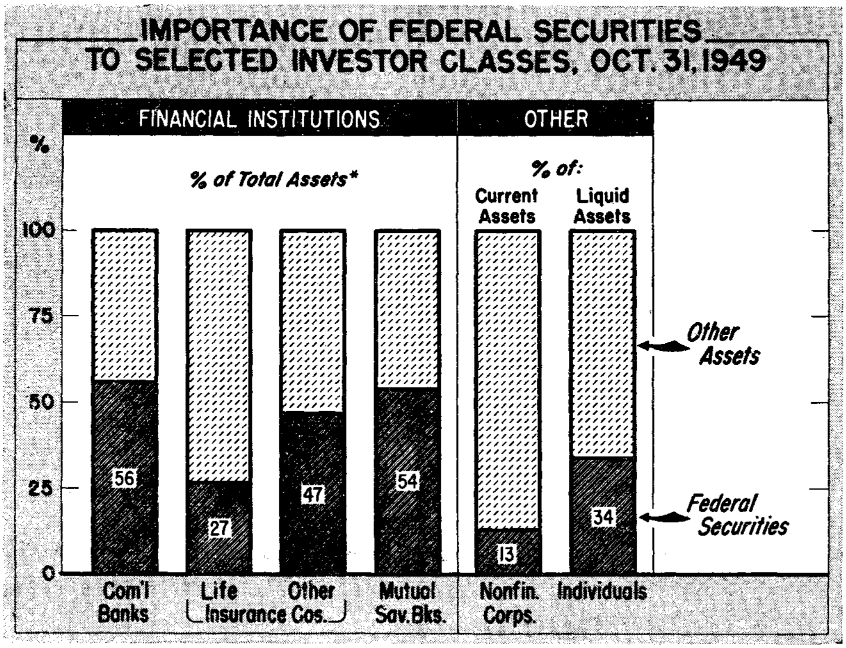
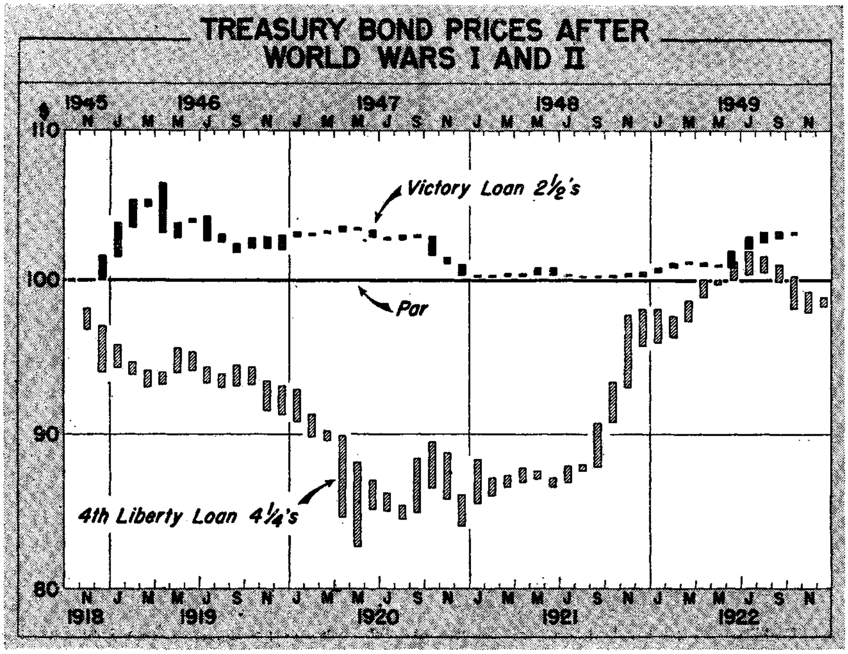


CHART 14



Senator DOUGLAS. Mr. Secretary, I should like to begin, if I may, with some questions on fiscal policy. I notice that you say at the end of the second paragraph of your statement:

By every standard of sound government finance the time to have a balanced budget is now.

Secretary SNYDER. Yes, sir.

Senator DOUGLAS. I wonder if you will describe the role which the Treasury plays in the formulation of the annual budget and the total receipts and expenditures.

Secretary SNYDER. The Treasury's part in the budget, of course—in the formulation of expenditures—is limited to its own department as to detail. But it is consulted on the over-all picture as the budget develops because this picture has a direct influence on the amount of revenues required.

As to the revenues, the Treasury Department cooperates with the tax committees of the Congress and has been in consultation with the joint tax group for over a year now in discussing the various types of taxes both existing and those that might be considered for additional revenue.

Senator DOUGLAS. Then do I infer from your statement that you believe the budget for the fiscal year 1950–51 should be balanced?

Secretary SNYDER. I certainly believe that an intense effort to balance it should be made; yes, sir.

Senator DOUGLAS. And would it be premature or going outside the province of your department to inquire whether you think it should be balanced primarily by the imposition of new taxes, or by an attempt to reduce expenditures, or by both methods?

Secretary SNYDER. That is a matter, Mr. Chairman, that is in the hands of the President; and as a member of his Cabinet, I would be guided by his statements.

Senator DOUGLAS. And you feel it would be premature to state to a committee of Congress what your own opinion on that would be?

Secretary SNYDER. In view of the fact that his budget statement comes out in about 30 days, I think it is a little early for me to comment on it.

Senator DOUGLAS. May I ask some questions about gold and silver?

Secretary SNYDER. Yes, sir.

Senator DOUGLAS. For some time there seemed to be a good deal of uncertainty as to whether or not the Secretary of the Treasury and the President had the discretionary power to increase or decrease the price of gold without congressional action.

Now, I understand that in the early part of November your office issued an interpretation stating that the price of gold could not be changed without an act of Congress. Am I correct in that?

Secretary SNYDER. Yes; and we can introduce into the record here the legal provisions relating to the price of gold.

Senator DOUGLAS. Is it your judgment that the Secretary of the Treasury and the President cannot alter the price of gold without an act of Congress?

Secretary SNYDER. Only an act of Congress can alter the statutory gold content of the dollar.

Senator DOUGLAS. What about the purchase price of gold, or that which is not minted into dollars?

Secretary SNYDER. That is tied up in the Bretton Woods agreement. Under the agreement the price of gold must remain at $35 per ounce unless there is agreement to change that purchase price within the International Monetary Fund.

Senator DOUGLAS. Of course, the gold dollar as such has virtually disappeared. Gold has gone underground, as it were. But the question is on the purchase price of gold bullion. Is it your judgment that the Executive Department could alter the purchase price of gold without an act of Congress, or would it be necessary to have an act of Congress to alter it?

Secretary SNYDER. The Executive Department by itself cannot alter the monetary price of gold.

Senator DOUGLAS. The purchase price of gold?

Secretary SNYDER. The purchase price of gold.

Senator DOUGLAS. It would need an act of Congress?

Secretary SNYDER. It takes corollary action.

Senator DOUGLAS. It would need an act of Congress?

Secretary SNYDER. It would take an act of Congress for the International Monetary Fund to take any action with respect to a change in the dollar price of gold.

Senator DOUGLAS. You mean the International Monetary Fund could reach an agreement to alter the price of gold, and that would be operative without the consent of Congress?

Secretary SNYDER. Mr. Chairman, this is Mr. Thomas Lynch, general counsel for the Treasury Department. May I have him reply to the technical question?

Senator DOUGLAS. Yes.

Mr. LYNCH. Replies to this question were given in the staff document submitted to the committee, and I believe that the matter is set out in full therein.

There is statutory power still on the books for the Secretary of the Treasury, with the approval of the President, to change the purchase price of gold. The fact is, however, that under the United States commitments respecting the International Monetary Fund, approved by Congress, gold may be bought or sold only within a margin of one-quarter of 1 percent of the par value of $35.

Senator DOUGLAS. That is, unless there is action by the International Monetary Fund to the contrary?

Mr. LYNCH. The United States Government could not agree to change the par value of gold without approval of Congress. That is provided in the Bretton Woods Agreement Act. So long as par value is fixed at $35 under the agreement the United States must buy within one-quarter of 1 percent margin of $35, and that $35 cannot be changed under the Bretton Woods Act without the approval of Congress. That is a summary statement.

Senator DOUGLAS. That applies to the purchase price of gold?

Mr. LYNCH. Purchase and sale.

Senator DOUGLAS. Could the executive branches of the Government propose to the International Monetary Fund that the price be altered without prior consent by Congress?

Mr. LYNCH. The executive officials of the United States dealing with the fund could take no action with respect to changing the par value of the dollar in terms of gold without the approval of Congress. That is specifically reserved in the act of Congress approving participation by the United States in the fund.

Senator DOUGLAS. And in your judgment no further legislation would be needed to make that power of Congress definite?

Mr. LYNCH. The statute relating to the participation of this Government in the International Monetary Fund is binding.

I would like to suggest, if I may, that the answers in some detail supplied to the staff become a part of the record.

Senator DOUGLAS. They are already a part of the record. You mean the record at this point? There has been a supplementary memorandum?

Mr. LYNCH. Yes.

Senator DOUGLAS. We will be very glad to do that.

In regard to the questionnaire, I do not know that this specific question was asked, and, therefore, I do not know whether it was replied to.

Secretary SNYDER. In fact, it was.

(The material referred to above is as follows:)

THE LEGAL PROVISIONS RELATING TO THE PRICE OF GOLD

The gold content of the dollar, and hence the statutory monetary value of gold in terms of United States dollars, was defined by the Presidential proclamation of January 31, 1934. The proclamation was issued under authority of section 43, title III, of the act approved May 12, 1933, as amended by section 12 of the Gold Reserve Act of 1934. That section of the act of May 12, 1933, authorized the President to decrease the weight of the gold dollar by not more than 50 percent, and section 12 of the Gold Reserve Act provided that devaluation should be not less than 40 percent.

The weight of the gold dollar fixed by the President on January 31, 1934, was 15$\frac{5}{21}$ grains of gold nine-tenths fine, that is, one thirty-fifth of a troy ounce of pure gold technically referred to as gold 1,000 parts fine. The monetary or statutory value of gold in the United States is therefore $35 per fine troy ounce. After several extensions the authority of the President by proclamation further to change the gold content of the dollar expired on June 30, 1943.

Only an act of Congress can now alter the statutory gold content of the dollar.

A FULL DESCRIPTION OF THE DISCRETION LEFT IN THE HANDS OF THE SECRETARY OF THE TREASURY AS TO THE PRICE OF GOLD

The Secretary of the Treasury has authority under sections 8 and 9 of the Gold Reserve Act of 1934, as amended, with the approval of the President, to purchase and sell gold at such rates and upon such terms and conditions as he may deem most advantageous to the public interest.[1]

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[1] Section 8 of the Gold Reserve Act, 31 U. S. C. 734, provides:

"SEC. 3700. With the approval of the President, the Secretary of the Treasury may purchase gold in any amounts, at home or abroad, with any direct obligations, coin, or currency of the United States, authorized by law, or with any funds in the Treasury not otherwise appropriated, at such rates and upon such terms and conditions as he may deem most advantageous to the public interest; any provision of law relating to the maintenance of parity, or limiting the purposes for which any of such obligations, coin, or currency, may be issued, or requiring any such obligations to be offered as a popular loan or on a competitive basis, or to be offered or issued at not less than par, to the contrary notwithstanding. All gold so purchased shall be included as an asset of the general fund of the Treasury."

Section 9 of the act, 31 U. S. C. 733, provides:

"SEC. 3699. The Secretary of the Treasury may anticipate the payment of interest on the public debt, by a period not exceeding 1 year, from time to time, either with or without a rebate of interest upon the coupons, as to him may seem expedient; and he may sell gold in any amounts, at home or abroad, in such manner and at such rates and upon such terms and conditions as he may deem most advantageous to the public interest, and the proceeds of any gold so sold shall be covered into the general fund of the Treasury: *Provided, however,* That the Secretary of the Treasury may sell the gold which is required to be maintained as a reserve or as security for currency issued by the United States, only to the extent necessary to maintain such currency at a parity with the gold dollar."

The authority of the Secretary of the Treasury in this respect, however, is limited by a number of factors. First is the obligation undertaken by the United States as a member of the International Monetary Fund. Article IV, section 2 of the articles of agreement of the International Monetary Fund provides:

"The fund shall prescribe a margin above and below par value for transactions in gold by members, and no member shall buy gold at a price above par value plus the prescribed margin or sell gold at a price below par value minus the prescribed margin."

The fund has prescribed a margin of one-fourth of 1 percent above and below the par value for purchases and sales of gold. Accordingly, the United States has an obligation to the International Monetary Fund not to purchase gold at more or sell gold at less, than $35 plus or minus the prescribed margin, unless the par value of the dollar should be changed consistently with the articles of agreement and with the Bretton Woods Agreements Act, which requires the approval of Congress for any such change.

Even without this legal obligation to the International Monetary Fund there are important considerations of policy which, in effect, circumscribe the discretion of the Secretary of the Treasury to change the price of gold. The gold policy of the United States has been directed primarily to maintaining a stable relation between gold and the dollar.

The importance which the Congress attributes to the maintenance of a stable dollar price for gold is demonstrated by a number of legislative provisions. The gold parity statutes contained in the Gold Standard Act of 1900 and the act of May 12, 1933, provide that the gold dollar "shall be the standard unit of value and all forms of money issued or coined by the United States shall be maintained at a parity with this standard and it shall be the duty of the Secretary of the Treasury to maintain such parity."

The Gold Reserve Act of 1934 provides that:

"The amount of gold certificates issued and outstanding shall at no time exceed the value at the legal standard of the gold so held against gold certificates."

In addition, section 5 of the Bretton Woods Agreements Act provides that neither the President nor any person or agency shall propose to the International Monetary Fund any change in the par value of the United States dollar or approve any general change in par values unless Congress by law authorizes such action.

Senator DOUGLAS. Now, may I ask a question about silver?

Secretary SNYDER. Reverting for a moment to my personal position on the price of gold, Mr. Chairman, I have tried to make that perfectly clear. I have no intention of making any change in the price of gold or of asking Congress or the President to make any change, and the President himself has stated rather categorically his position about it.

Senator DOUGLAS. I think that is made very definite now.

Now, as I understand it, you are purchasing silver under congressional action at 90½ cents an ounce, and the open market price is 73 to 74 cents an ounce and that, therefore, constitutes a subsidy to American silver producers of at least 17 cents an ounce, and possibly more, because if the Government did not purchase silver the price of silver would undoubtedly fall still lower.

I notice that you have made a somewhat guarded statement in your reply to the questionnaire in which you say:

On previous occasions the Treasury has stated that it would interpose no objection if Congress wished to repeal all the provisions relating to acquisition of silver in the above-named acts.

Secretary SNYDER. We have not changed our position.

Senator DOUGLAS. You have no objection, but do you have any recommendations?

Secretary SNYDER. That is a matter for Congress. We will not object to it if Congress sees fit to change it.

Senator DOUGLAS. But you do not plan to initiate any such movement?

Secretary SNYDER. No, sir.

Senator DOUGLAS. You are going to play passive on that issue?

Senator FLANDERS. Hopefully passive.

Senator DOUGLAS. Well, now, Mr. Secretary, I have been struck with the fact that most of the memoranda which you submitted this morning dealt with the issue of debt management, and I can see that you take the responsibilities which are imposed upon such a Treasury very seriously, and I think, so far as debt management is concerned, that you have legitimate reason for pride in the postwar record which the Government has made under your direction.

You have been able to keep the interest rates low and yet maintain the price of Government securities at par or above, and, so far as that is concerned, I think your job has been done extremely well. You have undoubtedly saved the taxpayers, with the help of fortunate economic circumstances, billions of dollars.

You are aware, of course, of the fact that among (A) the banking fraternity, and (B) those who believe in the power of the Federal Reserve System being exercised to check credit expansion, it is argued, for differing reasons, between these two groups, that in a period of rising prices and credit expansion it would be wiser to let the interest rate rise, even though that might mean a higher interest charge and also a lower price of the long-term securities, in order that this higher interest rate might then serve to repress or dampen down the volume of commercial borrowing from banks and hence check the private expansion of credit.

I think we have here a very important issue of public policy. The Treasury is charged with managing the debt. You have performed that function not only to the best of your ability but with great savings to the Government. The Federal Reserve System, on the other hand, is charged with an attempt to stabilize business conditions and to prevent undue expansions and contractions of credit—private credit primarily and public credit somewhat.

Now, suppose we should have a situation in which the consensus of Federal Reserve opinion would be that it would be wise to allow the interest rate to rise in order to check the volume of private borrowing and hence dampen down possible inflationary tendencies. But the Treasury, wanting to save money for the Government and wanting to fulfill its function, insisted upon low interest rates. Now, that would present a conflict of purposes, and, in view of the importance of the public debt, as you say, the Federal debt alone forming half of the total volume of debt in the country, the decisions on the public debt would vitally affect and might indeed control the decisions on private credit. So that you might have the Federal Reserve System chained to a low-interest-rate policy in a period when prices were expanding, employment was reasonably full, and when we would have the danger of private credit inflation.

I wonder if you have any comment you want to make on that issue as a general matter.

Secretary SNYDER. As a general matter, Mr. Chairman, there is no question but that the management of the debt and the control of credit and monetary affairs are closely interrelated and require an extreme amount of cooperation between the two agencies that are in control of the various segments—the Treasury and the Federal Reserve Board.

I have been very happy with that cooperation. I think it has been splendid, I think we have worked to the interest of the public as the results have shown. I will stand on those results—both as to what we have be able to do in the way of savings to the taxpayers and also the effect on the continued prosperity of the country.

Senator DOUGLAS. It is sometimes regarded as futile to discuss past history. I do not regard it as such, because I think if you analyze past history, it sometimes can teach you lessons about the future; and I raise this last question not to do any point scoring or to say who is right and who is wrong, but to try to look toward the future.

Is it not possible that the price expansion of late 1946 and 1947, which we can call quite a violent inflation, might have been partially changed or dampened down if the interst rate had been allowed to rise, even though that would have meant a heavier debt charge upon the Treasury and possibly, in the case of some long-time securities, though not E, F, and G bonds, some depreciation in their price?

Secretary SNYDER. Mr. Chairman, that is so debatable and other elements come into consideration there that——

Senator DOUGLAS. It is debatable, but we are trying to grope our way toward an answer, and we would like your advice.

Secretary SNYDER. We feel we have followed the best procedure that we could after careful consultation with many segements of the economy. The Treasury Department holds constant studies with various groups: bankers, insurance people, businessmen, savings bank people, investment bankers. We are in constant consultation with the Federal Reserve Board.

After all that consultation, however, the actual responsibility always fell back on the Treasury Department to make the decision, and we felt we made the decisions as ably as we could on the data before us.

Senator DOUGLAS. I would like to offer, if I may, an argument in support of your position, which you yourself have not given—namely, that I suppose you could have argued, and probably did, that by keeping the interest rate down, you thereby increased the Government surplus in the fiscal years 1947 and 1948 and enabled a larger amount of the bank-held public debt, primarily in short-time securities, to be retired. I suppose you could argue that you, therefore, effected a greater stabilizing influence through fiscal policy than could have been exerted by the Reserve System through credit and interest policy.

You see, I am jumping into the breach now in your defense.

Secretary SNYDER. That was the reason I said the matter was very debatable and we could get into a lot of arguments back and forth that would not particularly solve the problem. I am not trying to say we were right and somebody else was wrong, or that somebody else was right and we were wrong.

Senator DOUGLAS. Having argued on your side, let me, however, also argue on the other side. If you had been able to check the inflation of prices by credit policy, the cost of Government services would not have risen by as much as they did and, therefore, your expenditures would have been less, and the surplus would have been greater than it otherwise would have been, and the deficit in the present period probably would have been less.

Secretary SNYDER. Mr. Chairman, you are proving the very point that I made, that it is a most debatable matter, that you can argue back and forth for days.

Senator DOUGLAS. What we are trying to find are the reasons and the grounds on which one can debate, so that instead of this thing being done with a few high-powered experts and officials, the public and the Senators and the Congressmen can get some appreciation of what the intellectual issues are, because I have always felt that, in a democracy, monetary policy was not sacrosanct, that it vitally affects the life of the community and, therefore, the community should know something about it and should have some share in making the decision. That is why I would like a full unveiling of these matters, if we might have them.

Secretary SNYDER. I would be delighted to have all the unveiling possible, but please remember that you cannot discuss public debt policies—as to what is going to be done or not done in the future, as to interest rates and maturities and that sort of thing—the Secretary of the Treasury cannot discuss those things openly as an individual because the minute he does go on record as to his thinking, that becomes then the policy of the Treasury in the minds of the public; and it would greatly affect our market relationships and possibly cause us great difficulties in the management of the debt.

Senator DOUGLAS. Can we discuss intellectual issues based on past history?

Secretary SNYDER. The Treasury Department has to keep the practical side along with the intellectual side constantly in mind.

Senator DOUGLAS. I do not suppose anyone except, shall we say, financial die-hards, want to have a completely unsupported bond market. The question is where the yield in prices shall be allowed to fluctuate within certain narrow limits. That is the issue.

Senator FLANDERS. Mr. Chairman, I was interested in the testimony yesterday from Mr. Kline, of the Farm Bureau, who gave a very well-prepared written statement, and Mr. Grede and Dr. Lutz, of the National Manufacturers Association. I suppose in some sense those two organizations and those witnesses can be said to represent, perhaps, an informed point of view on the part of their organizations.

The interesting thing was that both of them in their testimony indicated that they did not feel it was necessary to support the Government security market, keep it from going below par, and felt there were advantages in more flexibility in the interest rate.

Now, in other words, if those gentlemen were correct and really represented their constituencies, there would be no feeling of distrust if there were a change of policy provided, as the chairman just said, that it was understood the support was going to be there; and that it was being undertaken in the purpose of some flexibility in the interest rate and not a dropping of controls to allow the market to go anywhere it pleased.

Secretary SNYDER. Mr. Chairman and Senator Flanders, there has been considerable flexibility in the interest rate. We have demonstrated that. The Treasury Department has never taken an inflexible position in reference to interest rates. We just have to keep a careful watch on interest rates fluctuating too rapidly one way or the other.

Senator FLANDERS. But the other point of view is that they should be allowed to fluctuate. There are reasons and purposes involved in allowing them to increase at times and in holding them down at other times. And that is determined by the point of support of the market, and I think it is true, is it not, that at no time has the market been allowed to go below par to any extent or for any length of time?

Secretary SNYDER. Of course, the bond market has not been supported on the 2½ basis for some time. There was only a short period when it was receiving relative support. But as to the flexibility of the short rate, during the course of my incumbency as the Secretary of the Treasury, it has fluctuated all the way from three-eighths to 1.12 at the present time, and that looks like considerable flexibility.

Senator FLANDERS. But was it allowed to fluctuate for the purpose of affecting commercial interest rates? That is the question.

Secretary SNYDER. Exactly; that was used for tightening up purposes to assist in the credit-control arrangement.

Senator DOUGLAS. Mr. Secretary, that was done about the middle of 1947, I take it?

Secretary SNYDER. Between then and now.

Senator DOUGLAS. So that during 1946 it was not done when the rate on Treasury bills was less than one-half of 1 percent?

Secretary SNYDER. Correct.

Senator FLANDERS. In other words, there is some question as to whether it was done at the time when it would have been most helpful to do it.

You are aware, Mr. Secretary, as you have indicated, this is a question which is of very serious concern to people who are thinking about this subject. We have to find some means of getting into it. We have to find some means of satisfying our responsibilities with regard to it as legislators.

I think we have a greater responsibility than that assigned with reference to the general public by the chairman. We have a specific responsibility for trying to understand this situation and coming to some conclusion on it.

I would like to read into the record two paragraphs from a letter from Marriner Eccles which raises the question in a fairly compact form. I believe, sir, you have a copy of this letter.

Secretary SNYDER. It was handed to me just as I started up here, and I have not had a chance to look at it.

Senator FLANDERS. I see.

I will just read these two paragraphs:

> The Federal Reserve System was established by Congress primarily for the purpose of determining and carrying out credit and monetary policy in the interest of economic stability and is responsible to Congress for that task. There is a seven-man Board of Governors, appointed for 14-year terms with approval of the Senate. The Board is assisted by an experienced and highly qualified staff of experts. There are 12 presidents of the Federal Reserve banks, each with a staff of specialists, and each Federal Reserve bank has a board of directors composed of leading citizens in its district drawn from professional, business, farming, banking, and other activities. There is also the Federal Advisory Council, composed of a leading banker from each of the 12 districts, established by Congress to advise the Board. All of these supply information and advice and many participate in formulation of monetary policies appropriate to the needs of the economy.
>
> Under present circumstances the talents and efforts of these men are largely wasted. Views of the Federal Reserve Board and Open Market Committee regarding debt-management policies are seldom sought by the Treasury before decisions are reached. The System, however, has made suggestions on its own initiative to the Treasury in connection with each financing, but very often these have not been accepted. Decisions are apparently made by the Treasury largely on the basis of its general desire to get money as cheaply as possible.

I might comment by saying that that desire is a fairly praiseworthy desire, and I think you should still maintain that desire.

Secretary SNYDER. Just before you leave that, Senator Flanders. You are going to have the Chairman of the Federal Reserve Board here tomorrow, are you not?

Senator FLANDERS. I believe so.

Senator DOUGLAS. Yes; that is right.

Secretary SNYDER. Read that paragraph to him and ask him if he concurs.

Senator FLANDERS. I will be glad to do it.

Now, Mr. Chairman, I have this suggestion to make for your consideration. I think that the Secretary makes a very important point when he suggests that what he says in public with regard to the bond market, maintaining its price, changing the interest rate, and so forth, has far more effect than when you, or I, or any of the witnesses we have had before us, make similar suggestions or similar statements.

Furthermore, I do not believe that any useful purpose would be served on having a long-range debate on this subject, with one witness appearing one day and another witness the next and another witness the next.

I think we have a duty to see if there is some composition that can be made in the public interest of these differences of opinion, and my suggestion is that we ask members of the two groups to meet with us in executive session and see if we can come to our own conclusion as a result.

Senator DOUGLAS. Would that be acceptable to you?

Secretary SNYDER. That would be acceptable to me, Mr. Chairman.

Senator DOUGLAS. We have a somewhat tight schedule next week, but I think we could probably fit it in. We will send an invitation to Mr. Eccles and also to Mr. McCabe if he cares to be there. It is possible we could arrange that this afternoon.

Secretary SNYDER. Unfortunately, I will not be able to attend this afternoon, Senator, but any day next week I am available for it.

Senator DOUGLAS. Mr. Secretary, yesterday Mr. Kline, in the testimony to which Senator Flanders has referred, made an interesting suggestion on the adaptation of the refunding policy of the Treasury to business conditions. And, before I go into that, I want to see if my own knowledge of the facts of the situation is correct.

As I understand it, the purchases of Government bonds, generally, for long periods of time, are made primarily by others than banks—namely, by individuals and savings institutions—and come primarily out of savings, and hence represent probably no real creation of additional monetary purchasing power, but instead the transfer of purchasing power to the purchase of Government securities which would otherwise be used for some other purpose; but that the purchases of securities by banks are primarily short-time securities and are primarily derived from the creation of credit by the banks, the writing up of deposits on the bankbooks with which these short-time securities are purchased, and that they, therefore, amount to an injection of additional monetary purchasing power into the economy.

Am I correct in that general impression?

Secretary SNYDER. That is correct.

Senator DOUGLAS. Mr. Kline's suggestion, as I gathered it, was that the refunding policy instead of being independent of the business cycle or business conditions should be adapted to business conditions. For example, in periods of so-called prosperity and rising prices, or inflation, there should be a relative shift from short-time Government securities held by banks to long-time securities held by nonbanks, individuals, and savings institutions; that in this way you would at least prevent from increasing, and probably decrease, the amount of bank credit which was available, and you would substitute for that genuine savings out of the current income; and that this would dampen down, therefore, possible inflationary influences.

Secretary SNYDER. Mr. Chairman, that is exactly what we did. We shifted $34,000,000,000 out of the commercial banking system into that type of portfolio. We study those portfolios every day of the year, and we are right on top of the available investment cash in all of those different types of institutions, and we consult with them every month in the year as to exactly how much they have available for investment purposes. And we have been attempting to do exactly what you have just outlined.

Senator DOUGLAS. Well, the converse of what Mr. Kline said was that in a depression period you should shift from the long-time holdings of Government bonds to short-time holdings; and that, therefore, you should diminish the holdings of long-time securities by individuals and savings institutions and increase the amounts of short-times furnished by the banks.

Secretary SNYDER. We have not had a depression since I have been Secretary of the Treasury.

Senator DOUGLAS. I am using the two words "prosperity" and "depression." Suppose we substitute for depression the word "recession." I think Mr. Kline would say that in a period of recession there should be a shift from long-time to short-time, thus creating additional monetary purchasing power through the banks.

Secretary SNYDER. That follows the policy that we have been using. Of course, we have not had any real recession.

Senator DOUGLAS. I am not trying to score a point, Mr. Secretary.

Secretary SNYDER. I am not trying to score points, either. I am just trying to say we are in accord with those views because that is exactly what we did on the one side. I have not had any experience to actually do the other to any degree.

Senator DOUGLAS. Has not this last year been one of recession on the whole?

Secretary SNYDER. There has been a shifting back and forth. We do not consider this last year a recession, you understand. Income was higher than it ever was before in the history of the country. 1948 was the most prosperous year in history.

Senator DOUGLAS. 1949 was not a recession?

Secretary SNYDER. 1948 was not, and in 1949 income paid to individuals is still running at a tremendous rate. We have had some adjustments, yes; but we have not had any recession.

Now there have been neighborhoods and localities that have had some difficulties; but, as a national picture, we have had adjustments but certainly no recession The income during the first 10 months of the year was higher than in 1948.

Senator DOUGLAS. Well, it was a recession from the latter part of 1948.

Secretary SNYDER. You are talking about the inventory adjustment which began at the end of last year?

Senator DOUGLAS. Mr. Secretary, wholesale prices went down, as I remember it, by 8 percent; manufacturing production went down, as I remember it, by about 16 percent. We have the charts. Unemployment went up from 3 percent; that is, if you take the nonagricultural working force, from 3½ percent to 7½ percent. I know there are lots of semantic difficulties on these things, but I would call that a recession.

Secretary SNYDER. Frankly, in the volume that took place, I would call it an adjustment.

Senator DOUGLAS. But if it had been a recession—let us put it that way. If it had been a recession, would it have been wise to have pushed the sale of E, F, and G bonds which are bought out of savings? Had it been a recession, might it not have been better to have shifted from long-time to short-time, which Mr. Kline suggested? Now we have got a purely suppositious question.

Secretary SNYDER. That is what led me to say, Mr. Chairman, we have to carefully study each time we make a decision in the Treasury the conditions of that time. We have never seen where there was any trend developing there. We saw adjustments taking place, and we conducted our affairs accordingly.

If such a condition as you envision should come about, we would have to sit down and give it our very careful consideration.

Senator DOUGLAS. How serious would the drop have to be for the adjustment to turn into a recession?

Secretary SNYDER. We would have to observe that and decide.

You see, Mr. Chairman, if I would venture to say that any point is the turning point, these gentlemen would never forget it; and if we ever reached that point, then we would be said to have a fully binding obligation. So, I will not venture to put any deciding line between what is an adjustment and what is a depression or what is a recession.

Senator DOUGLAS. That preserves administrative discretion but does not add to either public or senatorial enlightenment.

Secretary SNYDER. I will be glad to discuss the matter more fully in this executive session you are planning.

Senator DOUGLAS. Mr. Secretary, let me ask you a theoretical question.

Who in your judgment has the responsibility for monetary policy, the Secretary of the Treasury or the Federal Reserve Board?

Secretary SNYDER. Well, the Federal Reserve has the primary responsibility.

Senator DOUGLAS. Who has the ultimate?

Secretary SNYDER. I am talking about generally speaking. If you include debt management in monetary policy, that is another matter. The Treasury Department without question—the Secretary of the Treasury—has the responsibility for debt management, and it was given to him by Congress.

Senator DOUGLAS. But credit management is in the hands of the Federal Reserve.

Secretary SNYDER. Congress has placed that largely in the Federal Reserve's hands.

Senator DOUGLAS. Through the increase in the public debt, the Treasury and the Federal Reserve have become Siamese twins, as it were, joined together by an indissoluble connection. Now suppose the Federal Reserve wants to move one way and the Treasury wants to move the other, how strong is the filament which connects these two bodies, and which has the greater motive force to lead the other?

Secretary SNYDER. Theoretically and practically, I would say, the Treasury Department and the Federal Reserve Department must have full cooperation. I said that initially, and I still believe it.

Senator DOUGLAS. Suppose the Federal Reserve wants to raise the interest rate to check inflation and the Treasury wants to keep interest rates down to reduce the debt service, who in this partnership is then to decide?

Secretary SNYDER. Cooperation is a two-way street, and it is certainly to be hoped that the two agencies can sit down together and work out their problems. I thought we had been doing it very well.

Senator DOUGLAS. We had a whole list of questions, Mr. Secretary; but, in our desire to cooperate and have full cooperation between the legislative and executive branches, I feel somewhat constrained in the matter. I feel that I probably should not ask them with all these gentlemen of the press about. I feel that I should defer them to this executive session when I shall receive the first dividend in enjoyment which I have thus far experienced as a Senator.

Secretary SNYDER. Mr. Chairman, in order that you might have seasoned and carefully considered answers to those questions, if you would give them to us now, we will be glad to go to work on them.

Senator DOUGLAS. Senator Flanders has read an excerpt from Mr. Eccles' letter. I think you have copies of that letter. If you would address yourself to the letter, we would appreciate it. Also, here is the list of questions which I had intended to ask you.

Secretary SNYDER. We have a copy of the letter. We will be delighted to work on it and these questions in the interim.

Senator DOUGLAS. I am sorry to disappoint the gentlemen of the press, but the chairman, having run out of questions, feels it is proper to ask in the interest of cooperation——

Mr. Wolcott, excuse me.

Mr. WOLCOTT. That is perfectly all right. I am a very humble member of this committee, anyway. I have enjoyed the debate thus far very much.

I hope that no crime will be committed by me in my questions against the committee's willingness to cooperate with the Treasury in this respect. So, if any of the questions I ask are seemingly a crime which violates this spirit of cooperation, I hope the Secretary will refuse to answer them point-blank.

I think we should find out from the Secretary whether the Treasury has any program to offset a recession or depression or other adjustment periods.

Secretary SNYDER. What sort of program?

Mr. WOLCOTT. That is what I want to know.

Secretary SNYDER. That is a pretty broad question.

Mr. WOLCOTT. Put it this way: Have you outlined what the Treasury should do to offset a depression?

Secretary SNYDER. You mean in the management of the debt? Is that what you had in mind?

Mr. WOLCOTT. In all the fields over which you exercise an influence.

Secretary SNYDER. We will certainly attempt in any fashion we can to adjust our policy to the conditions of the times. As for having any direct program that we are going to take a certain step at a certain time, we will have to do that in consultation with other agencies because the Treasury alone does not have a great deal of control over conditions of that sort. And, as far as the taxing is concerned, that is a matter in the hands of Congress. And that, of course, is one of the biggest factors that can be used that we are connected with—the taxing program of any given year—and that is a matter, of course, that is in the hands of Congress. We can make recommendations but the Congress makes the decision and makes the actual tax legislation.

Mr. WOLCOTT. Would you suggest that taxes be raised in periods of depression or recession?

Secretary SNYDER. Be raised in periods of recession?

Mr. WOLCOTT. Yes; if it is necessary to balance the budget.

Secretary SNYDER. Well, I think those are matters that certainly have to be decided, taking into consideration the conditions of the times. And if raising taxes is going to drive us into a deeper period of recession, we would have to give it full consideration at that time, and consider the interests of the public.

Mr. WOLCOTT. I remember some testimony by one of your predecessors, Secretary Morgenthau, some years ago, when he said that the Treasury was on a day-to-day basis in respect to policy. Is the Treasury still on a day-to-day basis in respect to policy?

Secretary SNYDER. It has to be, Mr. Congressman, because of the economic conditions of the country, that is, so far as debt management is concerned. A very definite policy in other matters, but in debt management we have to be on a day-to-day basis—say a month-to-month basis, but it is practically the same thing.

Mr. WOLCOTT. There is a very close affiliation between debt management and our economy, generally, because of the interest rate.

Secretary SNYDER. There is no question in the world about that.

Mr. WOLCOTT. I guess perhaps what I am trying to get at is: Have you any program outlined as to what you might do in respect to debt management which might affect our economy generally if we were threatened with a recession?

Secretary SNYDER. The major things that we could do are tied up in whatever tax program is adopted in any one year.

Mr. WOLCOTT. Well, have you a program which contemplates any recommendations of Congress to offset a depression or a recession?

Secretary SNYDER. We have a study group constantly working with Congress on various types of taxes and their effects on the economy.

Senator FLANDERS. May I interrupt for an observation?

Mr. WOLCOTT. Yes.

Senator FLANDERS. What you have just been saying, Mr. Secretary, rather indicates to me that on the face of it you do not conceive of that management as being a major factor in stabilizing the economy.

Secretary SNYDER. It is very important when combined with other forces, Senator. But debt management by itself, set off alone, is limited in what it could do in stabilizing the economy. We have to work with the credit-control people, we have to work with the Congress, we have to work with a number of elements, and tie those all in together; then we can make the debt management fit into the stabilization program. But set off by itself, it has a limited effect.

Senator FLANDERS. I do not think anyone has felt that debt management was unimportant or was in any other relationship to the whole than the various other factors are.

Excuse me, Congressman Wolcott.

Mr. WOLCOTT. Perhaps at this point it might be interesting to determine what proportion of our debt now is in accumulated interest.

Secretary SNYDER. Have we got the figure on that?

Mr. HAAS. You mean on discount bonds, Mr. Congressman?

Mr. WOLCOTT. Interest on the whole debt, I guess.

Mr. HAAS. I beg your pardon.

Mr. WOLCOTT. It would have to be interest on the whole debt if we are going to compare it to the debt.

Secretary SNYDER. On the total debt the figure is $3,100,000,000.

Mr. WOLCOTT. $3,100,000,000?

Secretary SNYDER. Yes.

Congressman Wolcott, I do not want to diminish it, and I have emphasized the importance of debt management's part in the whole economic stabilization program. But I again accented the importance that it must be tied in with other elements, and it cannot simply by itself, isolated, have a tremendous effect. But tied in with the operation of Federal Reserve and with the tax program and with recommendations for budgetary matters, it is vitally important. I want to make that perfectly clear.

Mr. WOLCOTT. I think when you said there was this very close affiliation with great influence on our economy incident to debt management, that you surely could not be charged with saying there was not a great influence and a very close affiliation.

Secretary SNYDER. Yes.

Mr. WOLCOTT. Is your management of the debt predicated upon the continuance of the present inflated dollar?

Secretary SNYDER. Just what do you mean by that?

Mr. WOLCOTT. Well, we have about a 60-cent dollar as opposed to a 100-cent dollar on the 1936–39 level, and of course there is a reflection in the debt of that depreciation in the value of the dollar.

Secretary SNYDER. We have to measure that, of course, against what our national income is now and what the present economy is. We just cannot isolate it and say what the dollar might have been worth in purchasing power in 1939 and what it is today.

Mr. WOLCOTT. Let me put it this way: Do you think that the value of the American dollar should remain static on the $35-an-ounce gold base?

Secretary SNYDER. Under conditions as they are today, I see no reason, with the commitments that we have in the purchase and sale of gold, why we should make any change in the dollar price of gold—$35 an ounce.

Mr. WOLCOTT. I think you have made the statement that it would perhaps be disastrous if you were to make any change in the dollar price of gold.

Secretary SNYDER. Well, it would just mean this: If we would make a change upward in the price of gold, we would be taxing our taxpayers to pay the subsidy on our purchases of foreign gold. The present volume of newly mined gold, known newly mined gold, in the world is roughly 900 millions of dollars. Of that the United

States produces about 75 million. Last year we purchased more gold than all of the current world production of gold. Any increase in the price of gold would be a subsidy paid by the American taxpayer. I just cannot bring myself to agree to that.

Mr. WOLCOTT. That world production of gold is an estimate or the actual figure?

Secretary SNYDER. That is the actual known figure.

Mr. WOLCOTT. Do you know how much Soviet Russia produces?

Secretary SNYDER. That is why I put it "known" production.

Mr. WOLCOTT. We have been trying for a good many years to find out their production.

Secretary SNYDER. We do not know accurately what Russia is producing. That is why I qualified the statement and said the "known" world production of gold.

Mr. WOLCOTT. Have you taken into consideration some production by Soviet Russia, or is the Soviet production in addition to these figures?

Secretary SNYDER. No Soviet gold is in that figure.

Mr. WOLCOTT. In your statement you say that under the circumstances which existed stability in the Government bond market has been of tremendous importance to the country.

You mean by that it is important to stabilize the Government bond market if we are going to stabilize our economy?

Secretary SNYDER. The fact we have had a stable Government bond market has had a good influence on all other segments of our economy—in the operation of credit in various fields, in the development of industry, and in the financing of our crops.

Mr. WOLCOTT. I was merely leading up to this question: Do you advocate the continuance of pegging the bond market by the Federal Reserve or the Open Market Committee, or anyone else?

Secretary SNYDER. We have not had to put any pegs in there for some time.

Mr. WOLCOTT. I mean if there came a time when the Government bond market was declining, would you feel that the Government bond market should be stabilized at any given arbitrary figure?

Secretary SNYDER. Well, the Federal Government is under no implied obligation to peg any market.

Mr. WOLCOTT. I know that.

Secretary SNYDER. As to what our position will be, we will just have to determine it as conditions develop.

Mr. WOLCOTT. It has a very important influence on economic stability. I will put it this way: Do you believe it is necessary to support the Government bond market?

Secretary SNYDER. I will have to measure by conditions as they are at the time we make a decision.

Mr. WOLCOTT. That is not part of the program, however?

Secretary SNYDER. There is no program implied.

Mr. WOLCOTT. Have you any recommendations to make to the Congress in respect to what we might do as a stabilizing influence in respect to taking from you the authority which you now have to buy gold freely?

Secretary SNYDER. I would have to give that some consideration, Mr. Congressman.

Mr. WOLCOTT. Would you be opposed to the repeal of sections 8 and 9 of the Gold Reserve Act? I think those are the sections which give you that authority.

Secretary SNYDER. I would have to give that some consideration.

Mr. WOLCOTT. Under the Bretton Woods Enabling Act, we have provided—and with the chairman's consent I will read it into the record so that there will be no dispute about the language of the law. There seems to be a little dispute as to what section 5 of the act contains in this respect.

That provides:

Unless Congress by law authorizes such action, neither the President nor any person or agency shall on behalf of the United States propose or agree to any change in the par value of the United States dollar under article IV, section 5, or article XX, section 4, of the Articles of Agreement of the Fund, or approve any general change in par values under article IV, section 7.

I will also read article IV, section 1, defining the par value:

The par value of the currency of each member shall be expressed in terms of gold as a common denominator.

Section 2 of the same article specifies that—

The fund shall prescribe a margin above and below par value for transactions in gold by members, and no member shall buy gold at a price above par value plus the prescribed margin, or sell gold at a price below par value minus the prescribed margin.

Now if the directors of the fund, having set that margin at a quarter of 1 percent, increased it to, we will say, 10 percent, that would in effect change the gold content of the American dollar, would it not?

Secretary SNYDER. By their action you mean it would actually change or would theoretically change?

Mr. WOLCOTT. Well, I guess theoretically primarily, perhaps, but it would naturally follow—it would be an actual change.

Secretary SNYDER. If the board of directors of the fund were to make such an adjustment, it does not imply the United States will follow through and buy and sell gold at that price.

Mr. WOLCOTT. To be sure now.

Secretary SNYDER. It takes the consent of the United States along with it.

Mr. WOLCOTT. But it would in effect and in practice change the gold content of the dollar, notwithstanding the fact that our director on the fund might vote against it or might refrain from voting under the terms of the enabling act, which forbids him from voting any change without consent of Congress. Perhaps this is all theoretical, and I hope academic, because of the position which you have taken effectually.

What I am trying to find out here—what I am reading from here now is what I consider a splendid article which will appear in the Engineering and Mining Journal in next month's issue, which I have a tear sheet from. I think the article is very well put up and puts this whole problem into one package. And I might suggest to the chairman, if he cared to do it—and I have the consent of the Engineering and Mining Journal—that it might go into the record.

Senator DOUGLAS. We will be very glad to have that, Congressman Wolcott.

(The document above referred to is as follows:)

Could the Treasury Raise Its Gold Price Overnight?

(Herbert M. Bratter, Washington, D. C.)

"Can the Treasury overnight increase the price of gold?" This question was put to me by the editor of Engineering and Mining Journal. For years, as a Government economist and private citizen, I have watched American gold legislation from the ringside, but I hasten to state at the outset that I am no lawyer.

Had the question been phrased differently, the reply might be easier. Had the editor asked: "Do you think the administration wants to raise the price of gold or devalue the dollar any time in the visible future?" my reply would be "No."

However, the editor's question relates to power, not intent. It arises from the fact that there is on the statutes a clear power for the Secretary of the Treasury to change the price at which the Government buys and sells gold. While that power, last enacted in 1934, has never been specifically repealed, some hold that it has been in effect repealed by the subsequently enacted Bretton Woods Agreements Act of 1945. The most that the Treasury has stated about its 1934 power today is that the "discretion of the Secretary of the Treasury" to change the price of gold has been "limited" and "circumscribed." The power remains.

PRICE OF GOLD

Under the gold standard, as understood by economists, the terms "price of gold" and "gold content of the dollar" mean the same thing. Thus, in the United States today, regardless of the fact that the dollar is not internally redeemable in gold coin, the price of gold is $35 an ounce troy. The troy ounce contains 480 grains. The gold content of the dollar, therefore, is 480 grains divided by 35, or 13.71+ grains of fine gold.

Since 1934 the weight or gold content of the dollar has remained unchanged. Hence, there has been no change in the official price of gold in the United States. Were the gold content of the dollar to be reduced, the price of gold would be raised automatically, pari passu. If, for example, the gold content of the dollar were to be reduced by 50 percent the price of gold at the Treasury would be doubled.

It is possible for the Treasury to increase the price of gold while leaving unchanged the legal definition of the weight of the dollar, but if that is done, the country violates one of the rules of the gold standard. It was actually done in 1933. The administration at that time deliberately took the country off the gold standard, utilizing the Trading With the Enemy Act. Congress later endorsed the steps taken when it passed the Thomas amendment in May 1933. Subsequently, that year the administration raised the price of gold in the open market, despite some question in the Treasury as to the legality of what it was doing.

In sections 8 and 9 of the Gold Reserve Act of 1934 the legality of the purchase of gold at premiums above the legal price of gold was retroactively ratified.

"The par value of the United States dollar" is another term, understanding of which is necessary in connection with the subject of this article. Parity means equality of value, expressed in terms of the monetary standard. As between two countries whose currencies are each defined as specific weights of gold, parity is the ratio of the two official prices of gold. Within a single country which defines its currency unit as a weight of gold, parity is that weight.

In the United States the dollar is at the official parity whenever it equals one thirty-fifth of an ounce of gold. It is this which the Congress obviously had in mind in the Bretton Woods Agreements Act cited hereafter.

Under the Thomas amendment of 1933 the President was authorized to reduce the weight of the gold dollar by as much as 50 percent. No time limit was set on that power. But the Gold Reserve Act of 1934, passed after the open market price of gold in the United States had been raised to almost $35 an ounce, put a time limit on this power of the President, which was several times extended, but finally was allowed to lapse in June 1943. However, to the extent that the Secretary of the Treasury may have any power over the price of gold under the terms of sections 8 and 9 of the Gold Reserve Act of 1934, the President also has power; the power to consent. And the President's power to consent is certainly, in fact, the power to initiate action as well.

GOLD RESERVE ACT

Sections 8 and 9 of the Gold Reserve Act of 1934 read as follows:

SEC. 8. Section 3700 of the Reserve Statutes (31 U. S. C. 734) is amended to read as follows:

"SEC. 3700. With the approval of the President, the Secretary of the Treasury may purchase gold in any amounts, at home or abroad, with any direct obligations, coin, or currency or the United States, authorized by law, or with any funds in the Treasury not otherwise appropriated, at such rates and upon such terms and conditions as he may deem most advantageous to the public interest; any provision of law relating to the maintenance of parity, or limiting the purposes for which any of such obligations, coin, or currency, may be issued, or requiring any such obligations to be offered as a popular loan or on a competitive basis, or to be offered or issued at not less than par, to the contrary notwithstanding. All gold so purchased shall be included as an asset of the general fund of the Treasury." (31 U. S. C. 734.)

SEC. 9. Section 3699 of the Revised Statutes (31 U. S. C. 733) is amended to read as follows:

"SEC. 3699. The Secretary of the Treasury may anticipate the payment of interest on the public debt, by a period not exceeding one year, from time to time, either with or without a rebate of interest upon the coupons, as to him may seem expedient; and he may sell gold in any amounts, at home or abroad, in such manner and at such rates and upon such terms and conditions as he may deem most advantageous to the public interest, and the proceeds of any gold so sold shall be covered into the general fund of the Treasury: *Provided, however*, That the Secretary of the Treasury may sell the gold which is required to be maintained as a reserve or as security for currency issued by the United States, only to the extent necessary to maintain such currency at a parity with the gold dollar." (31 U. S. C. 733.)

The act which authorizes United States participation in the International Monetary Fund provides (Sec. 5) that:

"Unless Congress by law authorizes such action, neither the President nor any person or agency shall on behalf of the United States * * * propose or agree to any change in the par value of the United States dollar under Article IV, Section 5, or Article XX, Section 4, of the Articles of Agreement of the Fund, or approve any general change in par values under Article IV, Section 7 * * *."

The Articles of Agreement of the International Monetary Fund in article IV, section 1, define par value as follows:

"The par value of the currency of each member shall be expressed in terms of gold as a common denominator . . ."

Section 2 of the same article specifies that:

"The Fund shall prescribe a margin above and below par value for transactions in gold by members, and no member shall buy gold at a price above par value plus the prescribed margin, or sell gold at a price below par value minus the prescribed margin."

SNYDER COMMENTS

On repeated occasions, notably in press conferences, Secretary of the Treasury John W. Snyder has consistently denied any intention to propose a change in the dollar price of gold. In a statement handed to the press in written form on October 5, 1949, the Secretary went further. He not only denied the intention to propose a change. He made it clear that the power given the Secretary of the Treasury in sections 8 and 9 of the Gold Reserve Act of 1934 "is limited by a number of factors," first of which is the obligation of the United States as a member of the fund. After quoting article 4, section 2, of the fund agreement, already cited, Mr. Snyder's October 5 hand-out reads:

"The fund has prescribed a margin of one-fourth of 1 percent above and below the par value for purchases and sales of gold. Accordingly, the United States has an obligation to the International Monetary Fund not to purchase gold at more or sell gold at less, than $35 plus or minus the prescribed margin so long as the par value of the dollar declared to the fund remains unchanged. The par value of the dollar can be changed only pursuant to the provisions of the articles of agreement and the Bretton Woods Agreement Act, which requires the approval of Congress for any such change. Section 5 of that act provides that neither the President nor any person or agency shall propose to the International Monetary Fund any change in the par value of the United States dollar or approve any general change in par values unless Congress by law authorizes such action.

"Even without the legal obligation to the International Monetary Fund there are important considerations of policy which, in effect, circumscribe the discretion of the Secretary of the Treasury to change the price of gold. The gold policy of the United States has been directed primarily to maintaining a stable relation between gold and the dollar."

Mr. Snyder went on to emphasize the importance which the United States attaches to maintenance of a stable dollar price for gold. He pointed out that the gold parity statutes of 1900 and 1933 require the Secretary of the Treasury to maintain parity of United States money with the gold dollar.

Note, however, that both these statutes were on the books when Roosevelt late in 1933 raised the price of gold without the dollar's having been formally devalued. Note also that section 8 (already cited) permits the Secretary to buy gold on his own terms, "any provisions of law relating to the maintenance of parity * * * to the contrary notwithstanding."

Although this indicates that Snyder could, if he would, raise the price of gold, the likelihood of his doing so was lessened by President Truman's flat statement on November 10 that as long as he was President, the price of gold was fixed.

While the present Secretary of the Treasury evidently regards the Bretton Woods Agreements Act of 1945 obligation as overriding the powers given him under sections 8 and 9 of the Gold Reserve Act of 1934, it does not necessarily follow that a later law eliminates the provisions of an earlier law, unless those provisions are specifically repealed. On November 17, 1933, Attorney General Homer Cummings sent President Roosevelt a written opinion that the powers of the Secretary of the Treasury enacted in 1862 and 1864 to buy and sell gold (the powers since reenacted in sections 8 and 9 of the Gold Reserve Act) were still alive in 1933.

THE FUND'S POSITION

The board of executive directors of the International Monetary Fund, in which the United States has the largest voice, have it in their power to prescribe (under article 4, section 2, of the fund's articles of agreement) the margin above and below par value for transactions in gold by members. In the fund's present rules and regulations this margin is fixed at one-fourth of 1 percent. This margin could be increased without amendment of the articles of agreement. Only the rules would have to be changed. Were the margin to be expanded to, say 10 percent, the Secretary of the Treasury could use his powers under the Gold Reserve Act of 1934 to buy gold at $38.50 an ounce.

Several members of the World Fund have subsidized their gold-mining industries. While the intentions of the Bretton Woods Conference are somewhat obscure on this point, the fund in practice tolerates gold-mining subsidies so long as they are not on a uniform-per-ounce basis.

Individual subsidies to individual gold mines get around the fund's objections and are just as satisfactory to the miners concerned. It would be possible for the United States to subsidize its gold-mining industry without violating the fund articles of agreement. For example, suppose that the Secretary of the Treasury with the President's approval were to buy all the gold produced in excess of the previous year's output at, say, $40 an ounce, it would be possible to maintain that:

(1) The gold content or weight of the dollar remains unchanged.
(2) The par value of the dollar remains unchanged.
(3) The fund articles of agreement and recent policies are observed.

And this can be done without any new legislation by the Congress. That it would be done is, of course, most unlikely, in view of the lack of need for more gold in the monetary system and the relative smallness of the gold-mining industry in this country's economy.

THE OUTLOOK

On the surface or behind the scenes, so far as a Washingtonian can observe, there is not the slightest sign that the present administration desires an increase in the price of gold or devaluation of the dollar.

Whatever powers the Truman administration has over the price of gold, it has no intention of using them. Nor has it any intention of surrendering them.

Yet this generation has had experience with long-dormant laws and powers and their application to surprising ends. It has discovered that laws and promises do not always mean what they have long seemed to mean. Who can be sure, therefore, that in some future 1933, with another FDR in the White House, another Homer Cummings as Attorney General, another Herman Oliphant as Treasury General Counsel, it will not be determined that the Secretary of the Treasury has the power to increase the price of gold?

Mr. WOLCOTT. I think it throws a tremendous amount of light on this whole question, and the law is all here in 1–2–3 order.

Senator FLANDERS. Congressman Wolcott, may I inquire whether the article explains whether gold stabilizes the dollar or whether the dollar stabilizes gold?

Mr. WOLCOTT. I think there would be general agreement under the plan that gold would stabilize the dollar.

Senator FLANDERS. That is a debatable question.

Mr. WOLCOTT. I know. It was to me until these hearings. And I gather from the hearings that, much to my surprise, we are on some sort of a gold standard. I had not known that for some years. But every witness has brought out this very close affiliation between the American dollar and gold. So I assume from that, if we are not actually on a de jure gold basis we are at least on a de facto gold basis.

Senator FLANDERS. Or gold is on a dollar basis.

Mr. WOLCOTT. I will agree—I did not think we were in disagreement on this—that the dollar under the Bretton Woods agreement in practice has been substituted as a basis which controls the value of all major world currencies.

Secretary SNYDER. I think we are definitely on an international gold bullion standard. There is no question about that.

Mr. WOLCOTT. I do not think there is any question in anyone's mind about the desirability of getting as much of the debt into private hands as possible as a hedge against inflation. And we have been told that the drives on the savings bonds have been very successful in that respect.

Now how much can we rely upon future activities in that field to prevent the monetization of the debt?

Secretary SNYDER. Well, the savings bond program, as we have conducted it since the war, has been on a thrift basis and including with it at times an inflationary basis. But recently we have used it most as a thrift incentive, and it has been deemed so by all the banking institutions because we have had the hearty support of all banking groups in the savings bond programs. And it has been very effective in spreading the ownership of the debt and the interest on the debt.

We have tried to keep on that level, and we keep our eyes constantly on it, and if it ever got to be a drain on the economy, we would naturally taper off on the promotion of the savings bonds.

Is that the question?

Mr. WOLCOTT. Yes; I believe so.

The purchaser of the bond purchases it because he is thrifty. Many in Government and financial circles, however, have stressed the advisability of selling E, F, and G bonds to the general public to prevent further threats to the value of the dollar incident to the possibility of monetizing that debt if this debt were held by the banks in such a way that it could be monetized. So I think on the part of the purchaser it is a question of thrift, and on the part of Government there is this very decided factor, perhaps deciding factor, that the sale of these bonds to private holders does prevent further inflationary influences. That is right, is it not?

Secretary SNYDER. It is.

Mr. WOLCOTT. Now, what I am trying to find out is how successful we have been in that field.

I have before me a release of the Treasury Department on July 21, 1949, which is very short, and if I may, I shall read it. The number is S-2060. It says:

Acting Secretary of the Treasury Foley announced today that sales of Series E Savings Bonds in the recent opportunity Savings Bonds drive reached $1,216,230,000. This was 117 percent of the national quota of $1,040,000,000.

The Acting Secretary said:

"The Nation is to be congratulated on this further evidence that the spirit of thrift is very much alive in America.

"The success of the drive was due primarily to the work of the hundreds of thousands of volunteers who gave it their energetic support. These volunteers included representatives of practically every field of activity. National Director Vernon L. Clark of the Treasury's Savings Bonds Division joins me in extending hearty thanks to these volunteers as individuals as well as to their community, State, and national organizations."

Now I have also the Treasury Bulletin of November 1949 before me. And if I understand the figures correctly, they perhaps belie that statement by Mr. Foley.

Your drive was going on from sometime in May to sometime in June. Let's go back to April. Sales of E, F, and G bonds in April, just before the drive, were $331,000,000; in May 1949, during the drive, they were $322,000,000; in June, $359,000,000; July, $378,000,000, when there was not any drive on. There does not seem to be too much difference in the volume of sales.

Secretary SNYDER. I would like to look into it—those figures are not in my mind.

Mr. WOLCOTT. I will give you some other figures here from your report which, of course, are authentic.

The E's outstanding, which would be the bonds, presumably, for which there would be the greater demand in a drive of that kind, as of April 30, were about 33 billion dollars; May 31, about 33 billion; June 30, 33 billion; July 31, 33 billion; August 31, 33.4 billion; September 30, 33.5 billion.

Secretary SNYDER. I do not carry those figures in my mind. But are those net figures?

Mr. WOLCOTT. I think so.

Secretary SNYDER. Those are net figures, are they not?

Mr. WOLCOTT. From the Treasury daily statement.

Secretary SNYDER. They are net outstanding.

Mr. WOLCOTT. Yes; net outstanding. So that would not indicate there was in the aggregate much accomplished.

Secretary SNYDER. You have got to keep working to stay even sometimes, you know. I will be glad to look into that for you.

Mr. WOLCOTT. I wonder if Mr. Foley was not a little optimistic. I should not put it that way. Of course, I do not want to dispute the figures. But I wonder if the people were not perhaps justified in being a little bit misled by the Treasury's statement that we had sold $1,216,000,000 during that period.

Secretary SNYDER. If you desire it, I will have a reconciliation of those figures prepared.

Mr. WOLCOTT. I wish you would and I will appreciate it.

I bring it up only for the purpose of showing that perhaps our effort to put these bonds in position as part of our public debt, where they cannot be monetized, has not been the success that we in Congress are sometimes led to believe.

Secretary SNYDER. Congressman, I think the real test is the total volume outstanding. And that, of course, is an indisputable figure. We know exactly what that is and have so stated in my statement. And if that is being maintained, then we are accomplishing what we have been endeavoring to do.

(The following information was later submitted for the record:)

In response to Congressman Wolcott's inquiry about the opportunity savings bond drive:

The savings-bond program must be kept constantly before the public. The Treasury Department has had several promotional drives since the end of the war and in each case this has been one of the major objectives. As I said in my prepared statement, and again in the questioning which followed, we have continued to promote the sale of savings bonds since the end of the war in order to broaden the ownership of the debt; because of the anti-inflationary effect of such sales during periods of inflationary pressures; and as a means of encouraging thrift.

Another aspect of the promotional drives which might be mentioned is the probable effect which they have in cutting down redemptions. As I noted in another part of my statement, the savings-bond redemption experience since the end of 1945 has been more satisfactory than the turn-over experience in other forms of savings.

It is with all of these considerations in mind that we have sponsored promotional savings-bond drives since the end of the war. The important thing is to maintain the total volume outstanding. We have done this; and the total amount of E bonds outstanding has increased approximately $3,000,000,000 since January 1947, as shown in the following table:

[In millions of dollars]

	Sales	Accrued discount	Redemptions		Amount outstanding
			Sales price	Accrued discount	
1947—January	535	52	334	8	30,507
February	394	40	282	7	30,651
March	372	45	333	9	30,725
April	349	40	355	10	30,749
May	305	42	320	9	30,767
June	301	61	328	10	30,791
July	339	57	344	11	30,833
August	294	42	305	10	30,854
September	304	46	329	11	30,864
October	304	41	305	10	30,894
November	263	46	262	9	30,932
December	325	67	316	11	30,997
1948—January	479	60	299	11	31,226
February	367	44	233	9	31,394
March	383	48	328	13	31,485
April	320	44	332	14	31,503
May	305	60	303	13	31,552
June	341	78	332	14	31,625
July	379	70	305	13	31,755
August	334	49	307	14	31,818
September	304	52	289	13	31,872
October	305	49	274	13	31,939
November	308	59	281	13	32,012
December	399	83	292	14	32,188
1949—January	438	75	269	13	32,419
February	386	53	213	11	32,634
March	415	57	291	14	32,800
April	331	54	271	14	32,901
May	322	64	276	14	32,997
June	359	89	301	16	33,127
July	378	81	269	14	33,303
August	329	59	283	16	33,393
September	299	62	[1] 281	[1] 15	33,457
October	289	64	[1] 263	[1] 15	33,532
November	286	69	[1] 278	[1] 15	33,594

[1] Preliminary.

Mr. WOLCOTT. I am sorry I will not be here for this debate between you and Mr. Eccles and Mr. McCabe. I assume that the Treasury Department and the Federal Reserve have had pretty close contact in respect to monetary and credit policies, have they not?

Secretary SNYDER. It has been my opinion that that is true, yes.

Mr. WOLCOTT. Then can I leave here tomorrow under the assumption that this debate you are going to have will not elicit any more cooperation than has been elicited from previous meetings you have had?

Secretary SNYDER. Are you going to be here for the testimony of the Chairman of the Board tomorrow?

Mr. WOLCOTT. Yes.

Secretary SNYDER. That probably answers the question.

Mr. WOLCOTT. Then we can take your testimony today and his testimony tomorrow and by putting them together we can conclude what will be the result of the meeting which you are going to have in executive session here before this committee?

Secretary SNYDER. We are not limiting the scope of this meeting next week. The Chairman has asked to get parties together to visit. I did not know it would necessarily be a debate, but an open discussion of problems.

Mr. WOLCOTT. Perhaps I misused the word. But there has been open discussion between the Treasury and the Federal Reserve?

Secretary SNYDER. Constantly, constantly.

Mr. WOLCOTT. Do you want us to wait until we hear Mr. McCabe before we go further into the Eccles letter?

Secretary SNYDER. I have not had a chance to look at the Eccles letter, but anything you want to bring out of it, all right.

Mr. WOLCOTT. He says:

"The Federal Reserve System was established by Congress primarily for the purpose of determining and carrying out credit and monetary policy in the interest of economic stability and is responsible to Congress for that task."

I guess that is right, is it not?

Secretary SNYDER. I do not think there is any doubt about that.

Mr. WOLCOTT. He goes on to indicate that, because of the great influence which the Treasury has upon the decisions of the Federal Reserve Board, the Federal Reserve is put in the position now of serving two masters, the Congress of the United States and the Treasury.

Do you want to comment on that?

Secretary SNYDER. I do not think I want to comment on that. It is interesting to me that the Federal Reserve serves any master.

Mr. WOLCOTT. He says also, and this is particularly interesting in view of your statement of the decided influence of debt management on our economy generally:

Decisions are apparently made by the Treasury largely on the basis of its general desire to get money as cheaply as possible.

Is that the policy of the Treasury?

Secretary SNYDER. It is not.

Mr. WOLCOTT. Then he goes on to say that because of this policy on the part of the Treasury the Federal Reserve's hands are tied pretty much; that if you develop an easy money policy with respect to debt management, it is difficult for the Federal Reserve to offset that by exercising the orthodox controls which it has within the limitations of law.

Now we run up against that in respect to other agencies of the Government. The Federal Reserve could raise the rediscount rates, reserve requirements; it could manipulate the open market operations to a point where there might be a tightening of credit and at the same time this could be offset completely by the other agencies of the Government. The RFC, the farm loan agencies, and Export-Import Bank might completely offset the efforts on the part of the Federal Reserve to tighten credit or expand it.

Secretary SNYDER. As I said a while ago, it takes the coordination of the operation of many agencies to come up with a net result. And if they could all be brought to bear on a single objective, which I feel they attempt to do, why we accomplish the end result. But this Government was set up on a sort of check and balance theory, and so I think that comes into operation in many of those considerations.

Mr. WOLCOTT. Well, in the committee print I think you answered the question as to whether you were in favor of a credit council, or something along that line, rather generally. As I recall it, you objected to it because it might, in the process of coordination, mean that through any such council you might have to yield a little sovereignty in that respect.

Secretary SNYDER. I do not think I objected to it. I think I specifically said I had no objection to the formation of such a monetary council. I did express the doubt of whether or not it would accomplish the full objective for which it was set up.

Mr. WOLCOTT. Would you vest them with any powers with respect to the formulation of Treasury policies?

Secretary SNYDER. The Treasury will not delegate any authority except when ordered by Congress to do so.

Mr. WOLCOTT. Would you think it advisable for the Congress in the establishment of any coordinating body to vest that body with such administrative powers that they could veto Treasury policy?

Secretary SNYDER. Well, the question is raised: Is the legislative going to become administrative? I wonder whether or not Congress wants to undertake to spell out how we are going to manage a debt.

Mr. WOLCOTT. We are not going to do that. I did not intend that to be the question. I intended it to be along this line: If the Congress establishes a coordinating body, a body to coordinate policy—call it a Federal credit council or whatever you want to, but not a monetary commission; I do not have that in mind—do you think this commission should be vested with such power that, notwithstanding Treasury policy, they could establish policy?

Secretary SNYDER. I doubt if it should go beyond the type of advisory group of the NAC. It can be an advisory group, but the agency that has been charged by Congress with making final decisions will have to continue to have that responsibility.

Mr. WOLCOTT. And you think that logically should be in the Treasury?

Secretary SNYDER. The NAC has, as I think you know, been extremely effective in coordinating foreign monetary policy. It might well be that a domestic council of that sort would be helpful.

Mr. WOLCOTT. Could you suggest any standards under which they should operate in this field?

Secretary SNYDER. In order to be of value to you, I would have to give that very serious consideration and discuss it later.

Mr. WOLCOTT. What I am trying to find out here is: What would you suggest that the Congress do to help in the coordination of policy within or between the Executive establishment and independent offices of the Government?

Secretary SNYDER. I think possibly the formation of such a domestic council would be helpful. As a matter of fact, I was giving it a great deal of consideration about 2 or 3 years ago. I think I talked with one or two of you here about it. I think Senator Flanders and you were both interested at the time. And we were comparing it with the operation of the NAC. We never quite got around to making any definite proposals about it, but I will be glad to brush up on the thinking of that time and bring it up to the point where we can discuss it with you in more detail.

Mr. WOLCOTT. Do you think it should be given any greater authority in the domestic field than the NAC now has in the foreign field?

Secretary SNYDER. On the face of it, I would say "No." I would have to give it very careful consideration to see if there is any further latitude that should be granted domestically than is given in the foreign field.

Mr. WOLCOTT. And would the same results be accomplished by transferring the independent offices to the executive establishment, letting the President coordinate, as he does, the executive establishment?

Secretary SNYDER. For just a complete blanket answer, I could not give that. Some of the agencies could very appropriately be blanketed into some of the executive establishments, but I would have to give the whole picture careful consideration.

Mr. WOLCOTT. Of course, in doing so we would destroy the checks and balances you referred to.

Secretary SNYDER. You would. Every time you do that you are to some extent mitigating the check and balance theory.

Mr. WOLCOTT. Thank you, Mr. Secretary.

Senator DOUGLAS. I have just one final question that I would like to ask in order to make the record clear.

Did I understand you to say that you felt there was no indefinite obligation upon the part of the Government to support the bond market and to maintain prices of Government securities at at least par? There was no indefinite obligation?

Secretary SNYDER. I said there was no definite obligation.

Senator DOUGLAS. No definite obligation?

Secretary SNYDER. That is true.

Senator DOUGLAS. And therefore there is no obligation even at the present time or in the future?

Secretary SNYDER. Our obligation is to pay them off at par at maturity.

Senator DOUGLAS. But in the meantime there is no legal obligation upon the Government to maintain it?

Secretary SNYDER. It is a matter of policy.

Senator DOUGLAS. Again not to point out differences but for the purposes of clarification. Mr. Harl, the head of FDIC, testified on this other matter before us, and I would like to read from his testimony:

Mr. HARL. We have labored under the policy that Government securities will be supported at all times. In 1940 and 1941, when the war came on, I was a State bank commissioner. I was assured by people in high places that the Government bond market would be supported. In that connection we went to our banks and asked them to participate in the war effort by making certain purchases. Naturally, the bankers who were there in 1929 to 1933, in those days, and particularly in 1920 and 1921, when Libertys dropped to, I think, 85, were reluctant to participate, until we, as State bank commissioners, told them that we were told that the bankers of this country would be protected on a stabilized Government market.

Then I asked the question:

Was that protection a guaranty for an indefinite period of time, world without end, or was it for a stated period?

Mr. Harl replied:

There was no statement made as to the length of guaranty or the time involved. We were told that the Government bond market would be protected. As you remember very well, in those early twenties when Libertys went to 85 cents. Therefore, you know, if you discount 15 percent of your Government holdings in the banks of the country it would materially affect their capital structure.

Then I asked a further question:

But suppose the Federal Reserve, for example, should decide to either end the system of support price or lower the support price, where would you be then?

And Mr. Harl replied:

I think if that was done, that good faith would have been broken with the banking fraternity who have supported, by large investment, Government bonds. I don't think we could have won the war if the bankers of the country hadn't gone in and bought these bonds like they did. I understand that it cost us one-tenth of 1 percent to dispose of our Government's. The bankers rallied and bought these bonds. I know, frankly, that I would not have recommended to any bank under my supervision at that time that they invest heavily in Government's unless there was some assurance that they would be protected.

Then there is an intervening paragraph referring to the volume of these obligations, and in the next paragraph:

I think that the bankers of this country believed that, and had a right to believe, that their Government would see that the bond market was supported at par, or they would not, as trustees of these large sums and these large deposits, invested 56 percent of their assets in the securities of this Government.

I wondered if you had any comment on Mr. Harl's testimony, whether you agree with his inference which, I think, is almost a clear statement in his testimony, that Government securities would be supported at all times, or whether you think any modification should be made in that statement.

Secretary SNYDER. Mr. Chairman, I was not present at those discussions, and that was before my time in the Treasury; so I am in no position to discuss it one way or another as to what was said or what was not said.

Senator DOUGLAS. I wondered if you wanted to make any expression.

Secretary SNYDER. I have no comment on it. I think the bankers had the right to expect the debt would be properly managed.

Senator DOUGLAS. This is our difficulty: If there have been promises made, we would naturally feel obligated to carry them out, but if promises have not been made, we are not obligated to carry them out.

Secretary SNYDER. Mr. Chairman, do you want me to testify on something I know nothing about? I would have to check back with the Treasury people and see if there has been anything of that sort.

Senator DOUGLAS. I see.

Senator FLANDERS. I might raise the question as to whether an obligation of this sort, if made, is any more sacred than to redeem Government bonds in gold.

Senator DOUGLAS. That is another story.

Any other questions?

Thank you very much, Mr. Secretary.

Secretary SNYDER. One point about Congressman Wolcott's quarter of 1 percent margin on the gold price. That was to permit a handling charge and a handling charge only.

Mr. WOLCOTT. The point was, if they had the authority to set the margin at a quarter of 1 percent, they would also have the authority to set it at 10 percent.

Mr. LYNCH. I think that is giving the words a rather strained meaning. The record indicates that margin was intended to cover only what the conventional handling charge is, and at the same time the Congress, in giving approval to membership in the fund, said no action could be taken as to changing the par value. I do not believe that the margin requirement could in good conscience be stretched into an authority to do by indirection what Congress has forbidden.

The clear record as to the development of that provision shows it was intended only to cover what is a conventional handling charge in connection with the purchase and sale of gold.

Mr. WOLCOTT. The point was that the board of directors of the fund has the authority, even though the United States director might not approve of it, or might absent himself at that time, to provide for these margins. What I was getting at was: If the fund at any time did use this power arbitrarily or otherwise, there would be an effect upon the value of the American dollar.

Mr. LYNCH. It would not necessarily have any effect on the American dollar.

Mr. WOLCOTT. This prohibition in the Bretton Woods Enabling Act against what our director could or could not do without reference to Congress would, of course, be overcome by his being outvoted, which I presume, is not a reasonable assumption.

Mr. LYNCH. But I think that is only part of the picture, Mr. Congressman.

Mr. WOLCOTT. I frankly was discussing it more theoretically.

Mr. LYNCH. A change in the margin would not have the effect of changing the gold value of the dollar, because the restriction on officers of the United States in that respect is clearly stated in the Bretton Woods Agreement Act. The fact is as far as the United States is concerned it would be obligated still, under the mandate of Congress, to maintain, not to change, the par value. And I do not believe anyone would feel he had license to do it by indirection.

Mr. WOLCOTT. If the par value of the currencies of 47 other countries were changed, I am not so sure but that the par value of the American dollar would change almost proportionately.

Mr. LYNCH. Not the par value in the fund, Mr. Congressman.

Mr. WOLCOTT. I should not say "par value," I should say the value of the American dollar.

Mr. LYNCH. I just wanted to make the point and leave it clear. I do not believe we can assume there is available under this provision a means of doing indirectly something that is prescribed by Congress. We would view it in that light.

Mr. WOLCOTT. Thank you.

Senator DOUGLAS. Thank you very much.

Secretary SNYDER. Thank you, Mr. Chairman, and the members of the committee. It has been a very pleasant morning.

Senator DOUGLAS. May I say we will resume our sessions at 2:15 this afternoon when Mr. Sproul, who is the head of the New York Federal Reserve Bank, will testify.

(Whereupon, at 12:30 p. m., the subcommittee adjourned, to reconvene at 2:15 p. m. of the same day.)

AFTERNOON SESSION

Senator DOUGLAS. Ladies and gentlemen, if we may come to order, the witness this afternoon will be Mr. Allan Sproul, who is president of the Federal Reserve Bank of New York.

We are glad indeed to welcome you and will be glad to have you testify.

STATEMENT OF ALLAN SPROUL, PRESIDENT, FEDERAL RESERVE BANK OF NEW YORK

Mr. SPROUL. Senator Douglas and members of the committee, as I understand it, your interest at these hearings is in exploring the various points of view developed in response to your questionnaire inquiry, rather than in having individual witnesses try to cover all of the ground from the beginning, by means of a long prepared statement. In any case, I have given you my views on the general subject of your inquiry in the extended answers to your questionnaire prepared by a special committee of the Federal Reserve banks, which I sent you with a covering letter of my own.

Today, with your permission, therefore, I shall confine my preliminary remarks to a few brief comments on one or two critical points which, as I see it, need fresh emphasis or elaboration, in view of the other replies and testimony you have received.

(1) In an inquiry as broad as that which you are conducting, there is well-founded and proper concern with a host of questions, many of which, however important in themselves, may tend to divert attention away from the central problem. In the area of monetary, credit, and fiscal policies, and under present conditions, I believe that problem is how to combine effective monetary management with effective debt management.

There cannot be a purposeful monetary policy unless the Federal Reserve System is able to pursue alternating programs of restraint, "neutrality," and ease, in a roughly contracyclical pattern. Such programs must, as they accomplish an increase or contraction in the volume of credit and a tightening or loosening in the availability of credit, affect interest rates, not only for private credit, but for Government securities.

The terms of Treasury offerings for new money, and for refunding issues, must be affected. Yet those effects will, at times, be in-convenient and burdensome to the Treasury in its management of the enormous public debt, and may conflict with otherwise praiseworthy efforts to minimize expenditures for debt service.

This is an inherent conflict.

Senator DOUGLAS. You would not say it is an irrepressible conflict?

Mr. SPROUL. No; I would not. It will continue to arise, in one form after another, so long as this public debt, huge in relation to our present national income, is with us. It is important, therefore, that better means be found, if possible, for reconciling potential differences between the Treasury and the Federal Reserve System, so that action in the credit sphere may be taken promptly, as needed, in reasonable harmony with the action being taken by the Treasury in the sphere of debt management.

The record of cooperation in the postwar years has been better than might have been expected, and so has the record of our economy, whatever connection there may be between the two. But agreed action, in my opinion, has most often been too little and too late, so far as the aims of an effective monetary program were concerned.

For example, the System wanted to discontinue its preferential discount rate on Government securities maturing within 1 year, before the end of 1945; Treasury acquiescence, and the action, did not come until April 1946.

From the closing months of 1945 through all of 1946, the System was pressing for discontinuance of its artificially low buying rate—three-eighths of 1 percent—on Treasury bills; the action finally came, with Treasury agreement, in July 1947.

From that point on, as inflationary pressures increased, the System wished to follow a program of credit restraint which would have necessitated small but, perhaps, frequent increases in short-term interest rates which would have meant similar increases in rates on Treasury bills and certificates, and some increase in the yield of other short and intermediate Government securities.

The Treasury did a large part of the job, of course, by devoting its substantial cash surpluses to the retirement of debt in such a manner as greatly to aid in achieving the common objective; but the Treasury was generally several months behind in accepting the implications of a tightening policy for the interest rates on its short-term securities.

Now, and so far as we can see into the next fiscal year, there is not much chance of the Treasury's enjoying cash surpluses; in fact, cash deficits with their inevitable bias toward inflationary pressure, when the economy is already working close to capacity, seem to be in the cards.

It may become all the more important under such circumstances, and would become most important if inflation should in fact return, that the Treasury be receptive to rising rates—the same rising rates that would be required in attempting to hold in check any inflationary tendencies in credit expansion to the private sector of the economy.

It is this situation which lends weight to the suggestion that there be a congressional directive, specifying as part of the legislative framework for debt management that the Treasury should work within the structure of interest rates appropriate to the economic situation.

The implication of such a directive would be that the Treasury could not, as a matter of right or of superior position, call upon the

Federal Reserve System to "make a market for its securities" at rates which the System believed to be out of line with the degree of credit restraint considered necessary by the System.

I recognize that there would continue to be differences of opinion about these matters, and I realize that you cannot legislate cooperation between people, but the Congress, as final arbiter, might be able to provide a mandate which would charge debt management as well as monetary management with some responsibility for the objectives specified in the Employment Act of 1946.

The country cannot afford to keep money cheap at all times and in all circumstances, if the counterpart of that action is inflation, rising prices, and a steady deterioration in the purchasing power of the dollar, including the purchasing power of the dollars which the Government itself must spend and the purchasing power of dollars invested by the public in Government securities.

Whether or not a directive is possible or may be forthcoming, there seems to me to be a clear need to study this question of how to bring about a more regular relationship for consultation between the Treasury and the Federal Reserve System than that now temporarily provided through fortunate personal relationships.

One suggestion along these lines which may deserve your consideration is that there be created a national advisory council on domestic financial policy, a consultative body which would bring together the heads of the four or five principal agencies whose activities affect, directly or indirectly, the areas of prime responsibility of the Treasury and Federal Reserve System.

Such a council might also extend its scope to include within its purview, on a purely consultative basis, the lending and loan-guaranty activities of all other Federal financial agencies, in the interests of frequent consideration of overlapping mutual problems. This suggestion is open to the criticism that it might be just another piece of machinery delaying decision but not leading to harmonious action. Nevertheless, it is worth exploring. Another suggestion is that the Secretary of the Treasury be made a member of the Board of Governors of the Federal Reserve System. I have a latent distrust of these ex officio relationships, and it didn't work well in the early years of the System; but the idea should at least be reexamined in the light of present conditions.

(2) If a suitable permanent framework for the relations between debt management and monetary policy can be established, the tasks of monetary control and debt management will not be impossible. While the money market is not so sensitive to slight changes or disturbances as it was from 1946 through much of 1948, when large segments of the swollen public debt had not yet settled into firm hands, it is still sensitive to relatively small changes in the interest rate structure, and to any uncertainty concerning the future direction of rates created by such changes, in terms of its readiness to make funds available for expansion.

Through judicious use of discount rates and flexible open-market operations, it should be possible to make monetary policy reasonably effective without such abrupt and such wide changes in interest rates as used to be considered a necessary part of central banking technique. Such a monetary program would be consistent with very moderate fluctuations in the cost of servicing the debt, and would not contemplate nor require large changes in the prices of outstanding Government securities.

In this context, the question of par support of Government securities, to which considerable attention has been given at past hearings and which has evoked some comment by witnesses before your committee, would shrink to a relatively minor issue. With the market susceptible to and habituated to small rate changes, any slight and probably temporary decline in prices below par would not be a matter of major concern.

The likelihood that we shall be operating in this sort of climate is strengthened by the fact that we have already passed through the postwar period of most extreme capital demand, in excess of current savings, and an early recurrence of that kind of disparity, with the great upward pressure it exerts upon long-term rates, is improbable.

Moreover, the maturity of the Government debt now outstanding is being shortened automatically by the passage of time, a factor which exerts a mechanical downward pressure on the market rates for these issues—that is, a rise in their price, over time—allowing more and more leeway, each year, so far as outstanding issues are concerned for fluctuations to occur above the par level.

This does not mean, however, that there has been or can be a commitment, express or implied, to support all Government securities at par at all times. Such a commitment would make any pretense of credit policy over the long run rather ridiculous, since the essence of credit control is fluctuating rates, reflecting credit availability.

And just as the pretense of credit policy would be made ridiculous, the present forms of debt management would be made obsolete. If all Government securities of all maturities can be liquidated at par at any time they become, in effect, demand obligations and need only bear varying rates of interest if we want to reward various kinds of holders in various ways. And again I say it would be a spurious gain to support all Government securities at par or better, ad infinitum.

There may be extreme situations, which we cannot now perceive, when there would be greater losses and damage to the economy by reason of unbridled inflation, unrestrained by monetary action, then would result from allowing the price of Government securities to go below par.

(3) I favor the extension of national reserve requirements to all—or at least all insured—commercial banks; I also favor the uniform reserve plan, relating reserve requirements to type of deposit, and abandoning the outmoded geographical classification. But both of these are essentially matters of improved housekeeping; they do not affect the real fundamentals of monetary control. I do not apologize for them on that account.

I think it is unfortunate that needed improvements, which will add to efficiency and remove burdensome inequities, are often dismissed for lack of glamour or lack of urgency. But it is equally unfortunate if, in order to attain these improvements, they are "oversold," being offered as powerful remedies for problems that can better be solved in other ways.

As I see it, the case of these proposals rests on simple grounds. So far as the application of reserve requirements to State-chartered commercial banks is concerned, it is important to remember that these banks are exercising, by the acquiescence of Congress, a constitutional Federal function—the power to add to or subtract from the money supply.

While no one is more anxious than I to preserve those characteristics of local responsibility and initiative which are fostered by the State chartering of banks, I do question whether the arrangements which permit these advantages should also be used to avoid a proper share in the responsibilities of national monetary policy. To say that it would strike at the foundation of the State banking system to make nonmember banks subject to national reserve requirements seems to me to be putting the cart before the horse and then belaboring the horse.

State chartering and State supervision—the real essence of a "dual banking system"—would not be disturbed by the extension of the System's reserve requirements to all banks. We have nearly 2,000 State-chartered banks, at present, as voluntary members of the Federal Reserve System. Their aggregate earning assets are nearly twice those of the more than 7,000 State-chartered nonmember banks. The reserve requirements of membership have apparently not prevented the State-chartered members from thriving, nor has their membership destroyed their essential State character.

And, yet, monetary policy can't be fully effective unless all parts of the banking system, the whole banking community, have some understanding of it and play the game. There should be some direct contact between the Federal Reserve System and all banks—or all insured banks—of the country.

If wider access to the discount privilege on the part of nonmember banks is necessary to make this palatable, it might not be too great a price to pay, and would have collateral advantages in strengthening the emergency liquidity of the banking system. I must confess to some lingering feeling, however, that if banks want—or if in the national interest they should have—all or most of the advantages of membership, they ought to pay their dues. As a counterweight to possible concern that System control over all reserve requirements places too wide a range of authority in a distant Washington body, it should be pointed out that a transfer of authority over reserve requirements from the Board of Governors to the Federal Open Market Committee would assure a representation of regional banking experience in the determination of these requirements.

The type of deposit versus geographical location reserve proposal also rests on considerations of equity among banks and on the desirability of modernizing a control apparatus in order to permit the System to carry out its general mandate from Congress in the most efficient, practicable manner.

(4) No change in the System's power over reserve requirements should be presented, however, as an alternative to facing head-on the actual and potential conflicts between monetary control and debt management. It has been argued, for example, that increases in reserve requirements, whether primary or secondary or what not, provide a way of tightening up on the availability of credit without affecting interest rates and therefore without trespassing on Treasury prerogatives of debt management. We tried that approach in 1948 without appreciable results. Following the increases in reserve requirements

in that year, the banks sold Government securities to the market in a volume roughly equal to the dollar amount of their increased reserve requirements; the market in turn unloaded an equal volume upon the Federal Reserve banks. That result was inevitable, I believe, so long as the Federal Reserve held its buying rates—that is, held interest rates—virtually unchanged.

Senator DOUGLAS. And, therefore, the lending capacity of banks was not diminished?

Mr. SPROUL. Not diminished, except for the small amount that the leverage factor in reserves was diminished; that is to say, they might lend perhaps 5½ times instead of 6 times the amount of aggregate reserves.

Senator DOUGLAS. They have more money to count as reserves; and, even though the amount of reserves on deposit was increased, the larger amount of reserves permitted them to expand their loans at the same rate.

Mr. SPROUL. In general, that is right.

We saw the reverse operation this past summer. Reserve requirements were lowered and the banks used most of the proceeds to buy Government securities from the market, while the Federal Reserve banks sold, or redeemed, a roughly corresponding volume. There were other factors at work, to be sure, in both of these periods; but full review of the statistical record, making allowance for these other factors, still shows that the 1948 increases and the 1949 reductions in reserve requirements resulted mainly in shifts of Government securities between the Federal Reserve banks and the commercial banks.

The inescapable fact, in my opinion, is that moderate changes in reserve requirements, up or down, will have no appreciable effect upon the availability of credit to the general economy if rates have to be held constant.

Senator DOUGLAS. Interest rates?

Mr. SPROUL. Interest rates; yes. And if rates can vary, changes in reserve requirements are a crude way to do a job that the discount-rate and open-market operations can accomplish with much greater flexibility and precision. The proper role for changes in reserve requirements is in making long-run strategic alterations in the banking structure—in response to sustained gold flows, for example, or shifts in the public's habitual use of currency.

The one exception might be a period of run-away inflation of an extreme form such as has not occurred in the history of the Federal Reserve System. Under such circumstances, when all traditional control instruments have been outdistanced and crude but drastic measures become necessary, it might be effective to make temporary emergency use of very high reserve requirements, perhaps as high as 100 percent, against new deposits in order to immobilize for a time the money-creating capacity of the commercial banking system.

Short of that, given the environment created by the present large national debt, changes in reserve requirements seem to me to have no significant role to play in the day-to-day adaptation of credit policy to the changing business situation. They cannot be substituted for rate flexibility in influencing the availability of bank credit to the economy.

I have given you my views on what seems to me to be a central point of your inquiry with some collateral comments. I shall be glad to try to answer questions raised by this presentation or questions related to other aspects of your studies if you so desire.

Senator DOUGLAS. I think it is fairly clear that you believe fluctuations in the interest rate are the best means of checking excessively cyclical movements of business.

Mr. SPROUL. I think they are a necessary part of any purposeful monetary control; yes.

Senator DOUGLAS. Well, now, you would not withdraw all support of Government securities, would you?

Mr. SPROUL. Not by any means.

Senator DOUGLAS. And, therefore, the fluctuations in the prices of Government securities which would result from the adoption of the policy you advocate would probably be relatively minor?

Mr. SPROUL. I should think so.

Senator DOUGLAS. Now, would the minor fluctuations in the prices of Government securities and, therefore, in the yields on Government securities be sufficient to really have much of a controlling effect upon business?

Let me give an illustration if I may. With an average interest rate of 2⅕ percent, a fall of 10 points in the price of Government securities would send the interest rate up by something less than a quarter of 1 percent. Now, that is a rather slight increase in itself, and furthermore interest costs are a relatively small share in total cost of business, so you have what our mathematical friends call a second difference, a slight change in a slight change.

Would that have any more effect than raising the price of nails, let us say, by one-tenth would reduce the demand for houses?

Mr. SPROUL. I would not place the effectiveness on the size nor percentage increase in the interest rate. I think in dealing with the interest rate you are dealing both with expectations as to the future business situation and as to future profits, and the judgment of a responsible body of men as to what those conditions may be, so that I think you have an effect far beyond what I admit is the minor cost of interest in the carrying out of any business undertaking.

Senator DOUGLAS. Yes; but the market would know that the prices of Governments would not be allowed to fall very far and that the maximum increase which they might expect would be something around a quarter of 1 percent. So that the market would not move in this fog of uncertainty as to what was going to happen. It would know that there was a very definite feeling as to the degree to which the interest rate might rise; and, knowing that, would it operate as a deterrent?

Mr. SPROUL. If the market is uncertain, both as to the cost of credit and as to its availability, which are two important parts of the credit picture, and if a policy of restraint with respect to availability of credit is tied in with a policy of small changes in the interest rate——

Senator DOUGLAS. That goes to the question of reserve requirements.

Mr. SPROUL. That need not be a question of reserve requirements. It can also be a question of open-market operations and of the discount rate and of borrowing.

Senator DOUGLAS. But you, yourself, said, suppose the Government sells securities to the private market in a period of inflation in order to draw down their balances, as long as there is any program supporting the market, then the banks, security dealers, can present those bonds to the Reserve and you will be taking back in one pocket what you took out of the other.

Mr. SPROUL. Well, I said there might be a situation such as has not yet arisen where there would be such an unbridled inflation that we could not operate under such a modest policy, that we would have to seek more drastic means.

But I think that, under the kind of a situation we have experienced ever since the war, a modest policy has been effective without violent fluctuations in interest rates or in prices of Government securities.

Senator DOUGLAS. Do you think investors would be willing to sell securities if the price of these securities would fall so that they would then suffer a capital loss?

Mr. SPROUL. That would be a deterrent to selling in many cases.

Senator DOUGLAS. This therefore would strengthen the stabilizing influence of open-market operations?

Mr. SPROUL. I think it would. I think the main factor, of course, is the demand for capital funds in relation to the supply, and I think we had an extreme disparity in the immediate postwar years. If there is not a disparity or large disparity in the demand for capital in relation to the supply, these people who are selling Government securities will have to buy something else to put their funds to work. They do not go into a vacuum.

Even during that period we were able to sell almost as many short-term securities as we bought long at the time we were supporting the long-term Government-security market; so what we were putting into the system with one hand, the banking system, we were taking out with the other in that instance; but I agree with you that if we had a little more range of fluctuation, and if there was no commitment, expressed or implied, to support at par, and if the prices of some Government securities did go below par, causing the seller a capital loss if he sold, that might be another deterrent to sales.

Senator DOUGLAS. Of course, members of every institution see their own problems and see the possibilities in which they believe that their own institutions can contribute to the greatest stability. You have been emphasizing the stability which might be effected through raising interest rates to check undue borrowing and the uncertainty that might come from that.

I must confess that the fluctuations would be so small that I would like to see a stronger case made out than I think has been made out in the past for dampening off credit by slight changes in the interest rate. I have not seen any proof that in practice that has been effective. Of course, you may say it has not been tried.

Mr. SPROUL. Well, I think it was tried to some extent in 1948, although, as I say, slowly and hesitantly; and I think it did have some effect. But I would have to admit the monetary policy is only one weapon to be used, one factor in the situation. Debt management and fiscal policy are certainly important.

And beyond those factors there is the question of labor policy and wage rates, agricultural policy, support prices; there is the question of productivity of the economy; these are more pervasive and far reaching in effect than the small changes in interest rates we are talking about. But, if you want my monetary policy to make its contribution to this over-all objective, then you have to have some changes in interest rates; and I think the small changes can be effective insofar as monetary policy can be effective.

On the other hand, the older theory of larger changes, drastic changes, very high levels of interest rates at times to stop gathering inflation and bring a boom to an end, I do not think is practical politics in the present situation. I do not think people will submit to that sort of discipline. That discipline works through reduced supplies of credit, reduced production, reduced employment, reduced income, and depression; and, whether you like it or not, I do not think that is the kind of climate we live in.

Senator DOUGLAS. Have you thought about question of debt management and fiscal policy as well as money and credit policy?

Mr. SPROUL. Well, only in the terms expressed in my reply to the questionnaire and in my letter to you that fiscal policy certainly has an important role to play but that the record so far does not indicate that we can move always in the right direction in terms of fiscal policy and certainly not as promptly as is desirable at times to make it a flexible means of meeting the situation.

Senator DOUGLAS. You subscribe to the principle, do you, that in periods of prosperity the Government should have a surplus and use that surplus to retire a portion of the bank-held public debt, thus diminishing the amount of credit which can be loaned by the banks to private business, thus checking inflationary tendencies?

Mr. SPROUL. Yes; I think that the general objective of fiscal policy is in times of high levels of business activity, income, and employment to be in balance or to have a surplus, and in times of low level of business activity or unemployment to run a deficit.

I think that is a general policy, a general objective to be sought, but the means of doing so are so inflexible, so tardy in application, and the political pressures are so strong which interfere with reaching the objectives through the means that I am not too sanguine about its usefulness in meeting our problems.

Senator DOUGLAS. Witnesses from the National Association of Manufacturers testified yesterday that, in their judgment, except in extraordinary emergencies in peacetime, the Government budget should be balanced in each and every year, in depression as well as in prosperity. Do you agree with that?

Mr. SPROUL. No; I do not. The only reason I can see for such a statement is that, if you think that the pressures toward unbalancing a budget are so strong at all times that with an objective such as that you probably will reach the kind of situation we were talking about, then there might be some basis for it, but I certainly would not agree with it in theory.

Might I say another word on that question of balance? I think, in addition to the question of balancing the budget, there is an important question of size of the budget, which is a part of fiscal policy, and I quote here something I wrote recently to the Board:

> There is also the longer-run danger of devitalizing the economy. The problem of budget is not merely that of deficits and surpluses but also one of size. In this respect we might well take a lesson from the experience of Britain, where it is being recognized, even by the Labor government, that the budget is too high on both sides. Carried beyond some point, a large budget destroys incentive throughout the whole community. Today on a per capita basis our tax burden is actually larger than the British. The only thing that makes its burden more

tolerable here is that our economy is more productive, output per capita being approximately twice that in Britain, but we seem to be following the same road, which could result in a similar undermining of incentives and destruction of growth and productivity.

That, I believe, is a greater economic danger to the country than the question of surplus or deficit in the budget in any particular year.

Senator DOUGLAS. In your statement you say that this does not mean, however, that there has been or can be a commitment, express or implied, to support all Government securities at par at all times.

Now when Mr. Harl, the head of the FDIC, testified before us, he said he was a State banking commissioner at the time the first war issues were announced by the Treasury, and that an understanding was given to the banks that the Government would support the price of Government securities at par, and he took the position before our committee that there was an obligation on the part of the Government for the indefinite future to support the price of Government bonds and not allow them to fall below par.

Mr. SPROUL. I think Mr. Harl is grossly mistaken in his facts and in his theories. I was closely connected with the selling of Government securities all during the war and all of the drives and know of no such commitment being given by anyone who had any authority to give such a commitment, and I do not think such a commitment was ever given in a way that the banks of the country believed there was such a commitment.

On the other hand, I was strongly in favor of the support which was given to the long-term Government security market at the time we gave it, at the time we gave that support following the war.

Senator DOUGLAS. Is there any way of establishing which of you gentlemen is correct?

Mr. SPROUL. There were three Secretaries of the Treasury during that time; there are the records of the Treasury; there are the men who led the war-loan campaigns in the various districts, all of whom would have some knowledge or recollection or facts as to what was said or what was not said.

Senator DOUGLAS. That would require quite a dragnet for us to bring all those witnesses in here.

Mr. SPROUL. I think the only people who could have given any such commitment are either the Secretary of the Treasury or the Federal Open Market Committee, and as far as the Federal Open Market Committee is concerned, I could say as a member of that committee all during the period that no such commitment was ever given to anybody.

Senator DOUGLAS. You refer in your statement to the question of a uniform reserve for all banks, whether or not they are members of the Federal Reserve System, or at least of all banks inside the FDIC. It is argued in opposition to this that the deposits in the Federal Reserve System now comprise 85 percent of the total and that it is not necessary for the System to control the reserve ratios of the remaining 15 percent in order to control the total volume of credit; that the tail is relatively small compared with the dog. What would you say to that?

Mr. SPROUL. Well, I would say first that the tail ought to be a part of the dog, whether it is small or large, and I think that the national monetary and credit policy should have the support of all of the banks of the country and that they should meet the requirements of that national monetary and credit policy so far as it relates to the money supply.

On this question of the relatively small amount of deposits in the State nonmember banks, first as I have said, I think that is not a major problem in terms of credit policy and monetary measurement, but there is some deceit in aggregate figures. While 15 percent of total deposits is the aggregate figure, there are parts of the country where the volume of deposits held by nonmember banks is a much larger percentage.

But I think the main point is it is important, it seems to me, to have the requirements and the influence of monetary policy reach out through the whole country to the banking community in every area and the banks, the individual banks in every area, and not to have a system in which a large number of banks, even though their deposits are small, feel that they are outside the flow of national monetary and credit policy and can operate——

Senator DOUGLAS. You mean that they would feel more comfortable inside?

Mr. SPROUL. No; I would not say that. Not that they would feel more comfortable inside, but I think eventually they would gain a feeling of being part of the national banking community.

Senator DOUGLAS. You are doing it for their spiritual benefit?

Mr. SPROUL. No; doing it in terms of equity in dealing with the monetary and credit situation, in terms of some protection to the Federal Reserve System, although I am not greatly concerned about banks going out of the System, and in terms of some minor improvement in the effectiveness of monetary policy. I do not think it is a major matter, but I think it should not be dismissed because it is not a major matter.

Senator DOUGLAS. Well, most of the banks in your district, in fact the overwhelming proportion of the banks in your district, as I remember it, are members.

Mr. SPROUL. Yes, they are.

Senator DOUGLAS. As I remember the figures, roughly about half of all the banks of the country are not members of the System.

Mr. SPROUL. That is right. In our district we have 246 State members or 68 percent of the State banks of the district.

Senator DOUGLAS. As contrasted with about 22 percent of the State banks for the country as a whole.

Mr. SPROUL. Something like that, yes. We have a much larger percentage of State member banks than in most other sections of the country.

Senator DOUGLAS. Why does the Reserve System in New York have a greater attractive power than the Reserve System in other districts? Is it because the State banks are larger than they would be in the West, for example?

Mr. SPROUL. I think that has something to do with it. The State banks may be a little larger; they are older; they are more experienced in banking than in some parts of the West and South.

Senator DOUGLAS. Please don't reflect on the West.

Mr. SPROUL. I come from as far west as you can go myself. Also there is the question of par clearance which has not been a question in our district for many years, and that is one of the sore points about State bank membership.

Senator DOUGLAS. What about the strictness of State laws in the East as compared with the West?

Mr. SPROUL. I think that is important. Both the strictness of State laws and the quality of bank supervision under those laws. I can say that particularly about New York State, where most of our member banks are.

Senator DOUGLAS. The presidents of the various Reserve banks undoubtedly get together in your trade association. Do the presidents of other Reserve banks ever complain about the possibility that some of their State member banks would get out of the System if the reserve requirements were raised?

Mr. SPROUL. Yes; they did fear that possibility when reserve requirements were being increased, and they feel much more strongly about it than I do, that any substantial differences in reserve requirements might result in withdrawals from the System in numbers sufficient to be embarrassing.

But partly because of my own experience in my own district and partly because I think membership in the System is more valuable to those who have it than some of the dollars-and-cents calculations might indicate, as I say, I am not so worried about that as the others are.

Senator DOUGLAS. So it is mostly on the grounds of symmetrical logic that you would want to have uniform reserve requirements extended over all State banks?

Mr. SPROUL. I would resist that characterization.

Senator DOUGLAS. It was a compliment, I thought. When I say a man's reasoning is characterized by symmetrical logic, I mean it as a compliment, since the number of such persons is small.

Mr. SPROUL. It sounds remote from the affairs of New York and Washington.

Senator DOUGLAS. Life is not wholly logical; that is the point, and a great many people who want to fit the Nation into a given pattern do not fully appreciate the diversity of life and the local prides and local interests. If local pride and local interest do not threaten the national interest, why shouldn't they have their day in court?

Mr. SPROUL. I would not want to press too hard on the proposal for requiring all banks to maintain the same reserves, although I do think it would be valuable and has some importance, but I would not press it to the point of sacrificing something else that is more important.

Senator DOUGLAS. I suppose you could say that also if you wanted to restrict credit and tried to do that through alteration of reserve requirements, you would then impose the sole burden of restricting credit at present upon those inside the Reserve System.

Mr. SPROUL. Yes.

Senator DOUGLAS. And that those outside the Reserve System, on the one hand, would get the benefit of the added stability to the business system given by the tapering off of credit by those inside and at the same time enjoy the high earnings which would come from increased loans on their part, and that they would therefore live in the best of all possible worlds at the same time gaining the advantages of stability of the Reserve System and enjoying the lucrative fruits of low-reserve ratios for themselves.

Mr. SPROUL. I think that is so, but having argued myself against the use of increases in reserve requirements as an ordinary means of controlling credit policy, I cannot press that argument too strongly in urging that nonmember banks be required to observe those reserve requirements of member banks.

But I do think that there is a case in equity for requiring all banks to participate in the national objectives so far as credit policy is concerned. Perhaps equally important in terms of emotion is this feeling of local pride and local prejudice, but there is also, I think, a feeling against free riders, and the nonmember bank to a considerable extent is a free rider in the economy in terms of getting all the stability that the Federal Reserve System provides without observing most of the rules which it must enforce.

Senator DOUGLAS. What about the advantages of the Reserve System which the member banks have but which the nonmember banks do not have?

Mr. SPROUL. Well, it comes down largely to a question of dollars and cents and, as I said recently in a talk I made, anybody with a sharp pencil can figure out how he can save money by not belonging to the Federal Reserve System. You just need a grammar-school knowledge of arithmetic to do that.

Senator DOUGLAS. You mean that with the same amount of capital to make loans a nonmember State bank can make larger loans on a given amount of capital than can a member bank?

Mr. SPROUL. In general that is so.

Senator DOUGLAS. What about the advantages of the clearance of checks?

Mr. SPROUL. The nonmember banks can get their checks cleared just as well and just as rapidly as the member banks. If they are not cleared through the Federal Reserve System—and they can only be cleared through the Federal Reserve System in certain special instances—they are cleared through their correspondent banks, which in turn uses the facilities of the Federal Reserve System.

Senator DOUGLAS. Do you see any advantages which the members of the Federal Reserve System enjoy which nonmembers do not enjoy?

Mr. SPROUL. Members of the Federal Reserve System have access to the borrowing privilege directly, and on the basis of any of their assets, which may be acceptable to the Federal Reserve Banks, a privilege which the nonmember banks have either only indirectly or borrowing against Government securities where there is a special provision which permits nonmember banks to borrow.

Senator DOUGLAS. You mean that only member banks can apply for rediscount on commercial paper?

Mr. SPROUL. Yes.

Senator DOUGLAS. Member banks really do not apply for that much, do they?

Mr. SPROUL. They do not discount very much, and when they do discount, they use Government securities, and nonmember banks could also borrow on the basis of Government securities.

Senator DOUGLAS. The amount of commercial paper discounted amounts at present to $300,000,000; is that right?

Mr. SPROUL. Discounts now are all based on Government securities. There is practically no commercial paper in the operation at all.

Senator DOUGLAS. Well, then, that is not much of an exclusion privilege that the Federal Reserve members have.

Mr. SPROUL. I think there is a general prestige in many parts of the country which adheres to Federal Reserve System membership, which is considered important by the banks.

Senator DOUGLAS. Hasn't FDIC replaced the Federal Reserve System as a prestige-shedding institution?

Mr. SPROUL. No; I do not think so. According to the law, you have to put on your window that you are a member of the FDIC, and you are not required to put on your window that you are a member of the Federal Reserve System, but I think the prestige quality still adheres to membership in the System, even since the FDIC was established, and the fact that a majority of the larger——

Senator DOUGLAS. What you are saying is that the State banks that are members of the System lose money by being members, but they buy prestige in return for it and, assuming they are good businessmen, the prestige which they buy must be worth the diminished earning power.

Mr. SPROUL. In addition to prestige, I think it should be said that the bankers also have some regard for this national monetary system of ours. They know that for its working it requires the membership of a large number of the banks of the country and a large majority of the deposits of the country, and withdrawals of banks purely on the basis of profit, which would weaken or destroy the System, I think, would be an action which the organized banking community would not take, even though profits are diminished by their continued membership.

Senator DOUGLAS. You would think that the banks inside the System would, therefore, want to have uniform reserve requirements imposed on the banks outside the System, but we had the testimony of Mr. Brown of the First National Bank of Chicago and Mr. Burgess of the National City Bank of New York, that they were opposed to the extension of the reserve requirements to other banks.

They apparently did not object to the free riders. In fact, they thought there should be free riders. They did not call them free riders. They said that they were banks operating under the American dual system, which they wanted to preserve.

Now, can you explain the position taken by these gentlemen, which seems to be at such variance with their economic interests?

Mr. SPROUL. First, I would say as I said before that variance with their economic interests does not outweigh their understanding of the fact that a strong Federal Reserve System is necessary to this country and that their participation in it is absolutely essential, whether everyone is in it or not.

Senator DOUGLAS. But then you would think they would want to have the rules extended to others. You would think that once they themselves made the decision to stay in they would want to have uniform reserve requirements imposed on those outside. Men inside a union generally want to bring the nonunion members into the fold.

Mr. SPROUL. I was coming to that. A position has become established in the American Bankers Association, which represents big banks, small banks, national banks, State banks, member banks, and nonmember banks, and which has to arrive at its official positions as a compromise of a variety of conflicting interests. The position has been reached opposed to the extension of reserve requirements to nonmember banks.

There is also what I consider an emotional attitude toward the dual banking system, which talks in terms of the destruction of the dual banking system, but which evades or ignores the fact that this extension of member bank reserve requirements to nonmember banks need have and would have no such effect, that the dual banking system would continue to exist and thrive so long as the State banks were competently run and efficiently managed and so long as their community prospered.

Senator DOUGLAS. Is it conceivable that some of the member banks inside the System would prefer to have a considerable number of banks outside the System, because as long as there is this fringe of nonmember banks and the attendant possibility of State banks escaping from the System, there will be a check upon the power of the Federal Reserve Board to increase reserve requirements and, therefore, to diminish earning ratios?

Mr. SPROUL. I think first there is an attitude, which is fairly widely held by bankers and others, that too great a centralization of power in Washington is to be resisted wherever it shows itself and that one of the places it might show itself would be in this question of reserves of nonmember banks.

Senator DOUGLAS. I take it that possibly to meet that situation, as well as because of local pride, you made the suggestion that the reserve requirements might be turned over to the Open Market Committee, rather than to the Board of Governors of the System.

Mr. SPROUL. That was one reason for putting that in. I had others.

Senator DOUGLAS. If that were to happen, wouldn't it probably be well to do away with the Board of Governors?

Mr. SPROUL. I have something on that here. In my reply to your questionnaire I suggest that the responsibility for all major instruments of Federal Reserve policy should be lodged in the group now called the Federal Open Market Committee. Other monetary controls must be integrated with open-market operations, and there is certainly strong logic on the side of unified direction over all of them. Such a change would also assure the regular representation of actual operating experience, and an awareness of differing regional problems, in the formulation of the interrelated aspects of a national monetary policy.

It is not an ideal arrangement, nor even good administrative procedure to place open-market operations under a broadly representative committee, and to place the power over reserve and margin requirements, and the review and determination of discount rates initiated by the Reserve banks, solely under the Board of Governors. The Federal Open Market Committee has worked well in guiding the most important instrument of Federal Reserve policy. The next step should be the transfer of other closely related powers of monetary control to that committee.

This is a question on which men in the System may differ, displaying a bias, perhaps, towards the side they know best. As a Reserve bank president, it is probably natural that I should see advantages in this proposal, while members of the Board may react against it, as an intrusion upon their authority. On this question, just as on the substantive questions of credit policy, both views deserve a hearing.

My own view is that we shall do well to retain, wherever we can, the regional characteristics of the System, both in the matter of decentralized operation and, more important, in the matter of System national policy. No one would deny the need for coordination of general credit policy, but we now have, in the Federal Open Market

Committee, the statutory means of achieving this while retaining some regional participation and responsibility.

This committee is composed, as you know, of the seven members of the Board of Governors and five of the presidents of the Federal Reserve banks. Here are brought together, under statutory auspices and with statutory responsibilities, men who are devoting their full time to the problems of the Federal Reserve System and who are in touch with governmental policies and private views and opinions, in Washington and throughout the country.

It is the best expression which we have of the Federal character of the System, a character which is in tune which our political organization, with the continuously expressed intent of the Congress, and with the desires of our people.

And let me nail right here one or two arguments which have been advanced on the other side.

Senator DOUGLAS. You came loaded for this question.

Mr. SPROUL. That is right.

First, there is the argument that the presidents on the Federal Open Market Committee exercise authority without having responsibility. In the first place, as I have stated, membership on the Federal Open Market Committee, and the duties and responsibilities of the committee are now fixed by statute. Every man who accepts a place on that committee derives his authority from the Congress and assumes a responsibility to the Congress, and through it, to the public.

These presidents are mostly men who have devoted their lives to the Federal Reserve System; they are career men in the public service. It comes with ill grace for anyone who has ever served on the committee to hint that they are swayed by private interests to compromise public duty. You do not plan honor and integrity in a man by bringing him to Washington and giving him an official position in the Government.

Second, there is the argument by threat; by posing a wholly unacceptable solution as the only alternative to the giving of additional powers to the Federal Open Market Committee. This is the argument that if you are going to give additional powers to the committee, you should abolish the Board of Governors.

Such an argument seems to me to miss the whole point of the original suggestion. The essential and unique characteristic of the Federal Open Market Committee is its blend. It is like Scotch whisky in that respect. The Board retails all of its existing duties, but exercises its principal powers through majority membership in the Federal Open Market Committee. The presidents, with their experience gained through carrying out policy in the field, sit as minority members of the committee.

All participate in policy-making discussions, and conflicting views are given the test of thorough debate. You are protected from being blown off your course by either the political winds of Washington or the financial winds of Wall Street.

The compromise solutions which have been brought forward do not impress me. It is not enough, I am sure, to bring the presidents of the Reserve banks into the discussion of these matters of credit policy as advisers. Occasional requests for comments are not enough, nor is it enough to provide for attendance at meetings without membership or vote. *You have* to "belong" to be able to insist on consideration of your point of view.

Similarly, I do not believe that the suggestion that two of the Reserve bank presidents come to Washington each year for full-time service on the Board of Governors is practical. Such men would bring valuable lessons of past experience to the Board, but they would have divorced themselves from the insight produced by close contact with current operations.

They would be cut loose from their own staffs, their directors, and their districts, and transplanted to the somewhat unfamiliar Washington scene, while their institutions would be deprived of chief executive officers for a year at a time, one year out of six.

This is a case where the whole cannot adequately be replaced by either of its parts. In my view, we have developed through the Federal Open Market Committee a unique contribution to the processes of democratic administration. The System will best meet its responsibilities if this successful pioneering experiment is expanded to embrace all of the major policy determination of the System.

Nor am I frightened by the express or implied threats that to insist on placing more powers in the Federal Open Market Committee is to hasten the nationalization of the Federal Reserve System, and the removal of any taint of private participation in its affairs. I think we shall do well to retain the modest measure of private participation in the affairs of the System which we now have, to make effective use of those public-spirited men who are willing to serve as directors of the Federal Reserve banks. And I believe the Congress will feel that way if and when it examines the situation.

We are a successful working example of Government functioning in the economic field, with the aid and support of private business. Our experience in Government-business cooperation—with Government having the dominant and deciding voice—may be one signpost along the way to solution of that major problem, the relation between Government and business in our whole economy.

Senator DOUGLAS. Mr. Sproul, article I, section 8, of the Constitution gives to Congress the power "to coin money and regulate the value thereof," and acting under that power, we delegated authority in fairly specific terms to the Federal Reserve Board, and the members of the Federal Reserve Board are named by the President and have to be confirmed by the Senate, so that we exercise some control over the Board; but the presidents of the various Federal Reserve banks are not chosen by Congress and are not responsible to Congress. Are you not, therefore, proposing that a public function which the Constitution confided in Congress should now be turned over by Congress to a body five-twelfths of which would be outside the control of Congress and, therefore, outside the constitutional process?

Mr. SPROUL. I think Congress has already crossed that bridge by setting up the Federal Open Market Committee by statute and authorizing it to exercise the most important credit control function of the Federal Reserve System. And I am only suggesting that the other credit-control functions be integrated with that most important function which the Congress has already delegated to the Federal Open Market Committee. And the Congress has named the members of that committee.

Senator DOUGLAS. Of course, you could argue that this dualism and apparent contradiction could be cured instead by giving to the Federal Reserve Board the power to control open-market operations.

Mr. SPROUL. Yes; that has been argued, but as I say, I think the better results and retention of Federal regional character of the System would be achieved by putting those powers in the Federal Open Market Committee.

Senator DOUGLAS. It is a very nice question as to how much public power should be delegated to private bodies.

Mr. SPROUL. The Federal Open Market Committee, I would say, is not a private body.

Senator DOUGLAS. The presidents of Federal Reserve banks are not appointed by the Executive, nor are their appointments confirmed by the Senate. They are chosen by the boards of directors of the several Reserve banks, two-thirds of whose members are elected by the member private banks. You see, we have our pride, too, and we have our constitutional duties to perform.

Mr. SPROUL. We perhaps get some remote connection with you by reason of the fact our appointments are subject to the approval of the Board of Governors of the Federal Reserve System.

Senator DOUGLAS. I have no more questions. Mr. Wolcott?

Mr. WOLCOTT. I do not believe so.

Senator DOUGLAS. Senator Flanders?

Senator FLANDERS. Do you find any large body of disapproval of the giving of more flexibility in the interest rate by varying the point at which Government securities are pegged? Do you find objection to that in private bodies or groups to any large measure?

Mr. SPROUL. No; I do not think there is any large body of opinion among private banking, financial, or business groups that would object to it, and I think there is a considerable body of opinion which is in favor of it.

Senator FLANDERS. I may say the Secretary in his statement this morning indicated that he did not feel there was a promise to peg. So this particular Secretary of the Treasury agrees with the statement that you made and disagrees with Mr. Harl.

Mr. SPROUL. Yes.

Senator FLANDERS. Another question I wanted to ask is related to one point in the set of resolutions which had been adopted a year or so ago by the Farm Bureau national convention. It is related to the possibility of varying the gold content of the dollar.

I think for the record it would be useful to have your comments on that.

I might say that I have looked at your San Francisco speech and know that you have discussed that subject, and the idea will not come to you as something on which you have never given any thought.

Mr. SPROUL. I have a copy of that speech here, and I put into it my views on varying the gold content of the dollar. Would it be permissible to have those views placed in the record at this point?

Senator FLANDERS. I think it might be, unless the rest of you have some desire to have them read. I think it might be satisfactory just to put them in.

Mr. SPROUL. I would like to and be glad to.

Senator DOUGLAS. They will be made a part of the record.

(The material referred to above is as follows:)

REMARKS OF ALLAN SPROUL, PRESIDENT, FEDERAL RESERVE BANK OF NEW YORK, AT THE SEVENTY-FIFTH ANNUAL CONVENTION OF THE AMERICAN BANKERS' ASSOCIATION, SAN FRANCISCO, CALIF., NOVEMBER 2, 1949

As a native Californian—and a native San Franciscan—I have tried to think of something I might discuss which would be of special interest to our generous hosts at this convention. The fact that this is 1949, and that the whole State of California has been engaged in a 2-year round of celebrations of the one hundredth anniversary of the discovery of gold in California, and of its immediate consequences, gave me an obvious lead. Gold is something in which we are all interested. Nor is this an untimely topic on other grounds. The recent wave of currency devaluations which swept around the world, following upon the devaluation of the British pound sterling 6 weeks ago, has fanned into modest flame the always smoldering fires of the gold controversy. In addition, I was eager to review the gold question because it is a good starting point for an understanding of the place of the Federal Reserve System in the monetary and economic life of the country. When I finish with gold, I shall want to say something more specific about the System, and about your relations with it.

As central bankers, of course, charged with responsibility for our monetary and credit policies, we have the question of gold under more or less constant surveillance. Most of the time, in recent years, we have been under attack from two sides because of our attitude toward gold. Those interested primarily or initially in the price of gold, and in what they call a free gold market, have fired from one side. Those interested primarily and eternally in gold-coin convertibility—in a full and automatic gold standard domestically and internationally—have fired from the other. More recently we have had a brief respite from attack while these two groups fired at each other, each group arrogating to itself responsibility for the only true gospel according to St. Midas. What I have to say will probably bring that brief respite to an end. The fire will again be concentrated on the monetary authorities, for whom I cannot presume to speak except as one individual engaged in the practice of central banking, but who will no doubt be blamed for my views.

Let me take account of each of these two groups separately; those who concentrate, at least initially, on a free gold market, and those who will have none of this heresy, but who want a fixed and immutable gold price and convertibility of currency—and therefore of bank deposits—into gold coin.

The first group, which includes the gold miners, makes its argument on several grounds, trying to combine economics and psychology with self-interest. Let me paraphrase their principal arguments as presented at hearings on bills to permit free trading in gold in the United States and its territories. In this way I may avoid the fact as well as the appearance of building straw opponents. The arguments most frequently presented in favor of these bills were:

1. In the face of rising production costs and fixed selling prices, the gold mining industry has been forced to curtail its operations, and to the extent that it has operated, its profits have been reduced. The higher gold prices which would presumably prevail in a free market would correct this situation. This is the "do something for the gold miners" argument at its baldest.

When this argument is embroidered a little, it is claimed that since the prices of all goods and services have increased so substantially during the past 10 or 15 years, it is necessary to open the way for an increase in the price of gold so as to be sure there will be enough gold to carry on the country's business; to bring the price of gold into adjustment with the prices of everything else.

2. A second group of arguments expresses concern over the unsettling effects of the "premium" prices which are paid for gold abroad, and claims that a free gold market in the United States, with no gold export restrictions, would cause these premium markets abroad to disappear, with beneficial effects upon world trade and international relations.

3. Third, there is an argument in equity—that gold miners should be allowed to sell their product at the best price they can obtain, as do producers of other products; and that American citizens, like the citizens of most other countries, should be free to hold or to buy and sell gold.

4. Finally, there were those who viewed and favored a free gold market as a first step in the direction of a full gold coin standard, and who held that even a free market would act as a "fever chart" of the economy and lead to reform of extravagant Government fiscal policies, remove inflationary tendencies fostered by a managed currency, and lead to sounder conditions, generally.

To take these arguments up in order, it should be pointed out right away that it is quite possible that a free market for gold in the United States would not result in a rise in the price of gold, if for no other reason than that the Secretary of the Treasury is required, by law, to maintain all forms of United States money at parity with the gold dollar which contains one-thirty-fifth of an ounce of fine gold. This means that the Treasury should maintain the price of gold at $35 a fine ounce in legal gold markets in the United States. To do this, if there were a legal free market for fine gold, the Treasury should sell gold to the extent necessary to maintain the market price at $35 a fine ounce. We might, therefore, get what would be in effect gold convertibility by way of a free market, but not a rise in the price of gold. Aside from this possible outcome of the establishment of a free market for gold, what is it we are being asked to do? In effect we are being asked to do something to benefit the gold-mining industry, to encourage a shift of productive resources, in this and other countries, into gold production, in order to provide gold for hoarding. This, I submit, would be a witless proceeding, in terms of the welfare of the whole economy, matched only by our bonanza provisions for the special benefit of the miners of silver.

As for the economic embroidery of this request for aid to the gold-mining industry, there is no lack of monetary means of carrying on the business of the country, nor is there likely to be. It is the economics of perpetual inflation to argue that a rise in the commodity price level should be followed by an arbitrary increase in the price of gold and hence in the reserve base, thus permitting and, perhaps, promoting additional deposit expansion and a further upward movement of prices. Even on the basis of statistics, which are not always reliable or comparable, it is interesting to note that the increase in the price of gold in the United States, in 1934, raised the price of gold by 69 percent, whereas wholesale prices in the United States are now only 60 percent above the 1927–29 level. We have been plagued, if anything, with an oversupply of money in recent years, and the United States gold stock, at the present price, is large enough to support whatever further growth in the money supply may be needed for years ahead.

The second group of arguments has to do with the desirability of knocking out of business the premium markets in gold which have existed and still exist in various foreign countries. I share the general dislike of these markets because they are parasites on the world's monetary system and help to siphon into gold hoards the resources of people who need food and clothing and equipment—and who wouldn't need so much help from us if they didn't use scare foreign exchange to buy gold for private hoards. But I don't think the soundness nor the stability of the United States dollar is actually brought into question by these premium markets. At our official purchase price for gold—$35 a fine ounce—the United States has been offered and has acquired more gold than the total world production (excepting the U. S. S. R. for which reliable data on gold production, as on everything else, are not available), since 1934, the year of our devaluation. During those years—1934 to 1948 inclusive—estimated world gold production, valued at United States prices, was about 13.5 billion dollars and United States gold stocks increased 16 billion dollars.

Most of the producers and holders of gold have been quite willing to sell us gold for $35 a fine ounce despite the quotations of $45 and $55 and so on up in the premium markets. The fact is that these premium markets respresent insignificant speculative adventures around the fringe of the world supply and demand for gold. They reflect mainly the urgent and often illegal demands of a small group of hoarders, together with some private demand for gold to be used in relatively backward areas, or areas where the forms of civilized government have broken down, and where the metal serves the needs of exchange—or hoarding—better than a paper note. I do not think there would be any appreciable stimulus to United States gold production, if we opened the doors of this largely clandestine trade to our domestic gold miners. But, by legalizing it, we might well create what we are trying to destroy—uncertainty about the stability of the dollar and our own intentions with respect to its gold content.

The third argument—that the miners of gold should be free to sell their product at the best price they can get—is probably the giveaway. It is the argument that gold should be treated as a commodity when you think you can get a higher price for it, and as a monetary metal and an international medium of exchange when you want a floor placed under its price. I would say that you can't have it both ways. If you want the protection of an assured market at a fixed price, because gold is the monetary metal of the country, you should not ask permission to endanger the stability of the monetary standard by selling gold at fluctuating prices (the gold producers hope higher prices) in a fringe free market. Under present conditions, the only real price for gold is the price the United States Treasury is prepared to pay for it. So long as that is the case, there is no sense in a "make believe" free gold market, in which possible temporary or short-run deviations from the fixed price of the Treasury might have disturbing consequences.

Nor is the argument that citizens of the United States should have the same privileges as the citizens of other countries, when it comes to holding or trading in gold, at all convincing to me. It is true that in a number of foreign countries the holding of gold by private citizens is legal, and in some foreign countries strictly internal free trading in gold is permitted. In many cases, however, this merely represents the shifting around of a certain amount of gold which is already being hoarded in the country, since in practically all of these countries the export and import of gold on private account is either prohibited or subject to license. And, in many countries where gold is produced, some percentage, if not all, of the newly mined gold must be sold to the monetary authorities, a requirement which further limits the amounts available for trading and hoarding. These restricted and circumscribed privileges in other countries are no reflection of a loss of inalienable rights by our people. They are attempts by these foreign countries to adjust their rules with respect to gold to their own self-interest and, so far as possible, to the habits of their people, all under the sheltering umbrella of a world gold market and a world gold price maintained by the Treasury of the United States.

We have deemed it wise to maintain such fixed point of reference, in a disordered world. We have decided by democratic processes and by congressional action, that this policy requires, among other things, that gold should not be available for private use in this country, other than for legitimate industrial, professional, or artistic purposes. We have decided that the place for gold is in the monetary reserves of the country, as a backing for our money supply (currency and demand deposits of banks, and as a means of adjusting international balances, not in the pockets or the hoards of the people. If we want to reverse that decision, the means of reversal are at hand, but it should be a clear cut and a clean cut reversal, restoring convertibility. Providing a dependent free gold market, in which gold miners and a little gold group of speculative traders or frightened gold hoarders (such as those who now take advantage of a provision in the regulations to buy and sell "gold in the natural state") could carry on their business is not the way to meet the problem.

I do not propose to get in the cross fire of those who claim that a free gold market would be a step toward convertibility, and those who claim that a free gold market, without free coinage at a fixed price, would cause us to lose whatever modicum of a gold standard we now have and lead to monetary chaos. That is one of those doctrinal arguments in which the subject abounds. I will merely say here that I think authorization of a free gold market in this country, with no change in the present responsibility of the Secretary of the Treasury to maintain all forms of money coined or issued by the United States at parity with the "gold dollar", would probably lead indirectly to convertibility. The desirability of doing this is another matter, which I shall now try to discuss briefly and dispassionately. This is a hazardous attempt because there is no subject in the field of money and banking which so arouses the passions, and which so readily defies brief analysis.

Two groups of arguments for the reestablishment of a gold coin standard may, perhaps, be distinguished in the writings and speeches of those who propose it, one group relating primarily to the domestic economy and one to the probable effects on international trade and finance. In the first group the arguments run about as follows:

1. Replacement of our "dishonest", inconvertible currency with an "honest" money having intrinsic value would promote confidence in the currency, and encourage savings, investment, long-time commitments, and production.

2. Irredeemable paper money leads to inflation, whereas the upper limits imposed upon currency and credit expansion by a thoroughgoing gold standard serve as a restraining influence on irresponsible politicians and overoptimistic businessmen.

3. Present governmental taxing and spending policies are wrong and dangerous. The gold standard would put a brake on public spending.

4. As a corollary of the preceding argument, since the gold standard would hinder further extension of Government control and planning, it is a necessary implement of human liberty.

The second group of arguments, relating to the international advantages of a gold coin standard, generally make no distinction between the effects of a unilateral adoption of such a standard by the United States, and the multilateral establishment of an unrestricted gold standard by many countries, and of exchange rates fixed by such a standard. The arguments run somewhat as follows:

1. The existence of premium markets in gold abroad and the lack of gold convertibility at home creates—and is representative of—lack of confidence in the gold value of the dollar. In the absence of a thoroughgoing gold coin standard we cannot convince anyone that we may not devalue the dollar.

2. Restoration of "normal" patterns of international trade is being retarded by the inconvertibility of currencies in terms of gold and, therefore, one with another. This inconvertibility has led to tariffs, quotas, exchange controls, and to general bilateralism.

3. Under a managed paper currency system there is always the temptation to solve national problems by devices which lead to international disequilibrium. This, in turn, has led to domestic devices restrictive of foreign trade. The international gold standard, by eliminating the need for restrictive commercial policy, would increase the physical volume of international trade, resulting in an improved division of labor and higher standards of living for everyone.

First, let me say that I perceive no moral problem involved in this question of gold convertibility. Money is a convenience devised by man to facilitate his economic life. It is a standard of value and a medium of exchange. Almost anything will serve as money so long as it is generally acceptable. Many things have served as money over the centuries, gold perhaps longest of all because of its relative scarcity and its intrinsic beauty. In this country we still retain some attachment to gold domestically, and more internationally, but to carry on our internal business we use a paper money (and bank deposit accounts) which has the supreme attribute of general acceptability. There is no widespread fear of the soundness of the dollar in this country, no widespread flight from money into things. The constant cry of wolf by a few has aroused no great public response. Savings, investment, long-term commitments, and the production and exchange of goods have gone forward at record levels.

Much of the nostalgia for gold convertibility is based, I believe, on fragrant memories of a state of affairs which was a special historical case; a state of affairs which no longer exists. The great period of gold convertibility in the world was from 1819 to 1914. It drew its support from the position which Great Britain occupied, during most of the nineteenth century and the early part of the twentieth century, in the field of international production, trade, and finance. The gold coin standard flourished because the organization of world trade under British leadership provided the conditions in which it could, with a few notable aberrations, work reasonably well.

The ability of the British to sustain, to provide a focal point for this system has been declining for many years, however, and the decline was hastened by two world wars which sapped the resources of the British people. The heir apparent to Great Britain, of course, was the United States, but up to now we have not been able to assume the throne and play the role. And until some way has been found to eliminate the lack of balance between our economy and that of the rest of the world, other than by gifts and grants in aid, we won't be able to do so. This is a problem of unravelling and correcting the influences, in international trade and finance, which have compelled worldwide suspension of gold convertibility, not vice versa. The job before us now is to attack the problems of trade and finance directly. We should not deceive ourselves by thinking that gold convertibility, in some indefinable but inexorable way, could solve these underlying problems for us.

Nor is it true, of course, that gold convertibility prevented wide swings in the purchasing power of the dollar, even when we had convertibility. Within my own experience and yours, while we still had a gold coin standard, we had tremendous movements in commodity prices, up and down, which were the other side of changes in the purchasing power of the dollar. What happened to us in 1920–21 and 1931–33 under a gold coin standard should prevent a too easy acceptance of that standard as the answer to the problem of a money with stable purchasing power.

When you boil it all down, however, and try to eliminate mythology from the discussion, the principal argument for restoring the circulation of gold coin in this country seems to be distrust of the money managers and of the fiscal policies of Government. The impelling desire is for something automatic and impersonal which will curb Government spending and throw the money managers out of the temple, as were the money changers before them. To overcome the inherent weakness of human beings confronted with the necessity of making hard decisions, the gold coin standard is offered as an impersonal and automatic solution. Through this mechanism the public is to regain control over Government spending and bank credit expansion. It is claimed that whenever the public sensed dangerous developments, the reaction of many individuals would be to demand gold in exchange for their currency or their bank deposits. With the monetary reserve being depleted in this way, the Government would be restrained from deficit financing through drawing upon new bank credit; banks would become reluctant to expand credit to their customers because of the drain on their reserves; and the Federal Reserve System would be given a signal to exert a restraining influence upon the money supply. In this way, Congress, the Treasury, and the Federal Reserve System would be forced by indirection to accept policies which they would not otherwise adopt.

In effect, under a gold coin standard, therefore, the initiative for over-all monetary control would, through the device of free public withdrawal of gold from the monetary reserve, be lodged in the instinctive or speculative reactions of the people. No doubt some people would take advantage of their ability to get gold. There would be many reasons for their doing so. Conscientious resistance to large Government spending, or fear of inflation, might well be among these reasons. But speculative motives, a desire for hoards (however motivated), and such panic reactions as are generated by unsettled international conditions or temporary fright concerning the business outlook or one's individual security—all of these, and more—would be among the reasons for gold withdrawals. The gold coin mechanism does not distinguish among motives. Whenever, for any reason, there was a demand for gold, the reserve base of the monetary system would be reduced. Moreover, if only the United States dollar were convertible into gold while practically all other currencies were not, hoarding demands from all over the world would tend to converge upon this country's monetary reserves. Circumvention of the exchange controls of other countries would be stimulated, and dollar supplies which those countries badly need for essential supplies or for development purposes would be diverted to the selfish interests of hoarders.

Even if a particular reduction in the reserve base did occur for useful "disciplinary" reasons, the impact of such gold withdrawals upon the credit mechanism is likely to be crude and harsh. Since the present ratio between gold reserves and the money supply is about 1 to 5, and since some such ratio will be in effect so long as this country retains a fractional reserve banking system, a withdrawal of gold coins (once any free gold is exhausted) will tend to be multiplied many times in its contractive effect on bank credit and the money supply. In a business recession, the Reserve System might undertake to offset this effect as it does now in the case of gold exports but, if the gold withdrawals attained sufficient volume, the shrinking reserve position of the Federal Reserve banks would eventually prevent them from coming to the rescue.

It was, in part, to offer such arbitrary and extreme influences upon the volume of credit, and to make up for the inflexibility of a money supply based on gold coins (in responding to the fluctuating seasonal, regional, and growth requirements of the economy), that the Federal Reserve System was initially established. During the first two decades of its existence, the System devoted much of its attention to offsetting the capricious or exaggerated effects of the gold movements associated with continuance of a gold coin standard. We had an embarrassing practical experience with gold coin convertibility as recently as 1933, when lines of people finally stormed the Federal Reserve banks seeking gold, and our whole banking mechanism came to a dead stop. The gold coin standard was abandoned, an international gold bullion standard adopted, because repeated experience has shown that internal convertibility of the currency, at best, was no longer exerting a stabilizing influence on the economy, and, at worst, was perverse in its effects. Discipline is necessary in these matters but it should be the discipline of competent and responsible men; not the automatic discipline of a harsh and perverse mechanism.

If you are not willing to trust men with the management of money, history has proved that you will not get protection from a mechanical control. Ignorant, weak, or irresponsible men will pervert that which is already perverse.

Here, I would emphasize my view that the integrity of our money does not depend on domestic gold convertibility. It depends upon the great productive power of the American economy and the competence with which we manage our fiscal and monetary affairs. I suggest that anyone who is worried about the dollar concentrate on the correction of those tendencies in our economic and political life which have brought us a deficit of several billion dollars in our Federal budget, at a time when taxes are high and production, employment, and income are near record levels. I suggest that, going beyond the immediate situation, they address themselves to the difficult problem of the size of the budget, whether in deficit or surplus or balance. At some point the mere size of the budget, in relation to national product, can destroy incentives throughout the whole community, a dilemma which is even now forcing curtailment of Government expenditures by the Labor government in Great Britain. These are problems gold-coin convertibility cannot solve under present economic and social conditions. Gold has a useful purpose to serve, chiefly as a medium for balancing international accounts among nations and as a guide to necessary disciplines in international trade and finance. It has no useful purpose to serve in the pockets or hoards of the people. To expose our gold reserves to the drains of speculative and hoarding demands at home and abroad strikes me as both unwise and improvident.

Perhaps before I let go of this subject, which has held me and you overlong, I should say a word about merely raising the price of gold, without doing anything about a free gold market or gold-coin convertibility of the currency. This is something which has intrigued Europeans and others who are "short of dollars," has interested some of our own people, and has become a South African war cry. An increase in the price the United States pays for gold would have two major results. It would provide the gold producing countries (and domestic producers), and the countries which have sizable gold reserves or private hoards, with additional windfall dollars with which to purchase American goods. And it would provide the basis for a manifold expansion of credit in this country which might be highly inflationary.

We have been engaged in an unprecedented program of foreign aid for the past 4 years. The Congress has authorized this aid at such times and in such amounts as were deemed to be in the interest of the United States. This is much to be preferred, I suggest, to the haphazard aid which would be granted by an increase in the price of gold, which must be on the basis of a more or less accidental distribution of existing gold stocks and gold-producing capacity. If we raised the price of gold, every country which holds gold would automatically receive an increase in the number of dollars available to it. The largest increases would go to the largest holders which are the Soviet Union, Switzerland, and the United Kingdom. Every country which produces gold would automatically receive an annual increase in its dollar supply, and its gold-mining industry would be stimulated to greater productive effort. The largest increases would go to the largest producers which are South Africa, Canada, and probably the Soviet Union. That would be an indiscriminate way to extend our aid to foreign countries, both as to direction and as to timing.

The domestic results of an increase in the price of gold would be no less haphazard. This country, as I have said, is not now suffering from a shortage of money and it has large gold reserves, which could form the basis of an additional money supply if we needed it. An increase in the dollar price of gold would increase the dollar value of our existing gold reserves in direct proportion to the change in price. There would be an immediate "profit" to the Treasury. The "profit" could be spent by congressional direction or Treasury discretion. This would provide the basis for a multiple expansion of bank credit which, unless offset by appropriate Federal Reserve action, would expose our economy to the threat of an excessive expansion of the domestic money supply. The arbitrary creation of more dollars in this way would certainly be inappropriate under inflationary conditions, and would be an ineffective method of combating a deflationary situation.

At the moment, also, we should have in mind that there has just been an almost world-wide devaluation of currencies. Using the fixed dollar as a fulcrum, individual foreign countries have taken action designed to improve their competitive position vis-à-vis the United States, and to maintain their competitive position vis-à-vis one another. An increase in the dollar price of gold, which is devaluation of the dollar by another name, would undo the possible benefits of a venture in improved currency relationships which already has its doubtful aspects.

For all of these reasons it is encouraging to know that the Secretary of the Treasury has recently reiterated that the gold policy of the United States is directed primarily toward maintaining a stable relationship between gold and the dollar, and that for all practical purposes only the Congress can change that relationship. We have maintained an international gold bullion standard by buying and selling gold freely at a fixed price of $35 a fine ounce in transactions with foreign governments and central banks for all legitimate monetary purposes. This has been one fixed point in a world of shifting gold and currency relationships. We should keep it that way as another contribution to international recovery and domestic stability.

This whole discussion of gold has been a long wind-up for what may now seem to you like a small pitch. I want to end my remarks with a few words about the Federal Reserve System and the relations of your organization and you, as bankers and citizens, with that System.

In my gold discussion I tried to emphasize what seems to me to be a fundamental proposition in the case of a country with the domestic and international strength of the United States. We can't have, or we don't want, both an automatic gold-coin standard and discretionary control of the reserve base by a monetary authority. The existence of two independent and frequently incompatible types of control over reserves of our banking system is undesirable. In the light of that finding we abandoned the gold-coin standard as a control over the domestic money supply, and placed our reliance in monetary management by the Federal Reserve System. I think it has become established American policy that a principal means of Government intervention in the economic processes of the country is the administration of broad credit powers by the System. In this way a pervasive influence may be brought to bear on our economy, without intrusion upon specific transactions between individuals, which is likely to be the consequence of more detailed physical controls, and which would spell the end of democratic capitalism as we have known it.

I have thought it reasonable to assume that the public in general, and bankers in particular, clearly recognized the special place of the System in our economy. The fact that the development of a national monetary and credit policy is the responsibility of the Federal Reserve System should fix its place beyond question. This is not a function which can be split up and passed around. Many of the activities of other Government agencies engaged in making or guaranteeing loans, or conducting bank examinations, or insuring bank deposits, have a bearing on the way monetary policy works, but monetary policy, as such, is one and indivisible. It is only the supervisory and service functions performed by the Federal Reserve System which are comparable to the operations of these other Government agencies. The distribution of these incidental duties among such agencies can be largely determined by administrative convenience, historical precedent, and economy of operation, so long as there are arrangements for consultation to avoid unnecessary differences in policy and practice. But over-all responsibility for holding the reserves of the banking system, and influencing the creation of credit by varying the cost and availability of those reserves, can only reside in the one agency designated by Congress as the national monetary authority. The Federal Reserve System is not just one of a number of Federal agencies having to do with banking. Its duties and responsibilities are unique; they range over the whole of our economy and touch the lives of all our people.

I was somewhat dismayed, therefore, by recent reports that the American Bankers Association seemed to hold a different or opposite view. It is reported to have recommended to the Congress the maintenance of parity of compensation of the three Federal bank supervisory agencies (Board of Governors of the Federal Reserve System, Board of Directors of the Federal Deposit Insurance Corporation, and the Comptroller of the Currency), on the theory of equal pay for equal work; equal pay for sharing equally heavy responsibilities. I mean no disrespect of the Office of the Comptroller of the Currency, nor of the Federal Deposit Insurance Corporation, when I say there is and can be no such equality of responsibility. The bank supervisory duties of the Federal Reserve System are a distinctly minor part of its work. There is no desire to increase or add to those duties against the wishes of the banks or the best interests of the public. To represent the Federal Reserve System as just another bank supervisory agency, in the name of maintaining proper checks and balances in Federal bank supervision, seems to me to miss, and to misrepresent, the main reason for our being.

I mention this small but significant item first, because it cuts across the whole concept of the Federal Reserve System and, therefore, cuts across the whole range of our relationships with you. There are other points of apparent difference where we seem to be at odds, or not pulling together effectively, because of mistrust, or lack of proper consultation, or inadequate study of the broad aspects of the questions with which we are mutually concerned. I shall touch on a few of them.

Concentration of power.—The picture of a Federal Reserve System trying to arrogate power to itself, which at times you have painted, obscures the real picture. The real picture would show a Federal Reserve System trying hard to keep its powers in working order so that it can discharge its responsibilities as a monetary authority, with a measure of independence from the pressures of partisan political aims and the exigencies of managing a Federal debt which totals about $255,000,000,000 and, unfortunately, is growing. To lump the Federal Reserve System with the other bank-supervisory agencies at Washington, and to play one against the other, is not an attack on the real concentration of power; it is giving aid and comfort to those who would seize upon the failure of monetary and credit controls as a pretext for fastening more direct controls upon our economy.

Organization of the Federal Reserve System.—I have been as one with many of you in my opposition to undue centralization of control of the Federal Reserve System by the Board of Governors at Washington. In testimony before congressional committees and in public statements, I have affirmed my belief that we can have in the Federal Reserve System a wise blend of national authority and regional responsibility of Government control and private participation. I think we shall do well to retain and to improve the regional characteristics of the System, both in matters of decentralized operation and, more important, in matters of national credit policy. I should like to see the bankers of the country, and this organization of bankers, give some more thought to this problem, and I should like them to offer some constructive suggestions concerning it. The climate may be right for its calm consideration.

Reserve requirements.—The Federal Reserve System is charged with the responsibility of formulating and administering national credit policy. It does this chiefly through its influence upon the cost and availability of bank reserves. This is a proper exercise of Federal power, and its point of incidence is upon the commercial banks of the country because only they, among all of our financial institutions, have the ability to add to or subtract from the money supply of the Nation. I question whether there is good and sufficient reason for exempting any commercial banks from a minimum participation in this national undertaking. It only requires a moderately sharp pencil and a grammar-school knowledge of arithmetic to figure out how you can save money by not being a member of the Federal Reserve System as things now stand. But I don't think this country really likes "free riders," and nonmember banks, in that sense, are "free riders." I know the objections to compulsory membership in the Federal Reserve System; I recognize some of its dangers; and I think it is probably politically impossible. But it should not be beyond our ingenuity to devise appropriate powers of fixing reserve requirements, to be exercised within statutory limits by an appropriate body within the Federal Reserve System; reserve requirements which would be adequate for our national purpose, and which would apply to member and nonmember banks alike.

Here is another instance, I believe, where your theory of checks and balances runs the danger of being all check and no balance. And let it be clear that this is no attack on the dual banking system. State member banks have lived within the Federal Reserve System for years, and submitted to its reserve requirements, without loss of identity. We welcome this continued relationship. Nor am I frightened by the existence of a fringe of nonmembers, and the ability of State banks to move from one group to the other. A mass exodus of State member banks from the Federal Reserve System seems to me to be so unlikely as to be outside the range of practical consideration. But I do think that all commercial banks have a common obligation and a common responsibility in this matter of reserve requirements, and that they should assume the obligation and share the responsibility.

Correspondent bank relationships.—Somehow there has grown up a feeling in some places that we in the Federal Reserve System are out to undermine the network of correspondent bank relationships which you have built up over the years. Every time we suggest some change in the method of assessing reserve requirements, or make some minor improvement in our check-collection system, or in our methods of providing coin and currency, or in some other detail of our operations, the question seems to be raised. I can assure you that these things are suggested or done in an effort to improve the efficiency and economy of our operations in terms of the whole banking system, the business community, and the general public. There is no hidden purpose. We recognize that there are some things which correspondent banks can do better than we can, and we are glad to have them perform these services. At the same time we would caution them against competition in providing services which really do not pay their way, and remind them that there are some things which, perhaps, the Federal Reserve System can do better than they. Surely here is an area, if our motives be reasonably pure on both sides, where there is no need for friction between us.

Selective credit controls.—We have differed on the matter of selective credit controls or, more specifically, on the matter of control of consumer installment credit. I have advocated the continuance of the control which the Federal Reserve System exercised, briefly, over consumer installment credit. I would be concerned over the dangers of any further significant extension of selective controls, whether over the credit used in commodity markets, in real-estate transactions, in inventory financing, or in other forms of business lending. Requests for further powers should meet two tests—is the power really needed and will its use still leave an effectively functioning private economy? I have argued and still believe that control of consumer installment credit meets these tests. Your official position has been opposed to this view. I would ask you, however, whether you are happy about the way things are now going in this field of finance. I am not. I suggest that we might sit down together and reexamine the problem to our mutual advantage and to the advantage of the public which we both serve.

These are some of the matters which I think deserve your constructive attention. A negative approach has been and will continue to be effective in stopping the passage of individual pieces of legislation, which you happen to dislike, but it won't check the progress of the idea of Government controls and intervention, if you have little constructive to offer in the face of difficult economic problems. Over the years you will win a lot of battles but you will lose the war.

I recognize and share your dislike for Government controls and your distrust of too much centralized power. But I recognize, as I think you must, that a certain amount of Government intervention is necessary to the preservation of our political and economic system. The central problem in our country, and in all countries but Russia and its satellites, is how far such Government guidance and control can go without destroying the effective functioning of a private economy. In this country, with our traditions of individual enterprise, we have preferred to keep such guidance to a practical minimum, and to have it exercised largely through broad and impersonal controls—controls which affect the general environment. One cornerstone of such a philosophy is a competent and adequately powered monetary authority which can administer an effective monetary policy. In making monetary policy work to the limit of its capacity, we have one of the best defenses against control by Government intrusion in our personal and private affairs.

That is why I should like to see the American Bankers Association adopt an affirmative, constructive attitude toward the Federal Reserve System. If you don't like it, as it stands, put some real time and effort into the study of ways to improve it—its personnel, its powers, its organization, its functioning. In such an undertaking you will have the cooperation of all of us who are devoting our lives and our energies to what we believe to be a worth-while public service. In the struggle of ideas and ideals which now divides the world this is a minor front. But it is a fighting front. It is no place for a neutral.

Senator FLANDERS. We have had much to say both in your testimony and in the testimony of others regarding the use of the varying interest rate in controlling the supply of money. The importance and general effectiveness of that was something that I became rather skeptical of during the 1930's. I wonder if you feel variations in the interest rate are always an available means of controlling the money supply, particularly of encouraging it under conditions of depression.

Mr. SPROUL. I think they are very little use under conditions of extreme depression such as we had in the 1930's. Then we had a situation where there were tremendous excess reserves in the banking system, the interest rate approached zero in the case of the shortest term, highest grade securities, and the effect upon business, production and employment was very slight.

I think variations in the interest rate and the use of monetary measures of control and restraint can have their greatest effect in times of inflationary pressures before the economy has gone over the top and gotten into a depression.

Certainly there should be relaxation of any restraint on the credit supply and low rates of interest in depression circumstances, but they would not by themselves bring the economy back to high production, income, and employment.

Senator FLANDERS. Speaking of high rates in times of inflation, I do not remember what the call money rate went to on Wall Street in the first half or three-quarters of 1929, but it went pretty high without doing much to restrain borrowing. But perhaps that is a special case.

Mr. SPROUL. That was a special case in some ways, and we think the loophole was closed when Congress gave authority to the System to fix margin requirements, which is a selective credit control instrument which, I think, has its uses and its practical forcefulness.

We also have a different situation now from any which we have had before, and that is what I referred to in speaking of the sensitivity of the market. With a Government debt of the size of our Government debt and forming so large a part of the whole debt structure of the country, the System has a homogeneous market wherein which it can operate at all levels of rates such as it has never had before. So that we can step into the market and have our effect felt almost immediately, and I think have the reverberations spread out through the whole corporate security market and out through the whole banking and business community in a way not possible before the Government debt became such a large part of the whole debt structure.

Senator FLANDERS. Thank you.

Senator DOUGLAS. I have one further question that I should like to ask.

For some years it was a question as to whom the profits of the Federal Reserve System belonged. The Federal Reserve Board by administrative order is now turning over 90 percent of these profits to the Federal Government. But, as I understand it, they are doing it by administrative regulation and not by statute.

Do you have any opinion as to whether that situation should be formalized by legislation?

Mr. SPROUL. Of course, let me say I think there is no disagreement either within or without the System of the view that the majority of profits of the Federal Reserve System should go to the United States Treasury.

When it comes to how you get them there, I think the present method, while it seems to be working all right, is a perversion of the statute which authorized the charge of interest on uncovered Federal Reserve notes, and there is no reason why we should not make a cleaner and clearer-cut situation out of it and restore the franchise tax which formerly applied to the Federal Reserve banks.

Senator DOUGLAS. But you would have the franchise tax so it would take a larger proportion of the profits of the Federal Reserve banks than was originally the case?

Mr. SPROUL. The statute, as amended, applied, I think, to 90 percent of their net earnings after expenses and dividends. And I think that is an appropriate division at least until the Federal Reserve banks have built up their capital funds beyond their present modest amount.

Senator FLANDERS. Mr. Chairman, that leads me to another question. So long as the Federal Reserve banks' open-market operations are directed toward pegging the price of Government securities, it seems to me the System has the surest-fire earning operation the world has ever seen. You are directed to buy low and you are directed to sell high, and are given the opportunity to buy low and the opportunity to sell high. And that is something for which the world has been looking for thousands of years.

But when you come to your open-market operations, a different basis, which is that of more directly gearing your operations into the maintenance of production and employment and general high level of activity, may you not run into conditions in which the desirable operations will result in losses instead of profits?

Mr. SPROUL. That is possible, and that is why I say we still should be permitted to put some of our earnings into capital accounts so that we will have a cushion to carry us over a year or 2 years or 3 years when we might run into losses instead of profits.

Senator DOUGLAS. The vast proportion of the earnings, however, of the Federal Reserve banks comes not from speculative gains on Government securities but rather from interest on the Government securities which they hold. Am I not right?

Mr. SPROUL. Yes; our earnings are much more largely from interest on our holdings than they are from profits on sales.

The other side of Senator Flanders' operation is a whole private banking and business community which at times seems to want to sell at low prices and then buy back at high prices. That is the private-enterprise system at work.

Senator DOUGLAS. Any further questions?

Mr. WOLCOTT. Mr. Chairman, I think Mr. Sproul should be given an opportunity, if he cares to do so, to offer whatever recommendations he might make as to what the Congress could do, or what this committee could recommend to the Congress to be done, to prevent the ups and downs in our economic life.

Mr. SPROUL. I would like to have permission to write you a memorandum or a book on that subject. I do not think I could cover it free hand here.

Mr. WOLCOTT. I assume that is what we are looking for; that is our objective, anyway.

Mr. SPROUL. I have discussed it both in my answers to your questionnaire and in my covering letter, and somewhat in my testimony, insofar as it relates to monetary and credit policy, debt management, and fiscal policy. But maybe I misunderstood you. I thought you were going into the much broader question outside of the range of monetary credit policy.

Mr. WOLCOTT. No; in the field of money and credit and fiscal matters, what recommendations have you that the Congress enact into law to help?

Mr. SPROUL. As I said, I think the central problem of the whole situation as it exists under present-day conditions is the possible conflict between debt management and credit policy. And I suggest a consideration there, first, of a mandate from the Congress which would give a direction to the Treasury as well as to the System to direct its operations toward the general purposes of the Employment Act of 1946.

I also suggested in support of a systematic and logical monetary credit policy that the nonmember banks should meet the same reserve requirements as member banks.

I suggested that the principal credit control powers of the Federal Reserve System be placed in the Federal Open Market Committee to preserve the regional characteristics of the System while at the same time integrating those monetary and credit powers.

I think those are the principal suggestions or recommendations which I would have to make.

Mr. WOLCOTT. I thought you might want to get them in 1, 2, 3 order very briefly.

Mr. SPROUL. That is just about it in 1, 2, 3 order.

Senator DOUGLAS. Thank you very much, Mr. Sproul.

The committee will stand in recess until tomorrow morning at 10 o'clock.

(Whereupon, at 4 p. m., the subcommittee adjourned, to reconvene at 10 a. m., Saturday, December 3, 1949.)

MONETARY, CREDIT, AND FISCAL POLICIES

SATURDAY, DECEMBER 3, 1949

Congress of the United States,
Subcommittee on Monetary, Credit,
and Fiscal Policies,
Joint Committee on the Economic Report,
Washington, D. C.

The subcommittee met, pursuant to adjournment, at 10:05 a. m., in the caucus room, Senate Office Building, Senator Paul H. Douglas (chairman of the subcommittee) presiding.

Present: Senator Douglas (chairman of the subcommittee) and Representative Wolcott.

Also present: Dr. Grover W. Ensley, acting staff director, and Dr. Lester V. Chandler, economist to the subcommittee.

Senator Douglas. Ladies and gentlemen, I think we should come to order.

We are happy to have Mr. McCabe with us. I have been studying at odd moments the 70-page printed statement that you submitted earlier, on pages 21 to 91 of the committee print on Monetary Credit and Fiscal Policies, and found it very interesting. And now I understand, with indefatigable and good work as always, you have prepared a further 28-page memorandum to read this morning of observations on the testimony to date. We will be very glad to have you proceed.

STATEMENT OF THOMAS B. McCABE, CHAIRMAN OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM; ACCOMPANIED BY WINFIELD W. RIEFLER, ASSISTANT TO THE CHAIRMAN; AND WOODLIEF THOMAS, ECONOMIC ADVISER TO THE BOARD OF GOVERNORS

Mr. McCabe. Senator Douglas, I would like to take this occasion to introduce to the committee Dr. Winfield Riefler, on my left, and Dr. Woodlief Thomas on my right.

Senator Douglas. You are to be congratulated on the advisers that you have.

Mr. McCabe. Should I start, sir, with this statement?

Senator Douglas. If you wish, yes, sir. Proceed in your own way.

Mr. McCabe. Now that the hearings before this subcommittee of the Joint Committee on the Economic Report are coming to a close, I wish to commend most enthusiastically the objective manner in which you have addressed yourselves to your important task. I am sure that the witnesses who have appeared before you all appreciate, as I do, the earnestness, impartiality, and diligence which you and your staff

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have shown in your search for light on some of the most complex problems of our times. You have been concerned, not with any specific legislative proposal, but rather with the more fundamental questions of the principles which should guide future legislation. The report of this committee, composed as it is of members of both Houses who are well versed in money and banking, cannot fail to have great influence upon the direction of monetary, credit, and fiscal policies in the future.

The searching nature of the questionnaire sent out to qualified and interested individuals and the way in which you have brought out disinterested professional opinion have contributed to the sustained high level of discussion that has prevailed during the past 3 weeks of these hearings. The printed record with the testimony of men of broad experience from business, finance, and public life, together with the answers to the questionnaire, constitute a most important and constructive volume—one that will be a "must" in every library dealing with problems of money in the world today.

You are probing into a very delicate and very crucial problem. It is no exaggeration to say that nothing more vitally affects the welfare and destiny of this Nation than the integrity of its money and credit. The American dollar commands the highest confidence throughout the world. To maintain that confidence demands no less vigilance than liberty itself. The problems you have been exploring are at the base of that integrity and confidence. A free-enterprise economy cannot exist without appropriate central banking institutions to influence the availability and cost of credit. Unfortunately this point is not generally understood, and lack of background is not confined to the general public. The attitude of many business and financial leaders, and of some of our banking leaders and supervisory officials, whose devotion to the public welfare cannot be doubted, is explainable on no other grounds. Much of the diversity in the testimony before you reflects not so much basic disagreement as it does differences in appreciation of the importance of the problem.

I shall address myself directly to the role to be expected of central banking procedures in the functioning of the American economy. Central banking institutions have always been considered the necessary and essential complement of a free-enterprise economy. Money does not manage itself. Once commercial banking institutions holding demand deposits become important, central banking institutions must be organized to avert money panics and to mitigate booms and depressions. Although they have necessarily been given wide discretionary powers, they should in no sense be regarded as an invention of or an adjunct to a managed economy or an administered state. Instead, they are part and parcel of a free-enterprise economy, designed to maintain full and continuous use of its human and material resources. In modern terms this means that they are expected to help maintain a high and stable level of employment in a free-enterprise economy. They endeavor to do this by the prompt and flexible use of adequate discretionary authority over the cost and availability of money and credit. As in the case of the courts, they must be operated purely in the interests of the public, but at the same time they should be immune from political bias and control.

That is the traditional, the conservative, the classic position. It is the issue that was dealt with by Carter Glass, among others, when the Federal Reserve System was established. Misunderstanding about it underlies much of the criticism of our actions. I cannot emphasize too strongly the difficulties we are placed under when many of the most vociferous supporters of free enterprise, businessmen and bankers and their organizations, criticize the possession and use by the Federal Reserve System of necessary authority over the cost and availability of credit as if the delegation of this authority to the System were characteristic of a managed economy or an administered state. It is exactly the opposite. Otherwise I would not have been considered for my present post. Nor would I have been disposed to hold it.

Our main problems today have arisen as an inevitable result of the huge volume of war financing. They raise anew the question, How should central-bank procedures be related to the fiscal function of the state? The traditional position was developed in a world where public expenditures constituted a low percentage of the national income; where budgets were expected to be balanced annually; where the public debt, though it might have seemed large at the time, was very low in comparison with anything we face today; and where, incidentally, the widespread use of credit by consumers had yet to take root. It is clear that this is very far from the situation which confronts us today. In this country public expenditures, including Federal, State, and local, are of a magnitude that approaches one-fourth of the gross national product. Since the war, our Federal public debt has been considerably in excess of our entire annual national income, even though the national income is at record peacetime levels. Public debt now far exceeds the total of all private debt. The variety of new considerations that have to be taken into account in the modern formulation of fiscal policy is indicated in the report of the economists at their conference on fiscal policies held at Princeton. Their report is included in the record of your committee.

It is clear that we can no longer expect the wise exercise of traditional central banking powers, unsupplemented by other public policies, to maintain high-level stability in a free-enterprise economy to the same extent as was thought possible a generation ago. The impact of other public policies on the whole economy has grown too large in the interval. Does this mean that an administered economy is inescapable and that we must frankly accept the habitual resort to widespread controls in the form of price fixing, allocations, rationing, et cetera, in order to maintain high-level stability? These are incompatible with all of our conceptions of a free-enterprise economy in peacetime. To this question the answer is unequivocally "No." We can and we must retain the dynamic stimulus of free-enterprise institutions. The course of postwar experience, both here and abroad, has demonstrated anew that these institutions need to be protected through the exercise of central banking functions affecting the cost and availability of credit. These are still powerful instruments in the promotion of high-level economic stability. They must operate, however, in close conjunction with appropriate fiscal, debt management, and other governmental policies. The Committee for Economic Development has submitted to you a most thoughtful document addressed directly to this problem. It deserves careful consideration.

When I joined the Board of Governors in the spring of 1948, the economy was still undergoing the trials of the postwar inflation.

Money and liquid assets resulting from war financing were in oversupply relative to available goods and services. This vastly expanded money supply was supplemented by an increasing volume of commercial credit and consumer credit. Total loans at all commercial banks increased by more than $16,000,000,000 between the end of 1945 and the end of 1948. There was full employment, possibly over full employment; scarcities prevailed in the markets; our people were becoming restive under the impact of continuous increases in the cost of living; and the operation of the wage-price spiral that is characteristic of mounting inflation was everywhere in evidence. Inflation is a form of intoxication in which some groups gain at the expense of the rest of the population, particularly people of fixed incomes. Frequently it accentuates selfish interests. Many in these groups think that their financial progress has been due solely to personal merit. They are blind to the fact that the great impersonal forces of inflation greased the way. It was our unpopular task, together with the Treasury, to counteract these forces by monetary and fiscal measures under our respective or joint influences or control.

Let me enumerate the measures that were adopted and comment briefly on each. By far the most powerful measure of restraint was the use of surplus Treasury funds to retire bank-held debt, particularly Federal Reserve-held debt. The power of decision with respect to this measure lay wholly with the Treasury. I doubt whether the public in general appreciates how important this was and the credit that must be given Congress and the administration for making it possible during that period. There is no antidote to inflation equal to the development of a budget surplus and the use of that surplus to retire debt at the central bank. It was endorsed and, indeed, recommended by the Federal Reserve System.

The policy of restraint was also fortified by the campaign undertaken by the American Bankers Association to encourage voluntary restraint in the extension of credit. I have repeatedly commended this action in both public and private statements. This cooperation on the part of the commercial bankers exemplifies the fact that we can all pull together in this country to achieve public ends when leadership has understanding and conviction.

Another restraining measure was the reimposition of regulation W, establishing limits to the extension of installment credit to consumers. It was reinstated and administered by the Board of Governors of the Federal Reserve System when Congress granted a temporary authority in the summer of 1948. During the period of the lapse of this authority, the total volume of this credit outstanding increased by 2½ billion dollars.

Another measure, and one of the more controversial, was the decision of the Board of Governors, after receiving temporary authority from Congress, to increase reserve requirements of all member banks by 2 percent on demand deposits and 1½ percent on time deposits in the early autumn of 1948. The Treasury was informed of this decision and offered no objection.

During all of the period of strong inflationary pressures, there were related and highly controversial questions in regard to raising the cost of credit in the money markets. These involved, on the positive side, increases in discount rates made in 1946 and in 1948 by the Federal Reserve, the decisions by the Treasury in 1947 and 1948 to raise its rates on new issues of certificates, and the accompanying restrictive actions in the open market by the Federal Reserve authorities to increase the rates at which Treasury bills and certificates were traded in the market. They involved, on the negative side, supporting actions in the open market by the Federal Reserve authorities to maintain the 2½-percent rate on the long-term Treasury bonds, after permitting prices of these bonds to decline from high premiums they had reached.

I would like the committee, in judging this controversial subject, to be in possession of the facts. It has been said that the Open Market Committee of the Federal Reserve System, which is charged by Congress with responsibility in these matters, did not wish to continue to support the 2½-percent level on long-term Treasury bonds but was induced to continue this policy by pressure from the Treasury. This is not true. There were widely varying shades of judgment, not only throughout the country and in the Congress but within the Federal Reserve System, on the wisest course of action to pursue. It was my view, stated at the time, that the System was obligated to maintain a market for Government securities and to assure orderly conditions in that market, not primarily because of an implied commitment to wartime investors that their savings would be protected nor to aid the Treasury in refunding maturing debt, but because of the widespread repercussions that would ensue throughout the economy if the vast holdings of the public debt were felt to be of unstable value.

Senator DOUGLAS. Mr. McCabe, I do not like to interrupt you, but sometimes I think it helps if questions are asked during the statement rather than waiting to the end when the continuity is somewhat broken.

I think the committee on the whole is quite well aware of the fact which you mention; namely, that any dispute which occurred between the Federal Reserve System and the Treasury in the years 1946 and 1947 was not on the support price of long-term securities or the 2½-percent interest rate, but rather on the question of yields and prices of short-term securities. And I would invite your attention to pages 37 and following of your statement in the committee print at the bottom of the page under "Elimination of bill-buying rate." [Reading:]

> Federal Reserve authorities in 1945 and 1946 considered the discontinuance of the bill-buying rate of three-eighths of 1 percent and the repurchase option established early in the war. It was proposed that the rate on bills be permitted to approach the ⅞-percent rate on 1-year certificates, with support of the latter rate continued at that level. The purpose of these steps was to reduce the abnormal spread in the pattern of rates and to encourage banks to hold more bills.

While you were not a member of the Board during this period, is it not your understanding that in late 1945 and in 1946 and the first part of 1947 the Federal Reserve authorities did wish to have the interest rate on short-term securities raised?

Mr. MCCABE. Yes.

Senator DOUGLAS. And to allow the prices of those securities, if necessary, to fall?

Mr. MCCABE. That is right, sir.

Senator DOUGLAS. Now, then, you go on to say:

> In 1947 the Treasury concurred in the discontinuance of the buying rate on bills and the repurchase option as a part of a program in which an increase was permitted also in the rate on certificates.

I believe that action was in July of 1947.

Mr. McCabe. Yes.

Senator Douglas. So that after the lapse of about a year and a half the Treasury agreed to the policy which the Reserve System had been advocating since at least the beginning of 1946?

Mr. McCabe. Yes. There was strong pressure on the part of the Federal Reserve at that time to get that rate up.

Senator Douglas. And I think it may have been that to which Mr. Eccles referred in the memorandum that he submitted yesterday (see pp. 222–225); that Treasury action in some of these matters had been—I do not know whether he used this phrase—"too little and too late," but certainly too late.

Mr. McCabe. I believe Mr. Sproul used that phrase.

Senator Douglas. Of course, it is a familiar wartime expression.

Mr. McCabe. Yes.

Senator Douglas. You were not then a member of the Board and not responsible for any actions taken?

Mr. McCabe. I was chairman then of the Federal Reserve Bank of Philadelphia and had been for 10 years. So I was vitally interested in the problem at that time.

Senator Douglas. Did you concur in the general opinion of the Federal Reserve authorities that the rate on short-time securities should have been raised at that time?

Mr. McCabe. Yes.

Senator Douglas. For what reasons?

Mr. McCabe. We were just coming into the postwar period, and the evidences then were that we were entering an inflationary period. This was an instrument of Federal Reserve control that we felt should be applied to check the inflationary influence we felt was developing.

Senator Douglas. Was it your feeling. if the interest rate on short-time governments were allowed to rise, that the interest rate on loans to private borrowers would also rise?

Mr. McCabe. You see, the whole credit structure is closely related to the Government-bond market and very sensitive to the Government-bond market. So, if there is a rise in Government bonds, there is a stiffening of rates throughout the whole credit structure.

Senator Douglas. Stiffening, you mean, is the euphonious term for an increase?

Mr. McCabe. Increase; yes.

Senator Douglas. The way in which reality can be muffled in Washington with soft words is really quite amazing.

You thought, therefore, that this would check undue private borrowing?

Mr. McCabe. It would help.

Senator Douglas. But you did not put the policy into effect?

Mr. McCabe. The Federal Reserve was attempting to persuade the Treasury that that was the proper course to pursue.

Senator Douglas. Did you have the legal powers to put it into effect even though the Treasury did not concur?

Mr. McCabe. The Federal Reserve, through its open-market operations, could upset the proposed policy of the Treasury.

Senator Douglas. But you did not exercise your legal power because you wished to "cooperate" with the Treasury?

Mr. McCabe. At that time, we were emerging from a war period into a postwar period, and we had this colossal public debt. And at that time I was not Chairman of the Board. I would assume that its position was that it did not want to do anything that would upset——

Senator Douglas. Were you a member of the Open Market Committee at that time yourself, Mr. McCabe?

Mr. McCabe. No. The Open Market Committee is comprised of members of the Board of Governors and five presidents of Federal Reserve banks.

Senator Douglas. I wondered if perhaps it was your turn at that time to be a member.

Mr. McCabe. No; I was——

Senator Douglas. I see, you were chairman of the Board of Directors in Philadelphia and not president?

Mr. McCabe. That is right.

Senator Douglas. I see.

Mr. McCabe. Then I think you have to take into consideration the fact that during that time we had a debt-retirement program that was exerting considerable influence. And you see from the standpoint of the Federal Reserve and the execution of its functions, Senator, whenever you create surpluses in the Treasury you make our job very much easier.

Senator Douglas. Oh, I think the policy of debt retirement in 1946, 1947, and the first part of 1948 was a most excellent one.

I wish my colleague from Michigan were here so that he might hear the comment that I am about to make. I only wish that it might have been continued by the Eightieth Congress and we had not had the tax reduction which gave us a deficit. I wish they might have continued in their good works. But that is another issue.

What I am trying to get back to is this fact that for a year and a half the Federal Reserve Board on the monetary and credit side wanted the rates on short-terms to increase in order that the general interest structure would advance and private borrowings might be diminished and, therefore, inflation checked, but that you cooperated with the Treasury in yielding your point of view, or the System cooperated with the Treasury. And I wondered under those terms what is the definition of the verb "to cooperate"? Does it mean to acquiesce?

Mr. McCabe. Senator, I think you ought to weigh in that period, as I say, this debt-retirement program. The Treasury very vigorously was pushing that program.

Senator Douglas. But the retirement was being conducted out of surpluses of receipts over expenditures?

Mr. McCabe. That is right.

Senator Douglas. I do not see how it is involved with the maintenance of a low rate on short-term issues.

Mr. McCabe. That was very effective, the point I am making.

Senator Douglas. You mean that the Treasury felt this was sufficient? The Treasury felt that a reduction program was sufficient; that fiscal policy would be adequate to check inflation, and that you did not need added monetary and credit controls?

Mr. McCABE. Since I did not participate in those discussions at that time, I can only surmise.

Senator DOUGLAS. Here is the difficulty that we legislators labor under: We work to untangle a jigsaw puzzle and we generally find that the question directly addressed to the Government official is for a period in which he did not serve, or over an area for which he does not feel responsible, so that the Government official with perfectly good grace can say, "Well, it is impossible for me to answer."

And the poor frustrated legislator goes around in a merry-go-round hunting for the pea underneath the walnut and never finds it, and merely finds one administrative official after another telling him to look somewhere else.

Mr. McCABE. I thoroughly appreciate that; and I am in full sympathy with your problem.

Senator DOUGLAS. I do not know who was right in this period, very frankly, but I wanted to probe a little more deeply into the practical meaning of this verb "to cooperate." I notice that not only the Secretary of the Treasury refers to this verb but you do also. Favorite overcoat expressions which are sometimes used to cover up charming ambiguity of meaning are "to cooperate" and "to coordinate."

Excuse me.

Mr. McCABE. I cover some of the points you have made, Senator, a little later on in my statement.

Senator DOUGLAS. Will you proceed?

Mr. McCABE. In any case, the decision taken and executed was the decision of the Open Market Committee. It represented their combined best judgment, and I was convinced then, as I am now, in retrospect, that they were right. They were concerned with the huge size of the Federal debt and with its pervasive influence throughout the financial structure.

Senator DOUGLAS. You are still talking about long-term securities?

Mr. McCABE. Yes.

In view of the pervasive holdings of these securities, of the continued unsettlement that prevailed in the immediate circumstances of the postwar inflation, and of the fact that it had not yet been demonstrated that the great bulk of these securities was solidly held and that the floating supply had been absorbed, the adoption of a support level below par was a risk which the committee was not prepared to underwrite.

Our most controversial action during this period was to raise the reserve requirements of member banks. This decision was related to, but by no means conditioned solely on, the reluctance of the Treasury to increase short-term rates on bills and certificates as early as was recommended by the Open Market Committee. I propose, therefore, to discuss these two situations together. I have stated above that rightly or wrongly it was the decision of the Open Market Committee on its own responsibility not to risk a lowering of the support level on long-term Treasury bonds.

This decision in itself meant, of course, that funds paid out by the Reserve banks in support of the long-term bond market added to the bank reserves available for credit expansion. It meant that the System must depend mainly, for whatever restraining influence could be exerted, either on increasing short-term rates or on increasing reserve requirements, or both. Either or both of these actions, restraining in themselves, were bound to be partly negatived to the extent that support of the long-term market resulted in furnishing reserves to the banks.

I think it is true that the reluctance of the Treasury to move as rapidly as the Open Market Committee recommended reinforced the disposition of the Board of Governors to make use of the power to raise reserve requirements. I doubt, however, whether the Board, under the circumstances then prevailing, would have refrained from the use of the power to raise reserve requirements even if the Treasury had agreed earlier to an increase in rates on short-term bills and certificates. It is difficult to be categorical about this point because it involves an interpretation of what official reactions would have been in a hypothetical situation.

There are some who felt that neither of these restraining moves would be effective because they would tend to be offset by the funds that would necessarily be put out in support of the long-term bond market. There are others, particularly among the member banks, who felt that the increase in short-term rates on bills and certificates would be effective but that the increase in reserve requirements would be completely offset by support purchases of bonds. We can now look back and give definite answers to some of these considerations that were highly conjectural at the time. It is a matter of record that the combination of these moves did actually exert a net restraint; that short-term money rates did firm; that loan expansion did stop, and that this situation prevailed until the Federal Reserve reversed its policies when the inflation abated.

Senator DOUGLAS. That is from July 1947 on?

Mr. McCABE. That is primarily in the latter part of 1948.

I do not personally subscribe to the view held by some that this actual result reflected solely the increases in rates on short-term bills and certificates supported by the voluntary campaign of the American Bankers Association to restrict credit advances to essential productive credits. Personally, I believe it also reflected the increase in reserve requirements, for one reason because this increase diminished the liquidity of the member banks. In retrospect, however, I would also say that my reluctance to resort to changes in reserve requirements as a method of dealing with an inflationary situation has been increased, not diminished, by the experience.

As everyone knows, that particular episode in our economic history, the hang-over of postwar inflation, had come to an end by early 1949. We can now look back on the postwar period as a whole, consequently, with some perspective and some of the advantages of hindsight. It is my personal evaluation that this country, all things considered, came through that period of trial amazingly well, better than any other major country and with less social and economic distortion. The amount of inflation that actually occurred was less than there was reason to fear. By this, I do not mean in any sense that no mistakes were made, or that the inflation and distortions we have suffered were unavoidable. Some inflation was inevitable, probably a considerable inflation, but it could undoubtedly have been held within narrower limits. Nevertheless, taking all the complexities and perplexities of the problem into consideration and also the necessary coordination of millions of individual wills, I feel that it will be the verdict of history that our combination of democracy and free enterprise which we enjoy in this country gave a good account of itself during this period.

The monetary and credit measures which we adopted played no small part in that over-all result. Let me cite two specific instances. One of our controversial actions was the decision to reimpose restrictions on the extension of installment credit to consumers. When we reissued regulation W in the autumn of 1948, the automobile industry was producing cars to the full extent permitted by the availability of materials. This production was insufficient to meet the demand, however, with the result that so-called used cars commanded bonuses or premiums of as much as $500 or more in the gray market.

Senator DOUGLAS. May I interrupt a minute on a semantic question? When you use the term "gray market," does that mean a market that is not quite as dirty as a black market?

Mr. MCCABE. It is in between, sir.

It was part of our objective to defer some of this excess demand until materials became more freely available, that is, to a period when the demand so deferred would sustain employment and buttress high-level stability rather than augment the inflation and the wage-price spiral. I think the record shows that these expectations were on the whole borne out by the subsequent course of events. Of course, many factors played on the scene, and subsequent events cannot be explained in terms of any one factor alone. Nevertheless, it remains true that the premium in the gray market for automobiles disappeared shortly after the reissuance of our regulation, that we were able in March of 1949 to relax the regulation, and that the automobile industry since that time has been a bulwark to employment during the transition period of inventory readjustment that has prevailed in 1949. With materials more freely available, the automobile industry has been able to set new high records in production and sales at a time when this production was most effective and most needed as a contribution to high-level stability.

My second illustration is from the field of mortgage financing in its relationship to home-building activity. You are all aware of the spiraling costs of housing construction during the postwar period when what seemed like an almost unlimited demand for shelter impinged on the limited resources of the home-building industry. You are also aware of the turn-down in new housing starts that occurred in the autumn of 1948, the subsequent reduction in costs of new homes by 5 to 10 percent, and the renewed and sustained home-building activity at new record levels that made itself felt during the past summer. Performance of the home-building industry was a powerful factor in the maintenance of employment at high levels and without renewed inflation of costs during this past year. It is my personal judgment that monetary and credit factors played a significant role in these developments. The slowing up of new starts that made itself evident in the autumn and winter of 1948 was not unrelated to the decreased availability of credit at that time. The subsequent upsurge of activity during this summer was related in part to the effect on mortgage financing of our moves to ease credit during the spring of 1949, as well as to other actions by Government to ease mortgage credits.

So much for the postwar inflationary situation from which we have now emerged, and the lessons that the experience has brought to us. I wish to turn now to the current position of the Federal Reserve System in its policy operations in the money markets.

That position was announced by the Open Market Committee on June 28 of this year. I will quote that announcement in full so that you all may be familiar with it:

> The Federal Open Market Committee, after consultation with the Treasury, announced today that with a view to increasing the supply of funds available in the market to meet the needs of commerce, business, and agriculture it will be the policy of the committee to direct purchases, sales, and exchanges of Government securities by the Federal Reserve banks with primary regard to the general business and credit situation. The policy of maintaining orderly conditions in the Government security market, and the confidence of investors in Government bonds will be continued. Under present conditions the maintenance of a relatively fixed pattern of rates has the undesirable effect of absorbing reserves from the market at a time when the availability of credit should be increased.

I regard the announcement as a significant milestone because it reflected the joint judgment of the Treasury and of the Federal Open Market Committee that the postwar economic and financial situation had evolved to a point where open-market operations could safely be permitted to play a more orthodox role in our policies. Such operations will, of course, continue to be affected by concern for the stability of the Federal debt and its repercussions upon the entire debt structure. The public debt is now a dominant part of the financial structure. No one informed on money market operations expects that open-market policies will ignore this fact. The public debt, however, huge as it still is, has become sufficiently settled in the hands of stable holders to permit open-market policy to be formulated on a more flexible basis than formerly. I regard June 28, 1949, as a most important date. It signified removal of the strait-jacket in which monetary policy had been operating for nearly a decade; that is, since the beginning of the war.

The record that I have cited illustrates how we have been compelled to operate under utterly new conditions, unprecedented in modern times. What is their significance with respect to fiscal policies, to the relationships required between central banking authorities and fiscal authorities, and to the adequacy of traditional central banking powers? These questions are implicit in your inquiry. They demand the attention of thoughtful men everywhere. Unless we find the solution to these problems, our way of life, which is the way of the free world, will be in jeopardy. Having spent 33 years of my life as a private enterpriser, I want above all to avoid anything that either weakens our economy or puts the fiscal structure of our Government in peril.

I approach these problems with a feeling of humility which I am sure you and many of the thoughtful men who have appeared before you share. It is this feeling that makes me so sympathetic to the study which you are conducting. Out of all of the discussions, we can, perhaps, achieve better understanding for our future guidance.

I would be less than frank if I left you with the impression that the new position which was initiated on June 28 had ended the need for coordination between debt management and money-market policies. That need will, of course, continue. Many suggestions have been advanced in the answers to your questionnaire and in the testimony, suggesting formal procedures to assure a result that is in the long-run public interest of our democracy. Personally I am skeptical of the value of formalized procedures in a situation of this kind. The truth is that our problems arise out of the different character of the very serious responsibilities that are borne by the Treasury on the one hand and the Federal Reserve System on the other. The record of history is clear, that the institutions charged with these responsibilities should be mutually independent of each other, for the subordination of either might lead to unfortunate results. This seems to me to imply that we must rely on the men who carry these respective responsibilities, on their good will, constructive vision, and spirit of cooperation. There is no danger that Treasury officials and Federal Reserve officials will lack personal contact. The nature of their duties insures and will continue to insure that they face these problems together. I took pains to point out in my answer to the questionnaire that a splendid degree of cooperation exists between the Treasury and the Federal Reserve.

RESERVE REQUIREMENTS

I propose now to clarify several specific, but not necessarily related, points where the record indicates confusion. First of these is the general problem of reserve requirements. Three relatively distinct types of problems that fall under this heading have been dealt with in the record, and I want to distinguish them and comment briefly on each.

1. *To what extent should the Federal Reserve authorities have the power to raise or lower reserve requirements and under what conditions should this instrument be used?*

I am somewhat embarrassed in answering this question. The Congress has not seen fit in the past to delegate as broad authority with respect to this instrument as it has with respect to other instruments. Only 6 months ago Congress refused extension of the temporary authority that then existed. I am hopeful that as a result of this committee's interest the subject might be reviewed in broad perspective in a study under authority of Congress.

The Board has heretofore proposed that additional authority be granted so that it would be in a position to absorb additional reserves that might be made available in excess of the current needs of the economy. It has been recognized, and so stated, that reserve requirements are not a flexible instrument; in other words that frequent "jiggling" of the requirements should be avoided. The principal possible sources of additional reserve funds are (1) inflow of gold, (2) return of currency from circulation, and (3) Federal Reserve purchases of Government securities.

It should be recognized that from a long-run standpoint basic adjustments in reserve requirements may be needed from time to time to allow for fundamental changes in the reserve structure. An inflow of gold of a billion dollars a year for 5 or 10 years, together with a return flow of a moderate portion of the very large wartime increase of currency in circulation, could deplete the Federal Reserve banks' open-market portfolio below a reasonable operating level. It may also be essential at times for the Federal Reserve to purchase Government bonds in maintaining orderly markets for these securities. An increase in reserve requirements might be needed in order to immobilize any large amount of reserves created in this manner.

As I stated in my answer to your questionnaire, the Federal Reserve should have authority broad enough to meet its responsibilities under different situations. We have learned from experience that if we should again be confronted with the problem of dealing with a dangerous expansion of bank credit, flexible open market and discount policies would be more effective instruments than increasing reserve requirements.

2. Is the existing system of reserve requirements for member banks effective and equitable?

It is not necessary on this occasion for me to discuss at length existing methods of computing reserve requirements or why we believe a change in the methods is worthy of consideration. These matters are treated at some length in the answers which the Reserve bank presidents and I have submitted in answer to your questionnaire. The problem has been studied by various groups in the Federal Reserve System almost from the time of its organization and many proposals have been made for its solution.

We are convinced that the existing system should and can be greatly improved. We are not, however, committed to any particular proposal for change. Our staffs after years of study have worked out a method which is believed to be workable and equitable and may be the best that can be devised. It has already been presented informally to your committee.

Senator DOUGLAS. Is that a statement that was submitted about 2 years ago?

Mr. McCABE. That was the statement to the Joint Committee on the Economic Report about a year ago last summer.

Senator DOUGLAS. And as I remember it, it called for abolishing the present differentials based upon the nature and size of the city.

Mr. McCABE. It would base requirements on the nature of deposits rather than on geographical considerations.

Senator DOUGLAS. So that the same type of deposit would have the same reserve requirement irrespective of the city in which the bank was located?

Mr. McCABE. That is right.

The problem is a continuing one and inequities increase the longer it remains unsolved. It is my view that the problem should be studied by the appropriate committees of Congress, by banking groups, and others, as well as by the Federal Reserve. We will be prepared to present a definite recommendation at the appropriate time. If a national monetary commission is set up to study such questions, this would be one of the most important for it to consider.

3. Should banks which are not members of the Federal Reserve System be required to maintain reserve requirements essentially the same as those required of member banks?

I have discussed at some length, in the answers submitted to your questions, the difficult problem of the limitations that the existence of nonmember banks place on the effectiveness of Federal Reserve actions. The Reserve bank presidents, who are intimately concerned with this problem, have also given you their views and so have many others. Differences in reserve requirements are one of the most important aspects of the effect of nonmember banks on the Federal Reserve System.

Reserve requirements for State banks which are not members of the Federal Reserve System vary from no statutory requirements whatever in the State of Illinois, to requirements which, in percentages, are higher than those of member banks in a number of States. The essential difference between reserve requirements of member and nonmember banks, however, is not in percentages but in the composition of reserves. Even where the percentages of deposits required to be held as reserves are the same as, or higher than those for, member banks, the nonmember bank still has an important advantage. Nonmember banks can meet their reserve requirements through holdings of vault cash and balances with correspondent banks, while member banks can count only their balances with the Federal Reserve as required reserves, and in addition must hold for working purposes a certain amount of vault cash and balances with correspondents. Member banks not in reserve cities, the so-called country banks, as a group have recently been maintaining holdings of vault cash and balances with other banks amounting to about 15 percent of their gross demand deposits, in addition to balances with Federal Reserve banks of 12 percent against net demand deposits [1] and 5 percent against time deposits.

Senator Douglas. May I interrupt there, Mr. McCabe?

Has your organization ever been able to find the percentage of cash as distinguished from balances with correspondents at nonmember banks?

Mr. McCabe. We have an estimate of that, sir.

Senator Douglas. Would you submit that for the record?

Mr. McCabe. I anticipated that question because I thought you would be interested.

The ratio of cash to total deposit of insured nonmember banks, according to our estimate, is 2.6 percent.

I would be glad to submit these figures.

Senator Douglas. So that virtually all the rest of their required reserve is in the form of deposits in correspondent banks?

Mr. McCabe. I think this table gives the picture.

[1] Net demand deposits are computed by deducting holdings of balances with correspondent banks and other cash items from gross demand deposits.

Ratios of cash assets to deposits of all insured commercial banks, by class of bank, June 30, 1949—Ratios to total deposits

	Member banks					Insured nonmember banks
	Total	Central Reserve city banks		Reserve city banks	Country banks	
		New York	Chicago			
Cash in vault	1.3	0.5	0.4	1.1	2.1	2.6
Balances due from banks	4.4	.3	2.5	4.0	7.2	14.7
Cash items in process of collection	5.1	9.3	5.8	5.9	1.9	.6
Subtotal	10.8	10.1	8.7	11.0	11.2	17.9
Reserves with Federal Reserve banks	15.2	20.0	19.3	15.5	11.8	
Total, cash assets	26.0	30.1	28.0	26.5	23.0	17.9

Senator DOUGLAS. We worked out that the weighted average of reserves in the Federal Reserve System of member banks amounted to a little less than 20 percent, probably around 19 percent. Now, if we could get the average of the State banks in the form of deposits in correspondent banks, we could then find the average total reserve of the nonmember banks.

Mr. McCABE. We have here the percentage ratios.

For insured nonmember banks the ratio of all cash assets to total deposits is an average of 17.9; 2.6 of that is in cash in vault; 14.7 is balance due from banks; and 0.6 is cash items in process of collection; making a total of 17.9.

Now the country banks of the Federal Reserve System have an average of 2.1 percent of total deposits in the form of cash in vault, 7.2 percent in balances with correspondent banks, 1.9 percent in cash items in process of collection, and 11.8 percent in reserve balances at the Federal Reserve banks, making a total of 23 percent.

The country banks are carrying a total of 23 percent in those items against 17.9 percent for the nonmember insured banks.

Senator DOUGLAS. Or about 5 percent more.

Mr. McCABE. About 5 percent more. Now if you take a Reserve city bank—because in this column of insured nonmember banks you have not only country banks but you have Reserve city banks—the total for the Reserve city member banks is 26.5; and the total for the central Reserve city banks, for instance, in Chicago, is 28 percent; and in New York it is 30.1 percent.

Senator DOUGLAS. Have you got a weighted average for the System as a whole?

Mr. McCABE. Yes; 26 percent for all member banks.

Senator DOUGLAS. As contrasted with approximately 18 percent for the nonmember banks?

Mr. McCABE. Seventeen and nine-tenths percent.

Senator DOUGLAS. Eighteen percent, or 8 percent more for the member banks than for the nonmembers.

Mr. McCABE. Yes.

Senator DOUGLAS. I have never seen those figures before.

Mr. McCabe. I think they are of crucial importance.

We have some very interesting figures here also, sir, on comparative earnings.

(The table is as follows:)

Earnings of insured banks by class of bank, 1948

[In millions of dollars]

	All insured banks	Member banks					Insured nonmember banks
		All member banks	New York	Chicago	Reserve city	Country	
Earnings	3,404	2,828	476	120	1,058	1,174	576
Interest and dividends on U. S. Government securities	1,008	855	154	44	294	363	154
Interest and discount on loans	1,600	1,308	182	46	524	555	292
All other	796	666	140	30	240	256	130
Expenses	2,164	1,795	284	75	681	755	369
Salaries and wages	1,044	876	166	36	330	345	169
All other	1,119	919	118	39	351	411	200
Net current earnings	1,240	1,033	192	45	377	419	207
Net losses and charge-offs and transfers to reserve accounts	219	179	14	5	71	89	41
Profits before income taxes	1,021	854	178	41	306	330	166
Income taxes	275	234	39	11	91	92	42
Net profits	745	621	139	30	215	238	125
Ratio of net current earnings to capital accounts	12.5	12.0	8.4	10.4	13.1	13.8	15.7
Ratio of net profits to capital accounts	7.5	7.2	6.1	6.9	7.4	7.8	9.4

Mr. Wolcott. Mr. Chairman.

Senator Douglas. Mr. Wolcott.

Mr. Wolcott. In following Mr. McCabe, I did not know whether he had given us the average reserves of nonmember banks which might be located in central Reserve cities and Reserve cities.

Mr. McCabe. We have not broken that down. This is the average of all nonmember insured banks.

Senator Douglas. If you take the two systems as a whole, the contrast is between 18 percent and about 26 percent?

Mr. McCabe. That is right.

Mr. Wolcott. Excepting that the legal reserves in the Reserve city banks is 26 percent, and you say they are actually 31 percent. That builds up your average of member banks pretty high. I do not know whether we should compare that under those circumstances with the average reserves of the country banks that are not members.

Mr. McCabe. I do not know if you want to take the time right now to figure it out, but insured nonmember banks have cash assets of 17.9 percent of total deposits and country member banks, which are similar to insured nonmembers, carry cash assets amounting to 23 percent of total deposits. The legal reserve requirements today for central Reserve city banks is 22 percent; for Reserve city banks, 18; and for the country banks, 12.

Mr. Wolcott. Not 26?

Mr. McCabe. No; 22. We reduced it twice.

Mr. Wolcott. I guess I am speaking of legal limits. Your legal limit is 26?

Mr. McCabe. The legal limit is 26. You heard that 26 discussed at great length before your committee.

Mr. Wolcott. Yes; I had that 26 in mind.

Mr. McCabe. The practice of holding balances with correspondents is characteristic of our system of unit banks. In any inquiry of needed monetary and banking legislation, consideration should be given to the possibility of evolving a system of reserve requirements that would make allowance for holdings of vault cash and balances with other banks in such a way as to minimize the effect of differences between member and nonmember banks. In my answer to your questionnaire, I have submitted some alternatives that might be considered to deal with this problem.

THE PROBLEM OF A DIVIDED BANKING STRUCTURE

It has been intimated to the committee that we in the Federal Reserve are unduly alarmed by the problems presented by a divided banking structure since nonmember banks hold only 15 percent of the total commercial bank deposits in the country. I want to point out that this is an over-all figure and can be very misleading if not viewed on a geographical basis. The percentage of deposits varies between 4.5 percent and 62 percent from the lowest State to the highest.

Senator Douglas. What State is the lowest and what State is the highest?

Mr. McCabe. New York is the lowest and Mississippi is the highest.

Correspondingly, the number of nonmember banks varies between 13 percent and 85 percent of all commercial banks. I need hardly point out to Members of Congress the actual influence of these 7,000 nonmember banks representing 50 percent of the banking constituency.

I emphasized strongly in my answer to your questionnaire my fundamental faith in the dual banking system. The great commercial expansion of this country was ventured under that system, and I would be the last to advocate any policy that supplants it. I also emphasized my great concern lest our dual banking system degenerate into a hopelessly divided banking structure, and I gave you what I consider some constructive alternatives to deal with it.

My primary aim is to consolidate the efforts of all forces concerned with our financial integrity to the greatest extent possible in order to have this country adequately armed, so far as our money mechanism can accomplish that, to prevent credit excesses in an upswing and to make Federal Reserve resources universally available to banks if they need help in stormy weather.

Our banking and credit economy consists of an incredibly complex structure of interlocked assets and liabilities. No bank can operate that cannot convert its assets quickly into cash when depositors' use of funds results in a drain. In periods of financial strain there is no alternative but recourse to the Reserve System. This recourse to funds is always available to a member bank, with full assurance that the Federal Reserve will be in a position to meet its requirements, whatever they may be. I would like to see this recourse open also to nonmember banks who carry their reserves in the Federal Reserve banks.

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Senator DOUGLAS. May I raise a question there?

As long as the Federal Reserve System is willing to buy Government securities from the banks and give them Federal Reserve notes, if necessary, in return, does that not mean there is virtually no danger of bank failure?

Mr. MCCABE. I think the danger of bank failure has been greatly minimized over the last several years.

Senator DOUGLAS. And minimized not merely by the FDIC, but also minimized as long as the Open Market Committee will buy Government securities from the banks; is that not true?

Mr. MCCABE. I was very much interested the other day in Mr. Harl's testimony before you, where he emphasized so strongly the importance of the maintenance of the support program on the long-term Government bonds. I think he made a very strong point of that in testimony before this committee.

I think it is a combination of many factors. The banks are more liquid today than they have ever been in their history. Of their total loans and investments, roughly 50 percent are in Government bonds.

Senator DOUGLAS. Excuse me for interjecting, but I am asking this question to clarify my own mind.

Government securities differ from the private securities in that in the case of private securities there is no market that banks as a whole can depend upon to operate at all times; but, as long as the Open Market Committee is willing to buy bonds from the member banks, you do provide a market at all times for Government securities. Therefore, you now provide a degree of liquidity which was not present when Government securities formed only a small proportion of the holdings of the banks and the overwhelming proportion of their holdings was in the form of securities which they were not able to liquidate at the same time, or if they tried to liquidate all at the same time would result in a disastrous fall of prices in those securities; is that not true?

Mr. MCCABE. All the character of bank investments today is greatly improved over what it was 15, 20, 25 years ago. We never have had, Senator, a banking structure as strong as we have today.

Senator DOUGLAS. Here is the interesting thing. It has been made stronger, has it not, by the very existence of the public debt? That is a curious paradox.

Mr. MCCABE. That is a curious paradox, but it is true.

Senator DOUGLAS. There used to be an old saying that public debts were private blessings. Is that true in the case of banks?

Mr. WOLCOTT. I assume your question was predicated upon the fact that we could monetize much of our debt to prevent the failure of banks. If there came a time in our economy where that was necessary, what would be the natural effect under the quantitative theory of money upon our economy if you monetized enough of the debt to support the banks?

Mr. MCCABE. You are thinking that if overnight, using a hypothetical case, the Federal Reserve should purchase all of the Governments held——

Mr. WOLCOTT. Not all, but sufficient to prevent the banks from failing, if we take that means.

Mr. McCabe. You would have the potentialities then for a great credit expansion. It would depend on the circumstances at the time as to whether that credit expansion would take place, but you would certainly have the potentialities.

Senator Douglas. In a period of depression that very fact would lend an element of stability to the situation?

Mr. McCabe. Unquestionably, as you supply reserves to the banks in a period of recession or depression or whatever you want to call it——

Senator Douglas. "Inventory readjustment" seems to be the official phrase nowadays.

Mr. Wolcott. Is that not what we usually refer to as printing-press money? And do you advocate that in periods of depression we start the printing presses to offset the depression?

Mr. McCabe. Congressman Wolcott, as you well know, I am——

Mr. Wolcott. Perhaps I should not have asked you that question. I think it naturally follows that your answer would be "No," generally, but I think maybe, if I may offer the suggestion, a little of it might be all right and might prevent further depression, but you would not use that as the alternative to a depression.

Mr. McCabe. As you probably know, I think I am a rugged exponent of all the safeguards of our private-enterprise system and have an abhorrence of an unsound money. As long as I am in this position, I would fight with everything that is in me not to do anything that would break down the confidence of our people in our money.

Mr. Wolcott. I felt that was the kind of answer he would like to make to clarify the situation.

Senator Douglas. The purpose of the Chairman of the Federal Reserve Board is the purpose of everyone. No one would break down the confidence in money.

Mr. McCabe. Objections raised against inclusion of all commercial banks in common protective action against inflationary excesses do not, of course, arise when we talk of making the resources of the Reserve System available to all banks, regardless of membership, when the going gets rough. Whether it is more vital to restrain a boom or cushion a depression, in either case I have felt that the Reserve System should be in a position to use all its influence.

I think this should dispel the fog that has spread over the question of whether nonmember banks should be on an equal footing with member banks so far as reserve requirements are concerned. This is no new subject. It is as old as the Federal Reserve Act itself. Carter Glass was by no means alone in insisting that logic and simple fairness called for universal membership. I can imagine no more vigorous a champion of States' rights than he was. In the early and mid-thirties, Congress specifically provided that all insured banks, at least, should be members of the Reserve System. True, that decision was subsequently reversed.

Senator Douglas. Just a moment. When was it that Congress provided that all insured banks should be members?

Mr. McCabe. When the FDIC was first created.

Mr. THOMAS. In 1933.

Senator DOUGLAS. And when was it reversed?

Mr. McCABE. It was modified in 1935, and repealed in 1939.

Senator DOUGLAS. It was put into the law in 1933 and was repealed in 1939? Was it ever operative?

Mr. McCABE. It was supposed to become effective in 1936, but it never actually went into effect. A 1935 amendment excluded very small banks and extended the effective date to 1941, but this was repealed in 1939.

Senator DOUGLAS. There was no occasion for withdrawal?

Mr. McCABE. That was the intent of Congress at the time of the passage of the FDIC legislation.

Senator DOUGLAS. Then as the fear of break-down diminished——

Mr. McCABE. There was great pressure exerted throughout the country on that.

I mention this only to point out that there is nothing new or novel; there is no reaching for more and more power, when we bring to your attention the fact that nonmembership dilutes our ability to do our job—and that is all we are concerned with. Carter Glass put it in far stronger terms when he said it makes for competition in laxity.

As a businessman, I naturally dislike restrictive Government authority and centralization of power. Some of the fog that surrounds the subject of the role of monetary policy arises because of the erroneous belief that the Federal Reserve System seeks to play a far greater part than was intended and that it is reaching for more power. I have tried to bring out in this discussion, on the contrary, that the dilemma we faced until this year could not be resolved adequately because, in our considered judgment, we could not use the open-market powers—undoubtedly very great—which we already possessed without the likelihood of doing more economic harm than good.

The suggestion has recently been made to me by a very competent observer that one step forward might be taken through strengthening, in some appropriate and acceptable way, the relationships between the Reserve System and the supervisors of State banks. I have not thought this out completely, and I mention it only because this is one of many constructive thoughts that we are exploring to harmonize the policies of all supervisory authorities in attaining our common objective.

With your permission, I will introduce in the record a table which shows nonmembership by States, both as to deposits and numbers of banks. I would also like to introduce into the record excerpts from letters I have recently received from the presidents of the Federal Reserve Banks of Chicago, Minneapolis, and Kansas City, commenting on this subject.

Senator DOUGLAS. We will be very glad to have you do so.

(The material referred to above is as follows:

Commercial banks in the United States; percentage of nonmember banks, by States, June 30, 1949

State	Number of banks	Percent nonmember	Percent total deposits held by nonmember banks	State	Number of banks	Percent nonmember	Percent total deposits held by nonmember banks
Mississippi	203	84.7	62.0	Rhode Island	19	47.4	20.0
Georgia	394	83.5	28.9	Utah	55	43.6	16.5
South Carolina	150	78.0	32.5	California	204	43.6	8.5
North Carolina	226	76.1	45.4	Illinois	891	43.2	9.6
Iowa	665	75.5	48.1	Vermont	70	42.9	48.1
Tennessee	295	72.2	22.9	Connecticut	114	42.1	31.4
North Dakota	150	72.0	57.4	Oklahoma	387	41.9	14.0
Louisiana	161	71.4	23.0	Maine	64	40.6	31.4
Kentucky	385	70.9	37.6	West Virginia	179	40.2	23.0
Arkansas	230	70.9	32.1	Idaho	45	40.0	13.5
Wisconsin	551	70.2	34.0	Colorado	147	37.4	11.0
Missouri	599	69.9	21.6	Texas	898	36.6	11.1
Minnesota	682	69.6	26.9	Ohio	662	36.0	11.6
Nebraska	416	65.6	26.4	Virginia	314	35.0	19.3
Kansas	610	64.8	36.0	New Mexico	50	32.0	20.5
South Dakota	170	63.5	33.8	New Hampshire	75	30.7	32.3
Florida	190	61.6	23.0	Wyoming	55	25.5	16.3
Alabama	226	59.7	18.1	Nevada	8	25.0	8.4
Washington	122	56.6	7.9	Montana	111	24.3	13.3
Oregon	69	56.5	8.2	Pennsylvania	979	24.0	13.5
Delaware	39	56.4	33.7	Massachusetts	183	21.9	8.8
Arizona	11	54.5	16.5	District of Columbia	19	15.8	6.1
Maryland	163	52.8	26.2	New Jersey	334	15.3	12.5
Indiana	486	51.6	27.3	New York	648	12.8	4.5
Michigan	446	48.2	13.7				

COMMENTS OF RESERVE BANK PRESIDENTS ON NONMEMBER BANK PROBLEM

From H. G. Leedy, Federal Reserve Bank of Kansas City

It is sometimes said that the effectiveness of the Federal Reserve System is not reduced significantly by the presence of nonmember banks, as member banks hold 85 percent of all bank deposits in this country, leaving only 15 percent not directly subject to Federal Reserve influence. This statement greatly understates the problem.

Recently, one of our officers visited with a banker in a small town who is operating a national bank, and therefore a member bank. His competitor across the street is a State nonmember bank. The national banker indicated that there was serious question in his mind as to whether he should carry or could afford to carry the cost of being a member bank when he was trying to compete with an institution across the street that did not have to meet those particular costs. He not only thought that it was not fair and equitable, but he indicated serious doubt as to whether it was good judgment on his part to operate his bank as a member bank in that kind of competitive situation. This conversation is only one example of a host of similar conversations that we have had.

Repeatedly, we hear our member bankers raising serious question as to whether it is either equitable or good judgment for them to incur the additional dollar cost that is involved in being a member bank, and we hear nonmember banks commonly giving that increased cost as a reason for not joining the Federal Reserve System. Recently, a member bank withdrew from the Federal Reserve System, and in a letter to this bank made the following statement: "In this action we want to assure you that there is absolutely no ill feeling, as our association and business dealings have all been most pleasant, but it was thought that keeping such a large reserve with the Federal Reserve worked quite a hardship on us, and precluded our investing State and county funds in bonds, as we are required to keep the reserve with you on such deposits."

We also must recognize that part of the effectiveness of Federal Reserve credit action stems from the indication it gives of the viewpoint of the monetary authorities with respect to credit developments. An increase in member bank reserve requirements, for example, not only immobilizes part of a member bank's reserves but it also makes the member bank acutely conscious of the fact that the Federal Reserve officials think that credit expansion should be restrained. This in itself, I am convinced, tends to make member banks more selective in their extension of credit to customers. On the other hand, nonmember banks not only do not have that additional part of their reserves immobilized, but the Federal Reserve's expression of its attitude with respect to further credit expansion has little effect upon the nonmember banks' lending policy. In our Federal Reserve district, with 1,009 nonmember banks as compared with 759 member banks, this means that the lending policy of the vast majority of banks, and in some areas of the district nearly all banks, are affected little, if at all, by Federal Reserve credit actions.

From C. S. Young, Federal Reserve Bank of Chicago

Present capital requirements specify only capital stock and fail to take into consideration surplus and other accounts, which are part of the capital structure of a bank. In this way, a bank with a substantial and well-balanced capital structure may be ineligible for membership even though its capital structure is stronger than that of some bank that has the required amount of capital stock. A bank should have a reasonable amount of capital stock to be eligible for membership, but consideration should also be given to other capital accounts. Also, if a nonmember bank has a sound investment and lending policy and its management is capable, it should not be denied membership in the Federal Reserve System if the only reason involved is lack of capital sufficient for it to become a national bank.

No bank can insulate itself against the effects of System action by remaining out of the System, nor can it gain all of the benefits of membership without becoming a member.

The Chicago Federal Reserve District serves more member banks than any other district, and as of November 28, 1949, it had 1,006 members. Of the 14,000 banks in the United States, more than 2,500 are located in the Chicago district. Branch banks are operated in four of the five district States and 292 maintain branches. Of the commercial banks, 565 are national institutions, and 1,942 operate under State charter. Because of statutory requirements based on the population of the town or city they serve, 150 are denied the benefits of membership in the Federal Reserve System, and 222 cannot join or have had to withdraw from the System because they operate branches outside the city in which they are located and do not have the common capital stock required for membership under present statutes.

From John N. Peyton, Federal Reserve Bank of Minneapolis

It is a distressing fact that the Federal Reserve System which is the central banking system of the United States, serves directly less than half of the commercial banking institutions in the Nation. To be sure, the banks which are members of the Federal Reserve System hold the major part of the banking resources of the country, but the System cannot be said to be successful or fully effective under present conditions. In time of emergency, banks which are not members of the Federal Reserve System must rely on other commercial banks for credit, and it is probable that at such times these other commercial banks may be overextended and must rely, themselves, on the Federal Reserve System. This is exactly the situation which prevailed periodically before the Federal Reserve Act was passed, and the act was designed to cure this defect as one of its major objectives.

At the opposite extreme, in times of boom and speculative mania, the machinery set up by Congress through which the central banking system can restrain excessive creation of bank credit cannot be fully effective as long as thousands of banks can continue to operate as they please without feeling the restraints of such administrative actions as higher discount rates and higher reserve requirements.

LOANS TO BUSINESS

I wish particularly at this point to clarify my response in the questionnaire that dealt with the authority of the Federal Reserve banks to extend direct loans to industry. The statement has been misunderstood by some to indicate that I requested new authority to compete with the lending authority of the Reconstruction Finance Corporation. The fact is that the Federal Reserve banks have long had authority under section 13b of the Federal Reserve Act to make direct loans to industry. I was seeking in my answer to avoid conflict between the lending activities of the Federal Reserve banks and those of the RFC. I specifically stated that if Congress did not wish to clarify the position I would prefer that our authority be repealed, and I wish to reemphasize that statement because the Federal Reserve System should not be looking for new worlds to conquer. Furthermore, the very justifiable question can be raised as to the role of a central banking authority in the field of direct lending.

It is part of my basic philosophy to be wary of the growth of Government loan agencies that, in their competition with private lending institutions, weaken these institutions to the point where they no longer play a dynamic role in our economy. At the same time, I recognize that situations have arisen, and may arise again, particularly in periods of emergency, when the availability of public financing is essential to the survival of the economy. I recognize also that in the area of small business there may be financial needs at all times that justify direct Government attention and support. In my answer, I tried to deal with both of these needs.

The basic problem arises out of the nature of the credit relationship between borrower and lender that is appropriate to a private-enterprise economy. Though it may not so appear on the balance sheet, a business credit or business loan is not an isolated transaction that occurs once between a borrower and a lender and is terminated at the time of repayment. What a businessman needs, and what small-business men need above all else, is a credit connection, a recurrent source of loans to which he can turn periodically to finance his seasonal needs——

Senator DOUGLAS. Or, to use the phrase of the Bible, "an ever-present help in time of trouble"?

Mr. McCABE. Exactly—to tide him over emergencies, to advise him on plans for expansion and to help finance his growth. It is only very large concerns, with direct access to the central money markets, that can afford even to contemplate operations without an established recurrent source of financial accommodation. Most of our successful business enterprises, both large and small, are meticulous to cultivate and maintain customer relationships of long standing with commercial banks and other financial institutions, and vice versa.

It is this long-term nature of business-credit relationships that makes me fearful of Government lending activities. The danger is that such financial relationships, once established, tend by their very nature to be maintained, and that a growing sector of our private business economy may come to depend for its credit advances on the public credit.

The suggestions I advanced in my answer represented my best thought of how we in the Federal Reserve System might meet these conflicting objectives constructively, if the Congress placed our authority on a more effective basis. The advantages to the economy, should Congress do so, are that we are very close to banks and are familiar with their operations, that we have adequate resources, and that we have an experienced personnel capable of giving considerate and constructive attention to unusual credit situations, particularly those that are closely associated with the legitimate financial needs of small business. It has been my observation that an important difficulty of small business, particularly of relatively new ventures, to secure financing is due to the fact that it has no established banking connection. It is my thought that if the Congress so directs, we in the Federal Reserve could play a constructive role by devoting ourselves to the establishment of sustained customer connections between small-business units and their local banks. Clearly, this would be more welcome to small business than the prospect of continued dependence on public lending agencies.

Frequently, these connections are not automatically established in the market place, because a typical small business with no regular banking connection represents an unusual credit risk that does not conform to traditional standards. In such cases, the application may be turned down by the local bank because it has not the facilities to make the investigation essential to establish whether or not the risk is bankable. It is these situations where the Federal Reserve banks could operate most effectively. With their trained personnel and facilities they are in a better position to investigate unusual credit situations than many small local banks. If they found such situations justified the extension of credit, they could make the loan, subject always to the safeguard that the local institution carried at least 10 percent of the risk.

Senator DOUGLAS. That the Federal Reserve bank would make the loan, and not merely insure the loan made by a local bank?

Mr. MCCABE. My thought is here that the Federal Reserve under no circumstances would make the loan unless the local bank took 10-percent participation. The local bank could take any amount of the participation over 10 percent that it desired. Then I further stated that any time during the life of the loan the local bank could take over all of it or any part of it. That was in my suggestion.

They would always be prepared to sell back to the local bank any or all of their participation and we would consider their job well done when the borrower had acquired an established local banking connection and no longer repaired to the Federal Reserve bank for assistance.

I am aware that direct loans of a customer nature to industrial business units lie outside the main credit activities of central banking institutions. I would not expect that the dollar volume of such loans at the Reserve bank would ever be large. I would look on it as a pilot operation designed to establish regular customer relationships between local small businessmen and their local banks. I would judge its success not by the dollar volume of such loans outstanding at any one time but rather by the vitality that it gave to small business and to commercial banking.

If Congress were to request us to do a job like this, I can assure you that the Federal Reserve is organized to do it. As I indicated in my answer, I would want our existing authority liberalized and I would also want assurance that the law be amended so that we would not be in a competitive position with the Reconstruction Finance Corporation.

Senator DOUGLAS. As I understand your suggestion as it was developed in your reply to our questionnaire, the role of the Reconstruction Finance Corporation would then be the final defense, if you may use that phrase, and RFC would loan only after (*a*) the local bank had turned it down, and (*b*) the Federal Reserve had turned it down; so that the RFC in a sense would be the safety man in the banking back field.

Mr. MCCABE. In the RFC there are certain types of loans that I feel it should always have authority, and be in a position, to make. That is, there are types of loans to certain public utilities and railroads, there are also types of loans in times of great emergency that the RFC should be in a position to make.

In other words, I am going back to the original intent of Congress in setting up the RFC. The RFC also, if there was a good reason that the Federal Reserve bank could not get a participation of 10 percent from the local bank in the loan, and therefore, the loan was going to be turned down, that they would have a last resort to the RFC.

ORGANIZATION OF THE SYSTEM

It is of course vital that the Board of Governors and the Open Market Committee be composed of men of the highest caliber. I wholeheartedly agree with the view, which has several times been expressed here, that the best assurance that the System will continue to be able to arrive at informed and disinterested judgment on all questions of monetary policy is a strong Board of Governors. Only a Board made up of men of the highest competence can discharge the heavy responsibilities for monetary policy entrusted to it. That is why I feel so strongly that it was a great mistake for the Congress under the recent executive pay legislation to alter the relationship between the salaries of Board members and those of the top executive officers of the Government, which was established when the Federal Reserve was founded. It is not the salary level as such so much as the implied disparagement and reduced status of the Board which will make it extremely difficult in the future to induce outstanding men to accept Board membership. The Board is also placed at a disadvantage in its relationship with other agencies.

Senator DOUGLAS. May I interject here for a minute, and may I say that as a member of the Banking and Currency Committee, I was in favor of increasing the salaries of the members of the Board to $22,500. When that issue, however, was on the floor of the Senate in connection with the executive pay bill, I thought I detected a very strong move from the private banks of the country to keep the salaries of the Federal Reserve Board down on the alleged ground that they should not exceed the salaries of the members of the Federal Deposit Insurance Corporation.

The thought occurred to me—it may be that I am of an excessively suspicious nature—that the private bankers were using the FDIC as an instrument whereby they might prevent this increase in salary to the members of the Federal Reserve Board.

I wondered, on the basis of your experience in public affairs, whether you could tell me if this suspicion of mine is justified or whether it was the unfounded conclusion of a nature which perhaps is unduly suspicious?

Mr. McCabe. I think, Senator, to be perfectly frank with you, there was great pressure put on the Congress at the time this was before the Congress by some groups of the banking fraternity to keep on an equal basis the salaries of the Board of Governors, the FDIC, and the Comptroller of the Currency.

It has been true since I have been in office—when issues arise quite frequently the representatives of the banking fraternity take the position that all should be on an equal footing, and sometimes like to play one of us against the other.

I was told that the amendment which was offered had a good chance of passing until the pressure became so great to equalize this.

Senator Douglas. I think that is substantially true. From my observation so far as the Senate is concerned I have always been struck by the fact that there was a peculiar emotional affinity between various governmental agencies and various outside bodies, and at times it seemed to me as though the national banks had great emotional affinity for the Comptroller of the Currency, and that the State banks, particularly the nonmember State banks, had a great affinity for the Federal Deposit Insurance Corporation, and that the poor Federal Reserve System had very few friends in the banking fraternity.

I wonder if you feel as friendless as I, at times, thought you were.

Mr. McCabe. I would like to say this, however, Senator: That the Advisory Council to the Federal Reserve took a very strong position on this salary increase for the Federal Reserve, and there were a great many bankers throughout the country who felt just as strongly as I did about this. There were some of them who expressed themselves very strongly to me that they disliked this policy of trying to play one agency against another. I certainly do not want to take the position that I depreciate the positions of the directors of the FDIC or the position of that of Comptroller of the Currency. I think I would fail, however, in my duty if I did not bring forcibly to the attention of this committee and to other committees of the Congress my concern about this problem.

Senator Douglas. The arguments of those who said that the salaries of members of the FDIC and the Comptroller of the Currency should be on a level with the Federal Reserve System were based primarily on the relative work performed by these bodies in connection with bank examinations as compared with the bank examination work of the Federal Reserve System.

Now, the bank examination work of the Federal Reserve System is relatively minor, is it not, compared with your other responsibilities?

Mr. McCabe. That is right, it is important but it is not as important as our policy-making function.

Senator Douglas. Credit control?

Mr. McCabe. Yes; the policy-making function. I would like to say further that I have the very, very highest regard for the present incumbents of the offices in the FDIC and Comptroller of the Currency.

Continuing with my statement: The accusation has been made that the Board operates in an ivory tower, and that its decisions are surrounded by mystery——

Senator Douglas. You do not operate in an ivory tower, but you do operate in a very handsome building.

Mr. McCabe. I think the most beautiful in the country.

This is very far from the fact. I doubt whether there is any institution, public or private, anywhere in the world whose operations are so fully disclosed to the public as those of the Federal Reserve System. In the Federal Reserve Bulletin, in the annual reports to Congress—which include all policy actions of the Board and of the Open Market Committee, together with the reasons therefor—in regularly issued reports of day-to-day operations, in frequent other publications both of the Board and of the Reserve banks, and in public discussions, the actions and activities of the entire System are displayed as in an open book.

Senator DOUGLAS. The difficulty many of us find is that the language in this open book is of such a nature that it is very difficult for us to tell what the words mean.

Mr. MCCABE. Senator, as you and I work together more perhaps we can both get a better understanding of these words.

We occupy no ivory tower. We live in a goldfish bowl——

Senator DOUGLAS. Is this a description of the architecture of the Federal Reserve building again?

Mr. MCCABE. This statement can cover many things, Senator.

The unique organization of the Federal Reserve enables the System to be extremely close to the pulse of the economy at all times. Before coming to decisions on all matters of policy, the Reserve Board has the inestimable advantage of being able to communicate with and obtain factual information, as well as opinions, from the 12 Federal Reserve banks and their 24 branches throughout the country, on whose boards are more than 250 directors, drawn not only from banking but from the widely diversified industrial, commercial, agricultural, and professional pursuits of the Nation. The directors, the officers, and staffs of the Reserve banks and the Board, the Federal Advisory Council, and the member banks comprise the Reserve System. The Board has constantly available current information, drawn from this great System to supplement the vast mass of factual and statistical data gathered through other governmental sources.

Moreover, the System sponsors special studies as occasion demands. In addition, we are always at pains to consult with representative businessmen, the small as well as the larger ones, with trade associations and, in fact, with all who are affected by System operations. We try to weigh carefully their views and to distinguish broad national considerations from those reflecting narrower interests.

The art of central banking is far from simple, nor is it one of the exact sciences. That is why, as I have stated, I feel that your committee is doing such a useful educational job in bringing these monetary, credit, and fiscal problems to the attention of the public, and grappling with these problems. You can help greatly by such conclusions and recommendations as you may put in your report to chart the future course of monetary and credit policy and enable it to play its full part toward achieving our goal of steady economic progress.

Senator DOUGLAS. Thank you very much, Mr. McCabe.

There is a very central question that I should like to ask, but before I do that, I think I should lay a basis for it in a statement of my own.

Article I, section 8, of the Constitution lays down the powers of Congress, and the second paragraph of section 8 states that Congress shall have the power "to borrow money on the credit of the United States."

And then paragraph 18, the so-called implied powers clause, states that Congress shall have the power to make all laws which shall be necessary and proper to carry into execution the foregoing powers.

So that the Constitution lodges in Congress the power to borrow money and to make all laws which are necessary and proper to carry into execution the borrowing of money.

Now, since the details of borrowing money cannot be fixed legislatively, Congress has in practice confided virtually all of these powers to the Secretary of the Treasury with not many restrictions imposed, except a total limit——

Mr. WOLCOTT. Which is very ineffective.

Senator DOUGLAS. Which my colleague says is ineffective, and which on occasion in the past has been increased.

Mr. WOLCOTT. May I explain that remark by saying that when the differential in the debt limit between the total debt and the bonded debt was removed we, of course, put ourselves in the position, being the legislative body that we are, of increasing the debt limit whenever appropriations were made by the Congress which would carry the debt over the legal debt limit; so that the existing debt limit as provided by Congress is just something to be talked about every time it comes up, and it has as little effect as any act we have ever passed, because we can amend that inferentially and indirectly any time we please by appropriating money over that amount.

Senator DOUGLAS. We have confided those powers pretty largely to the Secretary of the Treasury.

Now, paragraph 5 of section 8 gives to Congress the power, which I have quoted several times in these hearings, "to coin money" and "regulate the value thereof."

Now, since metallic money is a relatively unimportant part of our monetary system and since Federal Reserve notes and bank credit form the overwhelming portion of the medium of exchange——

Mr. MCCABE. Bank deposits.

Senator DOUGLAS. Bank deposits, pardon me—in practice under the Federal Reserve Act we have confided most of our powers in those directions to the Federal Reserve System without much control exercised by Congress. We have, therefore, given to two administrative bodies these basic powers, and in the absence of further legislation by Congress, each has the legal power to proceed more or less independently of the other.

Now, since the Treasury is not lodged with the responsibility for legislating the value of money or maintaining a price level, let us say, and since its primary responsibility in this connection is the management of the debt, it seems to me that under those circumstances the Treasury would have an almost inevitable desire to reduce the interest charges upon the debt in order to reduce the total of governmental expenditures and to maintain the price of Government securities at not too far below par.

On the other hand, the Reserve System, being primarily charged with the regulation of the value of money in its broadest aspects, will have a natural tendency when prices are rising to try to check that rise in price and will, therefore, feel inclined to check that by the instruments which it has available.

One of those instruments is the method of open-market operations and its effect upon yields of Government securities and prices of Government securities. Therefore, irrespective of personalities, it would seem to me that in a period of inflation the Reserve System would have an inevitable tendency to want to increase interest rates as a means of checking further undue expansion of the volume of privately created purchasing power by the banks; but to do that would necessarily involve, in view of the fact that the Government debt is now so important, an increase in the interest charges which the Treasury and, therefore, the Government would have to pay, upon this public debt, and might involve—and, in fact, reciprocally would tend to involve—some reduction in the prices of Government securities in order to send the yields or true interest rate up.

It, therefore, seems to me that you have what I think Mr. Sproul described as an inevitable conflict, not necessarily an irrepressible conflict, but an inevitable conflict between these two purposes. There is no legal machinery at present provided to determine which of these policies will prevail. We might indeed have the two of them moving at cross-purposes.

Therefore, the two authorities fall back upon the magic words "cooperation" and "coordination," which have real meaning if they describe a genuine spiritual attitude on both sides, but the meaning of which is somewhat ambiguous, and the reality of which may at some times be lacking.

Suppose, for example, we were to move into a period of inflation after this "inventory readjustment" which is taking place, and you should wish to raise interest rates in order to repress the volume of private borrowings and, hence, inflation, but the Treasury should want to issue or refund Government securities at low rates of interest.

Here you are, twins, Siamese twins, but with no central coordinating nervous structure to dictate a uniform policy.

Do you see some possible dangers in that situation?

Mr. McCabe. Well, I could see very grave dangers if you had in the personnel of the Treasury and the Federal Reserve the type of people that just refuse to discuss these broad questions from the standpoint of the public interest. If we reached an impasse, Senator, I would think the first recourse would be to go to the President and have him arbitrate these differences in point of view.

Certainly, the Federal Reserve being a creature of the Congress and reporting to the Congress, should then make its appeal to the Congress to arbitrate the points of view.

As I see it, there are three steps: One is persuasion, the second is appeal to the President, the third is appeal to the Congress; that is, to meet this hypothetical situation that you advance.

Senator Douglas. Would it be helpful if Congress were to give a definite directive of policy which both the Treasury and the Federal Reserve would follow, not merely on money and credit policy, on the one hand, and debt policy, upon the other hand, but for the two as an integrated whole?

Mr. McCabe. I have thought a great deal about that, as to the type of directive, if you want to call it that, which the Congress might issue. It might be in the form of a resolution or the Congress might more definitely define the areas of responsibility, or the Congress might even go so far as to say which body would be the body of final decision.

I would have great difficulty, however, in drafting the kind of directive that I think might be suitable.

So frequently I have seen specific directives proposed. By the time they emerged from the various committees of the Congress they often were very difficult to carry out.

I remember so well being Foreign Liquidation Commissioner, trying to operate under the old Surplus Property Act, which to my mind was a hodgepodge, just cluttered with compromises, almost unworkable. You will remember Congress set up a three-man commission and an unworkable act and then in a period of time realized they had to change that three-man commission to a one-man administrator to get action, and then had to clarify finally certain sections of the law.

Now, that would be one of my apprehensions in a directive.

Senator DOUGLAS. In other words, just as Members of Congress sometimes have doubts about the administrative machinery of the Government, the members of the administrative apparatus sometimes have doubts about Congress; is that correct?

Mr. McCABE. I think this——

Senator DOUGLAS. Members of Congress sometimes have doubts about themselves, I may say.

Mr. McCABE. I think this committee, as a result of these hearings, and knowing the backgrounds of the men, could propose a directive that might be effective; but when I think what might come out of the hopper in the final form I have to be realistic enough to say to you that I think your greatest insurance is in the character of the men that you have on the Board of the Federal Reserve and in the character of the Secretary of the Treasury.

Now, the Secretary of the Treasury has and should have considerations other than just the interest rate on the Government securities. I think that most of the Secretaries of the Treasury I have known have been conscious of the broader implications of their job. That is, they have to think of tax returns and, therefore, they must be conscious of the economy and the things that are good for that economy.

They have certain monetary powers also. They have to be conscious of those powers. The Secretary of the Treasury is also a member of the President's Cabinet, he is chief financial officer, and he should be influenced to a considerable extent by the philosophy of the President in maintaining a sound economy. So there are many broad considerations in the picture.

Now, on the side of the Federal Reserve, we feel that one of our primary considerations in regulating the supply, cost, and availability of money and credit is to study all facets of the economy. I think we are set up in such a fashion that we not only have one of the finest research staffs in the world, but in addition to that, through our 12 banks and 24 branches and 250 directors, we can almost overnight find out through these directors the current things that are taking place in the economy.

Quite often the data from a research staff may be a few weeks old by the time you get it, but overnight we can get the information from our banks and through our directors of what is taking place currently; and we try to put those two things together.

Therefore, when we sit down with the Secretary of the Treasury—and I would like to say for the benefit of this committee that we spend hours, literally hours, in discussion of all phases of the problem—we try constantly to bring to his attention what is taking place as we see it. He has his own avenues of determining what is taking place in the economy.

To be absolutely realistic about it, I feel that for the immediate future the best solution I can see is for Congress to have sufficient confidence in the Treasury and in the Federal Reserve—confidence that they can coordinate—I have used the word "coordinate," Senator, instead of your word "cooperate"——

Senator DOUGLAS. That is not my word.

Mr. McCABE. Coordinate their activities to attain the desired objective of the Congress and the public.

Now, this "struggle" that it has been intimated takes place between the Federal Reserve and the Treasury—it is not new today. There have been differences of opinion since the Federal Reserve was first created, and quite rightfully so.

Senator DOUGLAS. What I am trying to say is that those conflicts of opinion are inevitable and irrespective of personalities, because each body is lodged with a different duty.

Mr. McCABE. Yes; and you know from your study of the history of other countries—the relation of central banks to the Treasury—that there have always been differences between the central banks and the treasuries. It is quite normal that there should be that difference of opinion.

What I am groping for, and the committee also, I know, is how in the future we can unite the opinions of both. I must say that in my period down here I have found the Treasury anxious and always willing to listen, to consult, and to get our point of view. I have gone to great lengths to get their point of view. I do not envy you in deciding at the end of these hearings your responsibility in trying to determine how you would resolve this point that we have been discussing.

Senator DOUGLAS. You are a little afraid, however, that if Congress were to give you a specific directive, the cure might be worse than the disease?

Mr. McCABE. Yes; I have some apprehension of that.

And then, of course, after you issue a directive there is the interpretation.

Senator DOUGLAS. We generally find that whatever directive we issue, the administrative agency always interprets it in the fashion most favorable to itself, and that they always have attorneys who tell their boss that he should do precisely what the boss wants to do.

Mr. McCABE. Of course, Senator, you can never eliminate the human equation in this problem or in any problem irrespective of what the directive may be. I have had enough experience in my lifetime to know that the issuance of a directive is not the cure-all; that, unless you have the right man to carry out the spirit and intent of that directive, you still have not accomplished what you want.

Senator DOUGLAS. I have been rereading the statement of policy of the Full Employment Act, which is reprinted at the bottom of page 26 in the footnote in our committee print. As a matter of fact, you submitted it yourself.

Mr. McCABE. Yes.

Senator DOUGLAS. And you will notice that the primary declaration of policy is for the—

Federal Government to use all practicable means * * * to promote maximum employment, production, and purchasing power.

In other words, the declared objective is maximum employment, production, and purchasing power. There is no specific mention made in that declaration of policy to prevent undue inflation. Would it be helpful if that second standard were added to the promotion of maximum employment——

Mr. MCCABE. You have maximum employment, production, and purchasing power. It does not say "full employment." It says "maximum employment," and I have a horror of making full employment your objective, because I think we have some experience——

Senator DOUGLAS. The act is guarded on that point. It does not say "full employment"; it says "maximum employment." But what I am getting at is this. As I remember the German hyperinflation of 1923 and 1924, everyone was employed. There was no unemployment in Germany; the industries of Germany were going at full speed, but the increase in prices was astronomical in nature.

Now, to merely have such a directive without prevention of inflation, it might be possible for someone to argue that the purposes of Congress were being fulfilled if you had everyone employed, even though the index of prices were to go up through the ceiling and soar toward the stratosphere.

Mr. MCCABE. Dr. Thomas points out to me that they did not have maximum purchasing power there. They had maximum employment and production.

Senator DOUGLAS. What is purchasing power in the large but the total volume of production in the economy? Some people did not have purchasing power; the holders of fixed incomes did not have purchasing power, but the volume of purchasing power is the total volume of production, because, after all, the money mechanism, as every schoolboy should know, as Macaulay would say, is merely a means to facilitate the exchange of goods.

So, I wonder if you have a sufficient directive binding upon the Treasury and the Reserve System, perhaps upon the Reserve System, but binding on the Treasury to prevent inflation——

Mr. MCCABE. I think it comes back largely, Senator, to the man who occupies the position of Secretary of the Treasury and, in the final analysis, to the President. If the President has the concept, which I feel is the concept of this committee, and if the Secretary of the Treasury has that concept, there is no difficulty in harmonizing the points of difference. Now, I fully appreciate what you are trying to do, and some of my very wise counselors tell me that it is possible to write such a directive. I would certainly explore those avenues. My own feeling is that the policy directive of the Employment Act of 1946, which is an act of Congress, is our guide until Congress rescinds it.

Senator DOUGLAS. Then there is no obligation upon the Reserve System to prevent inflation if inflation carries with it maximum employment, production, and purchasing power?

Mr. MCCABE. I would follow the steps that I enumerated. If we should encounter another inflationary period like 1948, and if we felt that the actions of the Treasury did not conform with the actions we though were right, of course, we would have used all the persuasion and presented all the facts and brought to their attention as forcibly as we could all the arguments then in the absence of action. The next step would be to go to the President. If we still felt that we could not get the desired action, we could then only go to the Congress which created us and to whom we are responsible.

Senator DOUGLAS. But you would prefer to do this only if an emergency arose and in default of adjustment otherwise?

Mr. McCABE. That is right. Now, if you could clearly define in the directive you have in mind—which I assume you have in mind—and that directive was clear enough, I can see that it could serve a useful purpose. I want you to understand I am sympathetic to the purpose you have in mind in suggesting a directive.

Senator DOUGLAS. Would you and your staff take this under advisement? Would it be possible for you within a couple of weeks to give us an opinion in writing as to whether or not you think such a directive could profitably be given and, if so, what you suggest it should be?

Mr. McCABE. I have every desire to help this committee in every way.

Senator DOUGLAS. Some time we may have to deal with this issue.

Mr. McCABE. We will give it the very best thought we have; will be glad to collaborate with your staff, and see if we can formulate such a directive.

(The material referred to above will be supplied at a later date for the files of the committee.)

Senator DOUGLAS. Now, may I ask you to turn to your testimony, in which you quote the announcement of June 28.

Mr. McCABE. Yes.

Senator DOUGLAS. In which both the Treasury and the Reserve Board joined, and which you regarded as a happy evidence of cooperation and coordination existing between the two agencies.

Mr. McCABE. I brought that out with the force that I did, Senator, because that announcement was the result of days of discussion and was the unanimous expression of the Open Market Committee. That announcement was drafted and redrafted, and it was submitted to the Treasury.

Senator DOUGLAS. And it was acceptable to them?

Mr. McCABE. It was acceptable to them.

Senator DOUGLAS. Was not this issued at a time of either recession or inventory readjustment, June 28?

Mr. McCABE. That was the period in June following 6 months of experience of recession. We had experience working together in an inflationary period and in this period of recession. We had the experience also of operating together in coordinating our open-market operations with debt-management problems. This announcement was reached, as I said, by mutual agreement.

Senator DOUGLAS. This is my point: Did not that announcement or decision mean that at the time it was issued—namely, one of recession or inventory adjustment—that securities would not be sold and did it not, therefore, tend to keep down or to depress interest rates and, therefore, of course, would it not be acceptable to the Treasury? But does it follow that, because the Treasury agreed at this time that the Treasury will go along with primary regard to the general business and credit situation in other periods?

If we were in a period of inflation and were to carry out this policy, it might mean—it would mean to the degree that the Federal Reserve Board exercised its powers—the sale of securities, a rise in the interest rate, and a fall in the prices of Government securities.

In other words, the instance of cooperation which you chose was one which was very happy from the Treasury point of view, when there was no conflict between the two purposes in a period of depression. But would this cooperation necessarily continue in a period of inflation?

Mr. McCabe. The acid test of relationships and even of partnerships, Senator, comes when you have to meet a critical situation in the future. I am going on the assumption that this was an agreement made by men of understanding and good will and that it means what it says.

Senator Douglas. That is not a statement of policy for an indefinite period of time. I think it is somewhat indefinite in language; but certainly, whatever it means, it does not mean the two bodies are bound forever.

Mr. McCabe. To the Federal Reserve, it means flexibility.

Senator Douglas. That in periods of inflation the interest rate will be increased and, if necessary, the prices of Government securities depressed?

Mr. McCabe. That the open-market operations will be flexible——

Senator Douglas. Flexible both ways?

Mr. McCabe. And that we will conform to the economic situation with which we are confronted.

Senator Douglas. You will have flexibility both ways?

Mr. McCabe. Both ways.

Senator Douglas. Do you think the Treasury so understands it?

Mr. McCabe. That is my understanding. The Treasury understands this: That they have the final decision on fixing the rate on any refunding of Treasury obligations. We so recognize that they have this final decision and that when they announce a maturity—the refunding of a maturity—they determine the rate.

Senator Douglas. The Government budget will be unbalanced this year by at least 5½ billions and possibly more. I hope we will be able to avoid that for the fiscal year 1950–51.

In that connection, I think a tremendous amount of self-restraint is going to be needed by the Nation as a whole, as well as by Congress. But if that self-restraint should be lacking and we should have an appreciable Government deficit in a period of revival and prosperity, with prices rising, and the Treasury would then be forced to issue new securities and not merely refund old securities. If the Treasury should then insist upon low interest rates in order to prevent cash outlays by the Government for interest charges rising, but the Reserve System believed that interest rates should be increased in order to check expansion in the private sector, you would be in conflict; would you not?

Mr. McCabe. Yes, and I would say that we would go to extraordinary lengths to convince the Treasury of the point of view of the Open Market Committee. I assume that the experience we both had in 1948 would serve us well in meeting such a future situation. That was the most inflationary period in my lifetime that we have had to face, and I think both of us learned a great deal from meeting the problems of that period.

Senator DOUGLAS. Do you think the checking of inflation in 1948 was primarily carried through by a rise in the general interest rate or by selective controls over consumer credit and raising of reserve requirements, and so forth?

Mr. McCABE. It was a combination of all factors. I think the actions of the Federal Reserve contributed materially. I think there were many other actions that also contributed. That is, I just cannot say that monetary and credit actions were alone responsible. I think that monetary and credit actions also contributed very materially in checking the recession that took place in the first 6 months of this year, because I think we demonstrated as a governmental agency our flexibility, and we were very quick to act on relaxing our various regulations—very quick to act.

I think that the record since the first of the year shows that as a governmental agency we have been unusually flexible. As a businessman, I have always had a perfect horror of governmental agencies that were inflexible. I think our record of flexibility since the first of the year speaks for itself.

Senator DOUGLAS. One of the advantages of a public hearing is that it permits the audience to ask questions of the witness, provided the members of the congressional committee acquiesce. I think it is an advantage of a democracy.

With the understanding that this is not a question which I myself ask, but it is merely a question in which I act as the imperfect vehicle through which an anonymous member of the audience asks this question, I shall read it, and you can make such reply as you may wish. I do not know whether this is true or not, but I merely read the question that has been passed up.

"Last week the Federal Reserve Board strongly requested the Treasury to withhold any announcement of refunding terms on the certificates maturing on January 1. The Board—so it is alleged—wanted to be free to let the market decline in order to establish a 1¼ percent interest rate, as opposed to the 1⅛ present rate, if conditions made this advisable. Nevertheless—so runs this question from an anonymous member—the Treasury a month in advance announced that on January 1 certificates would be refunded for 1 year at 1⅛ percent."

First I would like to ask if that is a correct statement of fact. No, I do not ask that—the anonymous questioner would probably like to know whether this is a correct statement of fact, and, if so, what comments you would like to make upon it.

Mr. McCABE. Senator, I think I have demonstrated my desire to be completely frank in these discussions, and I would like to continue to be frank. I question, however, if I should make any comment on this statement, because it involves a confidential relationship between the Open Market Committee and the Treasury, and I doubt if it is appropriate for me to comment on that in a public forum.

Senator DOUGLAS. Would you be willing to comment in an executive session?

Mr. McCabe. So far as the gentlemen of this committee are concerned, our records and our actions are an open book.

Senator Douglas. Is it true, however, that you live, therefore, in a perfect goldfish bowl? I would say there was a state of low visibility in some respects.

Mr. McCabe. You know we report regularly to the Congress the policies of the Open Market Committee and the actions of the Board, and keep them informed. As far as I am personally concerned, I have no hesitancy in commenting on the statement. However, I have to realize that, even though I am up here as an individual, I have a responsibility under what I consider to be a confidential relationship between the Treasury and the Federal Reserve, and I would just question whether I should comment on a statement of this kind. Am I not right, sir?

Senator Douglas. I am in some uncertainty as to whether you are right, but I know your motives are of the best. It is a very real problem. On the one hand, I think the Congress and, to some degree, the public are both entitled to know the issues which are at stake, and that in a democracy these proceedings should not be entirely confidential between the agencies of the public which transact them.

On the other hand, I am well aware of the difficulties which the Treasury may have in floating issues, and I am also well aware that there are sharp speculators, whom we certainly do not wish to aid. So I am in some uncertainty about the issue.

I would say this: That the least secrecy possible is the best.

Mr. McCabe. That is my viewpoint.

Senator Douglas. And I think that the democracy will not permanently endure a situation in which these decisions are made quietly and then not reported to the people.

Now, those may be the reflections of an inexperienced Senator, but in my judgment these matters should not permanently be kept secret, and I say this not with any desire to raise personal issues or to pit one agency against another at all, but simply in the interest of sound policy.

Mr. McCabe. Senator, in this particular case this refunding has not taken place.

Senator Douglas. But the terms have been announced.

Mr. McCabe. The terms have been announced. There is a question in my mind as to whether I would make any statement about a current transaction of this kind that might in any way embarrass the Treasury in its operations.

Senator Douglas. Well, I appreciate your motives; I respect your character. Is money and credit so mysterious a thing, however, that its operations should be hidden from the light of day?

Mr. McCabe. None whatever. I do not see any. There is a question always in your current operations, the question of tipping your hand to those of the public, and the speculators who are always watching for a tip. In this particular case it is not so much a question of tipping hands as it is that I would not want to be placed in the position of doing anything to violate a confidence with the Secretary of the Treasury.

Senator DOUGLAS. But certainly in the long run these gentlemen's understanding should not supersede the right of the public and the duty of Congress to have information?

Mr. MCCABE. I thoroughly appreciate that.

Senator DOUGLAS. Now, I have taken up a great deal of time and I appreciate your readiness to testify. If my colleague will permit me, there are a few questions I should like to ask about your recommendations on reserve requirements, particularly about making them uniform.

Mr. WOLCOTT. May I interrupt for a personal statement? I must leave and I regret it very much.

First, I want to thank you for your courtesy to me and I hope I have not made myself so obnoxious that I will not again sit in with you.

Senator DOUGLAS. You are always welcome.

Mr. WOLCOTT. I think I should want to express my appreciation to Mr. McCabe for the very splendid contribution he has made to our studies here this morning. I regret very much that circumstances are such that I am impelled to return to Michigan this afternoon.

Senator DOUGLAS. I feel, perhaps, Congressman Wolcott, that I should apologize to you for taking up so much time.

Mr. WOLCOTT. I did not have any questions to ask. I think Mr. McCabe has covered it very fully in answer to questions—all the questions that were in my mind and many that were not in my mind. It has been very helpful.

Mr. MCCABE. Thank you, sir.

Senator DOUGLAS. I think I will be able to conclude in a few minutes.

I have tried to go into this question of whether it is necessary to have uniform reserve requirements for nonmember banks as well as for member banks with a number of witnesses, and there is a point upon which no tangible evidence, so far as I know, has yet been submitted, and it is this:

Have there been any cases in practice in which when the Reserve Board was considering an increase in reserve requirements there was then the threat, explicit or implied, on the part of member State banks that if this increase were to go into effect they would withdraw from the System?

The argument of the Reserve System thus far has been hypothetical in nature, that this might happen, that this has been, I believe in the case of Mr. Eccles, a restraining influence upon their minds; but the advocates of so-called dual system, when I pushed them on the question of that danger have continually challenged me to bring forth one case in which a State bank has either withdrawn or has threatened to withdraw because of the imposition of reserve requirements.

Mr. MCCABE. I will just refer, if I may, to a communication from the president of our Federal Reserve bank in Kansas City:

> Repeatedly we hear our member bankers raising serious question as to whether it is either equitable or good judgment for them to incur the additional dollar costs involved in being a member bank, and we hear nonmember banks commonly giving that increased cost as a reason for not joining the Federal Reserve System.
>
> Recently a member bank withdrew from the Federal Reserve System and in a letter to this bank made the following statement:
>
> "In this action we want to assure you that there is absolutely no ill feeling, as our association and business dealings have all been most pleasant, but it

was thought that keeping such a large reserve with the Federal Reserve worked quite a hardship on us and precluded our investing State and county funds in bonds, as we are required, to keep the reserve with you on such deposits."

I could cite other examples. I can state, not as an actual withdrawal, but in 1948, when we had made one of the increases in reserve requirements, the president of a bank in Winchester, Va., came up to see me. He represented a clearing association of some 20 banks.

He came into my office one day suddenly without appointment and asked if I would see him. I immediately saw him. He expressed to me his great concern, as a result of a discussion among their banks, that we would lose members if this continued. He felt so strongly that he made a special trip up to see me.

We went to lunch, and I spent a good part of the afternoon with him, going over the whole situation. After I had presented all phases of the problem to him and what I felt were obligations of banks in the System, he asked me if I would come down to Winchester and address his group, including all the directors of those banks. I made a special trip down there and spent the evening with these directors.

In that case, to my knowledge, we did not lose any members. But I cite that to show what the presidents of our Federal Reserve banks and the managers of our branches face when the members become restive under this condition.

Now, our records show, Senator, that the reason of reserves was given for withdrawal in three cases in 1947. We had one in 1948 that gave that as a reason, and we have had four in 1949 that have given that as a reason. That is, have specifically given reserves as a reason.

I think that it is a threat. I think it does have an influence on the Board in making its decisions on increasing reserve requirements. Certainly the presidents of our Federal Reserve banks and the managers of the branches impress upon us with great force the possible results in this respect of any action to increase reserve requirements.

Senator DOUGLAS. Now, in your proposal for uniformity of reserves between nonmember and member banks, would you extend to nonmember banks the reserve requirements which are now applicable to member banks, or would you wait until the reserve requirements have been altered before making them applicable to nonmember banks?

Mr. McCABE. I would like to say that what we call our uniform requirement proposal has not been passed upon by the Board of Governors. The Washington staff has done a voluminous amount of work on this in collaboration with our field staffs. We have conferred with bankers and other groups about it, and we have presented it informally to your joint committee. We have tentatively drafted certain terms and conditions, and the highlights of those terms and conditions are these:

1. That the differentials in reserve requirements would not be based on geographical location of banks, as at present, but on type of deposits. Thus, the present designation of central Reserve cities and Reserve cities and the resulting differential in reserve requirements would be eliminated.

2. A relatively low percentage, as at present, would be prescribed for time deposits or savings deposits, a higher percentage for demand deposits other than interbank deposits, and a higher percentage for interbank deposits.

3. Vault cash would be counted as a part of required reserves.

Senator DOUGLAS. That would be a proposal which would make this more palatable to the nonmember banks?

Mr. McCABE. Well, it depends entirely when you say "more palatable." It would be, Senator, a question of each bank sitting down with a pad and pencil and figuring it out.

Senator DOUGLAS. This would apply to all banks?

Mr. McCABE. This would apply to all banks.

Senator DOUGLAS. My very able associate, Mr. Chandler, suggests that the issue there is how far they would be from the Federal Reserve bank, because if they were just around the corner from the Federal Reserve bank they do not have to carry much vault cash.

Mr. McCABE. All these are practical questions. It would be quite natural that every bank would sit down to figure out whether it would be better off, or whether the result will be the same or whether it would be worse off. So there are a great many practical considerations. We want to explore it further with banking groups, and we want them to get their pencils and paper out to figure the results of it, and then after we have explored it further with the banking group we would like to come back to the appropriate committee of Congress to discuss it.

Senator DOUGLAS. Probably it would be more acceptable to banks in the central Reserve cities, possibly a bit more in the Reserve cities than to the country banks, because the process of averaging would send the latter's reserve ratios up.

Mr. McCABE. On first blush, I think you probably would get more acceptance from the country member banks than you would perhaps from any other group. You might get some resistance from the correspondent banks in the Reserve cities and the central Reserve cities. If a higher rate applies on interbank deposits, you would get some resistance there.

Of course, you would get great resistance if you talked about making this applicable to all insured nonmember banks. That will come from the nonmember banks, of course.

Senator DOUGLAS. Would you make your graduation of reserve requirements on the basis of the type of deposit conditional upon establishing uniform requirements for nonmember banks as well as for member banks, or would you be willing to go ahead on this new type of reserve requirement for member banks alone?

Mr. McCABE. Personally, if I was assured, after conferences with the banker groups, I would accept it for member banks only if it was not possible to get the inclusion of the nonmember banks.

Senator DOUGLAS. Would you recommend an act of Congress to make any new provision that you introduced for member banks applicable to nonmember banks?

Mr. McCABE. You recall that in my answer to the questionnaire I submitted alternative proposals as to what I would recommend to the Congress. I said there that the ideal would be to have the same reserve requirement—not talking about uniform requirements necessarily but talking about all reserve requirements—apply to all insured banks. In that event the nonmember banks would have access to the credit facilities of the Federal Reserve.

Another proposal was made to me very strongly by a banker for whom I have great respect, and he made that second alternative proposal I wrote in my questionnaire: That the nonmember banks be allowed to carry their reserve with the correspondent banks. If that was done—and I think that might be a step in the direction—if that was done, then I think hooking up with that the uniform reserve proposal would be very desirable. In that event, I question, as I said in my answer, whether they should have access to the credit facilities of the Federal Reserve, if they did not keep their balances with the Federal Reserve—that is, the reserve balance.

Senator DOUGLAS. Well, thank you very much, Mr. McCabe. I am afraid we have kept you a long time and asked you many embarrassing questions.

Mr. McCABE. I will be glad to come back at any time, and I thank you for your courtesy.

Senator DOUGLAS. This concludes the hearings of the Subcommittee on Monetary, Credit, and Fiscal Policies. Several statements which have not yet been filed with the committee will be included in the printed hearings. (The statements appear on pp. 544–570.)

It is possible we may be able to arrange an executive session, not open to the press, of various leading officials of the Government.

(Whereupon, at 1 p. m., the hearings were concluded.)

MONETARY, CREDIT, AND FISCAL POLICIES

[The following hearings were held in executive session of the subcommittee but are made a part of the printed record by mutual consent]

MONDAY, DECEMBER 5, 1949

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON MONETARY, CREDIT, AND FISCAL POLICIES,
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The subcommittee met, pursuant to adjournment, at 10:15 a. m., in the caucus room, Senate Office Building, Senator Paul H. Douglas (chairman of the subcommittee) presiding.

Present: Senator Douglas (chairman of the subcommittee); also Dr. Grover W. Ensley, acting staff director.

Senator DOUGLAS. With your permission, Mr. Pace, we will make an executive record with the understanding that that will not be open to anyone except members of the committee; and if you come to any point that you do not want to have even on the executive record, that will not be recorded; and I understand that this morning we are going to consider not any details of the budget for the ensuing year, but simply budget procedure.

Mr. PACE. That is correct.

Senator DOUGLAS. I wonder if you would be willing to describe the budget-making process within the executive branch.

STATEMENT OF FRANK PACE, JR., DIRECTOR; FREDERICK J. LAWTON, ASSISTANT DIRECTOR; ELMER B. STAATS, EXECUTIVE ASSISTANT DIRECTOR; DONALD MacPHAIL, LEGISLATIVE REFERENCE DIVISION; JOSEPH E. REEVE, FISCAL DIVISION; G. GRIFFITH JOHNSON, FISCAL DIVISION, BUREAU OF THE BUDGET

Mr. PACE. May I ask one thing, Mr. Chairman? What are my time limitations?

Senator DOUGLAS. So far as I am concerned, the sky is the limit; but I imagine you are rather busy this time of the year.

Mr. PACE. That is very kind. In appearing here today I hope to make as broad-scale a presentation as possible. I plan to touch on four areas, and I would like your guidance as to whether these areas represent matters of paramount interest or concern to you.

The first is the one which you have suggested, the process by which the budget is prepared.

The second concerns the general characteristics of the 1950 budget and the break-down of programs in it.

Third, I would like to talk briefly about the problems that the executive branch faces with respect to the fixed and relatively fixed items in the budget.

Fourth, I would like to talk a little bit about the problem, as we see it, of achieving a balanced budget in any single year.

All of those are broad subjects; all of them, as we see it, go fundamentally to the heart of the problem. Does that generally fit in with your thinking?

Senator DOUGLAS. That will be fine.

Mr. PACE. In discussing the budget-making process, I would like to say at the outset that it has changed substantially in recent years because of the increased problems presented by the larger functions of the Federal Government. Budget making has become more of a year-round process, in contrast to a 3- or 4-month process running from about September through December. We have taken a great many steps toward tightening and improving this process. These are the steps I would like to touch upon with the subcommittee in pointing out just exactly what we are doing and why. The basic fact is that this a hard, grinding, difficult process that goes over a full year rather than a method whereby a number of programs are hastily thrown together and finally emerge in the form of a large and complex budget.

I have a chart here, Senator, that I think, better than anything else, will spell out just exactly what we do. Let me take for illustration, the 1952 budget, the one we will be preparing during this coming year. Immediately after January, when the 1951 budget is presented to the Congress by the President, members of the Estimates and Fiscal Divisions of the Bureau of the Budget will begin working with the various departments and agencies and discussing with them their programs for 1952 and the problems of integrating their operations in 1951 with the following fiscal year.

About May or June of this coming year I will meet with the various members of my staff to get from them a general judgment as to the outlook for 1952, as opposed to the outlook, as we saw it, in, say, December of this year.

After these meetings, I will meet with the Cabinet officers and the heads of the various agencies—that is, the big independent agencies. We will sit down informally around a table. They will have with them, probably, an Under Secretary or Assistant Secretary and their principal budget and administrative officers.

Let us take, for instance, our meeting with the Secretary of the Interior. The Secretary will tell me what he anticipates will be the focus of his program for 1952; in what areas he anticipates his program must move up; where he anticipates it will remain at the 1951 level, where he anticipates it will drop. He will also specify what, if any, programs he believes can be terminated in the year 1952.

At that time I will outline to him what, in my judgment, constitutes the President's fiscal problem for 1952.

Senator DOUGLAS. This is May and June?

Mr. PACE. Yes; that is right. These meetings will take place in May and June 1950, and the subject will be the outlook for 1952. That is the fiscal year which will begin July 1, 1951, more than a year ahead. I will tell him what we believe revenues will be for 1952, what the expenditure outlook is on the basis of preliminary projections, and what the President's policies are, based upon these estimates and projections. These policies may be expressed in terms of a restrictive budget policy, a budget policy that contemplates a going level, or an expansive budget policy.

Based on the information obtained in these meetings, I sit down with my staff and crystallize the various policy questions arising from what the Cabinet member anticipates he will do, the contemplated level of his programs, and the particular policy issues he has raised.

I will discuss these policy questions with the President over a period of maybe 3 or 4 weeks. I will take up each of the questions relating to the agencies and departments with him during this period. This fundamentally and significantly moves the focus of your budget-making process back from September to May or June.

The President, in considering his budget and legislative policies will, of course, discuss various aspects with Cabinet members concerned, with members of his personal staff or with those members of his executive office staff whom he considers to have related responsibilities in the field.

Based on the President's decisions, we will set what is known as a ceiling for the large departments and agencies; a ceiling gives an agency a target or planning figure within which to do its planning for the year 1952.

Senator DOUGLAS. That would mean make a first shot at a tentative budget in June?

Mr. PACE. That is correct. One point is worthy of mention here. You have noticed, I am sure, comment in the past that it is unwise to set an arbitrary ceiling at so early a date. In my judgment, that statement is born of a lack of knowledge of the total budget process.

There is a provision in the ceiling process which provides that those items that cannot be included within the limit of the ceiling shall be submitted as "B" items. These "B" items are listed outside of the ceiling itself and set forth the priority of importance of items in the mind of the Cabinet member or the agency head concerned. This means that in considering an agency's budget requests the Bureau has before it at all times not only a picture of the activities proposed to be carried out under the ceiling but a presentation of other proposed activities set forth in terms of priority.

The ceiling process has two other factors that I think are enormously important to better budgeting: One, it makes for much better planning—coordinated planning—at the department and bureau level.

For example, let us take one division in an important bureau of a large department. Formerly the division head prepared his budget and programed his operations with little knowledge of the program for his whole department.

When the division budget reached the bureau level, the bureau head, while perhaps reducing the requests somewhat, would consolidate the budgets of his various divisions for submission to the department. At the departmental level essentially the same process took place, with the department consolidating the requests of the various bureaus. Because of the lack of general objectives and planning goals, the initial steps in the budget process were carried out with little relationship to over-all fiscal policy.

Estimates would finally come to the Bureau of the Budget where the same process of cutting and consolidation would occur. The estimates would then go to the Congress, where you would have a repetition of the same program.

Senator DOUGLAS. May I interrupt a moment? The process inside a department is, of course, an expansive process as a practical matter. That is, the units will be liberal in their estimates of their own needs, and then as you move up through each level, there is an added degree of liberality or padding, so to speak, which is added until you finally get this figure.

Now, I think this is a good move to give them a ceiling which somewhat restrains their enthusiasm as they go along. What happens when the expansive forces within a department come in conflict with the contracting influences of the Budget Bureau?

Mr. PACE. What happens is that under the ceiling process you force the planning at the departmental and bureau level, rather than at the Presidential level. Given, say, a $2,000,000,000 ceiling, a department head must then allocate to each of his bureaus and divisions a certain amount of money, above which neither he nor they can go. Thus, you get a well-rounded process of planning.

Senator DOUGLAS. Prior to the introduction of this agency ceiling, did you not get into a terrific conflict with the expansive forces moving upward and you coming in at the end?

Mr. PACE. You certainly had a much more difficult problem. The ceiling process, in terms of administrative action, has done two great things. It has forced the department heads to do their own thinking on where they want their programs to go within a definite dollar limit, without eliminating the flexibility of Presidential decision at the last moment. Second, it has eliminated the gap that existed between Bureau of the Budget's judgment and the judgment of a department head. Now we are really talking broad-scale policy instead of trying to fight a battle of individual detail.

Senator DOUGLAS. Very good.

Mr. PACE. I follow a practice, Senator, of allowing any one of my staff to interrupt me and correct me where they feel I have erred; and with your permission, in this informal session I would like to do that.

Senator DOUGLAS. You are a very democratic bureau chief.

Mr. PACE. I am inclined to speak very frankly and very firmly, and I want to be sure that, based on my staff's knowledge, I neither overstate nor understate the case. Fundamentally, I think this has been a great forward step.

Mr. STAATS. It might be pointed out that agencies can always go under the ceiling.

Senator DOUGLAS. But they never do.

Mr. PACE. Oh, on occasions, yes. I could cite two or three examples.

Senator DOUGLAS. I think those fellows should be given the distinguished civilian medal.

Mr. PACE. We make an effort to reward them.

Senator DOUGLAS. Who has done that? Don't mention the bad boys, but you can mention the good boys.

Mr. PACE. I would prefer not to do that, because it would put the situation a little bit out of focus, because there are some reasons why some people went below ceilings that did not necessarily make them good; but I knew you would be happy to know that the situation does exist. Generally, the ceiling has been set on so tight a basis that it has forced some pretty hard constructive thinking to get within it.

After the setting of ceilings, the departments do their planning between the period of May-June to September. By mid-September they submit to the Bureau of the Budget their requests for the coming fiscal year.

Ceilings, of course, cover only the larger activities of government, not the smaller areas of spending. They are a little bit too elaborate to apply to every small agency. That being so, our examiners study the justifications presented in detail, including both programs covered by ceilings and those not covered. Then from the middle of September through November, they hold the budget hearings in which departments and agencies come before the Bureau just as they come before the appropriations committees. During these hearings each agency seeks the justify the presentations and estimates it has submitted to the Bureau.

My examiners, who have been working in the departments over the entire period of the year——

Senator DOUGLAS. Are they physically located in the Department, your examiners?

Mr. PACE. When I speak of being in a department, I mean they have been working closely with the department, studying its operations, and so forth.

Mr. STAATS. I think you might well mention the field trips in that same connection. They have regularly scheduled field trips each year.

Senator DOUGLAS. We should not forget, the major portion of Federal expenditures occur in the field.

Mr. PACE. There are field trips scheduled to the bigger installations and activities and to program areas where there are questions.

Senator DOUGLAS. You have regional examiners in the field?

Mr. PACE. We have field offices, but they are very limited in number. We have only four field offices and we have only four men in each field office. I have kept the number of employees in each office limited through choice, because I think if it became larger, a field office would lose its cohesive quality.

To return to our budget hearings, our examiners then carry through with questioning as to the program submitted by the departments. When the hearings are completed, examiners may ask agencies for additional information. On the basis of their knowledge of agency operations, gained through the steps I have described, the examiners prepare their recommendations for presentation to the director's review. The review lasts from early November to early December. The review board, itself, is composed of the heads primarily of our five main divisions. It is headed by Mr. Lawton, the Assistant Director, assisted by Mr. Staats, the Executive Assistant Director. Also included are the two top men in the Estimates Division, which is responsible for the examining work I am describing here; the two top men in the Fiscal Division, which is charged with broad over-all program analysis and fiscal planning, as opposed to departmental or organizational analysis and planning; the head of my Administrative Management Division, who is responsible for seeing that improved management work is tied into the budget process; the head of my Legislative Reference Division, which, as you know, is responsible for the Bureau's work in clearing and coordinating, for the President, draft legislation and agency reports on pending legislation. Finally, the head of the Statistical Standards Division sits on the review board to insure that attention is paid in the various decisions to statistical coordination and the statistical needs of the agencies.

Thus, there is a focus and emphasis in our reviews that goes beyond the purely budgetary and attempts to bring a full program viewpoint to bear. One thing I cannot emphasize too much is the close relationships which exist between both the management and fiscal functions and between the legislative and fiscal functions. In terms of planning a budget we must budget not only the amount of money that will be spent to carry out existing legislation, but must provide for funds necessary to meet the estimates for proposed legislation.

When the director's review is completed for a given department, we then meet with the President and take up directly with him the policy problems that have arisen for the programs concerned. As you know, I see the President maybe three and sometimes four times a week during this period, and I take up with him not only the large-scale policy issues but also, in some instances, the issues that arise within divisions of departments.

It is my responsibility to see that no large-scale fiscal decision is made without the President's participation and yet at the same time not to burden him with so much detail that he is overburdened by the budget. I would say that if I erred in one direction it was on the side of telling the President too much rather than too little. He has a deep and fundamental interest in the whole budget process, and I spend a great deal of time with him in obtaining his personal decisions.

After review by the President of each agency's requests, a final decision is reached. The President may wish, in some of the big money programs, to consult again with members of his own staff or with members of his Executive Office staff, including the NSRB, the NSC, or the CEA. He may also want to talk directly with various Cabinet members who are concerned.

Thus, the decision is reached for a department's program. We then notify departments and agencies by letter of their budget allowances, and they then have the chance to appeal to the Bureau if they wish. If there is an appeal, we meet directly with the agency to explain the reasons for the decision and to go over in detail the facts they wish to present. Thereafter an agency is entitled, if the decision is adverse, to make an appeal directly to the President.

I might say this off the record.

(Discussion off the record.)

Mr. Pace. From that, Senator, we pull out the whole budget process and tie it into the budget document, and then from probably now on we are beginning to draft the budget message as well as put the budget document to bed.

That fundamentally constitutes the whole budget process. It is a long, hard, grinding, pushing process, involving a great many details and requiring the full participation of my whole organization.

One other point that I would like to make is that we have, I think, made substantial strides forward in this area, particularly in the establishment of the ceiling process. I think, too, through the establishment of certain standards and guides for common services in the personnel, supply and other fields, we have achieved a basis for better analysis which has moved the budget process ahead.

In my judgment, our presentation this year for the first time of the budget on a partial "performance" basis will go a long way toward promoting a better understanding of the budget itself and toward giving the Congress a greater opportunity to evaluate the necessity of expenditures in one field as against another.

Senator DOUGLAS. How thorough would be your description of the work of each unit?

Mr. PACE. In the performance budget?

Senator DOUGLAS. Yes.

Mr. PACE. I think this year's budget will represent only a first step. I think that in the narrative statements it will be a very sound and thorough presentation. In terms of developing precise work and cost figures, however, we still have a substantial way to go.

I would like to mention in this connection that the performance budget itself is not a complete answer; it is only a step. One of the great problems in budgeting is that accounting systems in the various departments have grown up over a number of years in different ways to meet different purposes and under different circumstances. Thus, when you seek to compare performance in, say, the Department of Agriculture with what happens in the Department of the Interior, the different accounting procedures limit your capacity to do so.

We now have a joint accounting program that involves the Comptroller General, Secretary of the Treasury, and myself. This program is addressed to the problem of trying to establish a common basis of accounting throughout the Government. Although we can never achieve complete uniformity, an improved system will provide us with a basis for saying that it is unreasonable in our estimation to expend this amount of money in Department A, when Department B, which is performing substantially the same job, is spending a substantially smaller amount of money.

Improved accounting will not only provide the Executive agencies, but Congress as well with a better basis of evaluation. This is a long and difficult process. If it were possible to start afresh and set up a whole system of accounting in the Government, it would be a much simpler proposition than attempting to take all these existing systems and trying to pull them into a system which is really meaningful.

I was prepared to move on to the characteristics of the 1950 budget unless you have some questions.

Senator DOUGLAS. You may proceed.

Mr. PACE. I just want to talk to you very generally about the composition of the 1950 budget, based upon our midyear review, which was made in late October of this year. Much of this, I think, will be not new at all to your committee, but certainly it is an aspect that must be taken into account when one considers the part the budget plays annually in the functioning of the Government as a whole.

I have here a chart that possibly the committee has seen. For the purposes of your report, I can provide smaller copies of this to the committee if you wish. I think this, more than any other method of presentation, gets across what the problem is with respect to the composition of the budget.

Senator DOUGLAS. Are these the amounts appropriated or the amounts you recommended?

Mr. PACE. These represent the amounts of estimated expenditures—estimated expenditures for 1950 as of late this past October. In other words, it is nearly up to date as far as our expenditure estimates are concerned. To make a point clear, the Bureau of the Budget, when Congress adjourns, analyzes the amount and type of appropriations and other authorizations voted by Congress, and studies the impact of changed economic conditions on various agency programs. As a result of this analysis, revised estimates of expenditures are developed. This chart represents our judgment on the expenditures that will result both from the appropriations that were made by the Congress during the last session and from changes in program outlook.

Senator DOUGLAS. That leads us into a question which I perhaps should defer—namely, the question of contract authorizations.

Mr. PACE. If I could—I will move through this quickly and then——

Senator DOUGLAS. But that 13.2 billion for national defense does not include contract authorizations? It includes stock piling?

Mr. PACE. It does not include contract authority as such. The figure represents actual expenditures to be made this fiscal year, including expenditures to meet contract authorizations.

Mr. LAWTON. It includes money to liquidate prior contract authorizations.

Senator DOUGLAS. But does not include the contract authorizations for which expenditures will be made in future years? For instance, on national defense, would that include stockpiling?

Mr. PACE. It would include stock piling to the extent that you are required to liquidate contract authorizations in a given year, and in stock piling it would actually include——

Mr. LAWTON. Checks issued in payment for stock received under the stock piling, but would not include future commitments which would be liquidated in a subsequent year.

Mr. PACE. That is a point of paramount importance. That is the difference between the expenditure estimates contained in the budget which represent estimated cash payments within 1 year and the estimates of appropriations which represent the amount of authority requested from Congress to keep the various departments and agencies operating. Under the usual appropriation enacted by Congress, an agency has to obligate the funds for goods and services in the year for which the appropriation was made. All the goods and services contracted for, however, are not necessarily delivered or paid for in the year in which the appropriation was made and the funds obligated. Actual payment from the appropriated funds may not be made until 1 or 2 years later. This is one reason why it is extremely difficult to relate directly the amounts appropriated in 1 year to actual expenditures in that year. There is always a carry-over of obligated funds from 1 year which must be liquidated by expenditure payments in the following year or the year after that. The problem of reducing budget expenditures, therefore, is difficult to solve on the basis of a single year. A reduction in appropriations may result in little reduction of expenditures until the following year. I think that is probably one of the least understood of the problems involved in discussions of budget balancing.

Thus, to give you not a specific example but one that is theoretical, it would be entirely possible to cut a billion and a half to $2,000,000,000 off of the appropriations of the Military Establishment and still show correspondingly only approximately a 400- to 500-million-dollar reduction in the budget expenditures.

Is that an accurate statement from a theoretical point of view?

Mr. LAWTON. That is correct.

Senator DOUGLAS. Because of prior authorizations?

Mr. PACE. That is right and because expenditures in a single year result, not only from appropriations voted for that year, but from the unliquidated balances of appropriations enacted in prior years.

Mr. LAWTON. It may take you 18 months to 2 years to get delivery of a plane on which you start to let a contract.

Mr. PACE. When we fight to reduce a budget, we might be fighting to reduce a budget 18 months, 24 months, or even as much as 36 months hence.

Talking now to the problem of Federal budget expenditures, you will notice that national defense runs at around 13.2 billion. Veterans' programs run somewhere in the vicinity of $6,700,000,000, an increase of around 700 or 800 million dollars over what we had originally estimated. This increase results as you know, from the education and training situation.

I think it is an interesting thing to note that the trend of the veterans' education and training program had been showing a gradually downward trend over a period of time. Our estimates were made on the basis of that gradual decline. There came what appeared to be either a recession or a readjustment from an inflationary period, and this item shot up approximately $800,000,000. It is interesting from two standpoints. At the same time your tax revenues move down during a period of recession, in some areas of Government expenditures automatically move upward, irrespective of your desire to hold them down.

In the international field there is a reduction in 1950 over 1949. Interest on the public debt moves up slightly. About $200,000,000 of that resulted from a technical change in handling accrued interest on bonds, as you know.

In the agricultural field, although it moves down from 1949, it moved up about $800,000,000 over our January estimates. That is due, of course, to lower prices for agricultural commodities and illustrates what you might call an open-end program. An open-end program is one in which expeditures, under existing provisions of the law, rise or fall depending upon the number of people eligible and desirous of receiving some Federal benefit. Veterans' education and training or pensions are examples of open-end programs. For any single year, short of changes in legislation, neither the agency, the President nor the Congress has any control over the expenditures required.

Programs in the field of social welfare, health, and security have moved up about $200,000,000 and ran pretty much as planned in January of last year.

Senator DOUGLAS. $2,200,000,000, excluding Federal aid for education, which, of course, has not been passed.

Mr. PACE. That item appears in the education and research category.

Expenditures for transportation and communication move up over

1949 about $200,000,000 also. This increase arises from something with which you are very familiar, the failure to pass any postal rate increases on the one hand and the passage of higher postal salaries on the other.

I would like to say this off the record.

(There was discussion off the record.)

Mr. Pace. In natural resources, Mr. Chairman, we moved up slightly over 1949. Part of that is an increase in the atomic-energy program, which is included under natural resources. Again off the record——

(There was discussion off the record.)

Mr. Pace. In the natural-resources field the President has in the past few years, with only very minor exceptions, followed a program of no new starts. The new expenditures that have arisen in this area have arisen either from increased costs on projects now going and under way, or from additional new starts voted by Congress in the past several years.

This has been an area in which both the President and the Budget have attempted to exercise a very tight policy.

In education, labor, and housing, you will notice an increase there that runs approximately one billion one. Almost all of that—in fact, all of it is again the open-end program proposition. It is the RFC purchases in the secondary-mortgage market, which increased approximately one billion one over what we had estimated last January, this the "Fanny May" (FNMA) operation. Again, that is an area that is not subject to either budgetary planning or budgetary control, without some change in the basic legislation.

Senator Douglas. You mean that, from the savings and loan associations, et cetera?

Mr. Pace. There is over-all authorization in this field.

Mr. Douglas. That they turn in their mortgages to RFC?

Mr. Pace. That is right.

Mr. Reeve. The bulk of the mortgages now are being bought from the mortgage companies, who are really brokers and not financial institutions. About two-thirds of them come from there. It is lack of an adequate private secondary market which causes that.

Mr. Pace. You are generally buying Government-guaranteed paper. It is an interesting area in terms of a later discussion you might want to have on the problem of the capital budget.

Expenditures for general Government are running a little higher approximately in 1950 than in 1949. That increase largely represents pay raises for civilian employees enacted early this fall.

In the field of finance, commerce, and industry, expenditures are about the same level as last year.

I would like to again go off the record.

(There was discussion off the record.)

Mr. Pace. The point I wanted to make is a familiar one to this committee and is not offered by me in a defensive sense, but more in an analytical capacity. That is the tremendous preponderance in your budget of four big programs. When you add Atomic Energy; the National Advisory Committee on Aeronautics, the Maritime Commission, and other programs which must be appraised from a defense standpoint, even though they are civilian in nature, you find that the total amounts to about 80 to 82 percent of your total budget.

Therefore, the problem of considering what your budget will be over a period of time vitally concerns the outlook for four big items, supplemented by programs that are scattered all through the budget.

Mr. LAWTON. In considering your budget outlook, it is necessary to project programs forward. In any year, you are bound by the past to some degree, because you have commitments existing for a given year and a suceeding year. In looking ahead, however, when you are projecting over a longer period, then you do have the opportunity to disregard the past, because you can eliminate programs. That is, the Government can eliminate programs. One branch cannot do it alone. But you can change your focus on an agricultural program, for example, over a period looking 2 or 3 years ahead. You cannot change it for the current year.

Senator DOUGLAS. Let me take up one question, which always exercised me. When I was campaigning over the State of Illinois and would go into a county, I would frequently find three or four agencies of the Department of Agriculture, each with separate field representation—Soil Conservation, Production and Marketing, county agents, and so forth, and even more—and I had the feeling that there was undue duplication of field staffs, just from casual inspection of the Department of Agriculture.

We had the same thing in the city of Chicago—undue duplication of inspecting services, separate health inspection, separate building inspection, separate boiler inspection, and so on.

I wondered if it is not possible to develop not an omnicompetent but a multicompetent field service, which can take any number of these services performed by the same department, so that except in the big counties, for instance, in agriculture, you do not have to have four or five different men in the same county. In the Department of Labor, for instance, I have often wondered whether there was duplication between the administration of the Walsh-Healey Act and the administration of the Fair Labor Standards Act, whether those services could not be coordinated.

Yet, in practice each one of these services builds up a tremendous clientele and fights to the death for the vertical organization down through the country; and I wondered if that is not something that needs a major operation.

I do not know that the Budget Bureau is staffed or is strong enough to do it, but I have often thought that is something to which the Government somewhere someway should give attention.

Mr. PACE. I would like to say this and have my staff amplify it. Certainly, one of the major problems in the Government today is the effective organization of the Federal establishment in the field. In my judgment, there is little question that in many programs, field organization has grown over the years without sufficient attention being paid to possibilities of economy and with an eye to the most convenient and efficient service to the citizen. It is true that there has been a tendency to organize vertically. The beginnings of a trend in the other direction may have been initiated by the action of the Federal Security Agency last year in unifying its many field operations.

Now broadly, we face the problem of integrating major functions of the Government. As you know, the President will shortly name a

Water Resources Policy Commission which will study the allocation of responsibility in areas where there is obvious duplication. I think this broad approach, either through internal operation in Government or through the appointment of an outside independent commission, is one answer to that problem.

Would any of my staff care to amplify that?

Mr. STAATS. It strikes me that one of the things the Senator is interested in in his agricultural illustration is the problem of overlapping and duplication of functions of personnel operating in the field. That is one of the problems that the Hoover Commission looked into, but came up with no positive solution. It did, however, recommend further study. Our Bureau heartily concurs in that opinion. It is certainly a difficult problem.

Mr. PACE. Let me move on to another aspect of the budget, if I may, Senator, not because I think we have even remotely exhausted this area but only because of limitations of time. This is the subject of fixed or relatively fixed commitments in the budget.

One of the things that is particularly difficult for a President, his Budget Director and certainly to the Congress in seeking to achieve a balanced budget are the large fixed items facing you at the beginning of each fiscal year.

In achieving a balanced budget and a reduction of the debt one, at the same time, must recognize and consider the limitations that one faces.

Again I say this not as a reason why budgets cannot be balanced but largely as an indication of the necessity of analysis of this type of problem in determining when and where you should balance the budget.

I think unquestionably the balanced budget is a yardstick, an imperative yardstick, in the operation of the Government. I think that as an arbitrary criterion for a fiscal year, it is insufficient. I think in many instances it can do a great deal of harm and very little good.

Senator DOUGLAS. In periods of depression it could do harm.

Mr. PACE. There is no question about that.

Senator DOUGLAS. But in periods of prosperity I would like not only to see a balanced budget but a surplus.

Mr. PACE. Yes, a surplus.

I would like to move on just for a moment to show you the kind of problem you face when you start out at the beginning of a fiscal year to attempt to bring expenditures within your estimated revenues.

I have here a chart that is based upon our estimates of last January and does not reflect the changes that have occurred since that time. But in terms of expressing the principle rather than the specific details it is entirely adequate.

You will note that the chart contains two segments. One, in black, represents the fixed or relatively fixed commitments in the 1950 budget. These largely "noncontrollable" expenditures amount to 24.3 billion dollars out of the 41.9 billion dollars estimated last January. The other segment, in blue, is the controllable area of the budget, an amount totaling 17.6 billion dollars.

I think it is also interesting to note that most of the changes in the expenditure outlook between January and October took place in the black area on the chart or noncontrollable portions of the budget.

I cite by way of example, and in order to bring this up to date, the fact that included in this portion of the budget are estimated increases since January of 1.1 billion dollars for RFC purchases of mortgages, of $800,000,000 for price-support operations of the Commodity Credit Corporation, and of $800,000,000 for payments of veterans' education and training benefits. Thus, in these three programs alone you have an increase of 2.7 billion dollars above the original January estimates.

Am I accurate on that?

Mr. JOHNSON. That is right.

Mr. PACE. I will now run through some of the fixed or relatively fixed commitments rapidly. Expenditures from obligated balances of prior-year appropriations were estimated at 6.5 billion dollars in the original 1950 budget. Expenditures authorized from unappropriated funds amounted to 1.3 billion dollars. This amount, of course, has risen tremendously because of the increases in RFC and CCC expenditures which I mentioned a moment ago. Fixed charges in the budget, interest on the public debt and veterans' pensions, for example, totaled approximately 9 billion dollars in estimated expenditures.

To move on, expenditures to liquidate contract authorizations made available in prior years amounted to 3 billion dollars. Veterans' readjustment benefits, principally education and training, exceeded 2 billion dollars in the original budget. This figure also, as I have mentioned, is now considerably greater.

Grant-in-aid programs where the Federal Government provides funds to the States on a matching basis amounted to 1.3 billion dollars. Expenditures required to keep public works projects now under way going at a minimum level totaled 1 billion dollars. This means that when you started to plan your budget for the year 1950 you began with a base of about 24.3 billion dollars.

This second chart shows a break-down of the 17.6 billion dollars in so-called controllable programs.

Of this amount, 8.1 billion dollars is in the defense program, with the Air Force getting 2.4 billion, the Army 2.8 billion, and the Navy 2.9 billion.

The European recovery program at 3.1 billion; the Veterans' Administration, salaries and expenses, at 700 million; GARIOA——

Senator DOUGLAS. What is that?

Mr. PACE. Government and relief in occupied areas—$700,000,000.

Senator DOUGLAS. All right.

Mr. PACE. Controllable agricultural programs break down largely into conservation and use, Farmers Home Administration, and other, and amounts to $600,000,000, while Treasury runs $600,000,000.

For proposed legislation in 1950 the amount is 1.7 billion dollars. This included universal training, which did not become law and military pay, which did.

Senator DOUGLAS. The other military aid to Europe was not included?

Mr. PACE. That is right; it was not included in the budget because there was no firm figure that you could tie it to at that time.

Federal aid for education, which did not become law, and other, takes $300.000,000.

Your other areas, which represent your postal expenditures, your general Government operation, and your general administrative expenditures, run approximately 2.1 billion dollars.

Fundamentally, all this points to two great problems: One is the problem of the enormous carry-over you have from year to year and its effect upon your planning, and, two, the very definite limit that you face in achieving balance or imbalance in a given year.

Your problem is one of reducing administrative expenses by carrying on the best type of management improvement activity that you can and by impressing within the Government the necessity for management improvement; possibly, too, the development of some strong incentive in the departments and agencies to spend less money than is actually appropriated and to improve their internal operations so that they can make better use of that money.

Senator DOUGLAS. Have you ever thought of giving the supervisors and heads higher civil-service ratings according to the reductions in the staff which they do effect? That is Senator Long's suggestion.

Mr. PACE. Fred, why do you not come in on that one? That runs more to your line of experience than mine.

Mr. LAWTON. Of course, the theory of classification which is based on the kind of work you do is one thing which would have to be abandoned.

The second point is that you might have a series of individual judgments exercised by a great many people with the desire to gain some reward for themselves out of it which might be completely contrary to the program operations of the department or agency.

I think it is quite a misconception that if you add a few people to your staff you get a raise because you get a change in classification for the more people you have.

Senator DOUGLAS. That practice is taken into account in the question of salary increases for the supervisors. There is no doubt about that.

Mr. LAWTON. There are systems of reward, in fact, indicated in the new Pay Act, which has a provision that requires analysis of efficiency of operation of the agencies, with the ultimate idea there will be some rewarding. It can be done on the basis of cash awards at the present time.

Senator DOUGLAS. But those are one-shot affairs. The way for the wife to get a fur coat or a bigger house is to get a higher classification in the service.

And I checked with the Civil Service Commission and they finally came up with the fact they do constantly consider in deciding on the nature of the job how many men are under them. Of course, that goes on all the time in the military.

Mr. LAWTON. Attempting to set standards for that kind of an operation would be quite a job.

Senator DOUGLAS. I know.

Mr. LAWTON. I mean the degree to which you reward a person for change of operation.

Senator DOUGLAS. We have seen it operate in the military service even in wartime, presumably when we were trying to win a war and not to give promotions.

Mr. PACE. You do have to find some focus of incentive for reduction.

(Discussion off the record.)

Mr. PACE. The fourth subject I would like to touch on is the enormous problem faced in achieving a balanced budget in any single year. As I said earlier, fundamentally we subscribe to the principle of the balanced budget as a yardstick. Fundamentally, we feel that our planning for balancing budgets would be short-sighted if we restricted it to any given fiscal year because it must relate itself to both an economic cycle and to international commitments.

The first thing that I point to as a major difficulty of planning a balanced budget is the fixed commitments that are carried over the years.

Second, and more important, are the open-end programs, which neither a department, the Bureau of the Budget, the President, or the Congress actually can control in any given year. Those open-end programs on a large scale have come into increased prominence lately in the budget picture and we must give greater recognition to their impact in our consideration of the fiscal outlook.

No more graphic illustration of this could be given than the fact that increases of approximately $2,700,000,000 in estimated expenditures took place in the course of 9 months.

It is also true that in striving for a balanced budget you face the impact of economic fluctuations upon Government programs. I pointed out earlier in my testimony that economic fluctuations play a large part in budgetary change because, in a period of recession, you not only experience an immediate drop in tax receipts because of the income-tax structure itself, but you also are confronted with increases on the expenditure side in such areas as price support and veterans programs.

Also you cannot escape the implications of international programs which can significantly affect your budget outlook in a given year. The ticklish international situation in which we find ourselves naturally presents immediate problems which are difficult to take into account in long-range budget planning.

I would like to mention another point, and that is the maintenance of the Government plant. I estimate that we have a capital investment of over $25,000,000,000 in military installations alone, excluding things like airplanes, ships, tanks, and guns. I am merely talking about posts, camps, and arsenals, many of which were built on a temporary basis.

The problem now facing us is this: Should we allow these installations to go to pot completely and then have to replace them, at enormous cost, or should we spend the dollars necessary to maintain them adequately?

During the entire war period we followed a rigid policy of deferred maintenance in the whole civilian plant. Now, we face the problem of repairing and maintaining that capital investment as well.

We also must face the fact that many proposed developments will improve the economic status of the Nation as a whole. I am speaking, of course, about our highway system, the development of other transportation media, public power, flood control, and so forth. In other words, you must weigh the effect of what you might be doing in achieving a balanced budget with the effect it would have on the total economic condition of the country. Many expenditures for the economic development of the country will affect future budgets in terms of their contribution to the national income and the corresponding level of tax receipts.

I reiterate the fact that I subscribe to the principle of balancing the budget and as budget director devote my attention assiduously to that goal. However, there are forces present in any year which frequently make it impossible to balance the budget, even though we strive for specific economies throughout the Government.

That leads me to the final point I would like to make in this discussion, and it is probably the topic which concerns this committee most. Sound thinking traditionally has addressed itself to the fact that in normal times, with prosperious business conditions, a government should not only balance its budget but should achieve a surplus.

The fact is that we today have a high level of employment; that business conditions are good; that the level of tax receipts is high. Therefore, if the budget is not balanced under these circumstances, when will it be?

This question raises the point that these are not normal times. We are in a postwar period that is requiring enormous readjustments in our national economy and in our international affairs. We must catch up in maintaining the Government plant which we ignored for 4 or 5 years during the war.

We also face certain extraordinary measures that automatically arise in a postwar period, such as expanded veterans' benefits. Finally, we are devoting more than half our national budget to the direct support of a foreign policy. All of these things do not represent the normal requirements of this country in peacetime.

Therefore, my reaction to this situation is that while there are not normal times, we can look forward to a balancing of the budget in the not too far distant future when these extraordinary programs slacken off.

My concern is that if we proceeded upon the premise that these are normal times we might take certain actions to achieve an immediately balanced budget, which would in the long run harm our economy. This would make it even more difficult to achieve an over-all balanced budgetary operation in the future.

Senator DOUGLAS. Of course, we all have to form judgments on that and judgments differ.

My own judgment is these are not normal times, but they are going to be normal from now on. I mean, abnormal times will continue to be normal for years to come. That is, I think we can look forward to tension with Russia for years and years, that this may be part of their plan to get us into high expenditures by creating tension with the idea of weakening us economically. That may well be.

In view of that, I would not like to see us merely trust that tension will diminish and that foreign expenditures will fall and that we will have a painless reduction of these items. I am afraid we have either got to face the fact of unbalanced budgets continuing or use heroic methods to try to balance them in the face of tensions.

Mr. PACE. I certainly agree with you to the extent of saying that the abnormality of the times calls for increased efforts to place our governmental operations on a sound basis. I agree with your judgment that normal times, as we have known them in the past, are not going to be back with us.

Senator DOUGLAS. That is right.

Mr. PACE. I, however, point out that in terms of adjusting ourselves to these times we are right now in a period when our expenditures run substantially larger than they are likely to run a few years from now.

Mr. PACE. That is about the burden of my testimony, Mr. Chairman.

Senator DOUGLAS. May I ask some questions which have perplexed me?

Mr. PACE. Certainly.

Senator DOUGLAS. I have been perplexed by these deficiency appropriations which come in. When the deficiency appropriation was thrown on the table of the Senate 10 minutes before we adjourned—a billion dollars—not printed—nobody had a chance to look at it. We were told that unless we passed it the Veterans' Administration would have to stop paying benefits.

Now, I can understand that with these open-end programs it is impossible to budget in advance the precise amounts. You see we do not have a chance to scrutinize those, at least the Members of the Senate not on the Appropriations Committee, do not have a chance to scrutinize the items in those deficiency appropriations. I have sometimes had the sneaking suspicion that a good many of the department would hold back and then come in and fact the legislator with a fait accompli—"Unless you give us more money, we will have to go out of business."

I have the feeling that the deficiency appropriation is in a sense used in many cases in the negative to form a budget. Do you have any comments on that?

Mr. PACE. I will comment briefly first and then let Mr. Lawton speak because he has had long experience in this field.

The deficiency appropriation was devised to insure that necessary expenditures of the Government could be made where it would be harmful if they were not made.

Our efforts in the Bureau of the Budget have been to adhere to that concept. In other words, we make clear to the agencies that mere deficiencies in their original planning would not be considered for deficiency appropriation unless it could be shown——

Senator DOUGLAS. Do you pass on the deficiency budgets?

Mr. PACE. Yes, we do.

Senator DOUGLAS. Suppose you order economy. You know Civil Service can be very efficient in stalling action. Suppose you order economies, or Congress orders economies, to be made, and the agency says, "Yes." Then a lot of rigmarole goes on and the expenditures are not cut appreciably, and then at the end of 9 months the agency says, "Well, we are running behind 40 or 50 million dollars."

And they have probably some standard excuses which they have thought up.

Mr. PACE. We have, Mr. Chairman, as you know the power of apportionment whereby we apportion funds to the departments on a quarterly basis. These allocations are spaced so that agencies do not come up at the end of the year with totally inequitable requests for the final quarter.

When emergency requests arise we attempt to restrict them as far as possible.

In my judgment, however, there has been improvement, first through tighter administration of the apportionment process and second through improved departmental planning of legislative programs.

Some of your big appropriations come from legislation that is submitted late in the session on an emergency basis.

Fred, would you care to amplify what I have had to say?

Mr. LAWTON. In the case of the deficiency appropriations, they sometimes result from the original action on the appropriation by the Congress.

In two cases last year, one in the case of the Veterans' Administration, the House committee put a 10 percent cut in pensions and GI benefits on the basis the amount required was a guess anyway and that their guess might be as good as the President's. They recognized the nature of the cut, however, and stated in the report that if their guess was wrong they would have to meet the deficiency.

In the case of the large deficiency in veterans that occurred last year, there were two factors involved: One, the downtrend of the business cycle, and the reversal of the trend in on-the-job and below-college level training in schools. In addition, we had anticipated the bill would be passed early enough so that in the last part of June the Veterans' Administration would be able to spend some of the money appropriated for 1950.

The bill was delayed in passing. There was $350,000,000 of the bill available in 1949 but its late passage made it necessary to submit a supplemental for 1949 rather than use the 1950 money.

In the case of public works projects, the House anticipated a 15 percent reduction in cost. This was applied across the board on our going projects and to a few—I think there were 12—new starts.

Now you can make a saving due to reduction of costs where the bid is to be made in the future. But where there is a going project with a contract already made, a saving would depend on whether you were able to renegotiate the contract.

The Senate made some changes in the House action because it realized you could not get a cost reduction applied to going contracts where you were already operating under a bid price.

In the Post Office Department generally they have adopted the attitude that if business goes up you have to carry the mail and you have to have the appropriations. They tried one year to hold it on a different basis. The Post Office did the one thing they could do; they reduced service and immediately they were called to task for it. And we went back on this basis that if postal business increases your expenditures are necessarily going to increase, because you have to carry the mail.

Senator DOUGLAS. If you could eliminate the postal deficit, as postal activity increased receipts would go up, too.

Mr. LAWTON. That is right. That has been your major problem in that area. What to any business is its lifeblood, increase in operations—which has just been enormous in postal operations even after the war—is under these circumstances an additional burden every time you get more volume.

Senator DOUGLAS. From what you say, I would think the elimination of the postal deficit, except for the unpaid services performed to Government agencies, would be about the No. 1 task—that is, fiscal task—the Congress would have.

Mr. LAWTON. That is one of the major tasks; there is no question about it. And I would also like to see some of those services put out in the open so they are distinct from postal operation.

Senator DOUGLAS. The air-mail subsidy?

Mr. LAWTON. Yes; that subsidy area.

Senator DOUGLAS. Have you ever worked out how much the subsidy is?

Mr. PACE. Total payment to air lines for air-mail service and subsidy runs around $125,000,000 a year. The portion of that properly chargeable as a subsidy to the air lines cannot readily be determined under the present method of accounting.

Mr. LAWTON. The cost of handling the Government's mail and performing services for other Government agencies, as well as the subsidy to air lines, has been roughly estimated at around $160,000,000.

Senator DOUGLAS. That would include franked mail?

Mr. LAWTON. Yes; franked or penalty mail as well as the operation of buildings.

Senator DOUGLAS. And rental space. Does it include air-mail subsidies?

Mr. LAWTON. It does include air-mail subsidies.

Senator DOUGLAS. Are you satisfied there are not really subsidies to the railways on the postal service?

Mr. LAWTON. No; not when it is cheaper to send a car back deadhead than it is to return one loaded with freight on the return trip, which is true in a few cases.

Senator DOUGLAS. Have you got some estimates on what probable subsidies are to the railroads in excess of cost and reasonable profit?

Mr. PACE. I do not think we have that; no. The Post Office should have that, it would seem to me, but I do not think we have it.

Senator DOUGLAS. May I ask another question now?

Granted contract authorizations are necessary to some degree, is there any indication they have been authorized to an excessive amount?

Mr. PACE. What would you say on that, Mr. Lawton?

Mr. LAWTON. No. Contract authorizations are used where there is a long-range program that will not need cash in the current year. For example, in military procurement there are long-term items which may take 15, 24, or 36 months to procure, and it is necessary to have some authorization which will permit the Government to incur obligations, through contracts or otherwise, for such items.

That part of the procurement which is liquidated in the same year the authorization is granted must be paid off from appropriations. If it is to be liquidated in subsequent years, you have a contract authorization. That is the general distinction between the two. It is merely a part of programing.

Senator DOUGLAS. A contract authorization can be taken up in the same year; can it not? That is, suppose we pass a contract authorization for the budget for 1949–50, that can be taken up in 1949–50 and not merely postponed to 1950–51 and then met from a deficiency appropriation?

Mr. LAWTON. It can be if the program is advanced or if deliveries are ahead of the schedule which you forecast at the time you gave the contract authorization.

Senator DOUGLAS. That, as a matter of fact, is one reason along with these open-end programs for the deficiency appropriations?

Mr. LAWTON. It is a very minor reason.

Senator DOUGLAS. It is?

Mr. LAWTON. Because ordinarily you would not submit it as a contract authorization.

Senator DOUGLAS. If it is going to be spent in the current year.

Mr. LAWTON. If you feel that there is a possibility of receiving and paying for the goods and services in the current year, then you request an appropriation, not a contract authorization. A good many programs are combinations, so much in appropriations, plus so much contract. The appropriation is for paying for the part delivered and liquidated in the current year, the contract authorization for the part delivered and liquidated in the subsequent year.

There are times, of course, when your program is sufficiently advanced so that you get deliveries ahead of time and you are required to liquidate and pay the money to the contractor or to the deliverer of the goods in the same year in which you originally set the contract authorization.

Senator DOUGLAS. Have you made a study of that to find out how much of the contract authorization is taken up in the fiscal year for which the budget was passed, and how much is postponed to the future?

Mr. LAWTON. No; not in any definite figures.

In 1950, for example, the budget contains estimated appropriations totaling $3,000,000,000 to liquidate prior-year contract authorizations. The total amount of new contract authority requested in the budget, however, does not exceed that amount by very much. So it shows the bulk contract authority requested is certain to be liquidated in subsequent years. Very little of what you plan as contract authority is actually liquidated in the same year. That would very definitely be the exception, not the rule.

Mr. STAATS. Did your question pertain to the use of the contract authority in the year in which it is authorized?

Senator DOUGLAS. Or the degree to which used?

Mr. STAATS. If it were not used in the fiscal year for which it was authorized it would either lapse or have to be renewed by the Congress. In speaking of using contract authority, I am not speaking of the expenditures which will eventually be made, but of incurring the obligations for the future receipt of goods or services.

Mr. LAWTON. That is right.

Senator DOUGLAS. It would have to come back to the Congress.

Mr. STAATS. If it is in an appropriation act.

Mr. LAWTON. There are some contract authorities in basic legislation, such as public roads——

Mr. PACE. In which case they have an indefinite——

Mr. LAWTON. They have a fixed amount of money that is authorized for a year's program. The minute that money is apportioned and the State programs are approved by the Government—in this case by the Secretary of Commerce—that becomes a contractual obligation on behalf of the United States, although you may and probably will not have to liquidate it until at least 18 months to 3 years afterward.

Senator DOUGLAS. There is one feature that we introduced in the Housing Act I was very pleased about, and that was to vary the volume of starts of new public housing according to business conditions—increasing the number of starts if business conditions fell off, and diminishing the number of starts if business conditions advanced.

Could not that be carried into the general field of public works—roads and internal improvements?

Mr. PACE. It exists to a certain extent.

Senator DOUGLAS. You can stop it by Executive order.

Mr. PACE. There is a difference, however, in the kind of flexibility provided in the Housing Act and the flexibility available to the President in the public-works field. In the Housing Act the President may reach within specified limits an administrative determination without prior concurrence of Congress on the volume of new public-housing starts. In the public-works field, however, the President may determine as a matter of policy what new starts he proposes in his budget. The Congress can provide for these starts, reduce them, or increase them. Once the individual projects are under way, however, it is extremely difficult for the President to reduce the going rate on the projects below a certain minimum level which insures the most economical construction costs. He may thus exert a downward pressure on going public works or he may relax his policies and provide for faster completion. Decision as to starts themselves, however, rests not with the President but with the Congress. An example of the lack of significant flexibility in the public-works program generally is the public-highway program. Is that not right, Mr. Lawton?

Mr. LAWTON. Yes. In the highway field you have a matching grant to the State, and the Government expenditure is not made in that case until after the State has spent the money and submitted the bills. The Government then reimburses the State for half the cost of the work.

I seriously doubt whether by Executive order you could change that. Probably the only recourse would be persuasion of the governors of the States to delay their programs.

In the case of certain other types of programs, there is an annual authorization. In the airport-construction program, for example, the annual authorization is for $100,000,000.

Senator DOUGLAS. Could not that be varied?

Mr. LAWTON. It has been. We have never submitted more than $40,000,000. We have held it back administratively in the submission. Our actual estimate for authorization year by year has been much less than the total amount authorized in the basic legislation.

Senator DOUGLAS. Do you consider business conditions in determining how much you are going to recommend?

Mr. PACE. That is one of the considerations.

Mr. LAWTON. That is one of the reasons for the fact that in last year's budget there was only one major flood-control project recommended by the President as a new start. And there were only about nine improvements and new starts in the river and harbor field despite the fact there are 15 to 20 billion dollars in authorized projects on the books.

Senator DOUGLAS. Let me come to our friend, the river and harbor bill.

How do you make up that river and harbor budget?

Mr. LAWTON. Last year, in the 1950 budget, we provided for the minimum rate for going work. That was work under construction.

Senator DOUGLAS. That came to about $350,000,000, as I remember it.

Mr. LAWTON. In that neighborhood. And we allowed nine new starts which were largely channel improvements—in two or three cases because of a change in the capacity and the size of the tankers that are now being built. Norfolk was a case of that kind. They could not get into the berthing facilities with any of the new-type tankers at low tide. We had to deepen the channel about 6 feet because the draft of those boats had been increased about 4 or 5 feet.

In other cases, there were new lock developments, or replacement of old locks with modern and larger locks, the present towboat size being larger than the capacity of the locks themselves. It was necessary to split the tows up, an extremely high-cost method of transportation.

In one instance, the Government was suffering from it directly because a lot of oil was going to a Government airfield. We were paying the price for the transportation of half-loaded boats, since they could not get fully loaded boats through the locks.

Mr. PACE. I think you might point out that those were practically all low-cost projects.

Mr. LAWTON. All short-time projects, no major construction jobs.

Senator DOUGLAS. As I remember it, the continuation of previous projects amounted to $350,000,000. Your estimate was $760,000,000. I think that is right. So, there was $400,000,000 somewhere. And my proposed cut of $300,000,000 was to carry out existing projects and allow $100,000,000 for new work.

Mr. LAWTON. We have $700,000,000 as a total for continuing work for the Corps of Engineers.

Senator DOUGLAS. $700,000,000 for continuing work?

Mr. LAWTON. Well, $666,900,000.

Senator DOUGLAS. The question is at what rate you should continue.

Mr. LAWTON. We used two bases in our determinations: For projects in non-power-shortage areas, it was at the minimum economic rate. For projects that were in power-shortage areas, it was at a rate which would bring power on the line according to a certain predetermined schedule. The rate there was the going rate required to get the project into generation at a certain date. For McNary Dam, for example, the goal was the generation of power by 1953.

Mr. PACE. I might point out in that particular area that the quicker a project is built, the quicker you start getting an economic return; and, second, that generally the faster it is built, the more cheaply you can build it.

Senator DOUGLAS. I think you have it split into two items, one on page 1364, which is flood control, and then the other rivers and harbors. I do not know what page that appears on.

Here it is, page 1365. For instance, you have 249, or 229, excluding the St. Lawrence, existing rivers and harbors—and excluding Panama Canal. That appears under "Transportation and communication."

Mr. LAWTON. That is right, that is the rivers and harbors.

Senator DOUGLAS. A total of $753, plus the Panama Canal.

Are you satisfied on this maintenance and improvement of existing rivers and harbors?

Mr. LAWTON. A great many of the large projects in that rivers and harbors are power-development projects.

Senator DOUGLAS. Under flood control; yes.

Mr. LAWTON. Under rivers and harbors.

Senator DOUGLAS. Under rivers and harbors?

Mr. LAWTON. Yes; they are under both.

Senator DOUGLAS. I am very dubious about this whole levee program, I am dubious about a lot of the dredging, I am dubious about the building and maintenance of a great many of the breakwaters.

Mr. PACE. If I may digress a moment, Senator, I would like to mention a comparison of governmental expenditures which in my judgment places in sharp focus the issues underlying the budget. The Government spent $8 for national defense in 1939 for each man, woman, and child in the country; this year it is spending $85. The Government spent 15 cents for international affairs 11 years ago; today the cost is $42. The Government spent $4 for veterans' programs in 1939; in this fiscal year, the cost to each person will be $44. To service the debt cost $7 per person before the war, it cost $38 this year. For all other activities of Government in 1939, the cost per person was $49. Today, in sharp contrast to other increases, that cost has risen only to $80 per person.

Senator DOUGLAS. I think I am aware of that fact, but nevertheless I want to see if we cannot make savings in the domestic area as well as in these other areas too.

Mr. PACE. I am for that. My point is to place it in larger focus.

Senator DOUGLAS. I understand that. Those figures, I think, speak for themselves.

But on the other hand, when we know that the revenues this year will not exceed 38 billion—I would be surprised if they reached 38 billion—and that the expenditures would be at least 43.5 billion—and I would imagine that some of these contract authorizations and open-end programs will send the total up about to 44—and in view of continuing tension in the international field, in view of the improbability that great increases in taxes will be voted, I think we have just got to search every item.

Mr. PACE. I agree on that. My principal point on these figures is that really your big area of control in terms of a balanced budget lies, in the outlook for the larger programs in the Government.

Senator DOUGLAS. Let me turn from the substantive to procedural questions.

Do you think it would help if staff members of the Appropriations Committees sat in attendance at budgetary hearings of the Bureau on agency requests?

Mr. PACE. Mr. Lawton, why do you not talk on that? Mr. Lawton has been very closely associated with the appropriation process, and I think he can probably answer it better than I can.

Mr. LAWTON. I do not believe on the whole it would help too much. I think there are two reasons for this. One is the question that the staff members would be listening to a lot of things which may ultimately not be in the picture at all. You would have the question of whether they took part in the hearing or whether they sat by as observers.

Senator DOUGLAS. They should not take part.

Mr. LAWTON. In sitting by as observers, you have the problem of agency representatives either talking past the Budget Bureau and talking at the congressional committee staff or failing to talk as openly and freely as they should.

Two years ago we worked out with the committee a slightly different approach which we felt both saved the time of the committee staff and gave them the kind of information they needed. After we had completed the work on a particular segment of the budget, we sat down in session with our examiners and the staff of the Appropriations Committee that dealt with those particular subject matters, or areas, and went over in detail the prospective budget, the markings, what the differences were, the changes in program, and why, and gave them a picture of what the budget was, how it was built and why it was built as it was for a particular agency.

We did that, as a matter of fact, in a good many cases prior to the actual submission of the budget in order to let the committees get a head start in January on their own hearings.

If they come into a budget hearing, there might be a number of items presented in that hearing which will never appear in the budget. There may be other items that are materially altered because of general budget policy. When they get the complete budget, they must do the job all over again with a new orientation and a new point of departure.

I think that in the operation we conducted 2 years ago they got far more benefit from it by the discussions with the budget examiners and the explanation of the budget than they would have by sitting in the hearings.

Senator DOUGLAS. That holds them off at arm's length, so to speak, from the actual formation of the budget.

Mr. LAWTON. If they had to get into the complete formation of the budget——

Senator DOUGLAS. Not as participants but as observers.

Mr. LAWTON. I think you are assuming that the budget is built at the hearing time, which is not true at all.

For example, take the case of the hospital program. We decide with the hospital people in July what the patient load is going to be on which they will submit a budget. We decide certain ration costs; we decide staffing standards. These are built up by an analysis throughout the year, and by the time the agencies submit their budgets we have already agreed with them as to the estimated number of people that will be in Federal hospitals during the coming year.

The changes they may want to make in staffing standards or something of that sort are the things we discuss. The basic issue of how many people they are going to have to take care of has been settled already.

In a good many other cases, it is built on the basis of examinations that our people have made when they have gone out in the field. In repair and maintenance, to a large extent, we may have decided we are going to hold down or increase a standard of maintenance based on inspections we have made in the field. The hearing process adds very little to it. It is not just a hearing time proposition.

Mr. STAATS. In many agencies the formal hearing process is really not too important from the standpoint of the information that goes into our recommendation on that budget item, because our staff will have been in the field, will have been having conferences throughout the year with agency people. The hearing itself would probably be misleading in the sense of the kind of review given these budget requests.

Senator DOUGLAS. You mean they are really the kicks you get?

Mr. STAATS. It is a kind of a final round-up on the agencies' requests.

Senator DOUGLAS. What would you think of having Congress consider all appropriations in one bill? I believe we have provided for that for next year.

Mr. PACE. I have a rather extensive answer that I could give you on that. I believe I will touch on certain aspects of it, and then you probably might want to ask specific questions, Senator.

Fundamentally our thinking is that under the present practice of handling appropriations through 10 separate bills it is difficult for the Congress, one, to insure that a balanced program, which properly recognizes relative needs, is achieved equally in the various separate bills and, two, to relate from the individual appropriations and other authorizations contained in the separate bills to the total expenditure outlook and estimated revenues.

It is my judgment that, short of bringing together the consideration of tax and expenditure policies in one committee, more consistent congressional policy would probably be achieved by consolidating all annual appropriation bills into a single measure.

A consolidated appropriation bill, however, presents certain definite problems. A single bill coming at the end of the session makes it virtually impossible to eliminate what might be undesirable items or provisions in the bill. And in the absence of an item veto, it would make it exceedingly difficult for a President to veto a single bill which contained funds for the operation of the entire United States Government.

Its success or failure would depend also on the type of appropriation bill that you have. It if were to be sufficiently meaningful, provision should be made for relating the spending which would result from the funds to the total budgetary and fiscal outlook.

Fundamentally, in my judgment, is that a single bill is sound if provisions were made for an item veto.

Senator DOUGLAS. You favor the item veto?

Mr. PACE. Very definitely, yes, sir.

Senator DOUGLAS. Turning to the tax side, what would you think of having a tax system under which when your employment exceeded a given percent, or industrial production fell by a given percent, that rates of taxation could be altered?

Mr. PACE. You mean providing automatic flexibility?

Senator DOUGLAS. Of rates. Flexibility not of revenues but of the rates under some formula.

Mr. REEVE. Senator, our feeling on that—and it is not an area we have gone into extensively—is that something in this direction ought to be very carefully explored; that it does possess positive merit if it can be worked out on a practical basis. It does enter a field which Congress has, in the past, felt should be entirely determined in advance by the Congress itself. Therefore, the kind of formula you develop would probably have to be a matter of experiment. It would be very likely, in fact, after a few years' experience you would find the formula was not quite right and would not want to have it tied up in such a way that you would be lowering taxes when you should not, and so on.

Senator DOUGLAS. In other words, it is interesting, but in your judgment not a practical present possibility?

Mr. REEVE. I think it is a very important thing for your committee particularly and for the Congress to consider.

Mr. JOHNSON. I would like to mention the fact that it would amount to a rather drastic delegation of authority to the President by the Congress.

I think it is important to emphasize that tax decisions, and particularly important tax changes, ought to be made on the basis of longer range fiscal considerations rather than short-range considerations. And if you have a situation where the President would be likely to make use of the type of flexibility proposed, it would be, first of all, presumably a fairly substantial decline in economic activity. Consequently the only thing that would be useful would be a fairly substantial reduction in tax rates. A moderate change one way or the other probably would not be sufficiently useful to contemplate.

Now, in that sort of a situation, Congress would be delegating really an enormous amount of authority to the President in terms of income distribution, for example. And if you look at tax policy as being a long-range rather than a month-to-month or quarter-to-quarter matter, then it is hard to forsee a time when Congress would not have the opportunity to consider the move itself.

Senator DOUGLAS. Senator Flanders is ill, and while he planned to be here today, he was unable to and asked if I would inquire of someone about a capital budget. Are you planning to use a capital budget?

Mr. PACE. I think I would like to speak to that point myself because I think it is of real importance.

The capital budget is one that has a great deal of appeal on the basis that it presents a situation on the same basis as a business actually presents its operations.

There are certain returnable revenues from a business point of view which are handled differently in the traditional budget.

Let us take, for instance, the "Fanny May" program in which the Government is purchasing its own guaranteed paper. A bank would not show these purchases as current expenditure but rather as the acquisition of an asset, and since they were buying their own paper, they would set up no reserve.

The same thing fundamentally is true in a program like stock piling, where you actually acquire an asset, yet you show it as an expenditure.

A break-down of capital expenditures in the budget is extremely useful for planning purposes. It places in better perspective the purposes for which Government funds are being spent; it provides a chance to look behind receipt and expenditure totals to what is happening to the physical assets of the Government.

In terms of actual formal budget presentation, however, I have two strong objections to the capital budget. One is that a capital budget requires depreciation. To set up a depreciation in some large-scale operations of the Federal Government should be so complex and cumbersome as to be fundamentally meaningless.

In the second place, the problem of determining what is a capital asset is an extremely complex one. For example, is military equipment a capital asset? Eventually the determination must be made by an individual or group of individuals.

In the long run, your ability to control fiscal policy could be materially weakened with a governmental capital budget. Since business is operated on a profit motive, it has little problem in the presentation of a capital budget. Since Government is in business to protect and serve the people, however, and its motivation is essentially different, the presentation of the Government's budget on a capital basis would serve little purpose.

Senator DOUGLAS. In other words, it is supplementary to the budget?

Mr. PACE. Yes; it is a supplementary tool of budgetary planning. We hope, incidentally, to prepare a special table in the new budget showing a classification of Government programs by capital and other items.

Senator DOUGLAS. I always insist it is the cash project you should consider, not the appropriation.

Mr. REEVE. These capital items are in the cash budget, of course.

Mr. PACE. Your capital budget, therefore, is separate and apart both from your cash and your traditional budget.

In terms of the cash budget, we fundamentally think it has great merit as a starting point in any analysis of the problem. But it, like the capital budget, and like the traditional budget, has certain deficiencies in terms of presentation and in terms of conception. But in our judgment, sound budget and fiscal planning makes it desirable to have both the cash budget and the capital budget available as supplements and adjuncts to the traditional type budget.

Senator DOUGLAS. Could you not put those in an appendix?

Mr. PACE. That is our plan. We already carry the cash budget in that form, and we hope to include a break-down of capital expenditures in the next budget document.

Senator DOUGLAS. Thank you very much for coming. The other questions I have are policy questions and probably I had better not ask the members of the staff.

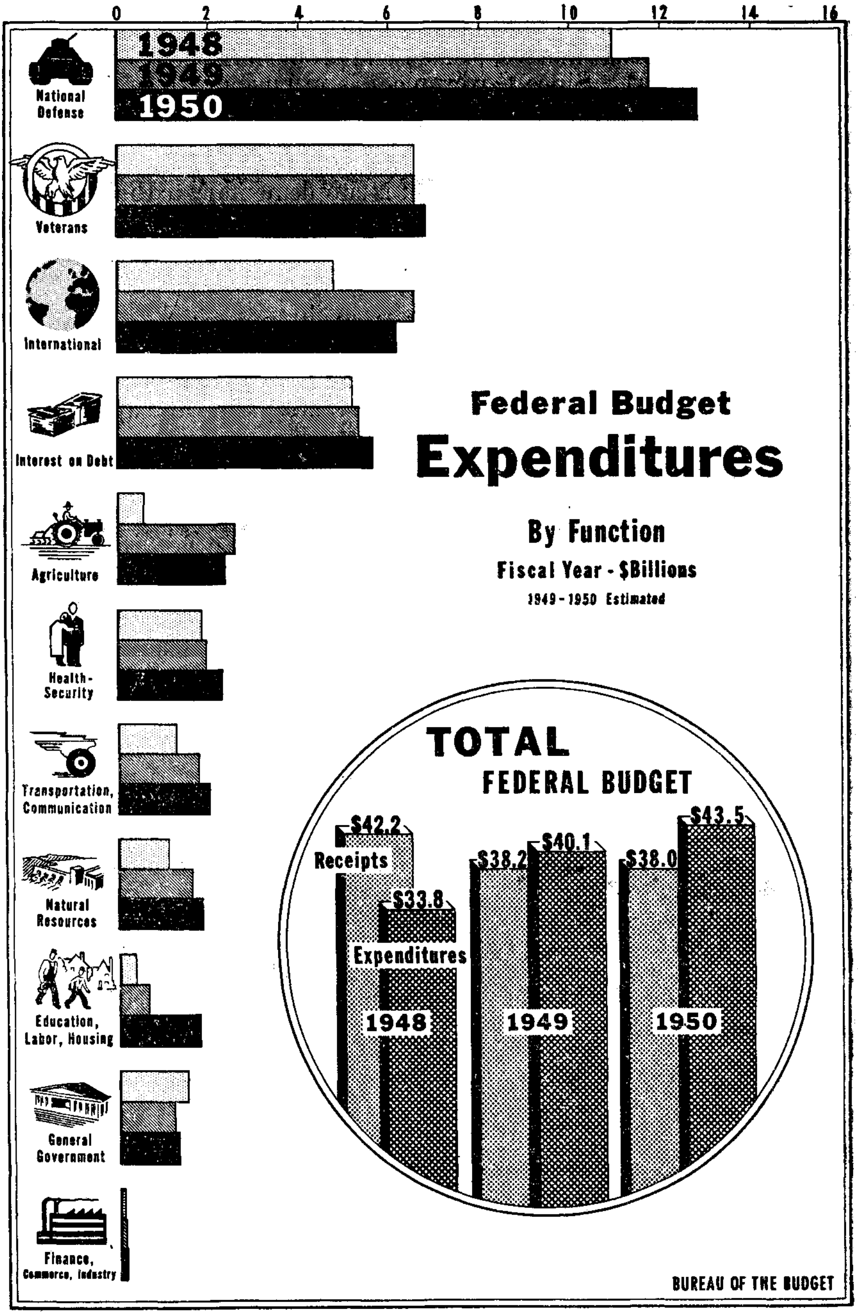
We will adjourn to some other time.

Mr. PACE. Thank you very much, sir. We appreciate this opportunity of talking to you.

Senator DOUGLAS. The committee will stand in recess.

(Whereupon, at 1 p. m., a recess was taken subject to the call of the Chair.)

(The following charts were later submitted by the Bureau of the Budget for the printed record:)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1948
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National Defense
Veterans
International
Interest on Debt
Agriculture
Health-Security
Transportation, Communication
Natural Resources
Education, Labor, Housing
General Government
Finance, Commerce, Industry
Federal Budget
Expenditures
By Function
Fiscal Year - $Billions
1949 - 1950 Estimated
TOTAL
FEDERAL BUDGET
$42.2
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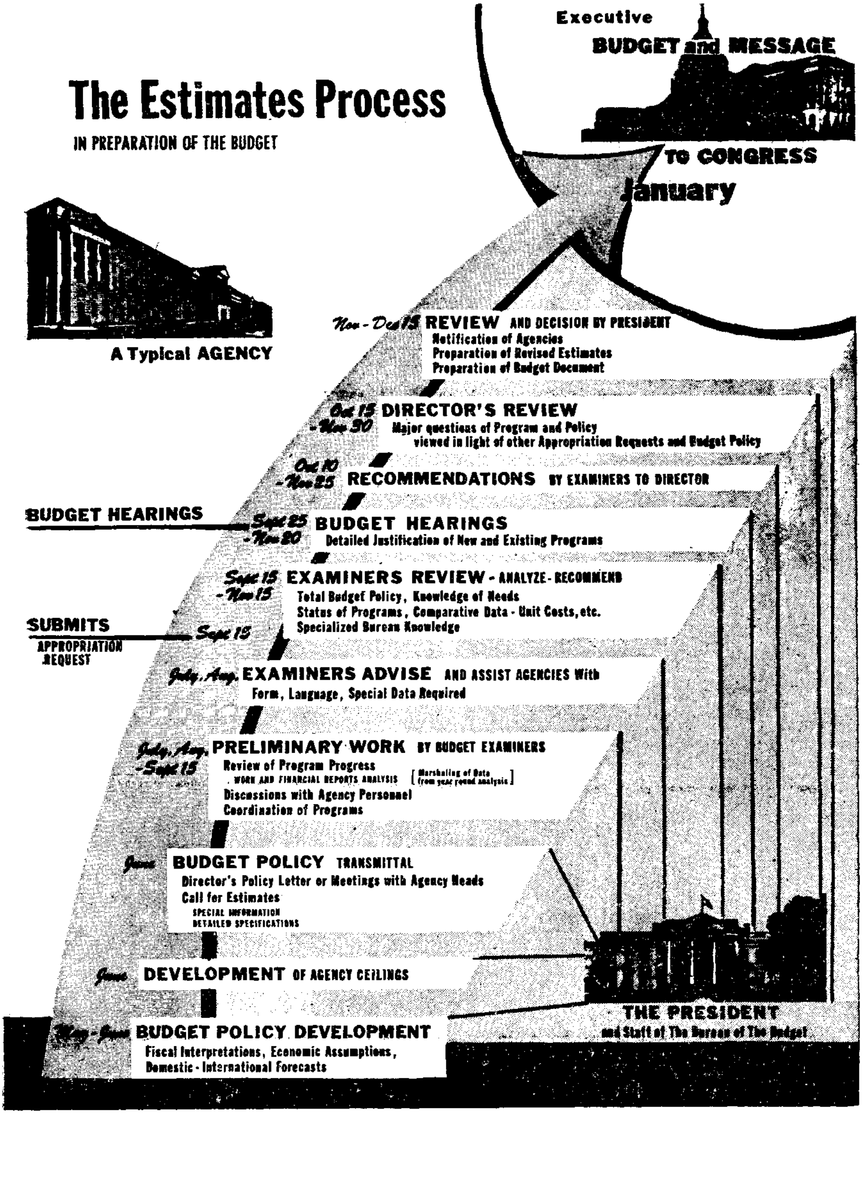
1950
BUREAU OF THE BUDGET


The Estimates Process
IN PREPARATION OF THE BUDGET
Executive
BUDGET and MESSAGE
TO CONGRESS
January
A Typical AGENCY
BUDGET HEARINGS
SUBMITS
APPROPRIATION REQUEST
Nov-Dec 15 REVIEW AND DECISION BY PRESIDENT
Notification of Agencies
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Oct 15 - Nov 30 DIRECTOR'S REVIEW
Major questions of Program and Policy
viewed in light of other Appropriation Requests and Budget Policy
Oct 10 - Nov 25 RECOMMENDATIONS BY EXAMINERS TO DIRECTOR
Sept 25 - Nov 20 BUDGET HEARINGS
Detailed Justification of New and Existing Programs
Sept 15 - Nov 15 EXAMINERS REVIEW - ANALYZE - RECOMMEND
Total Budget Policy, Knowledge of Needs
Status of Programs, Comparative Data - Unit Costs, etc.
Specialized Bureau Knowledge
Sept 15
July, Aug. EXAMINERS ADVISE AND ASSIST AGENCIES With
Form, Language, Special Data Required
July, Aug. - Sept 15 PRELIMINARY WORK BY BUDGET EXAMINERS
Review of Program Progress
WORK AND FINANCIAL REPORTS ANALYSIS
[Marshalling of Data (from year round analysis)]
Discussions with Agency Personnel
Coordination of Programs
June BUDGET POLICY TRANSMITTAL
Director's Policy Letter or Meetings with Agency Heads
Call for Estimates
SPECIAL INFORMATION
DETAILED SPECIFICATIONS
June DEVELOPMENT OF AGENCY CEILINGS
May-June BUDGET POLICY DEVELOPMENT
Fiscal Interpretations, Economic Assumptions,
Domestic - International Forecasts
THE PRESIDENT
and Staff of The Bureau of The Budget

MONETARY, CREDIT, AND FISCAL PROBLEMS

WEDNESDAY, DECEMBER 7, 1949

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON MONETARY, CREDIT,
AND FISCAL POLICIES,
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The subcommittee met, pursuant to adjournment, at 10:10 a. m., in room 135, Senate Office Building, Senator Paul H. Douglas (chairman of the subcommittee) presiding.

Present: Senator Douglas and Representative Buchanan; also Grover W. Ensley, acting staff director.

Also present: Leon H. Keyserling, Acting Chairman, Council of Economic Advisers; John D. Clark, member, Council of Economic Advisers; Gerhard Colm and E. Hoover, staff members of Council of Economic Advisers.

Senator DOUGLAS. Well, gentlemen, we are very glad indeed that you are willing to take time from what I know is a busy schedule, to meet with us. I had framed some questions on procedural issues and questions on substantive issues. I have always been much more interested in substantive issues than procedural issues, but I find that the people of Washington seem to be greatly interested in procedural issues, so I might as well start there.

Now do I understand that in making up the President's economic report that he writes letters to the heads of the various agencies and gets suggestions from them?

Mr. KEYSERLING. The way it would work is this, Senator Douglas. In October of the year the President sends a letter to the heads of the various agencies, including the independent agencies, and the Federal Reserve Board, in which he asks them for their recommendations with respect to two of the basic messages that he sends up in January, the economic report and the state of the Union message.

As soon as he gets these letters we get copies of them, and therefore have the benefit of them in attempting to formulate and integrate our proposals. But more important than that, perhaps, is the system whereby we maintain actual personal contact with the various departments primarily concerned with national economic policy.

We have our staff organized on what might be called functional lines with various people operating basically in various areas under supervision of members of the Council. Each of those persons maintains a rather formal relationship through an interdepartmental staff group with the various agencies of Government operating in that field.

I might give only two examples, to make it very brief. One is the Economic Outlook Committee, whereby we meet regularly with representatives of Labor, Commerce, Agriculture, Treasury, the Federal Reserve Board and the one or two other departments that are primarily concerned with the economic outlook from the viewpoint of their own particular programs.

We meet with them at least four times a year, sometimes more frequently. We call them in particularly in connection with the development of the economic report in its latest stages.

Not only that, but they call us in on occasions. For example, the Agriculture Department for a long time has had its own economic outlook conferences relating to its own forecasts, and we work with them on that.

Now, coming over to the policy side which I believe, Senator, is even more important, we have a series of contacts with the various Government agencies in that field, too, and aside from the recommendations which they make directly to the President, we have three or four or five working groups.

We happen to have one now in the field of attempting to evaluate international economic policy in terms of the over-all domestic situation. I use that simply as an example.

Now, the process takes another form also. After the first drafts of the economic report are prepared—and I am using the economic report to describe both our report and the President's because they go up to Congress together—then the process starts of circulating it among the various departments so that they have a full chance to examine it, to evaluate it, to comment upon it, and to give us their further thoughts.

If the first half of the work has really been done well, the second half is more a checking process. But that second opportunity is given them. And it goes right up to the top level because we have had a process beginning as recently as last year of having such persons as Secretary Sawyer, Secretary Snyder, and Mr. McCabe in turn come before the Council in a small room after they have had a chance to examine the document and to talk with us about it, to talk with us particularly about the elements affecting their programs, but more generally on anything they want to. In that way we try to come to a meeting of the minds.

Then finally within the last 2 weeks before the report comes up, there are meetings over at the White House where the four of five members of the Cabinet engaged in economic policy and the three members of the Council sit down. The President participates in these meetings, although he is not there constantly.

Of course, the Council itself has frequent discussions with the President on a wide variety of matters.

Senator DOUGLAS. The Federal Reserve cooperates?

Mr. KEYSERLING. Very fully. Mr. McCabe has appeared before the Council just as Secretary Snyder and Secretary Sawyer, and he also sits continually in the small group which meets ultimately around the Cabinet table with us.

Senator DOUGLAS. Now, the Government, of course, consists not merely of the departments, but it has a large number of so-called independent commissions and agencies which presumably report directly to the President, but which in the past have been somewhat difficult to coordinate. Do you get much response from them, from the Federal Trade Commission, the Interstate Commerce Commission and others?

Mr. KEYSERLING. The independent agencies are included among those to whom the President sends this letter in October, and they do furnish written replies to the President which we have the benefit of.

We also have been able to get the cooperation of the independent agencies in the collection of economic materials through their network of relationships throughout the country.

For example, the Securities and Exchange Commission has helped us and the Interstate Commerce Commission has helped us in maintaining factual contacts on matters of investment and on matters of railroad problems.

Senator DOUGLAS. The Federal Reserve, however, has cooperated fully?

Mr. KEYSERLING. The Federal Reserve Board has cooperated fully with us in meeting with us and in giving us the benefit of its views on the economic outlook. I suppose it would not be unfair to say that we have gotten as much help from the Federal Reserve Board as from any single agency.

The Department of Commerce actually does more processing of the factual material that we use. On the other hand, on the analytical and critical side I think the Federal Reserve Board has a good staff, and we have gotten complete cooperation from them at all times.

Senator DOUGLAS. Now, last week we brought out into the open what the insiders have known for a long time, namely, the considerable degree of conflict between the Federal Reserve Board and the Treasury on the interest rate on Government securities. The Treasury quite obviously takes pride in the low interest charges on the public debt, and in the fact that they have been able to keep the interest rate down so that the debt has been serviced at a minimum cost to the taxpayer and the prices of Government securities have been maintained.

On the other hand, it is quite apparent that while the issue may be somewhat muffled, the Federal Reserve Board has wanted to raise the interest rate as least on short-term Governments in periods of rising prices. I will put it this way, it has wanted to raise these interest rates believing that that would send up the whole structure of interest rates even though the long-time Government securities were kept somewhat around par, and hence repress private borrowing.

I have reached a somewhat tentative conclusion that it is an almost inevitable conflict in a period of inflation or threatening inflation that you have between the Treasury and the Federal Reserve Board, that the Treasury would tend almost inevitably to favor low interest rates, and the Federal Reserve Board will want higher interest rates, that is if they are alert; and there seems to be no way of dealing with the issue except by voluntary accommodation under the present situation. Do you have any comments, any of you, or Dr. Clark?

Mr. KEYSERLING. Well, I would like Dr. Clark to comment on the substance of it. I might make just one preliminary remark on the procedural factors. Basically the Federal Reserve and the Treasury are not structurally equally responsible to the President. Now, if the Congress wants to look to the President—and I say "if" because that is a matter of congressional policy—for rationalizing and deciding at the Executive level how he would resolve competing or allegedly competing policies between Treasury and FRB and make recommendations to the Congress based upon that integration, just as he does with respect to the Cabinet departments, then the problem would not be solved fully by turning over to the Council or to some third party the job of recommending to the President which of the competing views it thought—I am talking only of the executive side—which of the two competing views was more desirable, because the President still under the existing set-up would have an unequal and different relationship to the Treasury from what he has to the Federal Reserve Board.

Senator DOUGLAS. Much closer to the Treasury?

Mr. KEYSERLING. Yes, sir; so there is a basic question of legislative policy as to what Congress wants to do about that. Now, if Congress should decide to do something about that, I think personally that the President now has available devices for getting judgment as to how to reconcile these two competing policies if he were equally responsible for both.

I think that function of advising the President on competing policies of an economic character should rest, putting personalities aside entirely, in an agency such as the Council of Economic Advisers, because its very purpose under the statute, as I understand it, is to advise the President with respect to the whole congeries of national economic policies.

You will always have the question of fact that a government is a government of men, and the Council will have to have enough prestige with the President to have him take its views as against those of the Treasury or Federal Reserve. You always have the question that if the Council members are intelligent people, they will try to reconcile as well as decide. But subject to those human limitations it seems to me that that is an effective structure.

I would like Mr. Clark to talk about some of the issues of policy and substance that you raised in connection with this Treasury and Federal Reserve question, if you would, Mr. Clark.

Mr. CLARK. We have given first place in this field of monetary credit policy to requirements of the debt. We sometimes are amused to find that people who were scared to death at the prospect of $50,000,000,000 debt now seem to think that a $250,000,000,000 debt is a gentle domesticated animal.

It is not at all. It has been handled so prudently that it has been sleeping. But we think within it are the germs of disaster if it is not handled very prudently, and for that reason we have given first place to the requirements of debt management policy. With respect to that policy, we have been in some conflict with the Federal Reserve Board and in complete sympathy with the Treasury because we have felt that the only successful debt management policy is one which works by itself and where the positive action that is contemplated within it does not have to be called into play. The confidence that it will be called into play and that it will be effective will remove the need to use it. The public acting with that knowledge will not create the problem——

Senator DOUGLAS. You mean there would be a danger of panic selling of Government securities?

Mr. CLARK. Yes, sir; if the public became alarmed about the value of Government bonds. We think an essential feature of a successful debt-management policy is that the public have absolute confidence that the Government bonds are going to be supported at a point which they can know about and understand, and the only point that we think you can use is par. A little below par does not mean a thing to the public. A little below par, if that were the basis of support, might mean 98 today. But if it were 98 today after having been 100 yesterday, in moments when the policy is of any importance because conditions are arising which makes the market uneasy—and it is only then that the policy is important—98 today would mean in the minds of many people that it would be 93 tomorrow. They have known 83, because Liberty bonds fell to 83.

There is a lively awareness that a rather small increase in yield applied to the Government-bond market means a catastrophic drop in market price. You have had some of those figures given you of how an increase of 1 percent in yield would mean a market price far below par. We are certain that confidence by the public, including especially the country bankers, is important to maintain a Government credit position that will make it possible to roll over this $50,000,000,000 of debt that is maturing every 12 months, and that everything else must be subordinated to that.

Senator DOUGLAS. Well, now let us distinguish between the so-called long-time Government debt and the short-time notes and certificates. Is it not true that in the case of short-time notes you could maintain the parity of the issue by simply refunding at a higher rate of interest, and we would not have the problem of the depreciation of the value of the security by simply raising the short-time interest rate?

Mr. CLARK. Of course, the short-term bonds could not show in market quotations anything like the swings that the long terms do.

Senator DOUGLAS. As a matter of fact, a rise in the interest rates would be a protection to the value of the short-time issues.

Mr. CLARK. Not of the outstanding issues.

Senator DOUGLAS. On the long time you raise the yield by letting the price fall, but in the case of the short time, by refunding——

Mr. CLARK. Yes.

Senator DOUGLAS. At a higher rate. You have higher interest charges, but you do not have any depreciation in the principal value.

Mr. CLARK. You would have depreciation in all of the outstanding issues, and they are 95 percent of the outstanding short terms at all times.

Mr. BUCHANAN. Has there been any opportunity to analyze this recent flotation of 4.7 billion for 4¼ years at 1⅜ as to the offering now or any market reaction?

Mr. CLARK. I have not seen any financial analysis of that since it was announced based upon actual views in the financial market.

Senator DOUGLAS. Of course, the short-time issues are not held by individuals, are they? They are held by banks and by insurance companies. Are they permitted to take short-time issues?

Mr. CLARK. Yes; but I do not know how much they use it. The corporations put temporary surplus funds——

Senator DOUGLAS. I question how serious the depreciation, or effects of depreciation, on the short-time securities would be if it were acknowledged that the Government would refund at par, would raise the interest rate to make the issues more attractive or to help in setting the commercial interest rate.

We may be getting into the issue there as to how effective a rise in the interest rate is——

Mr. CLARK. That is what I wanted to say a few words on.

Senator DOUGLAS. In checking inflation. I have my doubts on that.

Mr. CLARK. The general debt-management policy, of course, requires that this manipulation of the interest rate on the short-term securities be kept within limits that will not affect the market on the long-term bonds. There is some relationship between the two yields, although it is not very easy to tell what that relationship will be at any particular time.

It varies from time to time, but it would not do to increase the short-term rates to a point that would then force either an increase in the long-term rates by permitting prices to drop, or force the absorption of an undue amount of long-term bonds by the Treasury and the Federal Reserve System in order to prevent it from dropping.

The other question is a very interesting one: Just how effective is the manipulation of short-term interest rates for the purpose that concerns us, that is, the objective of the Employment Act? I think the Federal Reserve people, like most of those who are very, very close to the operations that they carry on and consider important, greatly overestimate the significance of tiny fluctuations in short-term rates.

They do have an influence upon financial decisions so that it is an indirect way to influence financial operations. Financial operations themselves have an influence upon managerial decisions in business matters, but that is two stages removed from the original action of changing the short-term interest rate, and the force diminishes the further you get away from the origin.

Now it was 2 years ago, was it not, in 1947 that they were first having this discussion of changing the yield on these securities?

Following the change in rate, I was unable to see that anything had happened in business. I think they overestimate the effect of this kind of control of credit, unless it is used—and it may be—with broadax method, which we do not want to happen.

In 1920 they raised the discount rate to 7 percent. Certainly we can completely upset the business situation and swing it away from whatever channel it is following into some new one by those methods, but this little one-eighth of 1 percent shift, which was enough to control the flow of gold between England and the Continent when the Bank of England discovered this powerful weapon for that purpose, is not powerful enough to influence the vast American economy significantly.

You do not make managerial decisions as to enterprise upon a shift of one-half of 1 percent in discount rates.

Senator DOUGLAS. I tried to get some figures on what the interest costs were to business, and I reached the conclusion that the interest costs never exceed 3 or 4 percent of operating costs, and that a change of one-tenth in the interest rate, therefore, would produce a change of three-tenths of 1 percent in operating costs, and that consequently it was the case of what the mathematicians called second differences; and I have always used that as an argument to advocate credit control. But they come back with another reply, which is that long-time Government debt—and now I seem to be speaking contrary to what I said earlier—falls somewhat, to 98 or 99, that the insurance companies and others will then not present bonds to the Open Market Committee through middlemen for purchase, because they will not want to show a capital loss, and that this will dry up the accumulation of additional reserves and hence check the possibilities of credit expansion.

That was a new argument which I had never heard before.

Mr. CLARK. I have heard it, but against that I think more formidable on the other side is the effect upon the country bankers. I am a country banker myself. I know how our directors look on our bond portfolio, which I think is fairly typical of the small bank, and is more than 10 times the total capital funds of the institution. That is how far the Government bond represents the assets of the average American bank today.

Senator DOUGLAS. You believe that they would take fright and there would be panic selling?

Mr. CLARK. The very idea that they might find the market slipping away from under them is all that is needed to just send them into a panic, and they are almost that way every Monday morning nowadays.

I go around and visit them, and every time I drop in and talk to a banker, I find that he is worried about the latest rumor about something that is going to happen that will mean instability in the Government bond market. Why, we would find the bankers dumping all of their longer-term bonds so fast——

Senator DOUGLAS. Actually building up greater reserves.

Mr. CLARK. Yes. I think that is far more important.

Senator DOUGLAS. And hence at least making available still further credit for private industry.

Mr. BUCHANAN. Was this recent change in accord with the recommendations of the Council?

Mr. CLARK. Which change? You mean that of June 28?

Mr. BUCHANAN. Yes.

Mr. CLARK. No, sir; and I am not at all clear as to just what was intended by the announcement.

Senator DOUGLAS. On the June 28 changes, as I see it——

Mr. CLARK. That is the announcement of the new policy you are talking about.

Senator DOUGLAS. As far as the immediate situation was concerned, the interests of the Reserve and Treasury were identical. There was a period of what you gentlemen apparently now call inventory adjustment, but which I call recession, and there was a fear, a general fear of deflation; and this amounted to virtually saying that the Government would not sell, I think, and that it would therefore keep up the price of securities and the Reserve and the Treasury both were agreed on that. But I am not certain that the agreement would last in a period of inflation and rising prices. I think the division of interest would be there.

Mr. BUCHANAN. Well, then we find the Treasury and the Federal Reserve in accord, and the Council of Economic Advisers not in accord with the recent change. Is that a general summation of it?

Mr. CLARK. As to the attitude of each of the three toward it, I heard Mr. McCabe express the great satisfaction of their group, that this would mark a new important date in American history.

I do not think the Treasury has expressed its view of that particular announcement and what it meant.

Senator DOUGLAS. Was it a joint statement?

Mr. CLARK. No, it was put out by the Federal Reserve Board as something made after consultation with the Treasury.

Mr. BUCHANAN. The Secretary of the Treasury is on the Open Market Committee?

Mr. CLARK. No. We have been on all sides of this merry-go-round. We heartily supported Mr. Eccles' proposal to make it possible for the Federal Reserve Board to exert considerable restraint upon the expansion of credit in 1947 and 1948 by giving them secondary reserve requirements to be represented in frozen Government securities. We think it makes sense.

We have not thought that they were right in their ideas about the freedom of the market for long-term bonds. We think that has got to be supported at par. We have been with the Treasury all the way on that.

Senator DOUGLAS. Not necessarily above par?

Mr. CLARK. No. I think that so far as this statement emphasized the need for regularizing the market, it is a fine statement, just exactly what we need, and to us that means not to let it go below par, because that is the only basic point that the public can understand. On the other hand, you should keep it from going too high.

If you let it go too high, the extent to which it may go down is broadened and that would be demoralizing.

Senator DOUGLAS. The statement is primarily with regard to the general business and credit situation, which taken by itself would mean that the maintenance of a fixed value of Government securities was not the primary consideration nor the lowest interest charges on the public debt, but that general business and credit situation would be primary.

The Reserve Board thinks that it gives them power to move in a period of inflation or should give the power to move in an inflationary period to raise the interest rate or increase the yield.

Mr. CLARK. Yes. That is a normal policy in central banking, but with a $250,000,000,000 debt, I think it has got to yield to the requirements of stabilizing the Government credit.

Senator DOUGLAS. Now, there are some more procedural questions that I wanted to ask, although I am more concerned in getting at substantive issues. I suppose you have considered the Hoover proposal that the Economic Council should be an economic adviser to the President rather than a Council of Economic Advisers.

Mr. KEYSERLING. Yes. I will make two comments on that, Senator Douglas. First of all, the President sent out to the heads of all departments and agencies a request for comment upon the various proposals for Government reorganization. Therefore he sent to the Council a request for our comments upon the proposal to establish a one-man body.

We wrote a memorandum on which all three members of the council—it then was a three-member council, which was a few months ago—disagreed with that proposal for the establishment of a one-man body, and set forth the argument for a three-man body.

Of course, that has no bearing upon whether we were right or wrong. But I think it is interesting for the record that, despite some stories of some disagreements among the members of the Council, we after

3 years of experience felt uniformly that it was a profitable venture in terms of a three-man body instead of one.

Senator DOUGLAS. Why do you think that?

Mr. KEYSERLING. The reasons we think that are that in a new venture the question of the weight to be attached to the views of an individual or a group are of compelling importance. No matter what kind of law Congress enacts, you will finally get down to the question of operations. You finally get down to the question of whether the President of the United States, who must be supreme in the executive branch, will pay more or less weight to the recommendations given him by an advisory body of several members than to the advice of only one man.

You have the question particularly in our kind of economy, where we think and have always emphasized in our reports that the advice which our studies may give to private businessmen may also be important in the long run in permeating as an educational sense, influencing their policies, particularly if we maintain good relations with them.

We think that in accord with our democratic approach to things, the joint product of a three-man body, reached after deliberation, will carry greater weight than the views of one man, who, no matter what title you give him, is only one man.

Now, let me take a specific example out of what you have just been talking about. Suppose that there is a conflict between the Federal Reserve Board and the Treasury, and the President turns to the Council, as he properly might, for its advice. If the Council is one man, even if in the hierarchy of the Governemnt structure he were "higher" than the Secretary of the Treasury or the Federal Reserve Board (which in itself would be difficult since one is a Cabinet member and the other is a very important independent body), the President still ultimately would be faced with the fact that Mr. X said so-and-so, Mr. Y said so-and-so, and Mr. Z of the Council said so-and-so, and he would be confronted with the fact that each of them is only one man, and there is no intrinsic reason for believing that Mr. Z is more right than Mr. X, who, after all, is managing the Treasury day by day, or Mr. Y, who is a Board running the Federal Reserve.

On the other hand, if the President gets from a board of three, after deliberation, a measured judgment, which may represent some compromise because it is a board of three, he is in a better position, other things being equal, and he is not a czar, to say, "I have turned this over to a group of men who after deliberation come up with this judgment; and, therefore, I attach greater weight to it." And it does not put the Council in a position which inexorably one man would find himself in if in the executive branch he were constantly made the arbiter on issues in which groups of people feel very, very strongly.

Now there is one thing that could outweigh all of that if it were true. If it were true that a group of three members of a Council could never reach sufficient agreement among themselves so that they will always carry three points of view to the President, you would simply be compounding the felony. But I submit that that is not necessary, and the best argument that it is not necessary is that it has not happened, that despite the differing background and the differing experience of members of the Council, and despite the stories in the papers, the three-member Council was extraordinarily in agreement.

We took to the President monthly reports for 2 years. We took to him quarterly reports for 3 years. We wrote three reports of our own for the public in which we sought to expound our economic philosophy. We helped the President in the preparation of six Economic Reports and since the time we divided between the Economic Reports and the Annual Reviews of the Council, we did three of the latter.

In the wide range of matters involved in handling all those matters both as to outlook and as to policy, I will say without any fear of successful contradiction that we arrived at an amazing amount of agreement for three men dealing with matters as complex and on which such strong opinions are held as on economic policy.

In fact, aside from the question of our relationships to the Congress, I can identify almost no important area of basic disagreement that we had to take to the President. There was once a question of timing on one specific matter, but we had a record of about 85- to 92-percent agreement all the way through—which is even better than Drew Pearson's claim—and I think, independently of whether we were right or wrong, which can arise in the case of three men or one, that we can perform our function of advising the President or dealing with the public, which I think is a very important phase of our work, or even dealing with the Congress, which I also think is important, more effectively with the composite judgment of three men.

I think that the central problem which a body like the Council faces, whether it is one man or three, is how much the President relies on it. In the final analysis, although I believe very firmly that we should maintain contacts with the joint committee, we are primarily a body helping the President to formulate an integrated series of economic recommendations from the Chief Executive. That is what our statute provides.

In the early years of a venture such as the Council, whatever might be said later, any one person who was put in that position initially—and I have watched the Government operate for a long time—would soon find himself, because after all he is a man, whatever you call him, the center of so much cross-fire, overcover and undercover, that he would be, no matter how strong he was—and I have watched this frequently—in a very, very difficult position.

Now, that is a little harder to do with a deliberative body of three men; and, whatever you might lose by way of directness and drive in having three instead of one,I think it is better in the initial years, whatever might be true a little later on.

Now, there are ways that a three-man Council can partially meet the problem of maintaining close relations with the President. I do not think there is any basic inconsistency between having a three-man body and having the President have rather close and constant relations with us as a group, but particularly with the chairman, assuming only that the chairman truly represents the Council in dealing with the President and keeps the Council fully informed as to what is going on.

If those two things happen, the President's meeting more frequently with the chairman than with the body of three will not be disruptive within the body of the Council itself, and I do not base that on personalities but simply on comments about Government operations.

Senator Douglas. I have been startled with the fact that on a good deal of legislation we will get frequently a letter from the Budget

Bureau saying that the proposed measure is or is not in accord with the economic policy of the President. To what degree is that letter of the Budget Bureau a letter in which the Council of Economic Advisers join?

Mr. CLARK. Every matter like that is handled by the Legislative Reference Division of the Bureau, and it is a very busy one because not only do you gentlemen up here on the Hill and your committees ask for the administration attitude often in advance of introducing a bill, but all of the agencies of Government are under an Executive order to clear proposals with the Budget Bureau.

Whenever the proposal seems to the Budget Bureau to involve some problem within our broad field of economic stabilization, they include us in the offices of Government whose advice upon the matter is requested, and they play safe by asking us in many cases where our response is that there is no factor of particular significance in our field.

We do not want to be giving a lot of rather unnecessary advice. We stay out of a lot of it and they let us make the decision whether they should have a letter of advice from us. Many times the advice is informal, a talk with Mr. Jones, who is now the head of the division, and so forth. Sometimes it is a letter formally stating the position of the Council.

I have not set up any analysis of their reports to the Congress to see how far they follow our advice, but I think they generally do.

Senator DOUGLAS. But not invariably?

Mr. CLARK. Well, of course it could not be. We very often reply that it is a matter in which the economic consequences are neutral, and the decision must be made upon other considerations which are beyond our competency to advise them about.

Mr. KEYSERLING. Senator, the question of our relations with the Budget Bureau is the most fundamental question of the coordination of economic policy on the executive side that there is.

Senator DOUGLAS. Yes, because the Budget Bureau has virtually become the clearing house for legislation as well as for fiscal policy and the tax policy.

Mr. KEYSERLING. I might make a couple of comments on that. The Budget Bureau grew up over a number of years, and from being an administrative arm which dealt with the administrative expenditures of the various departments, it gradually by the very process of advising the President on expenditures covered almost every Government policy excepting independent regulatory policy. Harold Smith was a man of great enterprise and, in my judgment, wisdom, and I believe he was initially responsible for the establishment, or rather the building up—I do not know just which it was—of what was called the Fiscal Division, which attempted to introduce general considerations of economic policy more and more into the making of the Federal budget.

Now, when the proposals of the Employment Act came along there were varieties of views as to whether it should be part of the Budget Bureau or whether it should be a separate body. Anyway, the Congress concluded that there should be a separate Council of Economic Advisers.

From that point forward you really have this type of question: Should the general economic policies of the Government as they are recommended to the President by the Council start with the Budget Bureau's views on the budget as a starting point, and build around that, or should the very process of budget making, since the budget is a facet of economic policy, start with certain assumptions as to the economic outlook and general economic policy and objectives, and build around that?

I do not think you can provide a categorical answer to that. I frankly lean toward the view that it should be the second; that the budget, although a very important facet, is nonetheless a facet of general economic policy.

Well, it is going to take a little time to work all these problems out with the Budget Bureau. All I can say is that I do not see a contest of views; that we work more closely with them each year than we did the previous year, and that there really is very good cooperation between the Budget Bureau and the Council.

Senator DOUGLAS. You are in the same building?

Mr. KEYSERLING. We are both in the same building, work very closely together. We have interrelated task forces. We get on a very confidential basis the very preliminary drafts of what the budget looks like. We are perfectly free to suggest changes.

I can recall no ultimate conflicts but, in any event, if there should be an ultimate conflict on a matter that we think sufficiently important, we are both directly responsible to the President. But this is the most important question of coordination policy. I think we can work it out.

Senator DOUGLAS. Perhaps we can get into that by discussing now some of the substantive issues. The operating deficit for this year will be probably around $6,000,000,000. Have you figured out what the cash deficit, if any, will be?

Mr. KEYSERLING. Yes; we have a table here, have we not, which will show that with considerable exactitude? These things are guesses, of course. I think it might be just as well, Gerhard, if you read those figures off, because between comparing the calendar year with the fiscal year——

Senator DOUGLAS. Let us take the fiscal year 1950.

Mr. COLM. We have these figures on the calendar-year basis.

Senator DOUGLAS. Let us take the fiscal year 1949–50.

Mr. COLM. Unfortunately, we have two sets of figures. One is the conventional——

Senator DOUGLAS. The operating budget, and then the cash budget.

Mr. COLM. The operating budget we have in terms of the fiscal year, but the cash budget we have in terms of the calendar year in order to make a clear-cut distinction.

Senator DOUGLAS. All right, what is the estimate on the deficit on the operating budget for the fiscal year?

Mr. COLM. For the fiscal year 1950 it is 5.5 billion dollars. For the fiscal year 1951 there are not yet any firm figures, but present indications are that the deficit might be somewhat smaller than in the fiscal year 1950.

Senator DOUGLAS. But still an operating deficit assuming no new taxes?

Mr. COLM. That is right, under present tax status. Now the cash picture for the calendar year 1948 was a cash surplus——

Senator DOUGLAS. Let us take 1949.

Mr. COLM. If I give you the 1948 figure, I think the contrast becomes rather dramatic. We have an $8,000,000,000 cash surplus for the calendar year 1948. For the calendar year 1949, the estimate is 3.3 billion dollars' deficit.

For the calendar year 1950, that again is not a firm figure because the second half of the calendar year extends into the fiscal year 1951 for which plans have not yet been finally formulated, but the tentative figures again are around $5,000,000,000.

Senator DOUGLAS. Deficit?

Mr. COLM. Yes; cash deficit. Now usually the difference between cash and operating budget is around $3,000,000,000.

Senator DOUGLAS. Because of old-age collections?

Mr. COLM. Right, but this particular calendar year we have 2.8 billion dollars' disbursement of the dividends on account of the national service life insurance which is reflected in the cash figure, but not in the operating figure; and, therefore, in this year both figures happen to be very close to each other.

Senator DOUGLAS. Have you got your operating figure on a calendar-year basis, too?

Mr. COLM. We do not have that.

Senator DOUGLAS. No; that is only on the fiscal year. Well, now that points up the problem that for fiscal or calendar 1950, whether you take operating budget or the cash budget, there will be an appreciable deficit. Now, then, that raises a basic question. It will be necessary, therefore, for the Government to borrow sums to meet this deficit.

I would think it improbable that you could sufficiently step up savings out of current income to meet this, so that in the main the borrowings will have to be conducted through the banks financed by the creation of bank credit, monetary purchasing power, which will of course exert an inflationary effect on the economy.

Now, suppose the economy is in a period, A, of expanding employment, and B, rising prices. This will intensify, it would seem to me, the tendency for prices to rise, and therefore increase the net inflationary effect.

Mr. CLARK. That is almost a truism.

(Discussion off the record.)

Mr. CLARK. Referring to multiple bank examinations, I am not able to distinguish any difference in what should be the purposes of the several examinations; and, therefore, one ought to be enough.

Senator DOUGLAS. But which one?

Mr. CLARK. Well, as to that, I would vote for the central bank.

Senator DOUGLAS. There is another question, too, that comes up on policy, whether you choose market value or an estimated normal value in appraising assets. As you know, in the depression the process of taking market value was affected by the bank examiners forcing the bank to sell securities, which in turn drove the price of securities down still further and, therefore, put the banks in a still worse position. Should they take a longer-run view of it?

Mr. CLARK. The problems of another depression will inevitably bring about the same policy. I do not think there is any use in discussing what the policy ought to be generally, because if that kind of condition were to be repeated, and every insurance company in the country was broke on the basis of current value, we would certainly give them special kinds of value.

Senator DOUGLAS. The State of New York may have done it for insurance companies, the State of Connecticut, and some of the other States, but the national-bank examiners did not do very much for the national banks. Did they?

Mr. BUCHANAN. RFC did it; did they not?

Mr. CLARK. I think they were a little tighter perhaps, but there were very flexible rules about overdue paper. That is the place where it would be brought to a crisis, whether the banks have to charge off overdue paper. There was a lot of flexibility in that as compared to what would be looked on as the proper, prudent method of examination in more normal times.

Senator DOUGLAS. Well, I have no more questions. Thank you very much.

(Whereupon, at 12:10 p. m., the hearing was adjourned.)

STATEMENT ON FISCAL AND CREDIT POLICIES BY THE CHAMBER OF COMMERCE OF THE UNITED STATES

In this statement the Chamber of Commerce of the United States presents its official position as shown in policy declarations or as interpreted and applied by either its finance department committee or the committee on Federal finance on (1) objectives of monetary and credit policy, (2) credit controls, (3) the dual banking system, (4) the banking supervisory mechanism, (5) gold policy, (6) Government lending and guaranties, (7) policies on expenditures and taxation, (8) debt management, and (9) coordination of monetary, credit, and fiscal policies.

1. Objectives of monetary and credit policy

The Chamber of Commerce of the United States was a stanch supporter of the Federal Reserve System during the period of its inception and development. The chamber has continued to favor the use of its powers as a vital part of the mechanism of commerce, industry, and agriculture.

Economic stability is a proper objective of moderate exercise of the tools of monetary management possessed by the System. Beneficial economic effects can be obtained from changes in the volume and cost of money induced by such devices as open-market operations and changes in rediscount rates. Results are likely to be less satisfactory from changes in reserve requirements or from selective controls such as over consumer credit.

The national chamber holds that monetary factors, while of great significance, are only one element in the economic fabric and too much should not be expected from actions in this field. Experience has shown the futility of efforts to control the price level through the supply of money.

In the early days of the Federal Reserve System, the emphasis was on adequate credit for the needs of business and agriculture and on an elastic currency for avoidance of the money panics of the previous period. The Chamber has recognized valid reasons for the gradually increased emphasis upon the use of powers of the System for moderation of economic trends. At the same time, it has been impressed with the dangers in the use of monetary devices as demonstrated in the business declines of 1920, 1929, 1937, and even in 1948–49. In each case, improper timing or otherwise faulty use of devices, intended to check the booms which preceded the down-turns, may have aggravated subsequent economic ills.

In the light of problems created by war financing, which resulted in increased deposits, large bank holdings of Government securities, and abnormal liquid assets in the hands of individuals and corporations, special vigilance is needed for the safeguarding of the banking system against monetary panaceas offered as cures for inflation or deflation.

Flexibility of interest rates is essential if powers of the Federal Reserve System are to be effective. The freezing of interest rates by rigid support of prices of Government securities, even though defensible under the conditions obtaining, tended to nullify anti-inflationary effects of other operations of the System in the postwar years. Inflexible pegging of prices of marketable bonds may lead to adverse effects which should not accompany support of an orderly market.

Proper monetary and credit policies can contribute to economic stability. They should be coordinated with fiscal, lending, and other Government policies; with a view to a common purpose and avoidance of conflicting policies, not a massing of mechanisms in different areas toward implementation of a planned economy.

2. Credit controls

The national chamber favors maximum reliance upon voluntary methods and minimum use of regulatory devices in dealing with inflationary influences or in providing a stimulus against deflation.

Voluntary restraints upon the use of credit under the leadership of banking groups helped moderate inflation, while encouraging constructive employment of credit for needed production.

Tested devices for restraint of credit under existing permanent authority of the Federal Reserve System give greater promise of effectiveness than enlarged powers.

Credit controls necessarily are arbitrary, they are likely to be inequitable and to interfere with production essential for relief of shortages of goods. While credit controls are less objectionable from the standpoint of interference with individual freedom than other types of controls, they nevertheless may act as a restraint upon the fullest operation of the free-enterprise system.

Both as to business enterprises and individuals, curtailment of credit discriminates against those with limited capital or resources. Small business in a period of restricted credit is faced with increased difficulty in financing its needs. Restrictions upon consumer credit not only place individuals with low or medium incomes at a disadvantage but, by reducing mass purchasing power, contract markets for goods and thus contribute to unemployment.

The national chamber did not favor in 1948 either the increase in Federal Reserve authority over reserve requirements of banks or restoration of wartime control over consumer credit.

Under any circumstances any changes in reserve requirements are a harsh method of control which should be invoked only when fundamental changes have occurred in the banking structure. With the bond price-support policy in effect, it was obvious that the increases in reserve requirements made under the emergency law of 1948 would result in a shift of holdings of Government securities from the commercial banks to the Reserve banks without any material reduction in excess reserves. The action had little if any effect upon inflationary trends but served in particular instances to shut off credit which might have financed desirable production.

Controls over consumer credit can be justified in wartime as a means of limiting nonessential production and diverting savings into noninflationary channels. They have no place in our peacetime economy.

Voluntary restraints upon consumer credit have helped to prevent excesses, with fewer injurious effects than under Government regulations. Harmful results from restrictions in the post-war transition period outweighed any benefits.

3. The dual banking system

The national chamber favors presentation of the dual plan of Federal and State-chartered banking. It believes that the present dual system provides checks and balances consistent with effective supervision of a business which has definite public responsibilities.

While membership in the Federal Reserve System should be enouraged, the chamber is opposed to either a requirement that all banks shall join or to extension merely of credit powers of the System over nonmember banks.

Imposition of member bank reserve requirements upon nonmembers might be an entering wedge toward destruction of the dual system.

American banking as an essential segment of free enterprise requires the widest play of the initiative, resourcefulness, and intelligence of the management of individual banks and freedom from excessive regimentation.

4. The banking supervisory mechanism

The national chamber over the years has stressed repeatedly the desirability of independence of the Federal Reserve System from Treasury or political domination. It recognizes that developments with respect to the financing of two world wars and peacetime deficits, together with the accumulation of an enormous public debt, have made it impossible to realize the complete independence of monetary authorities which was envisioned at the time of enactment of the Federal Reserve Act. Nevertheless, it remains possible for the Board of Governors of the Federal Reserve System to avoid subservience to the Treasury, or the administration or to political influences.

Final decisions as to interest rates and other factors in Government financing necessarily must be made by the Treasury. Similarly, the responsibility in other areas in which monetary and credit policy is of moment lies with the President and officials of the executive branch. It is important that the Federal Reserve authorities in giving advice in these matters have an independent viewpoint.

Monetary policies are of such vital significance that the top positions in the Federal Reserve System should be attractive to men of the highest caliber.

The national chamber consistently has supported the principle of decentralization of authority in the Federal Reserve System. It opposed the tendency in the Banking Act of 1935 toward the concentration of power in the Board of Governors at the expense of the Federal Reserve banks. Any further increase in the power of the Board as against the banks would be undesirable. Decentralization of authority is consistent with the system of checks and balances throughout our Government, which has been a prime factor in preventing abuses in checking the world-wide trend toward totalitarianism.

In keeping with the dual banking system and decentralization in the central banking system, there are advantages from the standpoint of checks and balances in maintenance of the present triple supervisory mechanism.

The national chamber has not been disposed to favor any merger of the Office of Comptroller of the Currency or the Federal Deposit Insurance Corporation with the Board of Governors of the Federal Reserve System. While some economies might be effected by merging these three bank supervisory agencies, such savings might be at the expense of safeguards against abuses of authority or adoption of unwise policies. Inasmuch as these agencies are financed by assessments upon the banks and are not a charge against the taxpayers, the matter of possible savings need not be a compelling factor from the aspect of the Government's budget.

5. Gold policy

One expiring chamber policy declaration holds that "the gold standard is the only international monetary standard which has commanded any general acceptance," that "world trade moves on values based upon gold," and that "monetary policies in close conformity with the essential principles of the gold standard are desirable."

Throughout the years, the national chamber has been a consistent supporter of the gold standard, and opposed its abandonment in 1933. While it has not taken an official position with respect to new legislation on the subject, gradual steps toward resumption of convertibility of currency into gold would be consistent with its present and earlier policy declarations. Any change in the price of gold would appear to be in conflict with the chamber's traditional position.

6. Government lending and guaranties

Another policy declaration holds that Government credit extensions and Government intervention and bureaucratic action in the field of credit present a menace to chartered banking and the private-enterprise system.

It asserts that the Government should withdraw competition with private sources in the lending field and that the scope and power of Government lending and guaranteeing agencies should be reduced.

Still another policy statement declares that Government credits and guaranties are justified only as a temporary stopgap while world conditions are being restored to a basis providing confidence to private investors.

A special committee of the national chamber on the President's so-called point-4 program for economic advancement of underdeveloped areas criticized guaranties for private foreign investments and took the position that pledges of fair treatment of American private capital by foreign governments should be a prerequisite if guaranties were found to be desirable.

In general, the national chamber dislikes guaranties on the ground that they may lead to undesirable Government regulation of private enterprise or may involve the Government in business. The effect of assumption of risk by the Government may be to weaken the incentives which are vital in the free-enterprise system.

The chamber has recognized that under abnormal conditions of depression and war years both Government loans and guaranties in many instances have had justification.

Recent tendencies toward an expansion of loans and guaranty activities of the Government provide reason for a review and restatement of statutory principles as a protection to private business.

8. Policies on expenditures and taxation

The national chamber in its policy declarations has viewed with skepticism specific proposals for compensatory spending stabilization through budgetary manipulations or automatic adjustment of tax rates. The influence of budgetary operations upon the economy is, of course, recognized; but most plans for use of elaborate fiscal mechanisms for mitigation of boom or depression tendencies have been found to be impractical.

Another policy statement declares that it is of crucial importance that Congress curtail Government expenditures; that rigorous economy is the key to the problems of lower taxes, reduced debt, and a stable fiscal system; that a balanced budget with definite provision for debt retirement should be the normal procedure; and that temporizing proposals for budget balancing only in years of an expanding and prosperous economy should be rejected.

Other policy statements declare that extensive improvements in the Federal revenue system and much lower rates of taxation are esential to a healthy economy, that the burden of taxation should be widely and equitably distributed to reach all sections of the public and all forms of economic activity, and that Federal taxes should be levied for the purpose of obtaining essential Government revenues, with careful weighing of collateral effects, and not for special reforms or objectives beyond the realm of necessary Government functions.

The national chamber further believes that the heavy weight and burden of current business taxes deter production and new investments in facilities, which are the main means of realizing full peacetime employment and, with a balanced budget, are the real antidotes to inordinate prices and inflation.

In terms of current problems, these policies mean the utmost emphasis upon a reduction of expenditures and elimination or decrease of the more oppressive tax rates, especially the wartime excises. While a balanced budget is favored as a normal procedure, increased taxes would not be sanctioned if the particular levies appeared likely to add to the difficulties of the economy through further loss of incentives under the free-enterprise system.

9. Debt management

The national chamber holds that as an over-all policy there should be provision for orderly retirement of the debt, that there should be such conversion of debt as will reduce the volume of short-dated obligations to manageable proportions, that debt-management policies should be directed toward greater freedom of interest rates than permitted under excessively easy money policies of recent years, and that flexibility in market movements of interest rates is desirable to permit voluntary adjustments of the volume of credit.

Rigid support of the market for Government securities has impaired the ability of the Federal Reserve authorities to maintain normal credit controls. Hence, the chamber, during the period of active bond-price support, held that the policy should be relaxed and eventually abandoned.

In applying chamber principles to the existing situation, possible beneficial effect of debt retirement must be weighed against adverse consequences of such taxation as might be necessary without substantial curtailment of expenditures.

10. Coordination of monetary, credit, and fiscal policies

Some degree of coordination of proper monetary, credit, and fiscal policies is implicit in the declarations of the chamber. Consultation among the Government agencies concerned is desirable to assure harmonious action on matters which might have an influence on economic trends.

The national chamber has viewed with distrust plans for such coordination of monetary, credit, and fiscal policies as would create a powerful weapon with which to level the ups and downs of the business cycle. The instruments at hand in the monetary, credit, and fiscal fields can be used in moderation to good advantage but cannot cover the whole range of economic movements. Wages and other industrial costs and factors in agriculture and foreign trade may have a crucial effect on trends.

If a program sufficiently broad to embrace all economic elements is evolved, there is danger that it will lean strongly in the direction of a planned economy.

Almost inevitably, if there is a purpose actually to accomplish control over the economy, the program will be broadened to include direct controls affecting individual freedom as well as less restrictive controls involving monetary and fiscal policy. Free enterprise would be weakened if not destroyed.

The proposal for creation by law of a council of officials having to do with monetary, credit, and fiscal policies has its dangers in that there might be a tendency toward assumption of excessive authority in the planning field. Such a council, if authorized by law, should have no powers of decision. It should not be allowed to become a superagency with control over the whole area of monetary, credit, and fiscal policy in the Government.

Successful operation of the free-enterprise system requires the utmost reliance upon voluntary individual and group actions and minimum Government intervention. Government policies favorable to the exercise of individual initiative, giving recognition to the necessity of a reasonable profit, and providing encouragement to investment in new enterprise offer the best hope of economic stability.

Statement of William Green, President, American Federation of Labor

The American Federation of Labor, representing as it does the interests of nearly 8,000,000 working men and women, as workers, consumers, and public-spirited citizens, is vitally concerned with the manner in which the Government lives up to its responsibilities as set forth in the Employment Act of 1946. The monetary, credit, and fiscal powers of the Government are among its most potent instruments for the effectuation of that policy, and every path of action, or inaction, taken in the exercise of those powers has an ultimate effect in determining whether or not the objective of full and stable employment is met. Monetary, credit, and fiscal policies should, therefore, be consistent with and directed toward this aim.

With regard to Federal expenditure and revenue policies, the American Federation of Labor endorses the general recommendations set forth in the statement submitted to the subcommittee by the National Planning Association Conference of University Economists. An annually balanced budget is neither feasible nor desirable. It would be largely self-defeating and could be obtained only at the expense of general economic stability and progress. Whether revenues equal expenditures or are greater or less than expenditures at any given time should depend upon prevailing economic conditions and the outlook for the immediate future.

When unemployment threatens and deflationary trends are uppermost, a net deficit is appropriate as a matter of deliberate policy. The size of the deficit and the question as to whether it should be brought about by an increase in expenditures, a reduction in tax rates, or by merely allowing total revenues to fall as they normally would in a period of declining income with tax rates and expenditures stable should depend upon the relative severity of the economic downswing and upon judgment in view of the relevant circumstances at the time. When inflation threatens, a contrary policy should be followed to bring about a net surplus of revenues over expenditures. Under conditions of stable full employment, with neither inflationary or deflationary forces uppermost, a balanced-budget policy would be appropriate.

A high degree of flexibility and preparedness for prompt action is necessary for the maximum stabilizing effect of this policy to be realized. The so-called automatic flexibility now present in the system—such as is involved in unemployment compensation, the progressive income tax, etc.—while extremely valuable in slowing down the rate of cyclical changes and helping to fill the gap during the inevitable time lag before further deliberately planned action can be taken is not in itself sufficient to check these fluctuations. The sooner appropriate additional measures are adopted, the more effective they will be and the less drastic will be the nature and degree of the measures required. This requires that responsible officials in both the executive branch and in Congress be thoroughly cognizant of prevailing economic conditions and the future outlook.

Some criticism has been directed toward the principle of a flexible fiscal policy on the ground that it involves the necessity of forecasting the future and that these forecasts may not prove accurate. This is not a valid criticism, for the necessity of anticipating the future cannot be avoided, regardless of the nature of the policy. A policy of supine inaction involves an implicit forecast that the future will reveal that no action was required. This may prove to be as grossly inaccurate as any other type of forecast and much more dangerous, for it will not have given proper weight to all the available evidence. The necessity of well-informed estimates as to future trends as a guide for policy must be accepted. This in turn emphasizes the necessity for continuing improvement in our reporting facilities and in the tools of economic analysis and the importance of the work of groups such as the Joint Committee on the Economic Report and the Council of Economic Advisers.

The significance of governmental revenue policies and their effect on general economic stability make it doubly important that the tax structure itself be so designed as to contribute to, and be consistent with, the maximum attainment of the objectives of sound economic policy. This points to the pressing need for an early and thorough revision of the basic tax structure so as to eliminate regressive features and inequities and to base it squarely upon the principle of ability to pay.

In 1945, when Federal tax collections reached an all-time high, the proportion of tax income derived from progressive taxes levied on the basis of ability to pay also reached a high point, total revenue from Federal, State, and local taxes on personal and business income totaling 69.81 percent of the 51.4 billion dollars in tax revenue collected at all levels of government. Inheritance, estate, and gift taxes, which are also progressive, yielded 1.51 percent of the total revenue collected. Since 1945 the tax system has become increasingly regressive following two successive tax cuts which concentrated reductions in the income, estate, and gift tax fields. By 1947 only 58.74 percent of total tax collections was derived from income taxes. Since then the reduction in the proportion of revenue derived from income, estate, and gift taxes has progressed still further, under the effects of the tax cuts passed by the Eightieth Congress over President Truman's veto.

This drop in revenue from personal and business income taxes leads to greater reliance on the wartime emergency excise taxes, which are still seriously curtailing purchasing power and employment in 1949. States and municipalities are showing an increasing tendency to depend to a greater extent upon consumption taxes. Furthermore, the adoption by Congress of a sales tax in the District of Columbia was extremely regrettable from the standpoint of its implications as well as its direct effect. This heavier incidence of taxes, under the present structure, on low-income groups makes serious inroads into purchasing power and invites unemployment and depression.

Excise taxes imposed during the war on amusements, transportation, telephone, cosmetics, leather goods, jewelry, etc., have undoubtedly contributed to unemployment because of curtailed demand for the goods and services to which they apply. When enacted, these excise taxes were referred to as temporary war emergency measures. Consumption taxes of this nature are of dubious merit under any condition and are contrary to sound tax principles. Their retention under present conditions, solely on the basis of short-sighted fiscal expediency, is clearly contrary to the purposes of the Employment Act of 1946. Since the final impact of all taxes rests on individual or business incomes, regardless of where such taxes are levied, direct progressive taxation of incomes is not only the soundest policy in a democracy but is also the least repressive to production and employment. Such a policy would also increase the degree of automatic flexibility in the revenue system and would accordingly be most consistent with a fiscal policy designed to promote ful employment.

Revision of the tax structure could be accomplished now so as to involve no net reduction in revenue. Reductions in excises and other taxes on consumers should be accompanied by increases in taxes on income, corporate profits, inheritance, and gifts, so that the proportion of over-all revenue accruing from progressive taxes will show a substantial increase. Insofar as the elimination of excise taxes would lead to an increase in employment, production, and income, a net increase in revenue should result.

Also badly needed is an over-all approach to tax policies. Competition in the tax field between the various units of government continues unchecked at present. Steps taken by the Federal Government to improve the Federal tax system may be counteracted to a large extent by the actions of State and local governments. Coordination in tax policy is needed to eliminate overlapping, competition, and confusion. Greater cooperation in developing Federal, State, and local taxation revenue and expenditure policies would do much to contribute to economic stability.

In the field of monetary and credit policy, it is clear that the instruments of control possessed by the Government in this field are in need of improvement.

Ample and flexible powers should be available to the proper authorities in this sphere to enable them to apply timely and appropriate brakes to the expansion of credit when inflation threatens, to maintain the stability of the money market, and to take adequate expansionary measures when deflation threatens. Needless to say, monetary and credit policies should be closely coordinated as between the various agencies having responsibilities in this field, and in conjunction with the fiscal policies of the Government. The over-all guiding policy should be the maximization and stabilization of production and income and the maintenance of full employment.

While flexible monetary and credit controls alone are not enough to insure the maintenance of a high level of consumption and investment, they are an essential part of any over-all policy devoted to this end. They help to establish a favorable economic environment. They assure that, in deflationary periods, investment and production will not be retarded as a result of monetary restrictions and the scarcity of credit on favorable terms. They aid in checking inflation by forestalling the overexpansion of credit and the money supply.

The major responsibility for the administration of national monetary policy lies with the Federal Reserve System. During the war and postwar periods the presence of a public debt of unprecedented size has inhibited the ability of the Reserve System to exercise certain of its powers over the volume of money. The need for maintaining stability in the capital market, for facilitating the marketing and refinancing of the debt, and the desirability of keeping debt-service charges low, as well as other factors, required the Reserve System to support the Government-bond market by standing ready at all times to purchase all offerings of marketable issues. This largely deprived the System of its major instrument for checking credit expansion in time of inflation.

The size and distribution of the public debt and its pervasive influence upon the economy will necessarily have the effect of making the problems of debt management a major consideration in future Federal Reserve policy. The reasons for the bond-support policy seem compelling, and the effect of this upon the power of the Reserve System to limit credit expansion through its open-market operations must be accepted as an accomplished fact. This does not imply that, as some have stated, the Federal Reserve System is, as a result, a mere handmaiden of the Treasury Department. It is just a matter of the System being guided in its policies, as it should be and was intended to be, by general considerations of the public interest and necessity, the direction of which has been greatly affected by the growth of the public debt. Insofar as this makes for closer coordination and cooperation between the Federal Reserve System and the Treasury Department, it is all to the good.

Nor does this mean that the Federal Reserve System no longer has a vital part to play in stabilization policy. It does mean that the Reserve System is in great need of more effective alternative means of fulfilling its responsibilities and applying restraints to credit expansion when such restraints are called for. The power to control the volume of consumer credit should be restored to the System as a permanent feature. In addition, the authority of the Federal Reserve System to modify the required reserve ratios should be increased, so as to enable it to impose additional reserve requirements beyond the power which it now has. There also appears to be considerable merit in the proposal that the basis for establishing reserve requirements be revised, so that differeneces in reserve requirements would be based more largely on the nature of deposits rather than on the location of the banks. Furthermore, in the interests of equity and the maximum effectiveness of monetary policies, the burden of conforming to these reserve requirements should not be confined merely to member banks, but should be extended to cover at least all insured commercial banks. This would remove the danger that the relative competitive disadvantages of membership in the System, as compared with nonmembership would affect the money supply contrary to national policy and frustrate the counterinflationary efforts of the Federal authorities.

With the growth of the public debt, transactions in this field have acquired greater influence as an instrument of national economic policy, and it is important that debt-managed policies be coordinated with the other monetary and fiscal instruments of the Government so as to contribute to the aim of maintaining stable full employment. Aside from budgetary surpluses and deficits, different methods and types of borrowing, debt retirement, and refinancing have different effects upon the total incomes and expenditures, consumption and savings of individuals. Refinancing operations can be either restrictive or expansionary, depending upon the distribution of new security issues by types and terms, as between individuals and the banking system. Emphasizing the sale of savings bonds to individuals during inflationary periods has a contracyclical effect by reducing purchasing power and consumption. The redemption of those bonds by individuals in deflationary periods supports purchasing power and consumption. In general, the distribution of the debt should shift from bank-held debt to individually held debt in a period of inflation, and from individually held debt to bank-held debt in a period of deflation.

Active campaigns to stimulate the sale of savings bonds to individuals is appropriate policy for periods of inflation, and securities of this type should be available to the public at all times. When deflation threatens, however, promotional efforts along this line should be suspended and the expansion of the individually held portion of the debt should be discouraged. An increase in the volume of redemptions and a drop in new issues should be accepted as desirable under such circumstances.

Debt reduction should be viewed less as an end in itself than as an instrument of stabilization, and should be undertaken only when compatible with the broad policy of maintaining full employment, as a check on inflation. Long-run prospects of easing the burden of the debt lie in maintaining a rate of economic growth, with an ever-increasing national income, that will result in a decrease in the relative size of the debt as a proportion of that income. The relative size of the debt burden in the economy depends not only upon the pressure of its weight, but also, and perhaps to a greater extent, upon the strength by which that burden is to be borne. A debt-reduction policy that ignored its effects upon business activity and employment, and that was contrary to general stabilization policy, could very well defeat its own ends by precipitating a decline in national income and government revenues, and greatly increasing the relative size of the debt as a proportion of national income. High taxes levied on the mass of consumers for the general reduction of debt held by financial institutions may destroy purchasing power and lead to unemployment. With appropriate timing, on the other hand, the use of progressive taxes for the redemption of bonds held by millions of individual savers may have a stabilizing influence on incomes and employment.

As to the activities of Government agencies that lend to private borrowers or guarantee private loans, appropriate policy at any given time involves the reconciliation of a number of different factors. Broadly speaking, it may be said that Government lending operations should be coordinated with general monetary, credit, and fiscal policy, insofar as this is not incompatible with the major purpose for which the loan powers were set up. For example, it is apparent that good public policy required the expansion of loans for housing even during the period of postwar inflation. At any given time, the urgency of the need for certain types of undertakings may well outweigh considerations as to its adverse effects in relation to general monetary policy. It is largely a question of priorities. Furthermore, the stimulation and facilitation of production, through Government loan activities, in certain lines where the need is greatest and where serious maladjustments exist, may well be the most appropriate stabilization policy in that sphere, insofar as it enables the pressure of demand to be eased through an earlier supply, rather than by pricing potential buyers out of the market. Of course, where Government loan activities in these lines are required, during an inflationary period, steps should be taken by the monetary authorities to offset the effects of this policy on the money supply, as the best means of achieving the requisite degree of coordination in such a situation. As to the suggestion that these lending powers be placed in the hands of the authorities primarily concerned with over-all monetary and credit control, this would be to run the risk of subordinating a major purpose to what may well be a minor consideration, in that the monetary authorities may tend to place inordinate stress upon the general monetary consequences of a decision to make or not to make, or guarantee, a loan, at the expense of the perhaps more urgent direct objectives the lending power was designed to fulfill.

The nature and scope of the Government's authority with regard to loans to private investors is, of course, of major importance as an instrument of economic policy and particularly during periods when depression threatens. In this regard, it would be worth while to explore the need for a possible revision of the authorities, responsibilities, and policies of the Reconstruction Finance Corporation to see what steps might be taken to enable it to more effectively carry out its assigned duty "to aid in financing agriculture, commerce, and industry, to encourage small business, to help in maintaining the economic stability of the country, and to assist in promoting maximum employment and production." The volume of private investment is so vital to the maintenance of full employment and production that no policy that ignores the gaps and deficiencies of the private credit facilities available to agriculture, commerce, and industry can hope to be successful. The question of the need for a revision and a clear statement of the functions of the RFC, to enable it, as a continuing power, to encourage and facilitate added investment, where investment that would otherwise not take place is needed for particular purposes and to maintain employment and production, should be given careful study.

These instruments of policy are not foolproof, of course, nor should they be. There can be no substitute for sound, objective, and well-informed judgment on the part of those in whose hands the responsibility rests.

CONFERENCE OF AMERICAN SMALL BUSINESS ORGANIZATIONS,
Chicago 5, Ill., December 2, 1949.

Hon. PAUL H. DOUGLAS,
Chairman of Subcommittee, Joint Committee on the Economic Report, Senate Office Building, Washington, D. C.

DEAR SENATOR DOUGLAS: Credit, fiscal, and monetary policies, the subject matter before your committee, are inextricably bound up in one central, major question: Shall we, or shall we not, have a redeemable currency?

The Congress, by law, fixes the value of the dollar in terms of gold. The immemorial potency of the yellow metal is thus recognized. But no American citizen can own gold. Such a travesty of logic demands correction. Either the Congress is wrong in "anchoring" the dollar thus, or it is wrong in denying to the citizen the right to own the anchor. Either all things are relative in an expanding universe of money, and the dollar is here today and gone tomorrow, or else a fact outside our borders is also a fact inside them, and our citizens should have the right to own gold. A condition cannot long continue, in which the citizens of the world's dominant economy cannot own the evidence of that dominance, but must with docility submit to a deprivation not visited upon less fortunate citizens of mendicant countries.

As to the mechanics of the details of re-creating a convertible currency in this country, we yield to the technicians who are trained in such matters. But we yield to no one in denouncing the inconsistencies and the fatal contradictions of the present system, or rather lack of system, in United States monetary affairs.

It is now 40 years since there was any systematic review of monetary matters in this country. Every conceivable kind of trick, gadget, nostrum, panacea, and what not has been tried, and many of them embedded in what for the sake of courtesy we call a monetary "system." Actually it is an incredible hodge-podge of substitutes for reality.

Fifteen long years of experimentation with a "rubber dollar" here at home should be sufficient evidence of the fallacy of trying to establish a sound world economy under the Marshall plan (or any other plan), on the basis of debased paper currency with no tangible asset or standard of value to back it up.

Look at the record. Six thousand years of recorded world history have demonstrated that currency tinkering always means instability. A monetary unit based on political expediency; a prosperity based on war; an economy based on doles or charity or inflation are based on quicksand.

We have been floundering in financial quicksand most of the time for 15 years. Such a foundation cannot bring lasting domestic or international peace and prosperity.

If the Congress would rebuild the world economy—and our own economy—it must get out of the quicksand. We must get down to bedrock.

Bedrock, in this instance, is a universally accepted standard of monetary value. A standard which will not ebb and flow with the tide of arbitrary manipulation or political expediency.

Since we know that inflation was deliberately brought about by going off the gold standard and the devaluation of the dollar, is there a more logical cure to check inflation than to just as deliberately resume gold payments and stabilize the gold value of the dollar?

Why a National Monetary Commission?

A National Monetary Commission, created by Congress, with ample time and means at its service, can get down to bedrock fundamentals. It can determine the ways and means whereby the United States may take the lead in stabilization of our currency and our economy.

The Senate has already passed a bill (S. 1559) to this end. The joint committee should recommend that the House act on this measure. It is a joint, bipartisan attempt to restore some semblance of order to our chaotic monetary "system." Let this Commission point the way, the means, to restoring the convertibility of the dollar and making good on our promises to pay.

We believe the time has come to recover our national self-respect, our character and our honor, by saying only what we mean—and by meaning exactly what we say, as a people.

Herewith is a statement, which we desire to file in your record, attacking what we regard as the fallacy, nay, the idiocy, of further tinkering with the gold value of the dollar.

Respectfully submitted.

FRED A. VIRKUS, *Chairman*.

THE PRICE OF GOLD

I

Because the effect of a gold price change on other prices may not be immediate, many people, including authorities who should know better, assert that there is no such effect. But the facts are to the contrary.

As in the molecular structure of matter, indescribably numerous cross-relationships in every direction relate the values of commodities to one another. A change in the price position of one will affect that of many others.

A change in the relationship between the most potent commodity of all, gold, and the most fluid property of all, money, necessarily has the greatest of all price effects.

Thus a change in the United States valuation of gold, which would depreciate the dollar in terms of the most potent commodity, would eventually depreciate it (subject to the variable effects of lesser forces) in terms of nearly all other commodities.

Consequently, first and foremost, in all discussions of the United States gold price, let it be understood that raising the price of gold is the same thing as lowering the value of the dollar. No amount of gobbledegook can obscure this. So, inherent in discussions of the subject are moral as well as material issues. If we are going to break faith with the American consuming and investment public, let us call it breach of faith, and proceed from there. For devaluation is a universal capital levy, imposed on all the people unilaterally, to the extent that they own or use money, and extending over a period of many years, sometimes decades, before its effects are absorbed and the multifarious adjustments made.

Let us, therefore, dismiss at once, as so much moonshine balderdash, allegations to the effect that raising the American price of gold will not affect our public because that public does not own gold. Perhaps the effects will not be visible the following morning (except to owners of gold mines), but a lever of tremendous potency will have been moved, exerting an irresistible pressure that will ultimately diminish the purchasing power of the dollar in terms of real goods, over a period of many years.

It is noteworthy that the periods of greatest commercial prosperity in the known history of the world have accompanied those periods of greatest stability in the metallic content of money. In this regard, the question of whether the metal was gold, or silver, or copper, was secondary. It was monetary stability that created the climate for commercial prosperity. This was true whether in Egypt, or Persia or Rome, or the Hanseatic League, or what. Each and every blow at stability of metallic content is a set-back, from which the economy involved must recover and to which it must make its adjustments, before it can resume growth. The effect upon world economy is in rough proportion to the importance of the currency thus adjusted.

For example, the greatest commercial expansion in modern times took place in the century roughly from 1815 to 1915. It is not merely coincidence that during 97 of these 100 years, the world's dominant monetary unit did not change one iota in gold value. It was the establishment of the pound sterling on a fixed metallic gold basis in 1819 that preceded England's century of commercial glory. Whatever the complexity of causes, internal and external, for her later commercial decline, it is an indisputable fact that instability of her currency in terms of gold accompanied this decline, just as currency stability in terms of gold accompanied her world-wide dominance. The American people may well take note of this fact. To "adjust" the dominant American dollar now would be to strike the hardest possible blow at world prosperity.

II

In early days, before paper money was used and only coins circulated, hard-pressed sovereigns of the times simply put a little less metal in the coin. That was their kind of devaluation. Coin-clipping, as it was called, became a fine art. Obviously the coins clipped oftenest were least desirable, and periods of general commercial prosperity accompanied the least disturbances of metallic content.

Later, with the introduction of paper money, metallic content was expressed by the amount of metal obtaintable with paper, and variations in this amount served in lieu of coin-clippping.

The subsequent notion that money may be considered merely a mechanism, a tool of the money managers, received a tremendous impetus with the wider use of paper money.

Paper was obviously only a token, therefore it came to be assumed that money likewise was only a "token."

But in actual fact money is property, and its possession a property right, the abridgement of which under various guises (such as revaluation, devaluation, etc.) is merely another and more insidious attack on property.

As an attack on property is universally recognized to be an attack on investments, so revaluation or devaluation must be equally recognized as an attack on investments and the incentive to make them—on savings and all the civic virtues that go with saving.

The abridgement of property rights in this regard, which already exists in this country by reason of suspension of specie payments and nationalization of gold, will be carried further by any change in this price of gold, to the further peril of all forms of morality associated with property.

Revaluation is a capital levy. If the national economy is bankrupt, and requires such a levy to get going again, let us so admit. But if not, let us not "tinker" with the dollar, and newly upset the adjustments already made, to a revaluation which was the most drastic in the Anglo-Saxon world since before the Elizabethan era.

III

The stability of capitalism is not price stability; quite the contrary.

The essence of capitalism is variable price differentials, a milieu in which the entrepreneur can sell for more than he pays. In short, the profit motive.

The stability the capitalist wants is reliable constancy in the metallic content of the money unit.

The money managers who seek price stability are sociologists, not economists, and the emulsion of the two concepts may be difficult.

It may perhaps well be said, that if capitalism wishes to survive, it must voluntarily provide a tolerable sociological climate. This may be the crux of the problems of the day.

But if, as one of the desiderata of such a climate, it be found "socially desirable" to limit profits, let us do so honestly by taxing profits where they occur, not dishonestly by taxing all whether they have profits or not (which is inevitably the result of "monetary management" without specie payments).

The strains on the social and economic fabric, which may accompany submission to the discipline of a gold-coin standard, are the result of abuses of the standard, not of the standard itself.

IV

In actual fact, "stability" of the multifarious forces of commerce can never be achieved, and the purported use of monetary "adjustments" to achieve such stability is a chimerical dream. It can never reach its goal. The shifting pressures of commercial competition, among individuals or among nations, will always make somebody uncomfortable. Thus if the price of gold (i. e., of money) is to be changed every time acute discomfort occurs, by some interest big enough to demand and secure the change, then one by one, other big interests will abandon commercial activity, and the level of trade will sink to that of the huckster and hawker.

For the competitive currents of commerce to carry their burdens to the far corners of the earth, there must be a firm wall, impersonal, unyielding, unsentimental, impassive to all, against which these currents recoil, and along which they guide themselves. (This is merely another phase of the truism that in a capitalist society, the creation of much property depends on the destruction of some.) For the wall to be breached for a particular ship in distress is merely to confuse and discourage all other shipmasters, who have made their calculations based on the affirmed existence and location of the levee wall, and who, as such breaches recur, must be discouraged from sailing at all. Thus commerce is reduced to little boats and tramp steamers (to continue the metaphor), and the great ships of the line, whose very transit spells prosperity, stay tied at their wharves.

STATEMENT OF FRANCIS H. BROWNELL, RETIRED, FORMER CHAIRMAN OF THE BOARD OF DIRECTORS, AMERICAN SMELTING & REFINING CO.

GOLD AND THE MONETARY PROBLEM IN 1949

For over 100 years following the close of the Napoleonic Wars, international trade grew and flourished as never before in all history. The monetary basis of that prosperity was the prevailing form or type of gold standard. In the year following Waterloo, England established that type. She made her unit coin consist of a specific number of grains of gold, and then fixed or pegged the price of gold by directing the Bank of England to purchase all gold on offer in unlimited quantities at £3 17s. 9d, per standard ounce, and to sell all gold on demand in unlimited quantities at £3 17s. 10½d. per standard ounce. The difference of 1½d. (about 3 cents in United States money, valuing the pound at $4.86) was called a handling charge. But it also was a way of inducing others to buy gold in the market at prices between those of Government buying and selling (a difference so slight that it did not affect outstanding coins or the efficiency of the standard) and thus relieve the Government from the burden of handling such requirements.

Never before had the price been fixed effectively. The result is vividly described by Sir Charles Morgan-Webb in The Rise and Fall of the Gold Standard (p. 50):

"What made the currency revolution of 1816 unique was that, for the first time in the history of the world, there was a fixed and stable value of gold and of currency, which operated, not temporarily nor locally but permanently and throughout the world. Britain had provided the world with a new currency factor, a fixed unit of value.

"As soon as the world grasped this fact it hastened to take advantage of it. The stability of currency established by making the pound sterling a fixed value of gold was not confined to Britain. It was extended to the whole world by means of the sterling bill of exchange. Bills of exchange had been used to finance international commerce from time immemorial. But never before had bills of exchange, as good as gold, been available to ever trader in the world. As good as gold—the sterling bill of exchange was better than any gold of which the world had previously had any experience. The sterling bill of exchange was encashable in a new kind of gold, a gold with a fixed stable value, instead of in the old unstable fluctuating gold, whose value was just as likely to go down, as up, while the bill was current.

* * * The eighteenth century had witnessed a grim, prolonged struggle between Paris, London, and Amsterdam as to which should be the financial center of the world. With the sterling standard, Paris and Amsterdam faded out. London alone remained, indisputably, unquestionably the financial center of the world, with the bill of exchange on London establishing its predominance as the most efficient international currency the world had ever known, available for every country and every commercial center."

In 1931, England "went off gold," and when followed by the United States in 1933 the former type of gold standard came to an end and has never since been revived. The cause was the insufficiency of physical gold at the price pegged by England (equivalent to $20.67 per ounce) and in addition the maldistribution of what gold there was.

Today, 4 years after the surrender of Germany and Japan, the monetary chaos caused by the war shows little or no improvement. International trade is apparently becoming more difficult. The failure of steps so far taken emphasizes the desirability of a return of gold to the beneficent and successful function it performed in the nineteenth century.

There is a striking resemblance between the situation after Waterloo and that existing since the close of World War II. France under Napoleon, like Germany under Hitler, had for a time overrun Europe, but fell before the final alliance of other nations, including Russia. Monetary chaos prevailed in Europe then, much as now. England and Russia were the two leading nations and remained rivals for a century, even fighting the Crimean War. Today, the United States and Russia have a very similar relationship. England, like the United States today, having control of the seas, more advanced economically and more dependent on international trade, was preeminently more interested in restoration of conditions favorable to resumption of international dealings.

Today, as then, a monetary system, fostering multilateral international trade and convertibility of exchange, is of paramount importance.

The United States now has become the leading creditor nation, possessing 70 percent of the physical monetary gold, and is more powerful economically than any other nation. It is more abole than was England in 1816 to establish the same type of gold standard and so to foster international trade as in the days of its existence.

The requirements are—

(1) A determination of the price at which gold should be pegged; and then

(2) Resumption of coinage and convertibility of paper money into gold.

Before discussing these requirements, let us first review the present status of gold as money.

The principal factors in the present gold situation are found in the attitudes of England, the International Monetary Fund, and the United States.

England's gold policy

After England was forced off the gold in 1931, any immediate return seemed practically impossible. True, the British Empire then produced over 60 percent of all new gold mined, but it came from South Africa, Canada, Australia, and the colonies. Great Britain herself had to buy such gold just as much as if it originated in any other nation. The influential and famous English economist, the late Lord Keynes, was frank in expressing his own belief that gold had become obsolete and no longer necessary as money. But complete abandonment of gold was not politically feasible because of the Empire production and because the English people, like mankind at large, have supreme confidence in the value and ultimate desirability of a return to the former type of gold standard.

London had long been the financial center of the world, which was accustomed to look to English management of money as the acme of financial wisdom. Also, the world had very great confidence in fundamental English financial honesty, as well as financial know-how. English thought entertained the hope that this reputation might lead to the continuation of the pound sterling as the leading world currency, with only a slight and alternative use of gold, until later the old type of gold standard might again become possible or gold be entirely abandoned, as Lord Keynes suggested.

Essentially, the plan was to continue and still further to strengthen Empire preference and in addition to make bilateral trade agreements with other nations, governing exchange rates but using the pound sterling as the key currency. Gold was not actually reqiured, but would be accepted as the equivalent of the pound at the going price paid by the United States—$35 an ounce.

This English policy, perhaps from necessity as much as from choice, remains in effect today. The New York Times of September 10, 1949, reports Sir Stafford Cripps, Chancelor of the Exchequer, to have described the situation as follows:

"Tracing the historic development of the sterling bloc of nations who found it to their mutual advantage to base their currencies on sterling and hold their reserves in the same currency, Sir Stafford said it had grown today to the largest multilateral trading area in the world, embracing a quarter of the world's population."

International Monetary Fund gold policy

The Bretton Woods Conference was held before World War II ended. Lord Keynes headed the British delegation. While the final result was greatly influenced by the views of the United States, the Bretton Woods plan did embrace much of the English attitude in regard to gold. Rates of international money exchange are supervised by the International Monetary Fund. Gold is required only to a very slight extent. The United States dollar, or its equivalent in gold at $35 an ounce, is the principal money unit. Each country suggested, in the first instance, its own rate of excahnge. Other details need not here be described. Open-market exchange rates have varied almost always from the fund's official rates and the latter have in many instances served to complicate rather than to aid international trade and financial transactions.

When the International Monetary Fund began to operate, there was a free market for gold except in the United States, where ownership of gold, except in fabricated form such as jewelry and so-called natural gold, which is very small in amount, has been prohibited by law since 1933. But gold content of ores and concentrates brought into the United States from foreign countries for smelting and/or refining could be resold abroad. In the free market, gold was commanding a premium very substantially above the $35 level. About the middle of 1947, the International Monetary Fund concluded that an outside price above the $35 level was inimical to its own operation and requested all member countries to restrict and prevent sales of gold at more than the $35 level. Accordingly, the United States Treasury Department and the Federal Reserve requested all banks, American individuals and business enterprises to refrain from encouraging and facilitating traffic in premium price gold and in particular to refrain from extending the use of their facilities and funds for the carrying out of such transactions. Later, in November 1947, the United States further conformed to this request by exercising Treausry control over exports under wartime laws and prohibited further reexport of gold brought into the United States after November 24, 1947, by refusing to grant export licenses if an individual or a corporation in the United States participated in the sale of gold. Other nations, members of the fund, also complied with the fund's request.

As a result, the gold previously sold elsewhere came to the United States as practically the sole remaining governmental buyer. For several years, United States holdings of gold had remained substantially constant in the $20,000,000,000 bracket, as shown by the following table:

As of—	Ounces	Amount
Jan. 1, 1945	589, 106, 766. 0	$20, 618, 736, 710. 04
Jan. 1, 1946	573, 281, 235. 4	20, 064, 843, 237. 30
Jan. 1, 1947	586, 538, 499. 1	20, 528, 847. 466. 97
Jan. 1, 1948	650, 107, 101. 4	22, 753, 748, 547. 47

But after compliance with the fund's request, the amount rapidly increased.

	Ounces	Amount
On Nov. 16, 1949, the United States gold holding was	700, 861, 002. 4	$24, 530, 135, 083
On Jan. 1, 1947, it was	586, 538, 499. 1	20, 528, 847, 467
Increase	114, 322, 503. 3	4, 001, 287, 616

This gain, in slightly less than 3 years, of over $4,000,000,000 since compliance with the fund's request (1) is more than 5 years' total amount of new mine production, which was less than $800,000,000 in each year; (2) is over 10 percent of total monetary gold of $35,000,000,000; and (3) would, if continued at that rate, result, in about 10 years' time, in the United States owning all the monetary gold in the world. Its present policy is obviously steadily making the United States more and more the only nation that can determine the future of gold as money.

Present gold policy of the United States

This is succinctly and clearly expressed in the letter dated May 4, 1949, of the Acting Secretary of the Treasury to the Senate Banking and Currency Committee set forth in exhibit A, page 565.

The following quotations give the general principles:

"We believe that the United States should continue to follow the principle that the most important use of gold is for the domestic and international monetary functions of the Government and that gold should not be held by private individuals as a store of wealth. * * *

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"Since the gold dollar contains one thirty-fifth of an ounce of gold, this means that the Treasury should maintain the price of gold at $35 at ounce in legal gold markets in the United States. Therefore, the Treasury would hardly have any alternative if the proposed bills were enacted other than to sell gold to the extent necessary to maintain the market price at $35 an ounce. * * *

"The Treasury believes it to be of the highest monetary importance to the United States that it continue to sell gold to foreign governments and central banks at $35 an ounce whenever the balance of international payments turns in their favor and they ask for settlement in gold. To refuse to make such sales at $35 would be equivalent to a devaluation of the dollar and an abandonment of our adherence to a gold standard. * * *"

The type of gold standard outlined by the Treasury is often called the international gold bullion standard. It was first suggested as a means of overcoming the shortage of physical gold. It also weakens the brake (later discussed) on deficit spending exercised by the former convertible type of gold standard.

Objections to the international gold bullion standard

The international gold bullion standard utterly fails to provide that protection for the individual citizen which is the ultimate basis for mankind's belief and confidence in gold.

Since gold coinage began, the Roman Empire rose and fell. Many other nations, once powerful and prosperous, no longer exist. This century has seen the paper moneys of Czarist Russia, the Germany of the Kaisers, the old Austrian Empire, and China become utterly worthless.

But the gold content of the coins of all nations, whether the nations now exist or not, still retains its value.

France for centuries has been a great and leading nation economically, culturally, and intellectually. In 1914, the franc was worth 19.3 cents in gold or United States money and 107.1 francs would buy an ounce of gold at $20.67. Today, after devaluation, the franc is officially equal to $.0028. If 107.1 francs were invested in gold in 1914, it today would be worth $35, and the gold if sold, as it could be, for dollars at that price, would buy 12,500 present francs. But 107.1 paper francs kept since 1914 and then worth $20.67 in United States money, today are worth only 30 cents.

The experience of over 2,000 years has, as it were, burned into mankind a universal belief that gold money preserves its value, and so protects the individual owner, through wars, conquests, revolutions, insolvency because of governmental overexpenditure—in short, all the misfortunes that can happen to governments.

Why destroy this age-old protection to the individual citizen?

Why not preserve and retain it since it is possible to do so?

One wonders whether mankind will preserve its present opinion of gold if gold coinage is abandoned and the individual loses gold protection against the vicissitudes of government.

Gold is attractive ornamentally but its appearance can be readily copied. For utility purposes, unlike silver, it has very little value. Its monetary use, protecting the individual, is the real basis of the value and existing confidence in gold. If nations alone possess it and use it solely to settle international trade balances, individual men, slowly perhaps over two or three generations, may lose their high opinion of its value and so weaken, perhaps destroy, its further usefulness, even for the type of gold standard described by the Treasury. The United States then would lose the value of its gold holdings.

Most important of all objections is the fact that abandonment of coinage removes the greatest protection against excessive deficit financing of expenditures. The individual can no longer start to convert paper money into gold when such financing begins and the future purchasing power of his nation's paper currency is threatened, thus flashing a red-light warning to stop. The present type of gold standard gives little or no stimulus to the balancing of budgets.

The restraining influence on overexpenditures exercised by a coinage and convertibility type of gold standard is shown in the history of the last 70 years. In democratic governments the party in power is always confronted by the demands of pressure groups, each calling for government expenditures for its benefit. When such demands can only be met by increased taxation, the party in power must either raise taxes or deny the expenditure.

But when deficit financing can be resorted to without great opposition, it becomes possible to grant the demands of pressure groups without raising taxes. The political temptation to do so becomes too strong to resist. Pressure groups are granted expenditures to be paid for by increasing bond issues or other borrowings. Many, perhaps a majority, of the voters do not realize the ultimate effects of excessive deficit financing, and those that do are powerless to act concretely and can only talk and write about it—a process that has but little actual effect.

From 1879, when the United States resumed specie payments, down to the ending of gold coinage and convertibility of paper money into gold in 1933, the United States budget was seldom out of balance, and then only for short periods and in relatively small amounts. Also, the debt of the Civil War was paid off.

But since 1934 to date the budget has rarely been in balance. Deficit financing has been the usual rule. If the period of the war is eliminated (as it should be), we still have the 8 years before the war and 2 of the 4 years since Japan surrendered, in which deficit financing has been prevalent and is today more ominous than ever.

Nor is this the experience of the United States alone. The same general story is true of England, France, Italy, and the democratic nations of the Western Hemisphere.

Coinage and convertibility of paper into gold have been shown by the actual experience of democratic nations to be the only force that seems to be able to restrain unbalanced budgets and excessive deficit financing.

Without such support, no party in any democratic country seems able long to resist the temptation to please pressure groups by granting their demands.

But, with coinage and convertibility, those conscious of the dangers of excessive deficit financing quickly manifest their disapproval by converting paper money into gold. Such action speedily attracts the attention of many others who begin to do likewise. Conversion soon becomes so general as to cause great national alarm, felt by most voters, and so forces whatever party is in power to stop excessive deficit financing.

The above does not mean that deficit financing should never occur. Obviously it must in times of war. Even in peacetimes it is occasionally unavoidable.

But it does mean that the costs of new undertakings and increases in old lines of expenditure should be met by increased taxation or should not be adopted. Deficit financing should only be used for temporary emergencies. Coinage and convertibility are shown by experience to have the effect of restraining deficit financing within proper limits.

Let us now turn to the problems involved in following the English precedent of the nineteenth century.

Amount of physical gold in ounces

A fundamentally important fact in considering any type of gold standard is the actual amount of physical gold available for monetary purposes.

The exact amount is not known, but the best information (see exhibit C, p. 568) is that in round numbers (sufficiently accurate for present discussion), the total amount of gold in the world is about 1½ billion ounces. Of this, about one-third is in a fabricated form whose artistic, religious, or historic value exceeds that of the gold content. There is left about 1 billion ounces usable for monetary purposes. At $35 an ounce, this billion ounces is worth 35 billion dollars. Of this amount, the United States owns about 70 percent, or about 24½ billion in terms of dollars, and 700,000,000 in terms of ounces.

The actual physical quantity of gold in existence, in terms of ounces, cannot be increased by any act of government. The only way that amount can be increased for monetary purposes is by increasing the price. The quantity of gold at $10 an ounce for money purposes becomes automatically doubled by increasing the price to $20. An increase in price also tends to increase new mine production.

Changing the price of gold

It is absurd to think that any specific price can last forever unchanged under all future world conditions that may exist. Any price is not a physical standard of measurement, like the yard or quart. These are abstract measurements of a quantity regardless of its price. But gold is concrete. It represents the cost of labor and supplies in its production. Such costs frequently change. It is probable that no new gold would be mined today at the former $20.67 price except such as is a byproduct in the mining of other metals. World conditions will inevitably affect the price of gold in the future as in the past. The best that can be done in making a pegged price is to select one that will meet present conditions and will last in the future as far as mere man can foresee.

To resume at $35, only in a short time to find the quantity of physical gold insufficient at that level, would be most unfortunate, since it would simply repeat the experience of 1931–33 and again throw monetary systems into chaos more than ever. Also, present United States holdings would have become greatly depleted and scattered. Any future rise would not inure so exclusively to the Government but to the then holders of gold now owned by the United States.

If any increase in price is to become necessary, it should be made when, and only when, coinage and convertibility are again resumed and should be large enough to insure a continuance of the same price level for a long time to come. To resume specie payments at a price which leads to the early exhaustion of our vast gold stocks will only serve to discredit gold as the monetary standard and strengthen the hands of those who wish to perpetuate a fiat paper-money standard.

Amount of money to be backed by gold

The total supply of money to be backed by gold is an important element in determining price. It must not be greater than can be supported by the value of available gold at the fixed price.

No one contemplates the use of gold and silver alone for currency. Paper money and bank deposits are more convenient—in fact, necessary—and can be used in proper amounts if adequately backed by gold.

If one feels certain he can get gold in exchange for paper money or bank deposits if he wants it, he seldom asks for it, for gold is heavy and bulky to carry in the pocket, and in sizable amounts must be kept in a safe or safety-deposit box.

This faith in money applies only when the total supply is limited and the individual is sure that he can always get gold on demand. History proves beyond all question that confidence in the currency depends on the willingness of the Government to pay gold on demand.

A bank depositor similarly rarely calls for much cash as long as he feels he can get it if he wants to do so.

The United States has outstanding in 1949 over four times the paper currency outstanding in 1938. Almost all other nations have increased outstanding paper issues, some to an even greater extent. The amount of gold necessary for its backing is correspondingly increased.

The holding by all other nations of only 30 percent of total monetary gold requires that, in order for them to return to a gold standard of the nineteenth-century type, the United States must take action that will make is own holding serve to assist other nations in their return to gold. This does not mean that the United States must give or loan its gold to other nations. Resumption of coinage and convertibility would cause United States gold to flow to other nations. Large amounts of American paper money are held in other countries. Resumption of coinage and convertibility by the United States would bring much of this money home to be redeemed for gold. This would reduce the outstanding quantity of paper currency and redistribute some of our huge stock of gold. It would greatly strengthen the American dollar.

Percent of gold backing necessary

The United States now requires a gold backing equal in value to not less than 25 percent of the outstanding paper money it supports. Until a few years ago, 40 percent was required. Fixing the percent is difficult and involves some forecast of future developments. Conversion demand, and so the amount necessary to make the legal price effective, may vary greatly from time to time.

If the national budget is in balance, the 25 percent now required in the United States is adequate. But at other times doubt as to a nation's money may cause a flight to gold in excess of the 25 percent backing.

The situation is similar to the problem of commercial banks as to the amount of actual cash they should carry to meet demands of depositors. In normal times it need be only a relatively small percentage. But in times of financial panic or of doubt of a bank's solvency a run may start and very much greater amounts of cash become necessary.

Does the $35 price afford sufficient physical gold for a convertible gold standard?

The Economists' National Committee on Monetary Policy and the Gold Standard League evidently answer this question affirmatively, since they urge immediate resumption by the United States of coinage and convertibility without a change of price. They base their reasoning on the fact that the ratio of gold reserves to paper dollars, bank deposits, and Federal debt is higher today than before the United States stopped further convertibility and prohibited gold ownership by its citizens except in fabricated form.

But in those years there was no such fear of the future buying power of the United States dollar as exists today, not to mention as great or greater fear in many other countries of the future buying power of their respective currencies.

Also, there is a widespread belief, especially in European countries, that a rise in the price of gold will ultimately occur.

If gold coinage and convertibility are resumed at the $35 price level, there would be two strong incentives (neither of which was present in former days) to convert money into gold:

(1) The owner would then have just as many United States dollars and, in addition, the stable value of their gold content. Conversion into gold would be a hedge against future depreciation of the purchasing power of the paper dollar.

It would be unwise to ignore the presence of formidable forces, absent on other occasions, which today would induce a widespread conversion of paper money, bank deposits, and Government bonds into gold.

(2) The speculative chance of a future rise above the $35 price would induce extensive conversion. The speculator can't lose and might win. If the price does not rise, he still would have his money intact in number of dollars and the benefit mentioned in (1) above. This speculative factor would be weakened by a rise in the price before coinage and convertibility are resumed. The important fact to bear in mind here is that gold should have an official fixed value in terms of dollars which will make possible an early resumption of gold coinage without jeopardizing unduly our gold stocks.

Two such powerful inducements to convert money into gold will quite certainly lead to extensive conversion.

The Acting Secretary of the Treasury said in his letter of May 4, 1949 (exhibit A, p. 565):

"Even our $24,000,000,000 of gold holdings would be completely inadequate to meet a serious run on gold from the $27,000,000,000 of United States currency in circulation, over $140,000,000,000 of bank deposits and scores of billions of dollars of Government securities, not to mention other relatively liquid assets. Conversion of around 5 or 6 percent of these Government and bank obligations would be enough to bring the Federal Reserve banks below their legal minimum gold reserve."

This is a considered opinion of the Treasury officially communicated to a United States Senate committee.

But an increase of the price of gold could be made which quite certainly would prove adequate to meet conversion demand. The real problem is to determine what that adequate price should be.

When the United States raised the price of gold from $20.67 to $35, it raised the total value of all world monetary gold from a scant $20,000,000,000 to $35,000,000,000.

Also, the rise in price greatly increased mine production, since it made ore, unprofitable at $20.67 for gold, profitable at $35. Mine production in 1932 was 24,000,000 ounces, worth, at $20 an ounce, $480,000,000. The higher price gradually increased production until it reached its maximum of over 40,000,000 ounces in 1940, worth, at the $35 price, over $1,400,000,000.

These two additions to the gold supply have been offset by three recent developments: (1) The tremendous increase in paper money outstanding, bank credit subject to draft, and a huge total of Government debt which in many areas, as in this country, can be monetized; (2) the increase in the general price level; (3) the decrease in new mine production. Costs of labor and supplies have so greatly increased as to make the mining of much ore no longer possible. Production fell from 40,000,000 ounces, worth, at $35 an ounce, over $1,400,000,000, in 1940 to a production in 1948 of about 22,000,000 ounces, worth about $770,000,000.

At the present rate, world population is estimated to be increasing at about 1 percent per year, which would be over 50 percent in 50 years. A corresponding increase of world trade should follow. An increased volume of money will automatically be necessary. We should adopt a price that can be held for generations to come and at the same time insure adequate annual increments to our monetary gold stocks from mine production.

The gold delegation of the Financial Committee of the League of Nations issued an interim report in 1930, in which it said (beginning at foot of p. 14 of the official report):

"The demand for currency is naturally dependent upon the volume of production and trade and on the monetary transactions to which such trade gives rise. The demand for gold which forms the basis of currency in all gold-using countries will, in the absence of any important changes in currency systems, be determined by the same factors. We may reasonably expect, therefore, that the future requirements of gold * * * will tend to increase as production and trade expand. No direct measurement of the rate at which production and trade in gold-using countries of the world is increasing * * * can be made. But certain estimates exist which suggest that the normal rate of growth in the latter half of the nineteenth century and the early years of he twentieth was about 3 percent per annum * * * (foot p. 16). *The supply of new gold available for monetary purposes will be inadequate by 1934 unless measures to alleviate the situation are adopted in time* * * *." (Italics added.)

How quickly the gold delegation's fears of the insufficiency of gold were realized was evidenced by the events which took place in 1931.

Silver as aid to gold

Bimetallism was an attempt to use a dual standard. It established a legal fixed ratio for both gold and silver. The free market for the two metals rarely agreed with the official ratio. The result was that the metal which was overpriced at the mint (in comparison with its market price) was brought in for coinage, while the other metal, under Gresham's law, found the melting pot and was sold in the open market for a price greater than its monetary value. The Coinage Act of 1792 established the ratio between the two metals at 15 to 1, which at that time was the approximate market ratio. It soon changed, with the market ratio approaching 15½ to 1 before the end of the century. Gold coins disappeared from circulation. The act of 1834 established an approximate ratio of 16 to 1, which undervalued silver at the mint, with the result that silver coins disappeared from circulation. Later, the reverse took place and silver became overvalued.

It was this alteration in the standard, plus the powerful example of Great Britain on a single gold standard, which finally induced the major portion of the world to adopt the single monetary base of gold. Inherently, silver is just as capable of serving as a monetary medium as gold. Where it has been used as such a standard, it has turned in a monetary record infinitely better than that of fiat paper money. The great monetary error of the last century was the failure to use gold and silver jointly as the standard. This could have been accomplished by fixing the price of silver in the same way the price of gold was fixed.

Silver meets better the needs of Asiatic and other nations whose wage level is low, where banks are few, and saving is in too small amount to be handled satisfactorily by gold. They demand coins equivalent in value to from 10 cents to $1.

The volume of silver available for monetary purposes is less than 8,000,000,000 ounces. If its price were fixed at $1, it would be equivalent to adding a scant $8,000,000,000 to the gold supply which would be available in place of that much gold. The United States has about one-half the monetary silver, including all classes—free silver, subsidiary coinage, that held to redeem silver certificates, and that due it on lend-lease.

Rise in price of gold not inflationary

Much has been said and written to the effect that a rise in the price of gold means a devaluation of the United States dollar, with the resultant effect that prices of all commodities and of labor would correspondingly rise.

This could only occur if the United States used the so-called profit arising from the increased price in meeting deficits between expenditures and tax receipts.

Such a procedure is highly undesirable, much less necessary. It was not followed in 1934. The so-called profit was carefully protected. The rise in the price of gold to $35 an ounce was a distinct disappointment at the time so far as raising commodity prices was concerned. The great rise in labor costs and commodity prices occurred when the European war broke out. It was comparable to rises during other great wars and would have occurred if the gold price had not been increased to $35. Such rises are the result largely of the enormous amount of money placed in circulation in carrying on a war.

If the price of gold is again raised, the so-called profit should be held intact to provide certainly a sufficient fund to bear the possible demand for gold following convertibility.

It should not be used to support the International Monetary Fund or any other device designed to support the exchangeability of any other currency.

The price should not be raised except with a simultaneous resumption of coinage and convertibility.

Coinage and convertibility will probably cause the United States to lose gold, since paper dollars now hoarded abroad will be converted. But at times gold may come to the United States in quantities, having the effect of greatly increasing the reserves of commercial banks. This could be offset by sale of Government bonds from portfolios of Federal Reserve banks, as it has been in the past. It also could be avoided by a provision that the Federal authorities now controlling reserves should also have the power to declare, in their discretion, that at times such gold sold by banks to the Federal Reserve should be a mere credit, but not a reserve credit.

No ill results followed the rise from $20.67 to $35. It did abrogate contracts specifying payment of obligations in dollars of the former standard of weight and fineness, but a similar problem would not occur if there were to be a rise in the price of gold at the present time. Otherwise no disturbance of business or other evil results followed.

There was no inflation, for the United States did not place more money in circulation because of the increased value of its holdings of gold. Nor need it do so on a further rise in price.

Such a rise is only a means of increasing the physical gold supply to the amount necessary for modern conditions.

It is not dollar devaluation in terms of real buying power.

It is gold revaluation, to provide the increase of physical gold necessary to permit of resumption of coinage and convertibility. It performs the same function in protecting our gold stocks as arises in the discount rate under classical central bank policy.

The present $35 price of gold has borne no relation to the purchasing power of the dollar. That price has been in effect since 1934. But the purchasing power of the dollar has in the meantime fallen about a half of former purchasing power.

Congressional action

Attached as exhibit B is the statement issued by the Treasury in October 1949, holding, in effect, that the present gold situation in the United States cannot be changed except by congressional action. If none is taken, the United States automatically remains on the existing basis. The red light against excessive deficit financing cannot flash its warning. The United States will continue to purchase all gold offered, and its percentage of ownership of world monetary gold probably will continue to increase.

The alternative is for the United States, as the only Nation that can do so, to return to the nineteenth century type of gold standard of both coinage and convertibility of paper money into gold.

If it decides on the latter type, the only remaining question is: What should be the future fixed legal price of gold?

The question should be nonpartisan politically and is one that should be treated solely from a disinterested, patriotic standpoint of what is best, not only for the United States but for the world at large.

If Congress feels certain there is sufficient gold at the present $35 level, it should at once resume, at that price, coinage and convertibility by United States citizens, as well as all others.

If Congress agrees (as does this writer) with the Treasury on the insufficiency of gold at the $35 level, then it should consider some higher price of gold at which to resume coinage and convertibility by United States citizens, as well as all others. The gold content of the dollar would be also appropriately changed. In view of the former rise from $20.67 to $35, a $50 level naturally suggests itself. The following facts merit special attention.

(1) Such a price would increase United States holdings by about $10,500,000,000, or from 24½ billion dollars, in terms of dollars, to $35,000,000,000. This would seem to be quite certainly a sufficient reserve to resume coinage and convertibility, since there are many students of this subject who argue that already the United States has sufficient gold at the $35 level.

(2) The general level of commodity prices has risen over 100 percent since 1934, while the price of gold has remained stationary. Fifty dollars for gold today, as compared to $35 in 1934, is an increase of less than 50 percent, which would be $52.50.

(3) Percentagewise, a rise from $35 to $50 would be substantially less than a rise from $20.67 to $35.

(4) A rise to $50 would enable new mine production in the United States and elsewhere to rebound to the levels of 1940, and so assure sufficient gold for future increases of population and consequent increased trade.

(5) An increase of $15 an ounce would increase the value of the gold holdings of other nations by 43 percent, or about $4,000,000,000, and so would strengthen their currencies.

Such an increase would add 43 percent to the value of yearly mine production and would probably mean a return to the production rate of 1940, the maximum of all time. On that basis, the gold production of the world, excluding Russia and satellites, would be about 1¾ billion dollars per year, divided about as follows:

Australia	$107,000,000
Canada	266,000,000
British Africa	802,500,000
Total British	1,175,500,000
Mexico	41,600,000
Central and South America	108,000,000
United States	300,000,000
	1,625,100,000
Rest of world outside Russia	150,000,000
Total	1,775,100,000

Obviously, the dollar shortage of many countries would be greatly diminished. Shares of British African mines are largely held in England. England can get South African gold for merchandise or sterling and sell it for dollars. These factors would greatly reduce England's dollar shortage. The relief of dollar shortage to Australia and Canada would be great and Latin America would have its dollar problem substantially relieved, especially Mexico, Colombia, Nicaragua, Brazil, Chile, and Peru.

All told, the relief of dollar shortage would be well over $1,000,000,000 per annum.

(6) Fears have been expressed that an increase in the price of gold would nullify the recent currency devaluations by some 30 nations of about 30 percent. All these nations own gold, which at $50 an ounce would be increased in value 43 percent. This would be a substantial offset.

Many foreign currencies' parities are expressed in the first instance in terms of the United States dollar and only in the second instance in terms of gold. In these cases, the increase in the official price of gold in the United States would automatically bring about an increase in other countries. Under such conditions the rates of exchange between the United States dollar and the currencies of the other principal countries of the world would be unchanged by a rise in the price of gold.

Those countries whose currencies are defined in gold, can readily adopt the United States revaluation of the gold price and thus retain the present rate of exchange.

The feared nullification of devaluations would be doubtful of occurring at all, and if any does occur, should be limited to but few countries.

(7) A $50 price would settle at once all doubt as to future price changes and so would enable the world at large to adjust exchanges to such price without further uncertainty and delay.

If, however, Congress feels doubt as to what the price should be, then it should take steps to ascertain the proper price which would supply an adequate amount of gold and resume coinage and convertibility at that level.

Conclusion

To continue the present so-called International Gold Bullion Standard means disregarding the experience of the past and refusing to return to that type which for over 100 years proved its worth in balancing budgets, stabilizing moneys and promoting international multilateral trade more successfully than any system ever tried before or since.

The present United States gold standard is, in effect, a new experiment. So far, it gives no promise of success. All restraint on excessive deficit financing is lost. A real key currency convertible into gold, like the English pound in pre-World War days, is lacking. Exchange rates of currencies are determined, not by actual transactions in a free and open market, but by governmental action in sudden and drastic "devaluations," in which national political considerations have more influence than the realities of actual trade.

Is it not better and wiser to return to a tried formula which proved so successful in the past?

EXHIBIT A

THE SECRETARY OF THE TREASURY,
Washington, May 4, 1949.

Hon. BURNET R. MAYBANK,
Chairman, Committee on Banking and Currency,
United States Senate, Washington, D. C.

MY DEAR MR. CHAIRMAN: This is in further reply to your letters of April 25, 1949, stating that your committee intends to begin hearings on S. 13 and S. 286 on May 5 and requesting the report of the Department on these bills prior to the date of the hearing.

Both bills specifically authorize the acquisition, trading, and export by members of the public of any gold mined in the United States or imported into the United States after their enactment. S. 286 would also repeal sections 3 and 4 of the Gold Reserve Act of 1934. Since these sections contain the authority to regulate transactions in gold in the United States, their repeal would permit a free market for all gold. In substance, S. 13 would also result in a free market for all gold since it would not be possible to distinguish newly mined or imported gold from other gold.

The Treasury is strongly opposed to the enactment of these bills. They would create serious risks to our national monetary and banking structure and would result in a weakening of the present strong and stable position of the dollar in its relation to gold. At the same time, the advantages expected by their advocates appear to be based on misunderstandings and illusory hopes.

1. Enactment of either S. 13 or S. 286 would amount to a reversal of the decision made by the Congress in the Gold Reserve Act of 1934, that gold should be held by the Government as a monetary reserve and that it should not be available for private use for other than legitimate industrial, professional, or artistic purposes. We believe that the United States should continue to follow the principle that the most important use of gold is for the domestic and international monetary functions of the Government and that gold should not be held by private individuals as a store of wealth.

2. The existence of a free market for gold in the United States with a fluctuating price determined by private demand and supply would have exceedingly unfortunate consequences for our domestic economy. In fact, the Secretary of the Treasury is required by statute to maintain all forms of United States money at a parity with the gold dollar. Since the gold dollar contains one thirty-fifth of an ounce of gold, this means that the Treasury should maintain the price of gold at $35 an ounce in legal gold markets in the United States. Therefore, the Treasury would hardly have any alternative if the proposed bills were enacted other than to sell gold to the extent necessary to maintain the market price at $35 an ounce. Thus, the rise in the price of gold which appears to be contemplated by the proponents of these bills would not take place.

If the Treasury did not take measures to stabilize the market at $35, the shifting of the price of gold could not fail to confuse and disturb the public. The common interpretation of such fluctuations would be that something was wrong with the dollar and that the value of the dollar and all savings stated in dollars were going up and down with each fluctuation.

Such prices for gold, however, would probably be the result of a relatively trifling volume of transactions. No significant determination of the value of the whole world supply of gold could be made with the United States Treasury, which is the main factor in the gold market, left out of the balance. Because of popular misconceptions, prices determined by an insignificant volume of transaction, would be interpreted as applying to all gold, including the 24,300,000,000 in gold held by the United States Treasury. Thus, the public misinterpretation of the quotations in the so-called free market might cause a loss of confidence in the dollar and be extremely damaging to our economic welfare.

If the Treasury let the price of gold in the United States fluctuate it would be defeating the very purposes which have led us to acquire over $24,000,000,000 worth of gold. The Treasury has paid out those billions of dollars for gold in order to keep stable the relation between gold and dollars. There would be no clear reason why we should have bought this gold in the past or should continue in the future to buy gold at $35 an ounce if we were not also to be ready to sell it at the same price for any legitimate purpose in order to maintain the stability.

It would be exceedingly improvident for the United States to sell gold at $35 an ounce to foreign governments if such gold or other gold could be resold in the United States at premium prices. On the other hand, the Treasury believes it to be of the highest monetary importance to the United States that it continue to sell gold to foreign governments and central banks at $35 an ounce whenever the balance of international payments turns in their favor and they ask for settlement in gold. To refuse to make such sales at $35 would be equivalent to a devaluation of the dollar and an abandonment of our adherence to a gold standard. Moreover, if the United States should not continue to buy and sell gold freely for international settlements at $35 an ounce, we could not meet our obligations to the International Monetary Fund without adopting a system of exchange controls to prevent transactions in foreign currencies in the United States at other than official rates.

It should not be assumed, however, that it is at all certain that the proposed free market in gold would result in a marked rise in the price of gold for any extended period even if the Treasury should not stabilize the market at $35. Expectations of substantial increases in price are based on widespread exaggeration of the significance of various premium quotations abroad and inadequate appreciation of the degree to which prices of gold everywhere depend on the readiness of the United States to buy at $35 virtually all gold which is offered to the Treasury. There is also inadequate appreciation of the extent to which gold imports and trading are restricted in every important country in the world and the valid reasons for such restrictions.

3. The international monetary relations and obligations of the United States would also be prejudiced if gold were authorized to be exported and imported freely. One of the dangers of permitting exportations of gold from the United States without restriction is that much of the gold would flow to black markets abroad. In some countries the gold markets are illegal; in others, gold imports or dollar payments for gold are prohibited. These restrictions are designed to conserve urgently needed dollars to finance essential imports. Permitting gold exports to these markets would work directly against our efforts to restore Europe to financial solvency through the European recovery program.

In this connection, the International Monetary Fund has expressed its concern that international gold transactions at premium prices tend to divert gold from central reserves into private hoards. The fund has asked its members to take effective action to prevent premium price transactions in gold with other countries or with the nationals of other countries. The existence of a free market in the United States wtih a fluctuating price for gold, coupled with the repeal of authority to control the export of gold, would make it impossible for the United States to cooperate with the fund in achieving this objective.

4. Treasury sales of gold to the extent necessary to maintain a $35 price in a free market created by the enactment of either of these bills would, in effect, mean that any holder of dollars or dollar obligations would be able to convert them into gold. While this would be preferable to an erratic movement in gold prices in the United States, it would force this Government to a course of action which might have extremely serious consequences.

Internal gold convertibility is likely to exert critical pressure at the most dangerous and damaging times and to do little good at other times. It threatened the foundations of our financial structure during the depression and it might have done so again during the last war, yet it has proven of no use either to prevent inflationary booms or serve other desirable purposes at other times. When left in a centralized reserve, our gold stock gives impregnable international strength to the dollar. If our gold stock, on the other hand, were dissipated into immobilized private holdings, our power to maintain the position of the dollar might be critically weakened.

The problems of financing the last war would have been tremendously magnified if private citizens had been free to draw down our gold reserves. The prosecution of the war, for example, would have been critically hampered if Government and business borrowing had been limited because gold hoarders had left no excess reserves in the banking system.

Even our $24,000,000,000 of gold holdings would be completely inadequate to meet a serious run on gold from the $27,000,000,000 of United States currency in circulation, over $140,000,000,000 of bank deposits, and scores of billions of dollars of Government securities, not to mention other relatively liquid assets. Conversion of around 5 or 6 percent of these Government and bank obligations would be enough to bring the Federal Reserve banks below their legal minimum gold reserve.

Even in a letter of this length it is not possible to state all the considerations which cause the Treasury to oppose these bills. We believe, however, that the foregoing will give you a general indication of the difficulties and problems which the Treasury considers would arise from the enactment of either of them.

The Bureau of the Budget has advised that there would be no objection to the submission of this report to your committee since the proposed legislation is not in accord with the program of the President.

Very truly yours,

WM. McC. MARTIN, Jr.,
Acting Secretary.

EXHIBIT B

TREASURY DEPARTMENT MEMORANDUM FOR THE PRESS IN OCTOBER 1949

"The following statement was issued in response to inquiries at Secretary Snyder's press conference of Wednesday, October 5, 1949, concerning the legal authority to change the gold content of the dollar and the Treasury's price for gold. The Secretary again stated that he had no intention of proposing a change in the dollar price of gold. He reiterated what he had said on many occasions that he does not perceive any considerations which would justify such an action.

"(*a*) The gold content of the dollar:

"Only an act of Congress can now alter the statutory gold content of the dollar.

"The gold content of the dollar, and hence the statutory monetary value of gold in terms of the United States dollar, was defined by the Presidential proclamation of January 31, 1934, issued under authority of title III, section 43, of the act approved May 12, 1933, as amended. The weight of the gold dollar was fixed by this proclamation at fifteen and five-twenty-one hundredths grains of gold nine-tenths fine, that is, one-thirty-fifth of a troy ounce of pure gold (technically referred to as gold 1,000 parts fine). The monetary or statutory value of gold in the United States is therefore $35 per fine troy ounce. After several extensions the authority of the President by proclamation further to change the gold content of the dollar expired on June 30, 1943.

"(*b*) The price of gold:

"The Secretary of the Treasury has authority under sections 8 and 9 of the Gold Reserve Act of 1934, as amended, with the approval of the President, to purchase and sell gold at such rates and upon such terms and conditions as he may deem most advantageous to the public interest.

"The authority of the Secretary of the Treasury in this respect, however, is limited by a number of factors. First is the obligation undertaken by the United States as a member of the International Monetary Fund. Article IV, section 2 of the articles of agreement of the International Monetary Fund provides:

" 'The fund shall prescribe a margin above and below par value for transactions in gold by members, and no member shall buy gold at a price above par value plus the prescribed margin or sell gold at a price below par value minus the prescribed margin.'

"The fund has prescribed a margin of one-fourth of 1 percent above and below the par value for purchases and sales of gold. Accordingly, the United States has an obligation to the International Monetary Fund not to purchase gold at more or sell gold at less, than $35 plus or minus the prescribed margin so long as the par value of the dollar declared to the fund remains unchanged. The par value of the dollar can be changed only pursuant to the provisions of the articles of agreement and the Bretton Woods Agreements Act, which requires the approval of Congress for any such change. Section 5 of that act provides that neither the President nor any person or agency shall propose to the International Monetary Fund any change in the par value of the United States dollar or approve any general change in par values unless Congress by law authorizes such action.

"Even without the legal obligation to the International Monetary Fund there are important considerations of policy which, in effect, circumscribe the discretion of the Secretary of the Treasury to change the price of gold. The gold policy of the United States has been directed primarily to maintaining a stable relation between gold and the dollar.

"Since 1934 the United States has firmly adhered to the requirements of an international gold bullion standard. We have done so by buying and selling gold freely at a fixed price, $35 an ounce, in transactions with foreign governments and central banks for all legitimate monetary purposes.

"The importance which the United States attributes to the maintenance of a stable dollar price for gold is demonstrated by other legislative provisions. The gold parity statutes contained in the Gold Standard Act of 1900 and the act of May 12, 1933, provide that the gold dollar 'shall be the standard unit of value and all forms of money issued or coined by the United States shall be maintained at a parity with this standard and it shall be the duty of the Secretary of the Treasury to maintain such parity.'"

EXHIBIT C

Calculation of monetary gold

The estimate used on p. 13 of total monetary gold is	$35,000,000,000
The International Financial Statistics published by the International Monetary Fund for October 1949 (p. 26) estimates the gold holdings of international institutions, central banks, treasuries, and other governmental institutions, of 48 countries, including both the United States and Russia, as of June 30, 1948, as	36,145,000,000
Russia is estimated as	2,700,000,000
Deducting Russia, we have	33,445,000,000
The same publication in the same column states that estimates of the Board of Governors of the Federal Reserve System total	37,343,000,000
Again deducting Russia	2,700,000,000
We have	34,643,000,000

We can checks the above to some extent by the estimates of total world gold produced:

	Ounces
The annual report of the Director of the Mint, for 1942, pp. 103–104, estimates the total amount of gold mined since the discovery of America in 1492 to end of 1941 as	1,416,000,000
The Director of the Mint gives no estimate of production after 1941, but the American Bureau of Metal Statistics estimates the world production, outside of Russia and her satellites, for the years 1942 to 1948, inclusive (7 years) as	166,000,000
Total world gold produced since 1492	1,582,000,000

The amount of gold produced before the discovery of America was very small and would not greatly change the picture. The ancients lacked explosives and pumps, and had only hand tools. They had no knowledge of metallurgy. Their gold production was from placers, and from veins only to a small extent before water at depth or lack of air for breathing made further working impossible.

From total production there must be deducted losses at sea; burial; destructive uses, such as plating, gilding, abrasion of coins, much gold leaf; the large amounts used for religious purposes in cathedrals, churches, and temples; the amounts held in museums; and the amount in fabricated form held by private individuals, including settings of gems. The total of losses and nonmonetary uses is quite certainly well over one-third of the total produced.

SPOKANE, WASH., *December 12, 1949.*

GROVER W. ENSLEY,
Associate Staff Director, Joint Committee on Economic Report,
Washington, D. C.

DEAR MR. ENSLEY: I have just received your telegram which I interpret as a request for a statement for the Joint Committee on Economic Report. If I had received the original questionnaire, I would have submitted answers to most of the questions. Under the circumstances, however, I shall confine my comments to a brief and general statement on gold and silver and point out certain facts that were not brought out in the Joint Committee Print No. 98257.

In connection with "the price of gold," I call attention to the fact that, according to former Secretary of the Treasury Morgenthau's own statement, the $35 an ounce price for gold was "really set through a combination of lucky numbers" and not, as generally assumed, reached on the basis of investigation and study. Evidence of the fact that the price of $35 was not high enough is found in an act subsequently passed by Congress that reduced the required gold backing of the dollar from 40 to 25 percent, thus giving gold a value of $56 an ounce in our monetary reserve (p. 43, Bulletin 94829, U. S. Government Printing Office).

Further evidence as to the fact that gold is undervalued at $35 an ounce is found in the banking laws which require a reserve of only 14 to 20 percent and on that basis make it possible for a commercial bank to make loans and investments to the equivalent of $210 on each $35 an ounce of gold (World Report, December 23, 1947).

The contention that the price of gold should remain pegged at $35 an ounce also overlooks the fact that gold commands a much higher price in all the free markets of the world and that Great Britain's recent currency devaluation has had the effect of raising the price of gold to the equivalent of $60.79 as compared with the price in shillings at which gold sold in London before the gold standard was abandoned in 1931. Note the following equation: 85s : 250s :: $20.67 : $60.79.

To conclude that the fact that we have more gold than any other country in the world is of itself proof that the $35 price of gold is a proper one overlooks the fact that we need more gold than any other country in the world because we have a larger debt and other obligations than all of the other leading industrial countries of the world. Our productivity is greater than all of that of Europe and Asia combined, and, in order to maintain that production, we must have a sound monetary system which, if the history of money means anything at all, requires gold and/or silver redeemability.

To contend that the $35 price for gold should not be changed, is equivalent to contending that the price should not have been changed during previous monetary crises and that President Roosevelt should not have changed the price.

I should like to emphasize to the committee the fact that no effort has been made to determine what the price of gold and silver should be since Sir Isaac Newton suggested a figure based upon the relative output of the two metals. I am not myself contending that the relative production of the two metals offers sufficient grounds for determining the monetary values of these metals, but it is rather interesting to note that Newton's figure of $20.67 on gold worked exceptionally well for a period of over 110 years.

The $20.67 price worked, in fact, until England was forced to abandon the gold standard in 1931 which, as the committee knows, had the effect of devaluation and eventually led to the United States bank holiday and our devaluation of the dollar that was effected by increasing the price of gold.

It is not enough to say that Great Britain devalued the pound to get dollars because actually Great Britain's devaluation was made for the purpose of getting gold since with gold she can get currency of any country and can in many instances use other currencies to better advantage than United States dollars.

This is the proper time to consider whether or not Great Britain's devaluation, which was preceded by devaluations in Russia, France, China, and followed by devaluations of more than 30 other countries, will not bring about a drain on our gold at the price of $35 an ounce that may result in another depression and bank holiday. Forewarned is forearmed, and our gold supply is already shrinking.

I also submit for the consideration of the committee the fact that a free market for gold in the leading countries of the world would quickly determine through the natural law of supply and demand what value should be given to gold in our monetary system and that of the other countries upon whom rests the responsibility of trying to establish and maintain world peace.

President Roosevelt's statement in relation to silver, in which he said that this metal should have wider use in the monetary systems of the world, should also be considered and carefully weighed, especially in view of the fact that silver offers the most practical monetary medium for most of the world's peoples.

The matter of what the price of gold or silver is or should be must not be decided merely on the basis of whether or not the price would show a profit to the miners of the United States or any other country. As a matter of fact mining men do not ask for a price that will guarantee them a profit, but they do point out that they cannot operate except with a profit. Incidentally, I emphasize the fact that because gold and silver, especially silver, are usually found in association with other metals, copper, lead, and zinc the prices of these industrial metals, which are so essential to our everyday life, would be very much higher than they are now if gold and silver were selling at lower prices.

In other words, if mining, which is one of the greatest industries in this country, is to be maintained as an essential part of our economy, it is going to be necessary (1) to greatly reduce taxes and the cost of labor or (2) greatly increase the price of copper, lead, and zinc or (3) permit the price of gold and silver to reach the figures that would provide a realistically sound monetary value; and these prices can, as I have previously stated, best be determined by permitting and providing a truly free market for gold and silver in the free countries of the world.

Respectfully submitted.

Frank Lilly,

Statistician, Mines Research Bureau; President, American "Hard Money" Association; Executive Secretary, Prospectors and Mine Owners Association.

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