FEDERAL RESERVE ACT AMENDMENTS

(Sections 14 and 16)

HEARINGS

BEFORE THE

COMMITTEE ON BANKING AND CURRENCY
HOUSE OF REPRESENTATIVES

EIGHTY-THIRD CONGRESS

SECOND SESSION

ON

H. R. 8729

A BILL TO AMEND SECTION 14 (b) OF THE FEDERAL RESERVE ACT, AS AMENDED

AND

H. R. 9143

A BILL TO REPEAL THE PROVISIONS OF SECTION 16 OF THE FEDERAL RESERVE ACT WHICH PROHIBITS A FEDERAL RESERVE BANK FROM PAYING OUT NOTES OF ANOTHER FEDERAL RESERVE BANK

MAY 26 AND 27, 1954

Printed for the use of the Committee on Banking and Currency

UNITED STATES
GOVERNMENT PRINTING OFFICE
WASHINGTON : 1954

COMMITTEE ON BANKING AND CURRENCY

JESSE P. WOLCOTT, Michigan, *Chairman*

RALPH A. GAMBLE, New York
HENRY O. TALLE, Iowa
CLARENCE E. KILBURN, New York
GORDON L. McDONOUGH, California
WILLIAM B. WIDNALL, New Jersey
JACKSON E. BETTS, Ohio
WESLEY A. D'EWART, Montana
MYRON V. GEORGE, Kansas
WALTER M. MUMMA, Pennsylvania
WILLIAM E. McVEY, Illinois
D. BAILEY MERRILL, Indiana
CHARLES G. OAKMAN, Michigan
EDGAR W. HIESTAND, California
DOUGLAS R. STRINGFELLOW, Utah
WILLIAM K. VAN PELT, Wisconsin

BRENT SPENCE, Kentucky
PAUL BROWN, Georgia
WRIGHT PATMAN, Texas
ALBERT RAINS, Alabama
ABRAHAM J. MULTER, New York
CHARLES B. DEANE, North Carolina
GEORGE D. O'BRIEN, Michigan
HUGH J. ADDONIZIO, New Jersey
ISIDORE DOLLINGER, New York
RICHARD BOLLING, Missouri
WILLIAM A. BARRETT, Pennsylvania
WAYNE L. HAYS, Ohio
BARRATT O'HARA, Illinois
EUGENE J. McCARTHY, Minnesota

WILLIAM J. HALLAHAN, *Clerk*
ORMAN S. FINK, *Professional Staff*
JOHN E. BARRIERE, *Professional Staff*

CONTENTS

FEDERAL RESERVE ACT AMENDMENTS

(Secs. 14 and 16)

WEDNESDAY, MAY 26, 1954

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Washington, D. C.

The committee met at 10 a. m., the Honorable Jesse P. Wolcott, chairman, presiding.

Present: Chairman Wolcott, Messrs. Gamble, Talle, Kilburn, McDonough, Widnall, Betts, Mumma, McVey, Merrill, Oakman, Stringfellow, Van Pelt, Spence, Brown, Patman, Rains, Multer, Addonizio, Dollinger, Bolling, Barrett, O'Hara, and McCarthy.

The CHAIRMAN. The committee will be in order.

We are met this morning to consider H. R. 8729 and H. R. 9143, which are as follows:

[H. R. 8729, 83d Cong., 2d sess.]

A BILL To amend section 14 (b) of the Federal Reserve Act, as amended

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 14 (b) of the Federal Reserve Act, as amended (U. S. C., 1952 edition, title 12, sec. 355), is amended by striking out "July 1, 1954" and inserting in lieu thereof "July 1, 1956" and by striking out "June 30, 1954" and inserting in lieu thereof "June 30, 1956".

[H. R. 9143, 83d Cong., 2d sess.]

A BILL To repeal the provisions of section 16 of the Federal Reserve Act which prohibits a Federal Reserve bank from paying out notes of another Federal Reserve bank.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the third paragraph of section 16 of the Federal Reserve Act, as amended, is amended by striking out the sentences thereof which read as follows: "Whenever Federal reserve notes issued through one Federal Reserve bank shall be received by another Federal Reserve bank, they shall be promptly returned for credit or redemption to the Federal Reserve bank through which they were originally issued or, upon direction of such Federal Reserve bank, they shall be forwarded direct to the Treasurer of the United States to be retired. No Federal Reserve bank shall pay out notes issued through another under penalty of a tax of 10 per centum upon the face value of notes so paid out."

The CHAIRMAN. We have with us Mr. Martin, Chairman of the Federal Reserve Board, and Mr. Burgess, deputy to the Secretary of the Treasurer.

You gentlemen may agree on who will go first.

Mr. MARTIN. I would like to go first, Mr. Chairman.

The CHAIRMAN. Very well, Mr. Martin, you may proceed.

STATEMENT OF WILLIAM McC. MARTIN, JR., CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. MARTIN. I am glad, Mr. Chairman, to have this opportunity to testify on behalf of the Board of Governors of the Federal Reserve System relative to the proposed legislation which you have before you. The Board of Governors endorses both of these proposed bills.

H. R. 8729 would extend for another 2 years the authority—continuously provided since 1942—of the Federal Reserve to purchase up to $5 billion of United States securities directly from the Treasury. Without this authority the Treasury and the Federal Reserve on occasions would be unable to prevent the disturbing effects on the money market of the sudden drains that occur at tax payment periods. The use of this authority prior to tax payment dates avoids creating unnecessary financial strains that would otherwise occur if the Treasury had to draw heavily on its accounts. Temporary Treasury borrowing through this means followed by prompt repayment from the proceeds of tax payments provides a smooth operating mechanism, without the abrupt money market fluctuations that would otherwise occur, and thus is helpful in the conduct of Federal Reserve policy. Use of this procedure as required by law is reported each year in detail in the Board's annual report. We believe that this authority, under existing safeguards, should remain available.

H. R. 9143 would repeal the provisions of section 16 of the Federal Reserve Act which prohibit a Federal Reserve bank from paying out notes of another Federal Reserve bank. Under present law it is necessary for each Federal Reserve bank to sort all of the millions of Federal Reserve notes fit for further circulation which are received by it from member banks, according to the Reserve bank by which each note was originally issued. In addition, it is necessary for the Reserve bank to return such notes to the Reserve banks that originally issued them.

Such sorting and crisscross shipping of currency are expensive. It is estimated that the annual cost of these operations, which would not be necessary except for the statutory restriction, is in excess of $750,000 annually. The pending legislation would remove a provision of law which was thought to be important in the early days of the System but which in practice has not proved to be so.

Experience over the years definitely establishes that the requirement for the return of fit Federal Reserve notes to the Federal Reserve banks of issue has no important economic effect on the amount of Federal Reserve notes in circulation. The notes that are returned to the Federal Reserve banks of issue, in accordance with the requirements of the law, are again placed in circulation as demand for currency appears. Outstanding currency which is not needed by the economy is returned to the Reserve banks for credit to the reserve accounts of the member banks. In other words, the amount of currency in circulation rises and falls in accordance with changes in the demand for currency on the part of the public, and is in no way affected by the return of fit notes to the bank of issue. Accordingly no useful purpose is served by retaining the restriction upon a Federal Reserve bank's paying out of currency issued by other Federal Reserve banks. This matter has been thoroughly studied by the presidents of the Federal Reserve banks and has their approval.

The CHAIRMAN. With respect to H. R. 8729, how long has the Federal Reserve had the authority to make such purchases?

Mr. MARTIN. Since 1942, Mr. Chairman.

The CHAIRMAN. And it has been continued every 2 years, or something like that?

Mr. MARTIN. Yes, sir.

The CHAIRMAN. Are there questions?

Mr. PATMAN. On which bill, Mr. Chairman? On both of them?

The CHAIRMAN. Well, he covered both, so, without objections, we can take up both.

Mr. PATMAN. I have a question, Mr. Chairman.

The CHAIRMAN. Mr. Patman.

Mr. PATMAN. When did you first present this proposal, Mr. Martin, to repeal that section of the act which requires the Federal Reserve notes to be returned to the Federal Reserve bank issuing them?

Mr. MARTIN. To the Congress, Mr. Patman?

Mr. PATMAN. Yes, sir.

Mr. MARTIN. At the time of the Banking Act of 1935.

Mr. PATMAN. Do you mean it was presented then?

Mr. MARTIN. It was presented then. The Banking Act of 1935, as originally proposed in the House, contained a provision that would have deleted the provision restricting recirculation of notes of other Reserve banks. So it was in 1935, Mr. Patman.

Mr. PATMAN. All right. At what other times?

Mr. MARTIN. In the spring of 1943 we requested the chairman of the Senate and House Banking and Currency Committees to introduce a bill incorporating the repeal of this provision. Then in 1944, the Presidents' Conference of the Federal Reserve Banks accepted and approved a report of a special subcommittee, and it was decided at that time not to go forward with it until we had some other minor changes in the Federal Reserve Act that might be included with it. And so nothing was done.

Mr. PATMAN. Had you ever presented the matter to the Congress and called their attention at the same time to the enormous savings involved?

Mr. MARTIN. At the time of the Douglas questionnaire, in 1949, Mr. Patman, we did.

Mr. PATMAN. Well, of course, that is not exactly presenting it to the Congress, that is presenting it to a subcommittee of a joint committee. I wouldn't think so.

Did you ever ask the Banking and Currency Committee of either House to amend this law before?

Mr. MARTIN. We did in 1943.

Mr. PATMAN. Did you point out how much money it would save?

Mr. MARTIN. That I do not know, whether that was actually put into the record.

Mr. PATMAN. The other day was the first time I ever heard that there were any savings to amount to three-quarters of a million dollars involved. I just didn't know. But I am sure if the Congress has been told in the past that it involved a half million dollars, or three-quarters of a million dollars, they would have saved that money over a long period of time. I just wondered why it had not been presented.

Who first called that to your attention? Did any audit call it to your attention? I am talking about the Board of Governors of the Federal Reserve System now. When was the matter first brought up?

Mr. MARTIN. During my administration, Mr. Patman, it was brought up at the time that we were discussing your questionnaire. You see, I was a new man in the System and was reviewing all of these matters, and it was discussed at that time.

Mr. PATMAN. Did any audit ever bring it up?

Mr. MARTIN. On the expense side? I don't know whether we had any specific references to it.

Mr. PATMAN. How many audits have you had in the System? This is the 40th year, I believe, of the Federal Reserve System. You have had audits all along of the different banks during the years?

Mr. MARTIN. That is correct.

Mr. PATMAN. How many audits in all would you say you have had? A number of audits?

Mr. MARTIN. Under the law each Federal Reserve bank has to be examined at least once a year and that requirement has been met.

Mr. PATMAN. Now, here is what I would like to do, without asking you a lot of questions about it: I would like you to file, for the record, a statement showing, we will say, in the first paragraph—I am just giving it out in this order in order to make plain what I want—first paragraph, the bank that was audited, when it was audited, which bank, the date, the auditors, and the instructions given to the auditors by the Board of Governors, of the Federal Reserve System. Then somewhere I want you to state whether or not any of those audits brought out this particular point.

Mr. MARTIN. We will review the matter.

Mr. PATMAN. All right. Now, that will include all audits from the beginning of the System.

When was this filed [indicating] with the Banking and Currency Committee?

The CHAIRMAN. Mr. Patman, don't you think that would be too voluminous?

Mr. PATMAN. The way I asked for it it should not be too voluminous. I am not asking for any detail, except the instructions given the auditors.

The CHAIRMAN. Could that be furnished, Mr. Martin?

Mr. MARTIN. We can work up something on that, Mr. Chairman.

(The data referred to above is as follows:)

The 12 Federal Reserve banks opened for business in November 1914, and in each year, beginning with 1915, each of the banks has been examined at least once as required by the Federal Reserve Act, by examiners for the Board of Governors of the Federal Reserve System. Attached is a table showing the dates of these examinations, together with the names and titles of the respective persons who were in charge of the examinations.

These examinations are made under instructions of the Board to the effect that the examination of a Federal Reserve bank shall determine its financial condition, proper discharge of its responsibilities as fiscal agent of the United States, and compliance by management with applicable provisions of law, regulations of the Board, and any other applicable requirements. The examiners are instructed also to develop pertinent facts and opinions which will enable the Board to appraise the condition, operations, and administration of each bank. In conjunction with each examination of a Federal Reserve bank, the accounts of the Federal Reserve agent with respect to Federal Reserve notes and the collateral thereto also are verified. The instructions issued to the examiners set forth the minimum required to be accomplished and they do not operate as a limit upon the extent of the investigation made by the examiners when confronted by an unusual situation.

The reports of examination of the Federal Reserve banks submitted to the Board by its examiners are carefully reviewed by the Board, and the recommendations of the examiners requiring further action are taken up and followed to conclusion by the board of governors with the chairman of the board of directors of the Reserve bank. The examiners' recommendations do not include recommendations for changes in the law; as stated in the preceding paragraph, the function of the examiners in this regard is, rather, to determine compliance by management with applicable provisions of existing law.

In addition to the annual examinations of the Reserve banks by the Board's field staff of examiners, discussed above, all phases of each bank's operations are subjected to comprehensive and thorough audits throughout the year by the resident general auditor and his staff. The general auditor is an officer of the Federal Reserve bank, responsible directly to its board of directors through the chairman and the audit review committee. The general auditor submits reports of his audits to the board of directors, and copies of these reports from each Reserve bank are furnished to the board of governors, where they are carefully reviewed.

47918—54——2

Dates of examinations of Federal Reserve banks by examiners for the Board of Governors of the Federal Reserve System—February 8, 1915, to May 3, 1954

[NOTE.—Under each bank and opposite each year there are shown the month and day of the month as of which each examination was made, followed by a numerical code which, in conjunction with the list shown at the end of the table, identifies the person, or persons, in charge of each examination.]

Year	Boston	New York	Philadelphia	Cleveland	Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
1915	7-31 (1)	2-8 (1)	5-8 (1)	8-9 (1)	2-20 (1)	3-13 (1)	8-14 (1)	3-27 (1)	8-23 (1)	4-7 (1)	6-10 (1)	5-29 (1) 11-27 (1)
1916	1-31 (1) 6-30 (1)	2-5 (1) 7-8 (1)	1-22 (1) 10-26 (1)	3-20 (1) 11-6 (1)	3-28 (1)	4-6 (1) 9-30 (1)	3-13 (1) 8-25 (1)	5-2 (1) 11-27 (1)	3-4 (1) 11-17 (1)	4-24 (1)	5-8 (1)	8-12 (1)
1917	4-9 (1)	3-20 (1)	12-6 (1)	5-7 (1)	1-29 (1)	11-13 (1)	3-6 (1)	10-25 (1)	8-31 (1)	2-23 (1)	2-13 (1)	9-27 (1)
1918	1-29 (1)	6-1 (1)	11-16 (5)	8-17 (2)	2-25 (1)	11-23 (3)	3-19 (1)	10-12 (3)	9-7 (3)	4-16 (1)	5-3 (1)	9-21 (4)
1919	2-15 (2) 11-29 (2)	5-31 (2) (3)	8-30 (2)	4-19 (2)	3-22 (2) 11-1 (2)	10-4 (2)	1-18 (3)	10-11 (3)	5-3 (3)	4-5 (3)	2-28 (3) 11-15 (3)	8-30 (3)
1920	10-30 (6)	3-27 (2)	7-10 (2)	2-14 (2)	7-17 (6)	9-11 (2)	1-10 (2) 11-20 (6)	6-26 (6)	2-21 (6) 12-4 (7)	1-24 (6)	10-2 (2)	5-22 (6)
1921	6-11 (7)	2-11 (6)	4-30 (7)	3-26 (7)	5-21 (6)	10-29 (7)	9-10 (7)	4-16 (6)	11-26 (6)	1-8 (6)	10-8 (6)	7-9 (6)
1922	9-9 (7)	2-11 (2)	1-21 (6) 9-23 (6)	5-20 (6)	1-7 (7) 10-29 (6)	10-7 (6)	11-10 (7)	5-6 (7) 12-2 (6)	7-15 (6)	3-25 (7)	4-15 (6)	6-17 (7)
1923	5-12 (6)	1-5 (2)	5-5 (7)	7-7 (7)	4-21 (6)	5-26 (7)	6-16 (6)	9-8 (6)	3-24 (6) 12-1 (6)	4-7 (7) 11-10 (6)	2-10 (6) 9-29 (6)	3-3 (7) 10-20 (6)
1924	2-16 (6) 9-6 (6)	10-11 (2)	2-9 (6) 11-8 (6)	4-19 (6)	1-26 (6) 9-20 (6)	3-1 (6) 11-22 (7)	1-5 (6) 6-14 (6)	4-5 (6)	5-24 (6)	5-3 (6)	3-22 (6) 12-6 (6)	7-12 (7)
1925	5-16 (7)	5-29 (2)	5-2 (7)	1-3 (7) 9-5 (8)	4-18 (7)	3-28 (7)	2-28 (7)	1-17 (6) 11-7 (7)	2-14 (6) 10-17 (7)	1-31 (7) 11-28 (7)	9-26 (8)	7-11 (7)
1926	5-1 (8)	5-29 (2)	4-10 (8)	10-16 (8)	3-23 (8)	1-30 (7) 7-10 (2)	1-2 (7) 11-27 (8)	10-30 (8)	9-30 (8)	11-13 (8)	2-20 (8)	9-4 (2)
1927	5-7 (8)	5-28 (2)	3-26 (8)	10-8 (9)	3-8 (9)	1-22 (8)	9-10 (8)	11-12 (9)	4-16 (8)	10-22 (9)	1-4 (8) 12-3 (9)	7-16 (2)
1928	5-5 (9)	5-26 (2)	3-31 (9)	4-21 (9) 12-8 (9)	1-4 (9)	1-21 (9)	3-3 (9) 11-10 (9)	9-15 (9)	2-15 (9)	10-20 (9)	10-4 (9)	7-14 (2)
1929	1-3 (9)	5-25 (2)	5-4 (9)	9-21 (9)	1-17 (9)	2-2 (9) 11-23 (9)	10-26 (9)	3-23 (9)	4-13 (9)	10-5 (9)	3-6 (9) (10)	7-20 (2)
1930	1-4 (9) 11-15 (11)	2-21 (9)	1-18 (9) 12-6 (9)	7-19 (9)	2-5 (9)	10-4 (9)	9-6 (9)	3-29 (9)	5-7 (10)	6-26 (10)	4-16 (10)	5-31 (9)
1931	9-19 (11)	4-11 (9)	10-10 (9)	3-7 (9)	3-24 (9)	11-7 (10)	7-18 (9)	1-24 (10)	2-17 (9)	6-30 (10)	1-6 (9)	6-6 (9)
1932	8-13 (9)	6-18 (9)	10-15 (12)	5-28 (9)	5-9 (9)	11-12 (12)	9-17 (9)	1-23 (9)	1-5 (9)	3-5 (9)	2-13 (9)	4-2 (9)
1933	10-7 (9)	5-27 (9)	10-21 (9)	12-30 (9)	7-29 (9)	11-18 (9)	4-15 (9)	1-28 (9)	3-22 (9)	1-4 (9)	2-21 (9)	9-2 (9)
1934	4-14 (11)	3-10 (9)	11-17 (9)	10-27 (9)	4-28 (9)	5-26 (9)	2-10 (9)	9-8 (9)	1-20 (9)	9-29 (9)	6-23 (9)	7-21 (9)
1935	6-29 (9)	1-5 (9)	11-2 (9)	10-11 (9)	7-13 (9)	6-1 (9)	2-16 (9)	9-21 (9)	3-16 (9) 11-30 (9)	8-21 (9)	5-11 (9)	4-13 (9)
1936	7-22 (11)	1-4 (9)	9-19 (11)	8-29 (11)	6-27 (11)	5-30 (11)	2-15 (9)	10-31 (11)	10-10 (11)	5-8 (11)	3-18 (9)	4-11 (11)
1937	5-1 (11)	3-20 (11)	5-22 (11)	9-2 (11)	6-17 (11)	7-10 (11)	9-25 (11)	11-27 (11)	11-2 (11)	2-27 (11)	2-6 (11)	1-8 (11)
1938	3-22 (11)	4-9 (11)	5-20 (11)	6-17 (11)	2-25 (11)	1-28 (11)	11-19 (11)	10-7 (11)	10-28 (11)	9-9 (11)	1-6 (11)	7-15 (11)

1939	7-28 (14)	6-17 (14)	9-8 (14)	10-27 (14)	10-4 (14)	1-6 (11)	11-18 (14)	5-2 (13)	5-26 (14)	4-5 (11)	2-7 (11)	3-3 (11)
1940	11-8 (14)	9-7 (14)	7-24 (14)	7-2 (14)	11-30 (14)	1-4 (14)	6-1 (14)	5-10 (14)	4-19 (14)	2-2 (14)	2-24 (14)	3-19 (14)
1941	8-15 (13)	10-25 (13)	3-15 (14)	9-5 (13)	9-30 (13)	2-18 (14)	4-5 (14)	1-3 (14)	5-6 (14)	5-27 (13)	1-25 (14)	6-24 (13)
1942	12-1 (13)	10-3 (13)	9-11 (13)	3-18 (13)	8-15 (13)	1-5 (13)	4-11 (13)	2-21 (13)	5-13 (13)	7-6 (13)	1-30 (13)	6-5 (13)
1943	9-25 (13)	11-13 (13)	8-28 (13)	1-4 (13)	10-16 (13)	3-19 (13)	5-29 (13)	1-23 (13)	5-8 (13)	4-15 (13)	2-24 (13)	6-30 (13)
1944	4-29 (13)	9-9 (13)	3-4 (13)	4-1 (13)	11-29 (13)	11-4 (13)	1-15 (13)	5-20 (13)	2-11 (13)	8-5 (13)	7-15 (13)	6-17 (13)
1945	1-29 (13)	11-17 (13)	1-4 (13)	6-13 (13)	10-8 (15)	9-11 (13)	2-17 (13)	3-16 (13)	5-24 (13)	5-2 (13)	4-11 (13)	7-19 (13)
1946	9-16 (13)	6-28 (13)	11-7 (16)	6-4 (13)	11-30 (16)	5-10 (13)	4-13 (13)	2-27 (13)	3-22 (13)	1-14 (13)	2-5 (13)	10-9 (13)
1947	12-2 (16)	6-27 (16)	10-3 (16)	6-2 (16)	9-10 (16)	4-15 (16)	3-15 (16)	5-9 (16)	1-4 (16)	2-20 (16)	1-27 (16)	10-29 (16)
1948	12-1 (16)	2-20 (16)	10-14 (16)	1-5 (16)	6-7 (16)	11-4 (16)	8-20 (16)	7-28 (16)	1-30 (16)	9-16 (16)	4-10 (16)	5-7 (16)
1949	9-19 (16)	1-28 (16)	8-2 (16)	8-24 (16)	1-5 (16)	10-10 (16)	6-3 (16)	11-28 (16)	5-16 (16)	3-21 (16)	11-3 (16)	4-15 (16)
1950	8-28 (16)	6-9 (16)	12-1 (16)	9-19 (16)	2-17 (16)	11-6 (16)	3-10 (16)	10-13 (16)	1-27 (16)	1-4 (16)	5-15 (16)	4-11 (16)
1951	11-7 (17)	8-24 (17)	8-3 (17)	11-26 (17)	1-4 (16)	6-11 (17)	2-23 (17)	10-15 (17)	4-27 (17)	5-17 (17)	1-29 (16)	3-28 (17)
1952	8-6 (17)	10-17 (17)	11-28 (17)	9-22 (17)	6-13 (17)	1-30 (17)	3-21 (17)	8-27 (17)	4-18 (17)	2-25 (17)	1-4 (17)	5-12 (17)
1953	5-21 (17)	6-12 (17)	11-9 (17)	11-30 (17)	3-2 (17)	1-5 (17)	1-30 (17)	10-13 (17)	8-21 (17)	4-23 (17)	3-27 (17)	9-14 (17)
1954	1-4 (17)	3-19 (17)	----	----	1-25 (17)	2-19 (17)	----	----	----	----	5-3 (17)	----

NAMES AND TITLES OF PERSONS IN CHARGE OF EXAMINATIONS OF FEDERAL RESERVE BANKS

(1) J. A. Broderick, Chief, Division of Audit and Examination.
(2) J. F. Herson, with successive titles of Federal Reserve examiner, chief examiner, and Chief, Division of Examination.
(3) J. A. Will, Federal Reserve examiner.
(4) S. G. Sargent, Federal Reserve examiner.
(5) W. E. Walter, Federal Reserve examiner.
(6) W. J. Donald, Federal Reserve examiner.
(7) J. L. Buchanan, Federal Reserve examiner.
(8) P. A. Gordon, Federal Reserve examiner.
(9) F. J. Drinnen, Federal Reserve examiner.
(10) R. H. Brett, Federal Reserve examiner.
(11) L. A. A. Siems, Federal Reserve examiner.
(12) R. F. Leonard, Federal Reserve examiner.
(13) E. R. Millard, Federal Reserve examiner.
(14) H. O. Koppang, Federal Reserve examiner.
(15) M. R. Wilkes, Federal Reserve examiner.
(16) G. R. Murff, with successive titles of Federal Reserve examiner and chief field examiner.
(17) A. H. Lang, chief Federal Reserve examiner.

Mr. PATMAN. I have before me an audit and financial statement of December 31, 1953, together with auditor's certificate, filed by Anderson & Co., auditors, of Washington. When was this filed with the Banking and Currency Committee?

Mr. MARTIN. I am sorry, I do not know the date.

Mr. PATMAN. Will it be all right to ask the clerk that, Mr. Chairman?

Mr. HALLAHAN. We will have it in a minute, Mr. Patman. We have a letter accompanying the audit from Mr. Martin. I think it was the 28th of April.

Mr. PATMAN. I think this marks a milestone in the history of the Federal Reserve System.

Has any audit ever before been filed with any Congress or any congressional committee, involving the Federal Reserve System?

Mr. MARTIN. I do not know, sir. We will have to check that.

Mr. PATMAN. Well, don't you know?

Mr. MARTIN. I would want to check it before I stated categorically.

Mr. PATMAN. The Federal Reserve System is an agency of the Congress, yet never before has any audit of either the Board of Governors or any one of the Federal Reserve banks, ever been filed with a congressional committee until this. And this audit is not complete and does not mean anything, the way I see it.

It says:

> We have examined the balance sheet of the Board of Governors of the Federal Reserve System, and related statement of income and expenses for the year ended, and our examination was made in accordance with generally accepted auditing standards and included such tests of the accounting records and such other auditing procedures that we considered necessary under the circumstances.

Now, do you have a statement that would show the instructions that you gave these auditors when you employed them to make this audit of the Federal Reserve System?

Mr. MARTIN. I do not think I have any written statement, Mr. Patman.

Mr. PATMAN. Could you furnish it to us in this testimony?

Mr. MARTIN. A written statement that we gave the auditors? We gave the auditors complete scope. We did not limit them in any way.

Mr. PATMAN. I know the statement doesn't indicate any limitations or restrictions, but the point is, just according to generally accepted auditing standards, they could satisfy that by counting the petty cash and verifying the balances on the balance sheet, couldn't they?

Mr. MARTIN. Well, the auditors were given complete discretion to audit any way that they saw fit.

Mr. PATMAN. Any way, there are no recommendations here of any kind? Why didn't they recommend this, if it saves three-quarters of a million dollars a year, and it is wholly unnecessary and useless, and has been so for a period of 40 years. Why didn't these auditors recommend it last year?

Mr. MARTIN. Well, this is an audit of the Board's accounts.

Mr. PATMAN. I know, but that involves the whole System. You get your money from the 12 Federal Reserve banks, with which to operate, and the 12 Federal Reserve banks get their money in ways that we understand, but this $750,000 enters into it.

Mr. MARTIN. Well, the auditors, of course, would be interested in the policy of the Congress, as they approached it also, and the policy of the Congress did not provide for any other treatment of these particular notes.

Mr. PATMAN. I will get to something more important, Mr. Chairman, since you are going to furnish me that statement, which I think will bring us up to date.

I would like to have any specific recommendations. I do not think that would be asking too much, in another column or paragraph.

The CHAIRMAN. It might be helpful, Mr. Patman, if you would read the present law.

Mr. PATMAN. Do you mean section 16 of the act?

The CHAIRMAN. Yes, sir.

Mr. PATMAN. I am pretty well familiar with it.

The CHAIRMAN. This is with respect to H. R. 9143. Existing law which H. R. 9143 would seek to amend, reads as follows:

> Whenever Federal Reserve notes issued through one Federal Reserve bank, shall be received by another Federal Reserve bank, they shall be promptly returned for credit or redemption to the Federal Reserve bank through which they were originally issued or, upon direction of such Federal Reserve bank, they shall be forwarded direct to the Treasurer of the United States to be retired.

Parenthetically, I might say that the language isn't too good, but that is the way it reads. [Continues reading:]

> No Federal Reserve bank shall pay out notes issued through another under penalty of a tax of 10 per centum upon the face value of notes so paid out.

Mr. PATMAN. That is right. Now, the trouble—and I know it has caused a lot of trouble—has resulted evidently in a bank such as Richmond down here, which gets Federal Reserve notes from all over the country every day, having to bundle them up and send them to the banks—how, by mail, special messenger, or how?

Mr. MARTIN. Any one of those devices, Mr. Patman.

Mr. PATMAN. And do they do that every day or every week?

Mr. MARTIN. It depends upon the amount assembled.

Mr. PATMAN. Well, when it reaches a certain volume they send them. What is that volume?

Mr. MARTIN. I can't say. Shipments are being made daily.

Mr. PATMAN. They are made daily?

Mr. MARTIN. Yes, sir. Each bank will have different operating techniques on this. There is no uniform pattern.

Mr. PATMAN. Where does this $750,000 come in? How do you make that up? Break it down for us. Is most of it postage, express, messengers, or personal help in doing the work, assorting the bills? How is it made up?

Mr. MARTIN. It is made up of all of those items, Mr. Patman, and this matter was studied very carefully by the presidents of the 12 banks.

Mr. PATMAN. Could you give us some breakdown of it? Suppose you do that for the record.

Mr. MARTIN. We will do the best we can with it, but each bank has a different operating technique, and this is the best estimate we could come up with as to savings.

You can see what happens when the same notes will circulate in a given area, and as long as they don't get to the Federal Reserve bank they just go on circulating.

Mr. PATMAN. I understand that, Mr. Martin, but somebody arrived at this figure of $750,000 annually. That is not a small figure. Over 10 years that is $7,500,000. You used someone's figures in order to arrive at that. That is what I want, a breakdown of how you arrive at it.

Mr. MARTIN. We will do the best we can for you.

(The data referred to above is as follows:)

A reasonable estimated breakdown of the $750,000 savings mentioned would be as follows:

Shipping costs (postage and expressage on fit notes returned to bank of issue)	$500, 000
Labor costs (sorting and handling fit notes by bank of issue)	250, 000
Total	750, 000

Mr. PATMAN. All right, sir. But no audit has ever recommended this change, to your knowledge?

Mr. MARTIN. I do not think that an auditor would be within his prerogatives to take over the policy side of the Board.

Mr. PATMAN. Don't you think that an auditor should, if it comes to his attention, or if he discovers something whereby you could save an enormous amount of money, such as $750,000 a year, on something that is being done in a sort of idiotic fashion such as this, that he should recommend a change?

Mr. MARTIN. I wouldn't want to say that the statutory provision of the Congress was idiotic.

Mr. PATMAN. Well, it became idiotic in 1935, then, when you changed the system from a regional system to a central bank system, a hundred percent central bank system. That is when it became idiotic?

Mr. MARTIN. I am sorry; I cannot concede that it was changed to that in 1935.

Mr. PATMAN. You cannot concede that?

Mr. MARTIN. No.

Mr. PATMAN. Of course, before that time, Mr. Martin, the regional banks had some power. Now they have none.

Mr. MARTIN. Well, that is where you and I disagree, Mr. Patman.

Mr. PATMAN. What power does a regional bank have now, that the Board of Governors cannot overrule?

Mr. MARTIN. We have discussed this before at considerable length. I think that the presidents of the individual banks, when they serve on the Open Market Committee, serve as equals.

Mr. PATMAN. Well, now, you are talking about a different thing entirely. I said the regional banks. The Open Market Committee, that is what we call down South "tall cotton" there, because they can really do something. But you are talking about the Open Market Committee and I am talking about the regional banks.

Mr. MARTIN. Well, I do not think you can separate them out.

Mr. PATMAN. What authority does a regional bank now have that is of any importance that cannot be overruled or changed by the Board of Governors?

Mr. MARTIN. I think that you have to look at the System in terms of the Board of Governors, the Open Market Committee——

Mr. PATMAN. All right, let us look at it. Just name the power that they have.

Mr. MARTIN. Well, they have a president of an individual bank——

Mr. PATMAN. I know they have a president and a vice president and a managing director.

Mr. MARTIN. Who sits on this Open Market Committee.

Mr. PATMAN. Well, you are getting back to this tall cotton deal, you see. Let us leave that, and stay with the regional banks.

What power does a regional bank have now, that cannot be overturned or changed by the Board of Governors here in Washington?

Mr. MARTIN. Well, the Board of Governors—we have discussed this endlessly—accepts the recommendations. We are not in a position to operate. We are not in a position to get out in the field and determine whether each of these requests for discounts should be granted or not.

Mr. PATMAN. Well, I am asking you to name one power.

Mr. MARTIN. I cannot name one power in the sense that you are asking it.

Mr. PATMAN. I know you cannot. It is just not there.

Mr. MARTIN. No, I just don't agree with you on that. That is a matter of judgment, and we could discuss it endlessly, but I think you can recognize the power of the Open Market Committee.

Mr. PATMAN. Certainly I recognize their power, because they are running the country right now. They have more power than the Congress.

Mr. MARTIN. This system which you took a look at with great care at the time of the Patman questionnaire, is a unique organization, and it may need changes from time to time, but it has been constantly reviewed by the Congress, and by the public, and we welcome all inquiry into it, but it is not a Board operation alone, it is not an Open Market Committee operation alone, it is not an individual bank operation alone.

Mr. PATMAN. Well, then——

Mr. MARTIN. It operates as a unit.

Mr. PATMAN. In actual practice, though, Mr. Chairman, you know that the 7 members of the Board, when there are 7 members, have looking over their shoulders and directing and advising and suggesting to them, at all times, in the performance of their duties, the 12 presidents of the Federal reserve banks who are elected by the private banks, private commercial banks, and also 12 members of the Federal Advisory Committee. Those 24 men are right there looking over their shoulders and helping, and suggesting, to these 7 members of the Board of Governors of the Federal Reserve System.

That is correct, isn't it? They have power to advise you and suggest to you, and ask you what you are going to do and how you are going to do it, and to say "Do it this other way," or to suggest to you how they think it should be done.

Mr. MARTIN. I am sorry, I cannot concede that, Mr. Patman. That is a concept of management.

Mr. PATMAN. Well, let me ask it in another way.

Mr. MARTIN. I like to emphasize the word "System."

Mr. PATMAN. All right, we are talking about the System. Here are the seven members of the Board of Governors. Of course they sit on this Open Market Committee, the 12 members, 5 members of the presidents of the Federal Reserve banks, and they alternate except New York. New York is on that committee all the time.

The others have about a third year each, I imagine, in all banks except New York, and that is on it all the time.

Now, the 7 members of the Board of Governors must listen to these 12 presidents of the Federal Reserve banks, under the laws, requirements, and regulations. You cannot escape that. That is correct, isn't it? You listen to any suggestions or recommendations they make?

Mr. MARTIN. Certainly, we welcome it.

Mr. PATMAN. Then you also have another group. Twelve members known as the advisory group. They are selected by the commercial banks, too. One from each Federal Reserve district. That makes 24 of the finest and best and brainiest men of our entire Nation, standing right over that Board of 7 members, to help them do their work for the public good.

Now, the only ones that are absolutely charged with handling this system in the public interest are those seven members. The rest of them are not obligated to do that, because the presidents of these banks are elected, just as Members of Congress are elected. They do not call them constituents, but they are constituents. They are elected to their places. The big banks elect 2 of them, the medium-sized banks elect 2 of them, and the small banks elect 2 of them. And those six directors, naturally, have the balance of power, and they can elect the presidents and the vice president and run the show. Naturally they would. You would expect them to.

Mr. MARTIN. No, Mr. Patman; I challenge that concept.

Mr. PATMAN. Well, what part of it is it that you challenge?

Mr. MARTIN. I challenge all of it.

Mr. PATMAN. You don't challenge the way they are selected; do you?

Mr. KILBURN. Mr. Patman, would you yield?

Mr. PATMAN. I yield for a question.

Mr. KILBURN. Just for a very respectful suggestion, and that is to let the witness answer. He started to answer, and I would like to hear what he said.

Mr. PATMAN. I appreciate your suggestion and I will be very glad to let him answer. I yielded a while ago by asking him to tell me one power that the Federal Reserve System could not overturn and he couldn't tell me. Now, he can answer anything he wants to.

Mr. MARTIN. I would like to discuss this System set up. Naturally, we are talking about money and credit. So we have to relate our activities to the banking business.

Mr. PATMAN. That is right.

Mr. MARTIN. The banks own stock in the Federal Reserve System.

Mr. PATMAN. Now, wait. Is it stock, Mr. Martin?

Mr. MARTIN. Now, wait a second. Let me finish that.

Mr. PATMAN. You know that is not stock.

Mr. MARTIN. Just a second. This stock ownership, as I have said repeatedly to you, is not proprietorship, is not ownership in the ordinary sense of the word, but it is a device——

Mr. PATMAN. It is an investment, isn't it?

Mr. MARTIN. It is a device that makes possible in a democratic society participation in the management.

Now, this participation in the management was arrived at by 9 directors, 6 of whom are elected through this device of representation, 3 of whom really represent the lenders—the banks, small, medium, and large banks, and 3 of whom represent the borrowers.

If you think the president of X corporation that is borrowing from this bank is necessarily dominated by the bank, why, he has his interest as a borrower.

Mr. PATMAN. Now, let's——

Mr. MARTIN. Now, let me finish.

And then the public interest was put in, in a very proper way, as the evolution of the country developed, by having 3 directors appointed by the Board of Governors in Washington, and those 3 men can frequently be the controlling influence in the bank.

But if you go back to the early stages of this country and see the evolution of this system, you will find, as we pointed out repeatedly at the time of your hearings, that from the first bank of the United States on you had a shift, which attempts to keep a balance between private and public. The first emphasis was to keep the public out entirely, because that was the heritage on which the country was founded, a fear of Government. Then gradually you shifted into a period where the public interest was more and more recognized—not that it wasn't always there, but in terms of representation.

And today you have a balanced setup in the individual Reserve banks that, in my judgment, is not banker dominated.

Mr. PATMAN. Well, Mr. Martin, you brought in something that I had never known you to bring in before. When you said that these 9 directors, 3 of them representing the banks, 3 of them the borrowers, and 3 of them appointed by the Board of Governors—did I understand you correctly in that?

Mr. MARTIN. That is what I say the original intention, as I understand it, was, and——

Mr. PATMAN. Well, they are still set up in the same way, those nine, are they not?

Mr. MARTIN. Those nine, and if you will take a look at the directors—and I am not trying to avoid your question by this—I think you will find that the caliber of the men is a warranty that——

Mr. PATMAN. I am not questioning the caliber of the men. They are the finest and best people in our country. I agree with that. But I don't agree with you in this, and here is where I differ with you, and I have never known you to use the statement before that three of them represent the borrowers. I had never heard of that before. I have heard that 3 of them represent the banks, and 3 of them the business and industrial interests of the country, and 3 of them——

Mr. MARTIN. Well, are not the business and industrial interests the borrowers?

Mr. PATMAN. Well, I think that you will find that those three that you refer to as representing the borrowers are also bank stockholders. I think you will find that almost without exception that they are interested in banks, and that they are not directors or officers of the banks, because they cannot be officers and be 1 of those 3. But you will find six in there selected by the private banks.

Mr. MARTIN. They are prohibited by law from owning any stock.

Mr. PATMAN. Are you sure about that?

Mr. MARTIN. I think that is the law, but I am not sure. They are certainly not officers or directors of any kind.

Mr. PATMAN. I explained that. I know they are not officers or directors. They cannot be. But 3 of them are officers or directors, and 3 of them the banks select, and although they are not officers and directors, they are certainly not unfriendly to the banks or they wouldn't be selected by the banks. So that gives the banks 6 out of 9 directors to run that show. Did you find that?

Mr. MARTIN. I don't concede that. We will have to check on it.

Mr. PATMAN. Your contention is that they cannot own stock?

Mr. MARTIN. I am not sure about owning stock, Mr. Patman, but for the most part they don't. They certainly cannot be an officer or director or employee of a bank. That I am sure of.

Mr. PATMAN. Well, I will not go too far on that.

Right now you speak about this Open Market Committee, which I think is the most important committee in the United States. I think it is more important than the Congress, because the Congress had the power and the Congress delegated it to the Open Market Committee to determine the volume of money in the country, and the interest rates.

That is right, isn't it?

Mr. MARTIN. I think it is an important committee. I do not think it is quite as important as you think it is.

Mr. PATMAN. Well, of course, Congress can change it, that is the only difference. And if they were to get too much out of line I imagine there would be changes.

But as it is now, the 160 million people of this country delegated to this Congress 435 members of the House and 96 members of the Senate, the power to regulate money. This Congress has delegated that power to you, the seven members of the Board of Governors, and the five Federal Reserve bank presidents who were selected by the commercial banks of the country. So that the 12 make up the most powerful group in the United States, and more powerful than the United States Congress today, and yet this Congress has never taken a look at those 12 men. I have never seen any except you and 1 or 2 others. I am sure they are fine fellows and handsome men and brilliant, and that they possess all the qualifications that every good American should possess, but this Congress has never interested itself in even interrogating those 12 men, except just the chairman. You always speak for the group, I assume, Mr. Martin, do you?

Mr. MARTIN. I cannot say truthfully that I always speak for the whole group, Mr. Patman. Occasionally we have disagreements, but I am quite sure of one thing, and that is that you don't intend by your remarks to cast any aspersions on the character of the presidents that serve on the committee.

Mr. PATMAN. That is the second time you have said that. I never said that.

Mr. MARTIN. I just wanted to be sure.

Mr. PATMAN. I never said anything about the character of anybody connected with this, and I am not going to, or any private banker. I believe in the private banking system.

Mr. MARTIN. I did not want the inference to stand. That is the reason I was pointing it up. Because they are not subservient to the banks, I can assure you.

Mr. PATMAN. Who is not?

Mr. MARTIN. These presidents.

Mr. PATMAN. Well, I believe they are because their actions are that way.

Mr. MARTIN. Well, they are not here today, and that is why I wanted to be certain that you didn't want to ascribe to them——

Mr. PATMAN. Well, I think the banks are running the Federal Reserve System.

Mr. MARTIN. Well, that I just happen to disagree with.

Mr. PATMAN. Back when the act was passed certain big banks violently opposed it, and fought for years. Now, representatives of that same big bank in this country are the greatest defenders of the system, because it has changed around. At first the banks did not have charge of it. Now they have charge of it. They should be pleased with it because the action of the Open Market Committee has meant hundreds of millions of dollars of profit to the private banks of the country each year. That is my view of it, Mr. Martin.

Mr. MARTIN. Mr. Patman, I have to say here, in the friendliest spirit, that I consider it a very real honor and privilege to serve as Chairman of the Board of Governors of the Federal Reserve System, and I am quite confident that I am not subservient to the banking interests of the country, nor to political interests.

I am trying, to the best of my ability, to do what I believe to be right and consonant with this statute. You can take this away from me at any time. But it is a very real honor and privilege, and I don't want to disgrace that honor and privilege in any way by being subservient to anyone or anybody. That is my concept of service, and that is what I will attempt to carry out.

I say this in the friendliest spirit, because I ascribe to you a friendly spirit also in wanting to get the right answer. But there is an inference in what you are saying with respect to banker domination.

Mr. PATMAN. Well, there is no inference, there is a direct charge, Mr. Martin.

Mr. MARTIN. All right, you make the charge and I deny it. I would like to deny it personally for the record, and I would like to deny it on behalf of the absent presidents of the Federal Reserve banks who are not here this morning to deny it themselves.

Mr. PATMAN. And I suspect if I were in your place I would be overpersuaded by these 24 fine big American citizens that are looking over your shoulder all the time, too. I just don't believe I could overcome that pressure. I think that is the biggest pressure group in America.

Mr. MARTIN. I am extremely sorry that you have such a poor opinion of me, but that is unfortunate.

Mr. PATMAN. It is not that. I am not talking about personal matters, Mr. Martin.

Mr. MARTIN. But it cannot be on any other basis.

Mr. PATMAN. Well, you are just 1 of 12, you know.

Mr. MARTIN. Well, that is true.

Mr. PATMAN. You say that there are differences on the Board. I notice from reading your report, your annual report, that at one time that the private members, the presidents, actually outvoted the public members last year on a question. What question was that?

Mr. MARTIN. That was a matter of technique of operations in the open market.

Mr. PATMAN. Did that involve enlarging the instructions to the New York bank in carrying on open-market operations to also include long-term Government bonds?

Mr. MARTIN. That was what the matter was about. It involved denying to the New York bank discretion.

Mr. PATMAN. Denying them the opportunity of dealing in long-term Government bonds?

Mr. MARTIN. We had a discussion about whether we should delegate the authority, and to what extent the Open Market Committee should retain, in itself, the ability to determine that question.

Mr. PATMAN. Well, now, that brings up another question. Now, these 12 men that I have talked about, being so powerful, they have done some delegating, too. They have delegated the power that Congress gave them down to 5 members. The 5 members are yourself and the Federal Reserve bank president of New York—permanent members—and who are the other 3?

Mr. MARTIN. Well, there are 2 other members of the Board, and there are 2 representatives of the presidents. So that it is a 5-man executive committee.

Mr. PATMAN. Now, those 5 have delegated down to 1, haven't they, the president of the Federal Reserve Bank of New York, to actually run the show?

Mr. MARTIN. No; they have delegated to the manager of the open-market account——

Mr. PATMAN. Is he in charge of it?

Mr. MARTIN. Yes, sir; he happens to operate in the New York bank.

Mr. PATMAN. Well, the law fixes it that way permanently, doesn't it?

Mr. MARTIN. Yes, sir; it does. I see no reason to quarrel with that, as long as New York is the money market.

Mr. PATMAN. I am just quoting the statute.

Mr. MARTIN. That is right.

Mr. PATMAN. So the 12 delegate it to 5, and the 5 delegate the execution powers to 1 and that happens to be the president of the New York bank?

Mr. MARTIN. No; it happens to be the manager of the open-market account.

Mr. PATMAN. Well, he is under the president of the Federal Reserve Bank in New York, isn't he?

Mr. MARTIN. He is under the president, but he also has a special responsibility to the open-market account.

Now, in operating, you have to delegate at some point to individuals.

Mr. PATMAN. That is right. Now, last year, according to the figures that your organization has furnished to me, you must have done about $16 billion worth of business through the Open Market Committee, is that approximately correct?

Mr. MARTIN. We did a lot of business.

Mr. PATMAN. Does that mean purchases, unrestricted, without limitation, or does that figure also include purchases with restrictions tied to them, so that they coundn't be repurchased?

Mr. MARTIN. I think the repurchase agreements are carried separately in the report.

I am wrong. They are listed as purchases of securities. The report shows the distinction.

I thmk we have given you figures, Mr. Patman—at least I saw them go across my desk——

Mr. PATMAN. Yes, sir; I just don't have them before me, and I will not proceed further along that line because I can get the information myself from your organization which has already furnished them to me.

Mr. MARTIN. The weekly statement, Mr. Patman, has the repurchase agreements.

Mr. PATMAN. Yes, sir. But the point is there are about $15 or $20 billion worth of transactions a year. That is a lot of business, in anybody's book, and that is done through that one New York bank. I just wonder how many dealers do you deal with in making those transactions? You used to have a specific number, and I think some criticism came up before the joint committee about it, and I think it was changed. How many dealers do you deal with now?

Mr. MARTIN. We have listed for you in the report for 1953 the number of dealers as 18.

Mr. PATMAN. Eighteen dealers?

Mr. MARTIN. Yes, sir.

Mr. PATMAN. What do they make out of this, Mr. Martin? Do you have any way of determining that? Do they get any fees or charges or commissions?

Mr. MARTIN. We don't get into that. We are dealing with them on a dealer basis.

Mr. PATMAN. You don't have any idea at all?

Mr. MARTIN. No, sir.

Mr. PATMAN. You don't have the least idea?

Mr. MARTIN. Well, the least idea—I have from time to time talked to people about what they have made and what they have lost, but we have no record of it.

Mr. PATMAN. You have no record of that at all?

Mr. MARTIN. No, sir.

Mr. PATMAN. Now, on this difference between Mr. Sproul and you, is that difference still pending?

Mr. MARTIN. Mr. Patman, that is a difference of detail, not of objective. Mr. Sproul and I have very close relations, and I was asked recently, when that was revealed in the press, whether I was going to do something about it, and I replied to the newspapermen that asked me by telling them about the story of B. G. Wrigley and the chewing gum empire. He said that when he had two men in his organization who agreed on everything he began to wonder if he couldn't dispense with one of them.

I am glad that the Federal Reserve System has a man of Mr. Sproul's character and capacity who, when he has a point of view, will express it vigorously.

Now, if he were subservient to the banks, or dominated by the bankers, why, I doubt very much whether he would be the type of individual he is, and I am very proud of the character and capacity of Mr. Sproul.

Mr. PATMAN. In 1952, before the end of the year, what were your instructions to the one in charge of open-market operations in the New York bank? What was he supposed to do during the month of December 1952?

Mr. MARTIN. I have no idea offhand. We have a meeting of the executive committee every 2 weeks. There have been very few exceptions to that, and we change our instructions every 2 weeks.

Mr. PATMAN. You change your instructions every 2 weeks. But, generally, you were not buying bonds in 1952, in December, were you? You were not buying bonds?

Mr. MARTIN. At the tail end of 1952?

Mr. PATMAN. Yes, sir.

Mr. MARTIN. I don't think we were.

Mr. PATMAN. What were your instructions in 1953, in the early part of the year? Were your instructions to tighten up, or to loosen up, on money?

Mr. MARTIN. In the early part of 1953, as you well know, our policy was one of general restraint.

Mr. PATMAN. Why did you do that? Why were you putting on the brakes so?

Mr. MARTIN. At that particular time?

Mr. PATMAN. Yes.

Mr. MARTIN. Because we feared, as I have testified repeatedly, a bubble on top of a boom, and we felt that the money supply should be permitted——

Mr. PATMAN. Well, in December 1952, you said the danger of inflation was over.

Mr. MARTIN. Mr. Patman, you are not quoting me correctly.

Mr. PATMAN. Well, the papers misquoted you, then.

Mr. MARTIN. Well, the papers frequently misquote people. Not that I am attacking the papers, but——

Mr. PATMAN. Well, that was verified by your action in February reducing the margin requirement on stock-market transactions. If that is not in the direction of fighting deflation, I would like to know what it would be.

Mr. MARTIN. The speech to which you refer, Mr. Patman, in 1952, was an address which I gave to the Investment Bankers Association.

Mr. PATMAN. That is right.

Mr. MARTIN. Without benefit of manuscript.

Mr. PATMAN. Well, I am just quoting what the papers said, and I haven't seen it denied.

Mr. MARTIN. Well, I am not denying all of the implications of this, but I believe that the danger of drastic inflation was coming to a halt at the end of 1952, but it would have been—could have been—a very serious matter for us if the bubble that developed, the resurgence of business enthusiasm, if I may term it such, following President Eisenhower's election, in 1952, had been permitted to run itself into a speculative fever, and, therefore, we permitted interests rates to reflect the force of supply and demand.

Mr. PATMAN. For how long did you do that, how many months?

Mr. MARTIN. We did that roughly until the early part of May.

Mr. PATMAN. May 11?

Mr. MARTIN. Well, May 6 the Open Market Committee had its meeting and decided that we would reverse ourselves.

Mr. PATMAN. When did you reduce reserve requirements?

Mr. MARTIN. We reduced reserve requirements effective July 1, and July 9, in two bites. The announcement was made on June 24.

Mr. PATMAN. When did you reduce margin requirements for stock-market transactions?

Mr. MARTIN. Margin requirements were reduced about Washington's Birthday of 1953.

Mr. PATMAN. Weren't they authorized about the middle of February, and actually announced the 20th day of February, that you were reducing the requirements?

Mr. MARTIN. They were announced at the same time they were authorized.

Mr. PATMAN. Well, how can you justify saying that you were fighting a bubble on top of a boom all that time when you were making it easy for people to speculate than had been true for a long time before?

Mr. MARTIN. Unfortunately this matter of money management is not always reducible to precise logic.

Now, what I am trying to make clear here is that when you come out of 10 years of a pegged market you have a lot of things that need to be altered, revised, reorganized.

Mr. PATMAN. I am not asking you about that, Mr. Martin. I am asking one simple thing.

Mr. MARTIN. Unfortunately——

Mr. PATMAN. Well——

Mr. MARTIN. Unfortunately, this isn't one simple matter. This is a collection of activities. If there was one simple formula by which by which we could adjust the money supply of the country our job would be quite simple and quite easy. Unfortunately we cannot find any formula or any device or any way in which this can be done, except by constantly evaluating the changes in the situation and relating them to a flow of money.

Now, I visualize this money supply, as I have said a number of times, as a river, or spring, or stream, and we want that stream to be maintained in such a way that it won't slop over its banks and drown the crops on either side of the riverbed.

We also don't want the stream to run dry. We want it, when it increases its volume, to dig its way, have a bed in which it resides.

Now, in order to do that we have got to constantly be evaluating all of these factors, and we certainly are not going to be a hundred percent perfect.

Mr. PATMAN. How long has it been since you have supported long-term Government bonds?

Mr. MARTIN. I think we stopped about the first month—around, I would say, the last purchases, in May of 1951.

Mr. PATMAN. May of 1951?

Mr. MARTIN. I would like to correct the precise timing of that.

Mr. PATMAN. That is the time of the so-called accord. Now, it was your theory and the theory of the Open Market Committee, was it not, that by directing the interest rate on the short term, that would reflect the interest rate on the long term?

Mr. MARTIN. I believe——

Mr. PATMAN. In other words, by governing the short-term rate that would necessarily govern the long-term rate?

Mr. MARTIN. I think that what we are trying to do is to have as free a market as it is possible to have, without abdicating the responsibility which you gentlemen placed on us to supply reserves and absorb reserves.

Now, I don't think you gave us instructions to establish the relationships between the long end of the Government market and the intermediate end of the Government market and the short end of the

Government market, and take over the market process, but I think you did, at the time of the Federal Reserve Act, give us a responsibility to see that there were adequate reserves in the banking system.

That was when we changed—at the time of the Federal Reserve Act—to a managed currency, and that is why a lot of people have worried about whether we weren't going too far in the way of trying to regulate markets, and were not depending sufficiently upon the interplay of market forces. The decision to unpeg the Government securities market returned to that market not all of the forces, but some of the influences which had been precluded in that market by Government policy for a period of 10 years, and it brought into play once again the business judgment of deciding whether you wished to take a loss in order to make a loan, or whether you wanted just to rely upon the central bank to print sufficient currency to continue a fixed interest rate.

Mr. PATMAN. Now, Mr. Martin, of course I am glad to have you make the explanation you are making. It is interesting to me, but I feel it causes me to take up a lot of time that I do not think is required.

I still want to ask this simple question. This is a simple question. You have not supported the long-term bond market since May 1951. Has it been your theory and the theory of the Board that the market could be properly handled through the manipulation—I think the word is probably wrong—by handling the short-term rate, that that would be sufficient without handling the long-term rate?

Mr. MARTIN. We have tried to supply reserves which are required by the business community——

Mr. PATMAN. Well, that is my objection to the Federal Reserve System. They are always thinking about profits to the banks, it seems, and not thinking about the general welfare, and I think there is more to do than just furnishing reserves to banks. That helps the banks to make a lot of money and gives them the power, you might say, to print and manufacture more money, and they like, it; they love it. It is fine. And sometimes it is in the interest of the country. But I certainly don't think that the Federal Reserve System is charged with the duty primarily of furnishing reserves to the private banks. I think they have a duty of looking at the Employment Act of 1946 and carrying out other mandates of the Congress and considering the human budget along with the dollar budget.

Don't you agree with that?

Mr. MARTIN. Mr. Patman, I must deny the charge that you are making, that we are interested in supplying reserves for the benefit of the banks.

Mr. PATMAN. Well, I don't know that I would be justified in saying that you are doing it wholly for that purpose, but the result of it is the same. It does help the banks do that.

Mr. MARTIN. No, sir; I deny that.

Mr. PATMAN. You deny doing it for that purpose. I am sure you are stating what you believe is correct.

About the reserves: If you reduce the reserve requirements—the banks have no excess reserves now—and you reduce the reserve requirements, say, one point, how much excess reserve would that make available?

Mr. MARTIN. I would have to check one point. I would say it is about 7 or 8 hundred million dollars. Perhaps about a billion dollars.

Mr. PATMAN. About a billion dollars?

Mr. MARTIN. Yes.

Mr. PATMAN. What is the difference in you saying that all the banks of the country, without putting up an extra dime of capital, without putting up anything in the way of security at all, you can just create a billion dollars more money, and on that you can create about $6 billion—what is the difference between that and printing press money?

Mr. MARTIN. The forces of the market are at play.

Mr. PATMAN. I know, but it is the creation of money, is it not?

Mr. MARTIN. We have the power to create money. That is the strength of the Federal Reserve System.

Mr. PATMAN. Well, the private banks have it, too, don't they?

Mr. MARTIN. Not in that sense.

Mr. PATMAN. On their reserves don't they create it on an average of 6 to 1 now?

Mr. MARTIN. If they lend the money, or create the loans or investments, they can do that.

Mr. PATMAN. That is right. But under your capitalistic system, which I believe in, and which we all believe in, we think it is the finest and best system on earth, you cannot do business in this country unless people go into debt, can you?

Mr. MARTIN. I think it is possible to do business without going into debt.

Mr. PATMAN. Under our system?

Mr. MARTIN. Yes, sir; I think it is possible.

Mr. PATMAN. How would you do it? Suppose everybody paid their debts, what would you do for money?

Mr. MARTIN. Well, now, debt is an important part, I don't want to debate that. Debt is an important part of our business.

Mr. PATMAN. Of our economy. Could we do business without debt?

Mr. MARTIN. Well, theoretically, I think you could. You would have to change the system.

Mr. PATMAN. Well, you would have to pay out money into circulation, instead of borrowing it into circulation?

Mr. MARTIN. You would have to change your system.

Mr. PATMAN. You would have to change from your capitalistic system entirely. But under a system as we have now, if everybody paid their debts, all the money you would have left would be the $346 million Lincoln greenbacks, and the silver certificates, and the silver, and the copper coins; is that right?

Mr. MARTIN. Well, I don't know your figures, but——

Mr. PATMAN. Well, I am just giving them from memory. But your memory on that is better than mine.

Mr. MARTIN. You would have gold.

Mr. PATMAN. But it is not in circulation.

If everybody paid their debts, we would not have money to do business on, and we would be reduced to barter, wouldn't we?

Mr. MARTIN. Well, we could certainly go back to the stone age and engage in barter.

Mr. PATMAN. But the point is, Mr. Martin, the importance of your agency, and the Open Market Committee particularly, in handling credit. Don't you think, for the reason that people have to pay interest on the money that is in circulation, and the money that is available—somebody is paying interest on that money all the time—that the interest rate should be a low rate, and along the pattern fixed during World War II, and after that, rather than a high rate?

Mr. MARTIN. Mr. Patman, I testified before your committee and I sincerely would like to see interest rates as low as it is possible to have them without producing inflationary pressures, if it adds to capital formation. And I believe by and large that it does.

I think there are times, however, where we have to consider the saving and investment fabric of the economy also, and that we don't just create cheap money for the purpose of forcing people into debt, because you do not do people any favor by pushing them into debt.

Mr. PATMAN. I agree with you on that.

Mr. MARTIN. People that are sound will not ask to borrow unless they see an opportunity to make a profit out of it, or to derive a benefit.

Mr. PATMAN. That is right. That is the reason on a declining market people won't take money even if you pay them to take it.

Were you consulted about the issuance of these 3¼ percent bonds last April?

Mr. MARTIN. Yes, sir; I was.

Mr. PATMAN. Did you agree to it?

Mr. MARTIN. I agreed that it was in line with Federal Reserve policy, yes.

Mr. PATMAN. Aren't you sorry that you did?

Mr. MARTIN. No, sir.

Mr. PATMAN. Well, there has been a difference, within 1 year's time, in the high and low, on those particular bonds, of 11½ points. In other words, eleven and a half dollars on a hundred dollars, and then with the three and a quarter percent interest for that 1 year, that makes 14¾ percent in 1 year, on a riskless Government bond.

Mr. MARTIN. I regret that fluctuation. I wish it had not happened.

Mr. PATMAN. Well, don't you think it had something to do with managing money that cause it?

Mr. MARTIN. I have already testified, Mr. Patman, that we made a miscalculation in the spring.

Mr. PATMAN. In other words, you made a mistake?

Mr. MARTIN. All right, a mistake, yes. I do not apologize for making a mistake.

Mr. PATMAN. And if it was to be done over again it wouldn't be done under the same facts and circumstances?

Mr. MARTIN. I don't want to impinge on the Treasury's problem, which is debt management, but so far as monetary policy and credit control policy is concerned——

Mr. PATMAN. Do you agree with the credit policy that has been announced by Dr. Burgess, that we should get these bonds out of the banks by issuing more long-term bonds?

Mr. MARTIN. I think it would be desirable to have more of our debt in longer-term securities than we have today.

Mr. PATMAN. Well, do you think we should take all the bonds out of the banks?

Mr. MARTIN. No, I don't think so.

Mr. PATMAN. It was never intended that the banks should create money to buy Government bonds, anyway, was it, Mr. Martin?

Mr. MARTIN. No, but that could be arrived at in a number of ways. You could transfer securities out of our portfolio into the hands of the banks. That is a process.

Mr. PATMAN. Well, the banks have been forced into that position, not made to buy bonds. I do not agree, and I am not very patient with the banker who says he was forced by the Treasury to buy bonds. Nobody was forced to buy bonds. I do not agree at all.

But hasn't the economic situation facing each separate institution forced them into the business of being Government bondholders and brokers and commercial bookkeepers, to the extent that they could make more money with riskless securities and have no worries, and they have great earnings because last year they had the greatest earnings in all history, and a large part of it was from Government bonds—in fact, over a billion dollars of it was from Government bonds. Isn't it a fact that that policy has been causing the local banker to get out of the banking business, just by investing in Government securities, and that is a lot easier for him than dealing with a lot of local people on small loans, and then isn't it a fact that it is aggravating the situation right now, at this time, while we are talking, right here in this committee room, by the policies in effect that are feeding out to the different banks these RFC certificates of interest, Commodity Credit Corporation certificates of interest, and housing loans?

In other words, are not banks being persuaded too much in the direction of getting into outside paper and particularly Government paper, and Government-guaranteed paper, and getting away from local loans that the local banks were really intended to deal in, and the kind of service they were chartered to perform?

Mr. MARTIN. Well, now, you are again in what I call the realm of judgment, and I cannot make a blanket judgment on all of the banks of the country. There have been some tendencies from time to time which we have observed and wished had not moved in the direction that they did, but, generally speaking, credit and monetary policy and Treasury debt management policy have been moving side by side, as they should, to try to contribute to stability in the economy.

Mr. PATMAN. Well, are they, Mr. Martin? And the reason I am bringing this up, I think your organization has a lot to do with it. Now, there are about 14,000 commercial banks in the United States, and the bankers render no service when they buy Government bonds. They render no service to the Government at all. You couldn't cite any service they render. You don't have to have the banks buy them. Of course, as we said, during the war, first the individuals should buy the bonds, next the corporations and insurance companies. We shouldn't sell them to the banks except as a last resort because they create or manufacture the money to buy it. It was never intended that they should do that, and then that they should draw interest on it. It was never intended.

Now, if you were to use the standards that we usually use, and definitions, in determining what a subsidy is, wouldn't you consider that at least an indirect subsidy to the banks?

Mr. MARTIN. No, sir; I do not consider it an indirect subsidy to the banks.

Mr. PATMAN. And isn't it a fact that—now, understand, I am for the private banking system, and I am for a profitable banking system, I want them to make money, and although I am criticizing all these things I would not take them away from them quickly, or immediately, or until they had time to recoup their losses by making local loans, as they used to do, and as they should do——

Mr. KILBURN. Will the gentleman yield?

Mr. PATMAN. I yield.

Mr. KILBURN. I was wondering how you felt about this bill that we have before us.

Mr. PATMAN. Well, I can decide that myself and I am going to decide that when I get through interrogating this witness.

Mr. MULTER. Isn't that for executive session?

Mr. KILBURN. This is on this bill, I presume.

Mr. PATMAN. I don't know whether I can trust these fellows on these bills or not. I want to find out. I am going to ask them about the overall picture so as to know whether I should be willing to trust them on this particular bill.

At any rate, Mr. Martin, I wouldn't do anything to hurt the banking system, as such, because I believe in the private banking system, privately operated for profit.

But take that billion dollars a year that they received last year on Government bonds, for which a bank cannot render any service when it buys Government bonds, that is an indirect if not a direct subsidy, if you use the same standards that you would use in determining whether or not a farmer got a subsidy, and then the $100 million a year they get through your System for clearing checks, and then they get other subsidies the same way, including free use of Government deposits that run up to about $500 million, aggregating about a billion and a half dollars a year, subsidies that the bankers of the country get each year—I mean if you use the same standards and definition in determining what is a subsidy that is used to determine whether or not a farmer gets a subsidy, or a shipping line, or a railroad, or somebody like that.

I am not advocating taking it away from them. I am just criticizing for the purpose of directing the system from here on out and getting the bankers back into the banking business where they will serve their local communities, as they were intended to serve.

That means, on an average, $100,000 for each bank in the United States a year, on a $1,500 million subsidy. So that is a lot of money.

Mr. McDONOUGH. Will you yield?

Mr. PATMAN. I yield.

Mr. McDONOUGH. In reference to your criticism of this so-called subsidy, what neglect was created by the banks in their local loans, in their advancing money to local interests? Didn't they carry that on in addition?

Mr. PATMAN. To a limited extent, yes.

Mr. McDONOUGH. How much more could they have carried it on if they had not had these Government bonds?

Mr. PATMAN. They would have been eager to do something. They would have been hungry for loans. When you go out hunting you don't feed your dogs before you start out. If you fill these banks up with plenty of riskless securities on which they make plenty of money there is not much incentive for them to hunt or be on the alert to make loans and be patient with the small-business man who wants to come in and get a loan, because they already have plenty of earnings.

Mr. McDONOUGH. How much of that local financing was neglected? You have the figures on the subsidy pretty well. By comparison, give us some idea of the other.

Mr. PATMAN. Why was the RFC so necessary? Why did they do billions of dollars of business? Why are the small-loan companies springing up around every bank in the United States today? It is because those banks are not performing their local service, and there is a demand for local small-business loan offices around them, and they are springing up all over the country.

Mr. McDONOUGH. We are liquidating RFC.

Mr. PATMAN. I know we are, but, I say, there was a need for RFC because the banks were not making these loans, and there was such a clamoring that something had to be done to give the small man a chance to get a loan.

Now, we are liquidating the RFC and that makes it harder because the banks are still not making these loans because they are still not anxious, they still have plenty of securities, they still have enormous incomes and don't have the incentive to deal with local people and make small loans.

Mr. MULTER. Will you yield, Mr. Patman?

Mr. PATMAN. I yield.

Mr. MULTER. I think the trouble is that you use the word "subsidy," because of a misunderstanding about basic economic philosophy. When you let a man who cannot afford to buy a house or rent a house use public housing, that is a subsidy, but when you let the banks use all the Government's money without paying for it, that is free enterprise, because the banker is using the taxpayer's money free?

You are using the word "subsidy" in the wrong way. We shouldn't do that.

Mr. MUMMA. Mr. Patman, isn't it a credit to the banking business for all banks to have small-loan departments? I know the banks in my community are giving a lot of attention to it.

Mr. PATMAN. Certainly a lot of them are, and are to be commended for it. I think the National City Bank started out about 20 years ago and they have been making a lot of small loans. A lot of banks have, and they are to be commended for it, but, generally, there is a failure somewhere, or you would not find where there are 2 or 3 banks in a town 25 small loan offices around them and doing a big business. They would not be there if those banks had been performing the service.

Mr. MUMMA. The interest rate may enter into that a little bit.

Mr. PATMAN. Well, if the banks performed that service there won't be the demand for that many loan offices.

Furthermore, take the credit unions. They are taking this country like wildfire, and there is a reason for it, because they are rendering a great service locally.

Mr. KILBURN. The banks couldn't handle the kind of loan that credit unions are.

Mr. PATMAN. A lot of them are.

Mr. KILBURN. I mean the individual loans.

Mr. PATMAN. Of course, the credit unions are very necessary and separate and apart from the banks, but right now we have 17,000 credit unions, whereas a year or two ago you only had 6,000 or 7,000.

The CHAIRMAN. I think we are anticipating credit union legislation coming up next week.

Mr. MARTIN. I would just like to introduce our April 30 release, Mr. Patman, which shows as of March 31, 1954, loans and discounts as $67 billion of all commercial banks, and United States Government obligations $60 billion, and other securities $15 billion.

Mr. PATMAN. That is right, and if they hadn't had that $60 billion in United States securities they would have been hungry enough for loans, so that the local man would have gotten more consideration on the application he made for a loan. But as long as they are well fed, with Government securities and Government-guaranteed securities, and can create money on the books of the banks to buy them, it is just such a fine deal that you cannot blame them for not doing it.

Mr. KILBURN. It could be that credit unions can make loans that banks cannot make because of Federal and State bank examiners.

Mr. MERRILL. Mr. Chairman, I would like to have the witness answer that question. He started to and didn't get a chance to—the charge that it is drying up all the credit available to business in America.

Mr. PATMAN. I don't say it is drying it all up. I stated that the incentive is not as great for a banker to make loans when he has his portfolio filled with riskless securities, as when he doesn't have those securities, and he has to go back to the business that he was chartered to do, to make loans and serve local communities.

Mr. MERRILL. I would like the witness' answer to that.

Mr. MARTIN. I would like to have an opportunity to answer because we are pursuing, as you know, a policy of active ease, and we have been encouraging——

Mr. PATMAN. That is something else I never heard of until recently; what is active ease?

Mr. MARTIN. It seems to me it is fairly self-explanatory, Mr. Patman. I don't think it is a very difficult phrase. We don't know any better way of saying it.

What we are saying by active ease is that we want to see that there are sufficient reserves in the banking system so that this incentive—and don't forget that interest rates are lowered, which is a part of incentive, but this incentive to go out and get loans will be very real with the banks and bankers, and I think that as long as we keep a volume of reserves you will see the banks doing what they can to solicit loans. That is the policy that we are pursuing. We try to lean against the wind whichever way it is blowing.

Mr. PATMAN. If you reduce reserve requirements by one point across the board that says to the banks of the country "You are loaned up, but we are giving you the power to use a billion dollars more in reserves, and on that billion dollars you can issue $6 billion of money."

Mr. MARTIN. If you can get the loans.

Mr. PATMAN. If you can get the loans. Well, you give them the power. If they don't, they can buy Government bonds, can't they?

Mr. MARTIN. Interest rates are declining and, of course, you can just go ring around the rosy; if we didn't have to finance the Government it would be a lot simpler, too.

Mr. PATMAN. You have to finance the Government. That is no burden on the banks. Why, the Federal Reserve could buy up every Government bond that has been issued and it would be no strain at all, would it?

Mr. MARTIN. All that would be produced would be inflation.

Mr. PATMAN. Well, what is the difference between the Federal Reserve having a Government bond and a commercial bank?

Mr. MARTIN. What is the difference?

Mr. PATMAN. Yes.

Mr. MARTIN. Well, it is perfectly obvious, Mr. Patman.

Mr. PATMAN. Of course the commercial bank would have that money and that would be excess reserve, but you could cure that by increasing reserve requirements, couldn't you? You have doubled reserve requirements in this country, at one time?

Mr. MARTIN. You have set limits within which we can adjust reserve requirements, and you can change that—Congress can change that at any time that it sees fit.

Mr. PATMAN. I am not advocating buying them up, understand, but I am stating the Federal Reserve could buy up all that is offered in the market without any strain or trouble?

Mr. MARTIN. It certainly could. The Federal Reserve can peg securities at a given price, and it can let the purchasing power of your dollar just go completely to pot.

Mr. PATMAN. Now, Mr. Martin, since you knew that you were going to change this hard money policy last year, why didn't you gentlemen let the housing people know it before they raised the veterans' housing rate from 4 to 4½ percent? They raised it just about the same time, didn't they? In other words, they had been persuaded, by an argument which was unanswerable, that the traditional rate, the difference in the spread between long-term Government bonds and long-term housing loans, was 1½ percent, and when that 4 percent rate was fixed the long-term rate was fixed the long-term rate was 2½ percent; therefore, 4 percent was reasonable.

But under the policy of the first 6 months of 1953 the returns on Government bonds went up to 3, as the bonds went down, of course, and they had an unanswerable argument, that since these bonds had gone up to 3, you had better make that rate 4½ percent, and they had it just about the very time that you took an about-face and changed the monetary policy to where the bonds went back, and the same argument that was used to put the rate up should now be used to put it back. Don't you think so?

Mr. MARTIN. I want to say right there, that we don't want to get into semantics on this. If the demand for credit, if business activity had been maintained and expanded, interest rates would have tended to go up even from that particular period.

If business had stayed relatively stable in that period interest rates would have been stable.

Now, what actually happened was that business began to decline, and demand for credit declined, and as the demand for credit declines very naturally interest rates decline.

Mr. PATMAN. Mr. Chairman, I am taking entirely too much time. I apologize to the committee. I would like to yield until other members at least have asked all the questions they want to and I have one other question I want to ask later.

The CHAIRMAN. Are there further questions?

Mr. OAKMAN. Mr. Martin, is it correct that the Post Office has given up the job of selling the savings bonds, that that job has been taken over by the banks of the country, and that there are presently outstanding approximately 36 billions of dollars of savings bonds owned by approximately 36 million Americans, and that the banks issue these bonds and keep the records of them and buy them back, without charge?

Mr. MARTIN. The banks do a very good job. I would prefer you asking Dr. Burgess as to the procedure on that, if you don't mind; he is more familiar with it.

Mr. OAKMAN. I think Dr. Burgess would answer that in the affirmative.

Is that right, Doctor?

Mr. BURGESS. That is substantially correct.

Mr. OAKMAN. In my town of Detroit, the banks collect our city and county taxes for us and turn the money over to the city and country treasuries without charge. Mr. Patman refers to this as a one-way street, that the banks are on the take and never give any public service at all, which is an erroneous supposition.

Mr. PATMAN. I have conceded all the time, and I am glad to give the banks credit for doing a great job, in time of war in particular, as well as in time of peace, and I have never said a word against the private bankers. They are among our finest and best and most patriotic citizens in America. I am not doing anything against the private banking system. I am trying to do something to help them by criticizing them for their weak points and doing things which I believe would not encourage them to ride for a fall, as they are doing, and to have them back on the track to render local service, which is what they were chartered to do.

Mr. MERRILL. What was the reason for each Federal Reserve bank to have its own notes returned in the first place?

Mr. MARTIN. The original concept, Mr. Merrill, was that it would support the regional system. You see, at the time the Federal Reserve System was established there was a great deal of worry that you would centralize authority too much in Washington, and I think that worry was one that was quite real and quite justified, and, therefore, one of the provisions was that in tying in the issuance of notes they would be tied to the local communities more by this process of going through the individual regional banks.

Now, as the system developed, through the years, this as a check is something which has proved to be less and less effective in those terms, and I am quite certain that I would not be here advocating a change today if the presidents and boards of directors of the individual reserve banks had not recommended it.

Mr. MERRILL. They feel that this is no longer of any value at all, or at least that there are other ways of doing it?

Mr. MARTIN. That is correct, sir.

Mr. McCARTHY. Mr. Chairman.

The CHAIRMAN. Mr. McCarthy.

Mr. McCARTHY. What is done with the currency that is in bad condition? How is that handled? You are going to reissue that which is suitable for circulation?

Mr. MARTIN. I will ask Mr. Leonard to give you the process.

STATEMENT OF ROBERT F. LEONARD, DIRECTOR, DIVISION OF BANK OPERATIONS, FEDERAL RESERVE SYSTEM

Mr. ROBERT F. LEONARD. The Federal Reserve agent issues Federal Reserve notes to the Federal Reserve banks, against collateral. The Federal Reserve banks pay these out on demand. When the Federal Reserve notes come back to the bank of issue a certain amount of those are held as current working cash and are shown as a deduction from note liability. When they are paid out they again become a liability.

When the notes of other Federal Reserve banks are received those are returned to the bank of issue, and there are held as part of that bank's working stock, unless and until that stock becomes excessive, when part of it is turned back to the agent then it ceases to be outstanding.

Mr. McCARTHY. I don't think that is quite my question.

Mr. LEONARD. Oh, the old bills. The old bills are sent in——

Mr. McCARTHY. At the present time all bills are sent back, aren't they?

Mr. LEONARD. No, sir. The unfit bills, bills that are unfit for circulation, are sent in here by the various Federal Reserve banks to the Treasury Department, where they are retired and burned. The fit bills are sent back to the bank of issue.

For instance, if the Federal Reserve Bank of New York, as a result of the day's operations, winds up with fit bills of Boston, it sends those fit bills back to Boston. If it has unfit bills of Boston, it sends those bills into the Treasury for destruction, for the account of Boston.

Mr. BURGESS. The unfit bills would now be destroyed by the local banks.

Mr. McCARTHY. That is what I asked, really.

Mr. LEONARD. All unfit Federal Reserve notes are sent in to Washington where they are counted by the Treasury office and then burned here, under the supervision of the Treasury Department.

Mr. McCARTHY. The Treasury then notifies the bank of issue?

Mr. LEONARD. Yes.

Mr. PATMAN. Didn't you make the policy last year to the extent that small bills could be destroyed by the local Federal Reserve banks?

Mr. BURGESS. That is with respect to silver certificates and notes, which the Treasury is responsible for. They can be destroyed at the local Federal Reserve bank and save the postage and insurance.

Mr. PAYMAN. I saw where some of them got in a windstorm up in Pittsburgh and were scattered all over the place.

Mr. BURGESS. That is right.

Mr. MULTER. Mr. Chairman, I would like to ask Mr. Martin some questions. I cannot possibly do it at this time. The House is now in session. It will take much more than just a few minutes.

The CHAIRMAN. May I ask Dr. Burgess what his convenience is with respect to this afternoon? There is a general debate on the military-naval public works authorization bill this afternoon. I thought we might be able to meet during the general debate on that bill. Mr. Halahan is checking into that.

Mr. Martin, am I correct in stating that you are not available this afternoon?

Mr. MARTIN. I have an executive committee meeting this afternoon. It is a pretty important committee, as Mr. Patman has stated.

Mr. MULTER. Mr. Chairman, I will have to object to the committee meeting this afternoon while the House is in session. I am sorry to do it, but I have to.

The CHAIRMAN. There is a point of order that we cannot meet while the House is in session.

Mr. MULTER. I don't make the point of order, and don't want to deprive anyone from going on now, but I can't be here while the House is in session.

The CHAIRMAN. I hoped that we could finish with Mr. Martin this morning. If you withdraw your point of order you can continue here and perhaps finish.

Mr. MULTER. I am not raising a point of order so as to preclude anybody else from continuing with Mr. Martin, but I cannot be here and I don't want to lose my right to examine Mr. Martin.

The CHAIRMAN. Well, what are the wishes of the committee? When can you be here?

Mr. MULTER. I can resume tomorrow morning at 10 o'clock, if Mr. Martin can be here at that time.

The CHAIRMAN. We have three other bills tomorrow morning.

Mr. MULTER. I don't want to rush through these bills, Mr. Chairman.

The CHAIRMAN. The Chair doesn't want to rush anything through. We want to expedite the business of the committee as much as possible. Mr. Martin has been on the stand now an hour and 35 minutes.

Mr. MULTER. I haven't yet asked Mr. Martin a single question.

The CHAIRMAN. Well, if it is convenient for the committee we will proceed as far as we can until a point of order is made and the House is in session or the bells ring, in the hope that we may be able to finish Mr. Martin's testimony this morning. If you are going to object to meeting this afternoon while the House is in general debate, then, of course, that is your prerogative, so we cannot meet this afternoon.

Mr. Martin, would it be convenient for you and Dr. Burgess to come back tomorrow morning?

Mr. MARTIN. Yes, sir.

The CHAIRMAN. The committee will stand in recess until tomorrow morning at 10 o'clock.

(Whereupon, at 12:06 p. m., the committee adjourned.)

FEDERAL RESERVE ACT AMENDMENTS

(Secs. 14 and 16)

THURSDAY, MAY 27, 1954

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

The committee met at 10 o'clock a. m., Hon. Jesse P. Wolcott, chairman, presiding.

Present: Chairman Wolcott (presiding), Messrs. Talle, Kilburn, Betts, George, McVey, Merrill, Oakman, Stringfellow, Van Pelt, Spence, Brown, Patman, Multer, and O'Hara.

The Chairman. The committee will be in order.

We will resume the hearings on H. R. 8729 and H. R. 9143.

When we recessed yesterday we had not yet concluded the questioning of Mr. Martin, Chairman of the Federal Reserve Board of Governors. We will proceed to further questions.

Mr. Patman. Mr. Chairman, I want to ask a question but I would prefer that other members ask their questions before I resume, if you please.

Mr. Multer. May I proceed, Mr. Chairman?

The Chairman. Mr. Multer.

TESTIMONY OF WILLIAM McC. MARTIN, JR., CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM—Resumed

Mr. Multer. With specific reference, first, to H. R. 9143, Mr. Martin, I don't know whether I have the wrong act or the wrong bill. I have the act in front of me which has a section 16 in it, and it only has 1 paragraph and does not have the language sought to be stricken by the bill from Section 16 of the act.

The Chairman. I think if you will get a more recent print of the act you will find it, Mr. Multer.

Mr. Multer. Thank you.

Mr. Martin, yesterday Congressman Patman addressed some questions to you with reference to the so-called independent audit. Was that audit furnished to this committee—audit of 1954 for the year 1953, by your Board, if you know?

Mr. Martin. Yes, sir; that has been furnished. I believe it was under date of my letter to the committee, April 28.

Mr. Multer. And are you going to furnish to the committee a copy of the letter of instructions to the Andersen Co.?

Mr. Martin. We are going to work up the material along the lines that Mr. Patman requested yesterday. There were no instructions to Arthur Anderson. We gave them complete freedom to do whatever they felt was warranted by the situation.

Mr. MULTER. Was there any written agreement or retainer employing them? Anything in writing employing them to do this work?

Mr. MARTIN. Yes, I think there was.

The CHAIRMAN. I don't know whether Mr. Martin understands what you mean by retainer.

Mr. MULTER. Anything in writing employing them to do this work.

Mr. MARTIN. Whatever we have we will furnish, Mr. Multer.

(The data referred to is as follows:)

EXCERPT FROM THE MINUTES OF THE MEETING OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM ON APRIL 22, 1954

At this meeting Mr. Johnson commented on each of the firm's suggestions and the plans for putting them into effect. In the ensuing discussion of the report and memorandum, Chairman Martin stated that when arranging for the audit he made it clear to representatives of Arthur Andersen & Co. that they should make the audit as extensive or in such a manner as appeared to them to be desirable and that the Board would not want to place any restrictions on the firm as to the scope of the audit or the manner in which it was conducted.

There was unanimous agreement that a similar understanding should be had in connection with future audits.

The CHAIRMAN. I was thinking of a retainer in the sense of more tangible instructions.

Mr. MULTER. I am sure we will get whatever relates to the situation.

I may be unduly suspicious, Mr. Martin, but the forwarding letter of the accountants opens with the sentence "We have examined the balance sheet of the Board of Governors and the related statement of income and expenses for the year ending December 1953."

Do you know whether or not their examination was limited to the balance sheet and statement of income and expenses, or did they go beyond that?

Mr. MARTIN. They covered everything that they thought was a normal auditing procedure. They didn't go into all the policies and procedures of the Board.

Mr. MULTER. I wouldn't expect an auditor to go into the policies. I wouldn't think that would be their function. But I wonder, since the language that they use as to what they did is so limited, I wonder whether or not they did more than examine the balance sheet and statement of income and expenses?

Mr. MARTIN. They made some recommendations to us, most of which have been carried out and which we are going to supply you with on Mr. Patman's request of yesterday.

(The data referred to above is as follows:)

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM—COMMENTS AND SUGGESTIONS FOR CONSIDERATION

In connection with our examination of the accounts of the Board of Governors of the Federal Reserve System for the year ended December 31, 1953, we continued our general review of the system of internal control and accounting procedures. The following comments are not the result of a detailed study, and they should not be construed as an indication of a lack of internal control but as suggestions which might improve the already existing controls and procedures.

PREVIOUS MEMORANDUM POINTS

We were pleased to note that the comments and suggestions set forth in our memorandum of April 17, 1953, received full consideration, and that most of the recommended procedures have been adopted. The following suggestions have not yet been adopted and we present them for further consideration:

1. Use of an imprest bank account.
2. Use of a mechanical check signer for payroll checks.
3. Use of continuous form IBM card checks.
4. Adoption of a smaller inventory requisition form with blank spaces for writing in the items desired.

PETTY CASH

We noted that petty cash slips for the cafeteria market fund were prepared in pencil. We recommend that the slips be prepared in ink to prevent any subsequent alterations.

CHECK REGISTER

We noted an instance in the December check register where one page was underfooted and the next page overfooted to compensate for a voided check. The check register should be footed so that each page reflects only the items listed on that page.

VOUCHERS PAYABLE

We noted several vouchers which did not show the account distribution on the face of the voucher. We recommend that the account distribution be shown on the face of all vouchers in order to present a complete picture of the transaction.

AUTHORIZED SIGNATURE FILE

The file of signatures and initials of persons authorized to approve requisitions, etc., has not been kept current. We recommend that this file be brought up to date and kept current through a periodic review.

PURCHASE AND RETIREMENT OF FIXED ASSETS

In the past, the purchase of fixed assets has been charged to an expense account net of trade-ins received. We recommend that all purchases be recorded at the gross price, and that items retired be removed at gross cost from the asset account and charged to the related reserve for depreciation. Any allowances received should be credited to the reserve for depreciation.

In this connection, we also recommend that memoranda authorizing the retirement of fixed assets be approved by an authorized officer in the Division of Administrative Services.

PURCHASE OF ITEMS ON EXEMPT LIST

We recommend that the cost of minor "Furniture and equipment" items not to be capitalized be charged to the expense account "Stationery and supplies." We also recommend that items of this nature be provided for in the budget under "Stationery and supplies" instead of under "Furniture and equipment."

We shall be pleased to discuss with you any of the foregoing points or any other points on which you may have questions. The Board and members of the staff have consulted with us during the year as questions or problems arose. We wish to repeat that we welcome this for we consider our obligation a year-round one and not limited to the year-end-audit date.

We acknowledge, with appreciation, the fullest coöperation which we received from your entire organization during the course of our work.

There follows, for the record, the disposition of the comments and suggestions made by Arthur Andersen & Co. in connection with that firm's examination of the accounts of the Board of Governors of the Federal Reserve System for the year ended December 31, 1953, in continuation of its general review of the Board's system of internal control and accounting procedures. It should be noted that Arthur Andersen & Co. stated that these comments and suggestions were not to be construed as an indication of a lack of internal control but as suggestions which might improve the already existing controls and procedures.

Use of an imprest bank account.

An imprest bank account was instituted by the Board at the Federal Reserve Bank of Richmond (where the Board's bank accounts are maintained) on May 12, 1954, and is now in use as recommended by Arthur Andersen & Co.

Use of a mechanical check signer for payroll checks.

A mechanical check signer for payroll checks has been selected, and the Board is prepared to purchase and place it in operation when the present supply of paper checks is exhausted. This is expected to be about January 1, 1955.

Use of continuous form IBM card checks.

A continuous form of IBM card checks has been designed for use by the Board and will be used when the present supply of paper checks is exhausted. As stated above, this is expected to be about January 1, 1955.

Adoption of a smaller inventory requisition form with blank spaces for writing in the items desired.

A smaller inventory requisition form has been adopted as suggested and will be placed in use effective July 1, 1954. This date was selected because it is the beginning of a quarter, and time was required to prepare a supply catalog for use in connection with the revised requisition form.

That petty cash slips for cafeteria market fund be prepared in ink to prevent any subsequent alterations.

This suggestion was placed in effect immediately upon being made by Arthur Andersen & Co.

The check register should be footed so that each page reflects only the items listed on that page.

The instance noted by Arthur Andersen & Co. was the result of a clerical inadvertence, as it is normal procedure to foot the check register so that each page reflects only items listed on that page. This error was corrected immediately.

That the account distribution be shown on the face of all vouchers in order to present a complete picture of the transaction.

This suggestion was also placed in effect immediately.

That the file of signatures and initials of persons authorized to approve requisitions, etc., be brought up to date and kept current through periodic review.

A current file of signatures and initials of persons authorized to approve requisitions, etc., has been prepared and is in use.

That all purchases of fixed assets be recorded at the gross price and that items retired be removed at the gross cost from the asset account and charged to the related reserve for depreciation. Any allowances received should be credited to the reserve for depreciation.

This suggestion is now in effect.

That memoranda authorizing the retirement of fixed assets be approved by an authorized officer in the Division of Administrative Services.

There has been no retirement of fixed assets since this suggestion was received; however, the suggestion will be followed when fixed assets are retired in the future.

That the cost of minor furniture and equipment items not to be capitalized be charged to the expense account "Stationery and supplies", and that items of this nature be provided for in the budget under "Stationery and supplies" instead of under "Furniture and equipment."

The suggestions will be followed effective with the accounting and the budget of the Board for the calendar year 1955. It was, of course, not feasible to adopt this suggestion immediately as the accounting and budget procedure had been in operation for 1954.

Mr. Multer. Have you observed that there are some discrepancies between their statement, as submitted in this audit, and your own statement for the same period, as contained in your report for the year 1953, which was released on March 5, 1954?

Mr. Martin. I would be very interested in those discrepancies.

Mr. Multer. Well, taking the two balance sheets, we have a total of expenses listed in your report that total $4,239,515.74, and their report indicates expenses of $4,572,479.04.

There are other differences in the details and items of the expenses that I haven't been able to reconcile by trying to add some of the items together, where you seem to have 1 item, retirement contributions, for instance, they have 3 items. No matter whether you take 2 or 3 and add them together you don't get the same figure that you have.

Then there are other differences in the itemizations, under the expenses.

Has no one called those differences to your attention, Mr. Martin?

Mr. MARTIN. I would have to study the differences, Mr. Multer, but I can assure you we welcome any comments of that sort and I will be very glad to have them gone over and see what the explanation is. But I am quite confident of the soundness of the figures.

Mr. MULTER. Well, one set of figures must be wrong. They cannot both be right for the same period.

Mr. MARTIN. Well, until I analyze them and have them in front of me I can't possibly go into it.

Mr. MULTER. Do you have a copy of the annual report available, Mr. Martin?

Mr. MARTIN. Yes, sir.

Mr. MULTER. Do you also have a copy of the audit?

Mr. OAKMAN. Is there more than one copy of the audit available?

Mr. MARTIN. I don't know.

Mr. MULTER. I think, Mr. Martin, for the purposes of the record at the moment, it is sufficient to indicate on the record that these discrepancies do exist, and that they do need some explanation. I am sure that when you make a comparison of the audit with your report you will find those discrepancies. They should be explained.

I do think that having gone to the trouble of having the audit made that someone in the organization on your staff should have compared these two statements and tried to reconcile them to give us an explanation as to what the differences are.

I think you will find, too, that there is a difference in the amounts of the operating fund as set forth in that statement for the same period, and in your annual report, as it appears at page 54 of the annual report.

Now, I haven't had the time to make any detailed analysis. I just picked up the two here yesterday and went through them quickly, and picked out these items. I do not pretend to be an accountant, but the very fact that there are these differences in these very important items should have been called to your attention, and I do hope you will have an explanation furnished to the committee to be made part of the record with reference not only to the discrepancies which I have pointed out to you now, but to all of the discrepancies between the report, as published, and the statement of audit, as submitted.

Mr. MARTIN. I will be very glad to go into the report very carefully and analyze all the so-called discrepancies.

(For data referred to see pp. 62 and 63.)

Mr. MULTER. I am sure the committee will appreciate that, Mr. Martin.

With reference to the saving of $750,000 in the event that this bill is enacted, who will save that money?

Mr. MARTIN. The Federal Reserve banks will save the money. The Federal Reserve System.

Mr. MULTER. Is that money that will be saved because of the fact that it would be no longer necessary for them to transport these notes back and forth between the various banks of issuance?

Mr. MARTIN. That is correct.

Mr. MULTER. There can be no other savings as a result of transmitting them because you will still have to report back to the bank of issue as to any notes that may be canceled or any notes that will be received and held for future issue; am I right?

Mr. MARTIN. Well, there is labor and transmittal. That is what is really involved, Mr. Multer. That has been carefully analyzed by each of the banks, and we think that the figure is a sound one, a fair one, based on operating procedures and techniques, and it was the recommendation of all 12 of the presidents of the Federal Reserve banks that this be done, and that it would arrive at a saving of the amount that we have stated.

Mr. MERRILL. Will the gentleman yield?

Mr. MULTER. Yes.

Mr. MERRILL. Do I understand this, that the only difference will be that at the present time whenever a Federal Reserve note from, say, Boston, comes into the New York bank, they immediately take it up and ship it back?

Mr. MARTIN. That is correct.

Mr. MERRILL. Under the new system, as long as that note is usable, or fit, it will just come in and be considered a part of the currency as if it were a New York note or a Treasury note, and will just be handed out again without that requirement; isn't that it?

Mr. MARTIN. Exactly right.

Mr. MERRILL. So all you are doing is eliminating this whole machinery of looking for notes that are not from the particular bank in question, and you are just using these notes as if they were currency of that bank or the Treasury; is that right?

Mr. MARTIN. That is exactly right.

Mr. MERRILL. That would save a lot of money, then. You don't have to have machinery for detecting them, first, and then sorting them out and sending them out; is that it?

Mr. MARTIN. That is right; yes, sir.

Mr. BETTS. Would you yield?

Mr. MULTER. I yield.

Mr. BETTS. That excepts the ones that are canceled, doesn't it?

Mr. MARTIN. Yes; the ones canceled as unfit are in a different category.

Mr. MULTER. And that is the sole purpose that is sought to be accomplished by this bill?

Mr. MARTIN. That is correct, sir.

Mr. MULTER. Well, then, haven't you gone too far in what you have done here? You seek to strike this language and don't put in any language in lieu of some of the language you are striking. Why not simply add to the section a sentence which would eliminate the necessity of transporting these notes back and forth? You have gone much further than that. Each of these banks originally are authorized and are still authorized to issue these notes against certain definite reserves in certain specific percentages; am I right? They are not given carte blanche to issue notes as they please. The notes must be issued against certain definite reserves and in certain limited amounts.

Mr. MARTIN. The only thing that we are attempting to change there is the statutory requirement that when a note is paid out it must be paid out through the Federal Reserve bank whose note it represents. That is the only thing.

Mr. MULTER. I have no objection to that being done, if you stop there. But you are going much further. These banks are banks of original issue of these notes, right? And eventually these notes are intended to be redeemed. Am I right?

Mr. MARTIN. We are not changing the redeemability feature at all.

Mr. MULTER. But the language you are striking from the statute:

> Whenever Federal Reserve notes issued through one Federal Reserve bank, they shall be promptly returned for credit or redemption to the Federal Reserve bank through which they were originally issued or—

and so forth. That is the language you are striking out.

In other words, these notes will never be redeemed or returned for credit?

Mr. MARTIN. Oh, no, we are just eliminating the statutory requirement that they have to be returned every time they are received by a bank.

Right here in Washington, D. C., you may have 10 Federal Reserve bank notes circulating at any given time; the public does not note any difference in them. But the minute they get to a Federal Reserve bank they have to be returned to San Francisco, Minneapolis, or St. Louis, wherever the note was originally issued. If you have one in your pocket you don't return it.

Mr. MULTER. Of course I don't. But the point I am making is that if you strike this language and don't put any other language in, these Federal Reserve banks become mints. They issue currency forever and a day that will never be redeemed.

The CHAIRMAN. I think probably the next sentence in the act will cover what you are getting at, Mr. Multer.

Mr. MULTER. Suppose they are never turned back to the Treasury. Suppose the Federal Reserve Bank in Richmond gets a note issued by the bank in New York. The Treasury does not get it. How is it going to be redeemed?

Mr. SPENCE. Is that provision for redemption mandatory? Or can they continue in circulation?

Mr. MARTIN. At the present time, Mr. Spence, they can only continue in circulation if they are returned to the bank of issue.

Mr. SPENCE. That is not mandatory that they should redeem them?

Mr. MARTIN. Oh, no.

Mr. SPENCE. They can continue to circulate?

Mr. MARTIN. Oh, certainly, through their machinery, their facilities.

Mr. SPENCE. Why was that provision originally put in the law? What fundamental purpose did you have in mind?

Mr. MARTIN. Well, in the early days of the System, the idea was that you would limit the amount of notes in circulation to the needs of the economy by confining the base of these notes to the regional district, and by having the notes presented frequently to the issuing bank, even though they might be paid out again. And it was intended to be a bulwark of the regional system of the Federal Reserve, and to control the total issue of notes as well as safeguard the regional autonomy, shall we say, of the bank of the district.

Well, now, through the years that, in our judgment, has come to be a safeguard that has not performed any function whatever, except this additional expense of this crisscross sorting and sending these notes back and forth.

Mr. SPENCE. Well, that was a provision for control, wasn't it?

Mr. MARTIN. That is right.

Mr. SPENCE. Why isn't control just as important now as it was then?

Mr. MARTIN. Because in terms of the total volume of currency we think we have adequate control here in Washington, and that this recommendation would not be presented to you if it were not a recommendation of the regional banks themselves.

Mr. SPENCE. But has your control in Washington been changed, through the years, so that it gives you greater power here than you have had heretofore?

Mr. MARTIN. I think under the Banking Act of 1935 we do have more control than we had in the early days of the System. But as far as we can see, on the volume of notes issued, we can't see that this is any active safeguard in terms of the amount of currency that we have. The important thing is that the currency supply respond to the needs of the public, and from that standpoint it does not matter whether the New York Federal Reserve Bank, for example, paid out its own note, or that of the Richmond bank.

Mr. SPENCE. What proportion of these notes that have been returned to the bank of issue have been put out of circulation and what proportion have been redeemed?

Mr. MARTIN. Mr. Leonard may be able to answer that.

Mr. LEONARD. Mr. Spence, last year, about $2,800 million of fit notes were returned by 1 Federal Reserve bank to another Federal Reserve bank. During that same year, something over $6½ billion in notes were redeemed.

I might say, if I could, Mr. Spence, that this is purely a mechanical proposal, that the notes are redeemed when they become unfit for use. That is the present practice, and that will be the practice. So long as a note is outstanding, regardless of where it is held, regardless of who issues it, it is secured by collateral. This does not change the collateral requirements.

Mr. SPENCE. How could the bank release that collateral except by redemption of the note?

Mr. LEONARD. It can't, unless and until—unless and until the fit note comes back to the bank of issue, and the bank returns that note to the Federal Reserve agent. It ceases to be an outstanding note and then the bank withdraws its collateral.

Mr. SPENCE. That provision has been in the law ever since the Federal Reserve Act was passed, hasn't it?

Mr. LEONARD. Yes, sir.

Mr. SPENCE. In the original Federal Reserve Act?

Mr. LEONARD. That is my recollection.

Mr. SPENCE. Excuse me for taking up your time, Mr. Multer.

Mr. MULTER. That is all right, Mr. Spence.

I can understand, Mr. Martin, that the individual Federal Reserve banks may have made this recommendation but, frankly, I am not satisfied that this is solely accomplishing the one thing and cutting out the unnecessary expense of transmitting notes back and forth.

I think by taking out this language you are destroying the original intent of the section, and you are putting these banks in a position to issue these notes, and you lose all control over the situation.

I don't think this is the way to save that expense, if that is the sole purpose to be accomplished.

Mr. MERRILL. Will you yield?

Mr. MULTER. Yes.

Mr. MERRILL. As I understand it, this provision, when it was first put in the law, was not put in there for the purpose of trying to make these notes more easily redeemable; redemption of the notes was not one of the functions of this section; am I right on that?

Mr. MARTIN. That is substantially correct.

Mr. MERRILL. It was solely designed so that you would keep releasing money from all of the 12 Reserve districts, through their bank; is that it?

Mr. MARTIN. That is correct.

Mr. MULTER. I most respectfully disagree with both of you. The title of the section is "Reserves Against Deposits of Notes, and Redemption of Notes, Exchange for Gold Certificates."

Show me another section of the law which covers that or even refers to redemption of notes.

Mr. MARTIN. There is no change in the provisions on redemptions of notes contemplated in this. As Mr. Leonard has pointed out, this is purely a mechanical operation.

Mr. MULTER. Am I right, Mr. Martin, that there is no other section of the Federal Reserve Act dealing with redemptoin of notes?

Mr. MARTIN. I am sorry, Mr. Multer, maybe I ought to know the Federal Reserve Act by heart, but I don't.

Mr. MULTER. I know you can't know all these details, but is there anyone here who knows?

Mr. LEONARD. This is the principal section dealing with the redemption of the Federal Reserve notes and the collateral in back of them.

Mr. MULTER. Right. Now, you are going to take out of this section the words dealing with redemption of notes, beginning with "Whenever a Federal Reserve note issued through one Federal Reserve bank shall be received," right on down to the sentence "No Federal Reserve bank shall pay out notes issued through another under penalty of a tax of 10 per centum upon the face value of notes so paid out."

Why do you have to take the penalty out if the redemption provisions are going to continue and you are just going to save money in transporting notes back and forth?

Mr. LEONARD. The sentence which is proposed to be deleted does not relate to the redemption process of Federal Reserve notes and the transfer of collateral behind Federal Reserve notes.

The penalty is imposed upon a Federal Reserve bank for paying out a fit Federal Reserve note which has been issued by another Federal Reserve bank. The penalty does not relate to the redemption of the Federal Reserve note.

Mr. MULTER. If you take these two sentences out how are you going to continue to control the issuance and reissuance, as they must go together, of these Federal Reserve notes?

Mr. MARTIN. There will be no change under the procedure for issuance or reissuance of Federal Reserve notes except that they will not have to be returned to the bank of issue when they arrive at a given bank, other than the bank of issue. That is the only change contemplated and proposed.

Mr. MULTER. If you take out these two sentences show me another sentence in the law which will then provide for the redemption of Federal Reserve notes.

Mr. MARTIN. Mr. Leonard will speak to that, Mr. Multer.

Mr. LEONARD. Mr. Multer, the pressure for redemption of Federal Reserve notes comes from the fact that the note, so long as it is outstanding, must be secured by collateral, regardless of where held, and regardless of whether fit or unfit.

Most notes redeemed or a great proportion of the notes redeemed are sent in by the bank of issue to Washington itself for redemption. It is constantly doing that.

The rest of redemption is whether the note is clean enough, whether it is fit for circulation. When it ceases to be fit it is forwarded into Washington for redemption.

When a Reserve bank has an excess of Federal Reserve notes for its use, and it wants to regain its collateral or if the reserve were getting low, it would return those notes, those fit notes, back to the agent and the collateral would be freed.

So it is the pressure of the collateral requirement and the reserve requirement which is effective.

Mr. MULTER. I follow what you say, but what is bothering me is this: When the note is unfit for further use it is canceled, the issuing bank is notified, and if its reserve requirements are still the same as they were when that note was issued they may issue a new note in its place; is that right?

Mr. LEONARD. Correct, if they put up the collateral.

Mr. MULTER. The reserve requirements are not changed, and they are still authorized to issue $10 million worth of Reserve notes, and a million dollars worth are no longer fit to be used. They can cancel those notes and issue new notes for the same million dollars; is that right?

Mr. LEONARD. Yes, sir.

Mr. MULTER. If they were authorized to issue $10 million in Reserve notes a year ago, and they are all still fit today, but the reserve requirements have changed, and they are now, according to the standards of the law and the regulations of the Board of Governors, authorized to have outstanding only $9 million dollars, how would they get back that million dollars in Reserve notes, if you take this sentence out?

Mr. LEONARD. The saving grace, I think, to the question which you raised, is this: That the notes do wear out.

Mr. MULTER. Let us forget about the notes wearing out. Let us assume they are good forever and a day and will never become unfit. Let us assume that $10 million face value of notes is going to be good forever and a day. For the purpose of my question, let us assume that. But the $10 million that the Federal Reserve bank has issued is against certain reserves, and if those reserves have diminished that bank must call in a part of the $10 million; am I right?

Mr. LEONARD. If your premise were right; yes.

Mr. MULTER. If the reserves go down under the standards set by the law and the regulations, and they no longer have the right to have $10 million outstanding, the difference must be called in and redeemed?

Mr. LEONARD. In the extreme case you cite the reserve ratio could be restored by one Federal Reserve bank discounting with another, under provisions of the Federal Reserve Act. So that there are other provisions which take care of it. However, if I may——

Mr. MULTER. The other provisions provide that the Federal Reserve bank may increase its reserve requirements so it can continue to have the right to have those notes outstanding; is that what you are saying?

The CHAIRMAN. Mr. Multer, if you will read the balance of the section, that is covered to me very specifically, as to how this operates.

Mr. MULTER. I have read the language. It has not helped me understand the situation.

The CHAIRMAN. It seems very clear to me.

Perhaps I am a little naive.

Mr. MULTER. Perhaps I am naive. I have had a little banking experience, not too much, but if I can't understand it, I think those who have had no banking experience will not understand it.

The CHAIRMAN. Maybe I can understand it because I haven't had any banking experience.

Mr. MULTER. Well, then, you had better help out me and my friends who have had banking experience. As I recall it, the original purpose of giving the Federal Reserve banks the right to issue these notes was to permit them to issue currency to meet the demands for currency; that is right?

Mr. LEONARD. Yes, sir.

Mr. MULTER. In other words, they had certain reserve requirements, and they were permitted to issue notes, as currency, legal tender, against their reserves?

Mr. LEONARD. Against collateral and subject to reserve requirements.

Mr. MULTER. Yes, that is correct. That collateral and those reserve requirements—the reserve requirements won't change, but the reserves set up in accordance with the requirements will change from time to time.

Mr. LEONARD. The reserve requirement is 25 percent, against the notes in circulation.

Mr. MULTER. Yes, and when value of those reserves fall under the 25 percent the bank no longer has the right to have outstanding notes which were issued against 25 percent.

Mr. LEONARD. It cannot permit its liabilities to exceed that position, but——

Mr. MULTER. Let us stop there a moment. When the 25 percent against its deposits and reserves falls to 20 percent the Federal Reserve bank has the choice of 1 or 2 things, and I think only 1 of 2 things: Either to supply the deficiency and bring it back to the 25 percent, or call in its notes that are issued against that 5 percent deficiency. Am I right?

Mr. LEONARD. It has only one choice. It has no control and cannot call in the notes. Therefore, it has to keep its reserve from falling low, and under the provisions of the law it can do that by borrowing from another Reserve bank.

Mr. MULTER. What happens if it cannot borrow or cannot restore the 25 percent?

Mr. LEONARD. That is a matter, I suppose, that would have to be submitted to Congress.

Mr. MULTER. I don't think so.

Mr. LEONARD. The Board has power to reduce reserve requirements under certain provisions, but if there were to be a change, a continuing change in circumstances, the matter would be submitted to Congress, but——

Mr. MULTER. Before we submit it to Congress, the Congress in enacting this very statute under which you are operating certainly never intended that the Federal Reserve banks should be in position where they could have outstanding more than could be set by law.

Mr. LEONARD. It is inconceivable that the situation you describe can arise because of the fact, which is an essential part of this whole operation, that the notes do wear out and constantly, day in and day out, old notes are being sent in for destruction, and new notes are being issued keeping the amount in circulation essentially in balance.

Mr. MULTER. So that the amount of currency in circulation is practically always the same. As fast as you cancel a note because it is unfit you put in a new note in circulation in its place?

Mr. LEONARD. Yes, sir. The total amount. There will be a change over the years, in the total level, whether it is $29 billion or $30 billion, but during a period, those 2 roughly do correspond, the amount of notes redeemed and the amount of new notes issued back to the bank, balance out approximately, year after year.

Mr. MARTIN. You will see, Mr. Multer, that the reserve ratio in each of these banks is published, on a weekly basis. This is the ratio of gold certificates to total deposit and note liabilities of the Federal Reserve bank. That is one of the things we watch. Now, in the unlikely contingency that the system as a whole would be facing a decline below the legal reserve requirements, the only recourse in that situation would be to come to Congress. But that is our major responsibility as the Board of Governors. We are watching those reserve ratios all the time to see that the law is complied with. And so far as this particular provision for the mechanical operations of the system are concerned, it is certainly not a life or death matter, but it is a definite saving, and it is not affecting the total volume of currency, to permit us to keep general control over the whole situation, but not require each of the banks to go through a crisscross sorting operation for the sake of maintaining the status of their particular issue.

Mr. MERRILL. Will you yield, Mr. Multer?

Mr. MULTER. I yield.

Mr. MERRILL. I won't put this in the right language, but assuming that the condition did arise where you are going to have to reduce the amount of notes outstanding, we will say, for the original bank. Is there some mechanism available whereby you could block the recirculation of a Richmond banknote without having that note first shipped back to Richmond?

Do I make myself clear?

We will say that you are going to have to cut down 10 percent on the amount of notes that Richmond has outstanding. That is what Mr. Multer is worrying about.

Mr. MULTER. That is right.

Mr. MERRILL. We know we have got to cut it down 10 percent. Is there some mechanism available so that a note, on the Richmond bank, that comes into the Washington bank, or comes into New York, could be blocked and not reissued without this cumbersome mechanism which we now have of shipping every one of them back to Richmond first?

Mr. MARTIN. On the specific note, I don't think there is any.

I will ask Mr. Young to comment.

STATEMENT OF RALPH A. YOUNG, DIRECTOR, DIVISION OF RESEARCH AND STATISTICS, FEDERAL RESERVE SYSTEM

Mr. RALPH A. YOUNG. You have to think of the total money supply, deposits subject to check and currency. The total of that will run at the present time in the neighborhood of $126 billion. I could be wrong on that figure. It is thereabouts. The public decides how it wants to hold its money. Whether it wants to hold its money in the form of demand deposits, or in the form of currency, and it is the problem of the system to be in a position to supply the currency which the public needs, subject to the limitations which Congress has imposed with respect to the issuance of money.

Now, when there is a public demand for currency which is so great, let us say, that it is drawing down the reserve ratio of the banks, a public demand for bank deposits which is causing banks to expand credits, and to build up deposits at the same time—the total is expanded—the Federal Reserve has a drain, both in terms of providing reserves and providing currency.

It is then the problem of the System to meet that situation by making its funds less available through the several devices that it has for doing that—open-market operations, the discount mechanism, and the discount rate mechanism, and perhaps changes in reserve requirements.

So that the growth of the money supply will be restrained.

Mr. MULTER. Now, with approximately $29 billion or $30 billion in currency in circulation, and if the demands of the public become greater for currency—things get a little shaky and they start hiding their money in vaults instead of the checking accounts or savings accounts—and you find you need $35 billion to meet that demand, you can control that situation very easily, can you not? If the demand should arise, and they needed another $5 billion in currency, you could change the situation very easily by issuing the additional currency?

Mr. YOUNG. If it is a matter of shifting from deposits in banks and into currency, and that is what the public wants to do at the time, that can be provided for very simply as long as the Reserve banks have sufficient reserves.

Mr. MULTER. Right.

Now, having gone to the $35 billion, and we want to cut back to $25 billion in currency, how do you accomplish that?

Mr. YOUNG. Well, the public, if it decides that it wants less currency, there is some contraction in the currency outstanding and in circulation, from the present time, against a year ago, say around a billion dollars. The public brings that money to the banks, the banks in turn take this money and deposit it with the Federal Reserve banks in their reserve accounts. The Federal Reserve banks, no longer having a demand for currency, take the currency and turn it over to the Federal Reserve agent and redeem the collateral which has been pledged against it, and their liabilities are reduced, their reserve ratio is up, and so forth.

Mr. MULTER. Isn't this very sentence you are trying to take out of the law intended to permit you to accomplish just that?

Mr. YOUNG. I don't quite understand your question, but I think if I do understand it your understanding is incorrect.

Mr. MULTER. Well, what does this sentence accomplish, then?

Mr. YOUNG. All that this bill does is to remove from the statute the requirement as to the return of currency received by one Federal Reserve bank, which has been issued by another bank to that issuing bank, for cancellation or reissue, as that bank may see fit, in accordance with the demands of the public at the time, for the use of currency.

Mr. MULTER. Am I right in saying that if we take this sentence out of this section that the only redemption of Federal Reserve notes thereafter would be by the United States Treasury?

Mr. MARTIN. Oh, no, there won't be any change in the redemption. Do you have the provision there?

STATEMENT OF ALFRED K. CHERRY, LEGISLATIVE COUNSEL TO THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. ALFRED K. CHERRY. There are about seven pages of that section relating to the issuance of Federal Reserve notes: What is the nature of the obligation, where they are redeemable; the procedures spelled out with reference to the application for notes by Federal Reserve banks; how the bank goes to the agent; places collateral; receives notes in amount equal to that collateral; long paragraph relating to the reserves——

Mr. MULTER. Will you give me the numbers of those paragraphs?

Mr. CHERRY. They commence with section 16, sir.

Mr. MULTER. I have it in front of me. Just indicate the numbers.

Mr. CHERRY (reading):

> Section 16, Federal Reserve notes, to be issued at the discretion of the Board of Governors of the Federal Reserve System for the purpose of making advances to the Federal Reserve banks—

and so forth.

Shall I continue to read the whole sentence?

Mr. MULTER. No, I have it in front of me.

Mr. CHERRY (reading):

> The said notes shall be obligations of the United States of America and shall be receivable by all national and member banks and Federal Reserve banks and for all taxes, customs, and other public dues. They shall be redeemed in lawful money on demand at the Treasury Department of the United States, in the city of Washington, District of Columbia, or at any Federal Reserve bank.

Mr. MULTER. You might just as well take out of that section the words "or at any other Federal Reserve bank," as take out this sentence.

Mr. CHERRY. Not at all, sir.

Mr. MULTER. How will they get back to the Federal Reserve bank for redemption if they don't send them back? How will the Richmond Federal Reserve Bank redeem notes of the New York Federal Reserve Bank?

Mr. CHERRY. When they are unfit, the Federal Reserve note, we will say, of the Federal Reserve Bank of New York, turns up in the Federal Reserve Bank of Richmond, who sends——

Mr. MULTER. I am not concerned about the unfit notes, because you are just taking a piece of paper that is close to being useless and substituting another piece of paper. You are taking one bill that is no longer fit and substituting for it another bill that is fit. I am not concerned about that. I am concerned about what happens to notes that should be redeemed, which are still fit for physical transmittal but are no longer good currency in accordance with the requirements of law, because there has been a change in requirements, or the amount of requirement has fallen below the required amount and that bank has no longer the right to have outstanding its original issue?

Mr. CHERRY. If the Federal Reserve Bank in New York wants to redeem or restore some of its fit Federal Reserve notes, it gives them over to the Federal Reserve agent located at that bank and receives in return an equal amount of collateral which it has deposited with the agent. The agent then holds those Federal Reserve notes in his custody and they are no longer in circulation.

Mr. MULTER. Well, you are assuming, of course, that that bank had the right to issue and did originally issue $10 million of Federal Reserve notes, and because of a change in circumstances, or regulations, or what have you, it now only has the right to have outstanding $9 million; you are assuming that in order to cancel the $1 million of notes that it has them on hand.

But if the notes are all over the country how is that bank going to get back a million dollars in notes to cancel, when it no longer has the right to have them outstanding?

Mr. MERRILL. Would there be anything wrong if the Richmond bank—I don't think this would ever happen, but assume it did happen—if the notes were not wearing out and the Richmond bank found it had to call some of them in. Wouldn't it have the right to send a note or message to other banks and ask them to forward to them a certain number of the Richmond notes that they might have received from their transactions? Won't that be possible?

Mr. LEONARD. Yes, sir.

Mr. CHERRY. Yes, sir.

Mr. MERRILL. Couldn't they do that?

Mr. LEONARD. Yes, sir.

Mr. MERRILL. Then there is no reason for spending $750,000 a year to take care of a situation, which if it happened, and it is not going to happen, could be taken care of with a 3-cent stamp; isn't that right?

Mr. MULTER. How is the Bank of Richmond going to know who has the million dollars of notes?

Mr. MERRILL. Well, suppose they have to spend 33 cents. They can send a letter to each of the 11 banks.

Mr. MULTER. And ask each bank to send them a million dollars in currency?

Mr. MERRILL. You are assuming that something is a fact that can never be a fact.

In the first place——

Mr. MULTER. Oh, no, we assumed we would never have a depression in this country, and we had it. We assumed we would never have another recession in the country, and we are in it. We can't control the economics of the country. This statute is set up against any foreseeable accident, if we can call those things accidents.

Mr. MERRILL. Assuming this thing happens, which I don't think it will ever happen, that the notes can't be redeemed because of the fact they are not wearing out fast enough, then there is available to the bank the very simple procedure by which they could get those notes back into their own hands simply by requesting them from other banks in the form of a letter. There is no need for this cumbersome procedure to guard against it because you have got a method of getting those notes back to the Richmond bank if you want them, and that is simply to write to the other banks and ask them to return to the Richmond bank a certain amount of Richmond notes they may have on hand.

Mr. MULTER. It is a very simple procedure for the bank to write and ask for it. How are you going to enforce compliance with the request?

Suppose the recipient of the letter doesn't comply. How are you going to get that million dollars of notes out of circulation?

Mr. MERRILL. I don't think we should spend $750,000 a year on a bunch of darn fool assumptions that never happen, and that is not said with respect to your assumption. I don't think we should continue a procedure as awkward as this merely to guard against eventualities that just couldn't happen.

Mr. MULTER. How anybody can sit here and say that that can't happen, to the extent of a million dollars or $5 billion, or $10 billion, is beyond me, because you just can't sit here and say it can't happen.

We have seen our currency contracted and expanded, and we have heard all sorts of demagoguery about the expansion and contraction, and it is going to happen again, and you have got to have something in this law to compel compliance with a situation such as this.

These Federal Reserve banks have been given the right to issue these notes as legal tender, as a matter of convenience, and, as I see it now, and nobody has yet convinced me to the contrary, to take this sentence out is to convert those Federal Reserve banks into United States mints, to send out that currency and have no control of it when the currency must be contracted.

I am willing to be convinced. My mind is still open on it. But I say this bill will operate to do more than just save $750,000, and I don't mean that you are intentially trying to do something other than to save the $750,000. But despite all that anyone has yet said on this subject, I say, taking out that sentence converts all your Federal Reserve banks into banks of issuance without control over recall.

Mr. MERRILL. They don't have any control over recall now except as by accident they come to the bank.

Mr. YOUNG. That is correct.

Mr. MULTER. There is no accident about it now. The bank that gets it must return it under penalty of 10 percent of the face amount.

Mr. YOUNG. Only if it comes back to the bank from circulation. The Federal Reserve banks are handling millions of pieces of paper, currency, per annum, and the turnover of currency, in the stream of transactions at the Federal Reserve banks is very large, so that as a matter of practice if there were a letter written, such as Mr. Merrill has suggested, by the Richmond bank to the other Federal Reserve banks, with respect to getting back some of its notes from circulation, the normal movement of currency, through financing institutions, through banks, and through the Federal Reserve banks, would enable such a retirement to be accomplished within a very short time.

Mr. OAKMAN. Mr. Multer, would you answer a question? Do you approve of the present archaic system? Let us take as an example, a man who has to commute back and forth between San Francisco and New York, let's say, on a monthly basis. He cashes a check in New York before he goes. That money lands out in the Federal Reserve bank in San Francisco. Under the present law they have to return that money to New York. While in San Francisco he cashes another check. For this check he gets Federal Reserve notes on the Federal Reserve bank of San Francisco. A man likes to have a little extra money with him when he is traveling. He gets back to New York and he spends those. So the money he left in San Francisco is returned to New York, the money he spends in New York is returned to San Francisco, and he does the same thing once or twice a month, so his money is constantly either pursuing him or traveling with him on the same plane, or the same train, going back and forth from coast to coast.

Does that make sense? Does that make for simplicity or economy of operation?

It seems to me to be a stupid, incongruous situation.

Mr. MULTER. I will agree with you, but in order to change that you don't throw the whole system out of the window. You put something else in its place. That is the point I make.

Mr. OAKMAN. There is no reason that you can set forth why one Federal Reserve bank would want to hoard the notes of another?

Mr. MULTER. By trying to save money and destroy that archaic system, as you term it, you are simply making these banks banks with the permanent right of issuance of currency, with no control over the recall of the currency.

I say if you want to accomplish that, let us put some other language into this law so that there will be some central control. If you don't want control to rest in each of the banks of issue—how many banks of issue are there?

Mr. MARTIN. Twelve Federal Reserve banks.

Mr. MULTER. Twelve?

Mr. MARTIN. Yes.

Mr. MULTER. All right.

If you don't want each of these 12 required to make their own redemptions, let us write something into the law and give somebody here in Washington the right to control that situation. But don't just take it out of the law so that there is no redemption any more of these notes.

Mr. OAKMAN. Do you know that there are more unregistered, that is coupon, municipal bonds outstanding in the United States today than there are of notes of all the 12 Federal Reserve banks put together?

Mr. MULTER. But they don't take those bonds into the restaurant or hotel and offer those coupons as currency. We are talking now about currency.

Mr. OAKMAN. You can take a matured bond coupon to any bank and get your money for it.

Mr. MULTER. Yes, but unlike those coupons, these notes are currency, they are legal tender. It is no different than a promissory note. Now, the promissory note, eventually, must be redeemed. It has a due date. Or if it hasn't a due date it is payable on demand and somebody eventually presents it and says "Give me my money."

If you want to change the currency system and have these banks given the right to issue currency and let it ride through the country as currency the same as United States Treasury currency, let us say so. Let us not continue to have them issued as notes against collateral, with no right of redemption of the note, when the collateral may change. And it may change for any number of reasons.

Mr. MARTIN. There is no change, Mr. Multer, in the collateral, or the redemption provisions whatever.

Mr. MULTER. You say there is no change in the collateral?

Mr. MARTIN. No, sir.

Mr. MULTER. You can never foresee a change in the collateral?

Mr. MARTIN. I didn't say that; I said in this contemplated proposal there is no proposal to change the collateral or redemption requirements.

Mr. MULTER. But the amount of collateral that a particular issuing bank has will change, in dollars; will it not?

Mr. MARTIN. Well, those changes are all provided for. They can borrow from another bank, if they need to.

Mr. MULTER. They may borrow, and if they can't borrow?

Mr. MARTIN. Then they can't issue the notes. They are stopped right there.

Mr. MULTER. But the notes are already out. I am looking at a time when you may have to contract the amount out. How are you going to do it? The reserve requirements in dollars has fallen, let us say, and there is no longer the right to have outstanding the notes out. How are you going to get the notes back and cancel them?

Mr. MARTIN. If there is no need for the currency, and the currency is not being used by the public, it will be returned to the banks and the banks will return it to the Federal Reserve bank.

Mr. MULTER. I am talking about when there is still need for the currency, and the currency is out, but the bank that issues that note has no longer the collateral behind it that is required, and cannot borrow the money to make up the collateral. What are you going to do with those notes then?

Mr. MERRILL. Will you yield, Mr. Multer?

Mr. MULTER. Yes.

Mr. MERRILL. If you have ever issued a note, there is collateral back of it or you wouldn't have issued it.

Mr. MULTER. I have issued a thousand-dollar note against $2,000 in collateral, and my $2,000 in collateral-depreciates to $500. You who are holding my thousand-dollar note originally issued against $2,000 collateral, have a right to say "Increase your collateral to $2,000."

Mr. Martin says I can go to another bank and borrow $1,500. The bank won't lend it to me. What am I going to do about it? I should either retire that note or I should reduce it to $250.

The CHAIRMAN. Mr. Multer, the gold collateral behind a Federal Reserve note is set by law.

Mr. MULTER. The percentage is set by law.

The CHAIRMAN. The value is set by law.

Mr. MULTER. Does the law also fix the value so it can't depreciate?

The CHAIRMAN. That is correct.

Mr. MULTER. I would like to see the law that controls economics to the extent of saying that a thousand dollars in securities today is worth a thousand dollars in securities tomorrow.

The CHAIRMAN. Have you read the Gold Act of 1934? You will find it there.

Mr. MULTER. I have an open mind. If anybody can give us any additional facts I would like to have them.

The CHAIRMAN. Unless Congress changes the dollar value of an ounce of gold there is a fixed value for collateral.

Mr. MULTER. Shall we now get into an argument on the gold standard?

Mr. Martin, you told us about the membership of the Board of Governors, and indicated, I think, that three of the members are supposed to represent the public. Was that your statement?

Mr. MARTIN. I discussed yesterday the composition of the Board of Directors of the individual Reserve banks, and I said there were nine directors. I said 3 were appointed by the Board of Governors in Washington, and 6 of them are elected through the procedure of the banking system that provides for 3 of them representing the banking community, small, medium, and large banks, and 3 of them, the class B directors, which represent, as I said yesterday, the borrowing interests—that is, the business interests of the community, that are not officers, directors, or employees of banks.

Mr. MULTER. Would you say, by and large, that those three directors that represent the borrowing community are fairly representative of the general public outside of the banking interests?

Mr. MARTIN. I think that we have been successful in getting pretty wide representation; yes, sir.

Mr. MULTER. I think that concludes my examination.

Mr. TALLE. Mr. Chairman.

The CHAIRMAN. Dr. Talle.

Mr. TALLE. Dr. Burgess has been waiting here patiently now for 2 days. He is a very busy man. Couldn't we move along a little faster?

Mr. PATMAN. I have some questions to ask Mr. Martin, Mr. Chairman. I don't think it will take long.

Mr. TALLE. You took all of it on yesterday, Mr. Patman.

Mr. PATMAN. Well, I felt it was justified.

Mr. TALLE. I hope that is correct.

Mr. PATMAN. I think it is correct. I think the record will show it is along material lines and justified.

The CHAIRMAN. Are there further questions of Mr. Martin by other members of the committee?

Mr. SPENCE. I would like to ask Mr. Martin, what control does the Board of Governors of the Federal Reserve System have over the volume of Federal Reserve notes issued by the banks?

Mr. MARTIN. Well, we have the requirements, Mr. Spence. The amount outstanding is limited by the requirement that gold certificate reserves equal, at least, 25 percent of the notes and deposits of the Federal Reserve banks. We have supervision of that, and this reserve ratio that I called attention to, that is published for each bank, weekly, gives us an indication of how those are being used.

Now, we have all of our instruments, reserve requirements, open market operations, and the discount mechanism, to make adjustments around this requirement which is given us by law.

The CHAIRMAN. The law compels you to make that weekly statement?

Mr. MARTIN. That is correct.

Mr. SPENCE. Other than that you would have no power over the expansion or contraction of the notes?

Mr. MARTIN. Not of the notes per se. Our power relates to the total supply of money-demand deposits and currency in circulation outside the banks.

The CHAIRMAN. Mr. Patman.

Mr. PATMAN. Mr. Martin, who is really the head of a Federal Reserve Bank, such as, for instance, the Richmond or New York? Is it the president of the bank or the chairman of the board?

Mr. MARTIN. Mr. Patman, the board of directors elects the president, and the salary of the president, and the selection of the president is approved by the Board of Governors here in Washington.

Now, the operating head of the Reserve bank is the president.

Mr. PATMAN. In other words, he is in charge?

Mr. MARTIN. He is the full time operating head of the bank.

Mr. PATMAN. He is over the chairman of the board?

Mr. MARTIN. No, I wouldn't say that at all.

Mr. PATMAN. Well, can we put it this way: On any matter except that affecting his duties as Federal Reserve agent, which, of course, requires him or permits him to deliver Federal Reserve notes to the bank—in other words, he operates in a dual capacity, if I understand it correctly. In one capacity he represents the Board of Governors, and the United States Government, and in that capacity he has his vault, with all the Federal Reserve—new Federal Reserve—notes that came direct from the Bureau of Engraving and Printing, right to his vault, and he has them there. He is the one in charge of that. And he has a duty to perform, and when the bank wants Federal Reserve notes, of course he is on the board and requests Federal Reserve notes, and when they request Federal Reserve notes he transforms himself back into an agent of the Board of Governors, and goes in there and gets the notes and delivers them to the bank.

Now, in that capacity he is representing the Board of Governors, isn't he?

Mr. MARTIN. He is appointed by the Board of Governors.

Mr. PATMAN. That is what I say, but in everything else about that bank the president is the head of it, isn't he, and in charge of it?

Mr. MARTIN. He is the operating head, but——

Mr. PATMAN. Well, that means he is in charge, doesn't it?

Mr. MARTIN. He has to report to his board of directors.

Mr. PATMAN. I know he has to report to them, and the Federal Reserve agent is one of the directors to whom he has to report?

Mr. MARTIN. That is correct.

Mr. PATMAN. But for all practical purposes, and, in effect, and really, the president of the bank, except in the operation that I have just mentioned, the president of the bank is actually the head and the supervisor in charge of that bank, put there by the board of directors?

Mr. MARTIN. He is the operating head of the bank.

Mr. PATMAN. Well, you construe that to mean the head of the bank, of course the operating head is the head of the bank. All right. We have got that straight.

Now, Mr. Martin, we have about a half billion dollars surplus in these Federal Reserve banks now, don't we, perhaps a little better than that?

Mr. MARTIN. I think so.

Mr. PATMAN. Why is there any such need for big surplus in those banks? You don't operate on surplus, do you? It is not needed in your operation?

Mr. MARTIN. Are you suggesting we have no capital, no surplus?

Mr. PATMAN. I am not suggesting, I am asking you a simple question. Why should you have such a large surplus when you don't use this surplus in your operation?

Mr. MARTIN. I don't think it is a very large surplus, Mr. Patman.

Mr. PATMAN. Over half a billion dollars, isn't it?

Mr. MARTIN. I think that is a matter of judgment, and with respect to the operations that are engaged in.

Mr. PATMAN. Well, isn't it a fact that the only reason you need that surplus is to take care of lean times, if lean times should ever come, to make sure that you could pay that 6 percent on the investment of the commercial banks, and also to take care of the salaries and operating expenses of the bank without having to go to the Congress for an appropriation?

Mr. MARTIN. No, I wouldn't say that, Mr. Patman.

Mr. PATMAN. What other reason would you have for having that surplus? What do you need it for except that?

Mr. MARTIN. Well, theoretically we don't need any.

Mr. PATMAN. You don't need any surplus?

Mr. MARTIN. Theoretically, we don't need any capital and surplus.

Mr. PATMAN. That is right. You don't need any capital at all?

Mr. MARTIN. But you wouldn't have a business operation then, of course. You might just eliminate the necessity for any capital, any surplus, just make it entirely a bookkeeping operation.

Mr. PATMAN. Well, that is all it is now. You see, your only power that really counts is the power to create money, isn't it?

Mr. MARTIN. Oh, no. We do a great deal more than that.

Mr. PATMAN. Well, that is where you get your money, you create it. You don't create it from any investment of the private banks, you don't create it from any reserves of the private banks, you don't create it from any surplus of the Federal Reserve banks, you create it because you have the power of a bank of issue. That is the central banking system. That is the capitalistic system, isn't it?

Mr. MARTIN. Well, the capitalistic system is considerably more than that, but we have the power to create money, which has been given us, by the Congress, and the system that we have permits us to supply bank reserves and absorb reserves as needed by the community.

We also hold the reserves of the member banks. They are deposited in the Federal Reserve banks. It is a system which has been developed on a decentralized basis, as far as possible, to avoid the type of money panic that we had up until the establishment of the Federal Reserve bank.

Mr. PATMAN. I knew that was the purpose of it, Mr. Martin. What I am leading up to is, you have testified before that you believe that the law should be restored that was repealed in the 1935 act, providing that after the exepnses of the Federal Reserve bank had been paid, and the 6 percent on the investments by the private banks, that 90 percent of the earnings would be paid into the Treasury. That was, I think, inadvertently repealed in the 1935 act, without any consideration by either party. Somehow or another it went in there. I don't think it was deliberately done. But it was repealed. And you said you were in favor of restoring that act, haven't you?

Mr. MARTIN. I said that I would have no objection to seeing the franchise tax stay.

Mr. PATMAN. Well, that is approval.

Mr. MARTIN. The procedure under which we have been operating was cleared, so I understand, by Chairman Eccles, with both committees of the Congress at the time it was put in.

Mr. PATMAN. That is right. In other words, you said that you would voluntarily put in 90 percent.

Mr. MARTIN. We have been operating as though there were a franchise tax.

Mr. PATMAN. I know you have, that is the reason I cannot understand why you did not put it in this particular bill, when you sent it up here to be introduced, why you didn't put that provision in there to restore the law that would require you to put the 90 percent back into the Treasury.

Mr. MARTIN. There are a number of changes in the Federal Reserve Act that I hope——

Mr. PATMAN. Well, that is a very important one.

Mr. MARTIN. No, I don't think that it is of overriding importance because no losses are being caused by that; whereas this is an out-of-pocket expense that is proceeding from day to day.

Mr. PATMAN. Well, why is it that every year, instead of putting in 90 percent you just put in nearly 90 percent, 89 percent or 86 percent?

Mr. MARTIN. We have written you several times explaining this.

Mr. PATMAN. Not that particular point. I am asking you something new.

Mr. MARTIN. I don't believe so.

Mr. PATMAN. I am asking you something new.

Mr. MARTIN. I don't think so, Mr. Patman.

Mr. PATMAN. All right. I would like to see it.

At any rate, you have not been putting in 90 percent. You have been putting in nearly 90 percent.

Mr. MARTIN. We have provided for building of a little contingency. Do you have the figure on it, Mr. Leonard?

Mr. LEONARD. The interest has been figured as if the franchise tax were in effect. When the franchise tax was in effect to provide that after the surplus had been built up to a hundred percent of the subscribed capital——

Mr. PATMAN. That has already been done.

Mr. LEONARD. But that is not the case. It is a continuing provision.

Mr. PATMAN. Do you mean it has not been built up?

Mr. LEONARD. In two cases, because of the growth of the bank, the capital had increased more than surplus had.

Mr. PATMAN. And that is the reason you didn't put in 90 percent because you were letting that surplus in that particular bank build up to a hundred percent?

Mr. LEONARD. Yes, sir.

Mr. PATMAN. Well, that is news to me. I didn't know that before.

Mr. MARTIN. We will put this into the record, if it is all right, Mr. Patman. I think we sent this to you, but this table will cover it.

Mr. PATMAN. I would like to have it in. I had overlooked that particular point. I didn't know that you had explained that before.

The CHAIRMAN. Without objection, it may be inserted in the record.

(The material referred to is as follows:)

The Board's press statement of April 23, 1947, announced adoption of a policy under which the Reserve banks would pay approximately 90 percent of their net earnings after dividends to the Treasury. The question has been raised as to why the interest payment for the year 1953 was not 90 percent of net earnings after dividends. (It was 89.465 percent.)

The whole tenor of the Board's statement of 1947 was that the interest payment was in lieu of payment of a franchise tax. The franchise tax provision of the law, which was repealed in 1933, read as follows:

"After the aforesaid dividend claims have been fully met, the net earnings shall be paid to the United States as a franchise tax except that the whole of such net earnings * * * shall be paid into a surplus fund until it shall amount to 100 percent of the subscribed capital stock of such bank, and that thereafter 10 percent of such net earnings shall be paid into the surplus."

The surplus of two of the Federal Reserve banks, Dallas and San Francisco, was below their subscribed capital stock at the end of the year 1953. Accordingly, in computing the interest payments to be made by these two banks, amounts sufficient to bring their surplus up to 100 percent of subscribed capital were deducted. A summary of the interest payments for 1953 follows:

Net earnings after dividends		$382, 905, 824. 95
Deduct amounts necessary to bring surplus to 100 percent of subscribed capital at—		
Dallas	$1, 177, 144. 51	
San Francisco	1, 095, 700. 02	
		2, 272, 844. 53
Amount subject to 90 percent payments		380, 632, 980. 42
90 percent of this total would be		342, 569, 682. 38
Interest payments made totaled		342, 567, 984. 63

The difference of about $1,700 between payments made and exactly 90 percent of net earnings after dividends and after allowing for building up the surplus of the Federal Reserve banks of Dallas and San Francisco arises from the fact that the interest rate established is carried four places beyond the decimal point. This interest rate is then applied to the average daily amount of Federal Reserve notes outstanding in excess of gold certificates pledged with the Federal Reserve agent as collateral.

Summary of interest payments on Federal Reserve notes by the Federal Reserve banks, 1947–53

Year	Amount	Percentage to net earnings after dividends	Year	Amount	Percentage to net earnings after dividends
1947	$75, 223, 818	[1] 89. 9	1952	$291, 934, 634	[2] 86. 3
1948	166, 690, 356	90. 0	1953	342, 567, 985	[3] 89. 5
1949	193, 145, 837	90. 0			
1950	196, 628, 858	90. 0	Total	1, 521, 065, 076	89. 1
1951	254, 873, 588	90. 0			

[1] In 1947 payments were still being made to the U. S. Treasury under the provisions of sec. 13b of the Federal Reserve Act relating to industrial loans. These payments ($35,605) and additions to sec. 13b surplus ($86,772) were deducted along with dividends before computing the interest payments.

[2] Before computing the interest payments, $6,265,359 at Dallas and $7,629,052 at San Francisco were deducted from net earnings to bring surplus to 100 percent of subscribed capital stock, in accordance with provisions of the franchise tax when it was in effect.

[3] Before computing the interest payments, $1,177,145 at Dallas and $1,095,700 at San Francisco were deducted from net earnings to bring surplus to 100 percent of subscribed capital stock, in accordance with provisions of the franchise tax when it was in effect.

Mr. PATMAN. Mr. Martin, don't you have a lot of complaints from banks now about the interest rate being restrictive to them on savings?

Mr. MARTIN. I haven't had any to come to my attention.

Mr. PATMAN. None have come to your attention? Don't you hear complaints about the competition they are having with the savings and loans associations?

Mr. MARTIN. Well, I have heard, from time to time, in casual conversation complaints; yes, but no official representations.

Mr. PATMAN. Suppose a bank that is chartered, a national bank, chartered to serve a community, and instead of serving that community they are investing practically everything in Government securities and rendering no local service, would you take any action on that? Is there any agency in your Government that is charged with the responsibility of supervising a situation of that kind, whereby the local people could get some benefit from their bank?

Mr. MARTIN. Mr. Patman, you have raised that point a number of times before——

Mr. PATMAN. But I never got a satisfactory answer. That is why I asked it again.

Mr. MARTIN. Well, you probably won't get a satisfactory answer this time. But we are not operating the banks of the country.

Mr. PATMAN. That is right. And there is no agency of our Government to cover that.

Don't you think that is a weak point in our banking system, that everything is done for the banks and nothing against them? In other words, they can go against their charter, they can do anything they want to, they can abuse their charter, they can refuse to render local service, and yet there is no agency of our Government whose duty it is to point that out and make sure that they get on the track and render local service?

Mr. MARTIN. Well, as I indicated at the time of the joint committee hearings, we accept responsibility for compliance with the law, and we try to watch out for the general interests of the community, but I happen to believe in free enterprise, and I do not think it is the prerogative of the Federal Reserve System to dictate to the banks how they should treat their customers, as to whether they should lend money or not lend money. I don't think we are charged with that responsibility.

Mr. PATMAN. Well, I am for free enterprise, too, but I didn't know that you would be against free enterprise if you required people to carry out their sworn duty and obligations in getting a charter to render local banking service.

Mr. MARTIN. The provisions of the charter are carried out. You are now talking about the matter of judgment.

Mr. PATMAN. Who is going to supervise them, from the standpoint of the people?

Mr. MARTIN. We are accepting general supervisory authority, but you are putting into this our judgment against their judgment with respect not to compliance of the law but with respect to conduct of the banking business.

The CHAIRMAN. Mr. Patman, will you yield to me?

Mr. PATMAN. Yes, sir.

The CHAIRMAN. If a national bank is violating its charter doesn't the Comptroller of the Currency have some jurisdiction?

Mr. MARTIN. Yes, sir.

The CHAIRMAN. And if a State member bank is violating its State charter, the State banking commissioner would have jurisdiction over the operations of that bank?

Mr. MARTIN. That is correct.

Mr. PATMAN. Now, you use the phrase the Comptroller of the Currency will do it. Have you ever heard of a case when he did it?

Mr. MARTIN. Mr. Patman——

Mr. PATMAN. That I am talking about? I can show you statements all over this country where they are just loaded down with Government bonds and not making any local loans. They are just living on the fat of the land by having riskless securities in their portfolio, and rendering no local service at all, and yet the Comptroller of the Currency, or no other agency of the Government, takes any standard against them.

Mr. MARTIN. Mr. Patman, I would like to introduce into the record, if it is agreeable with the chairman, a statement that shows the amount of loans that the banks are making, which shows that about one-third——

(The data referred to above is as follows:)

Distribution of total assets of insured commercial banks in United States, selected years, Dec. 31, 1935–53

[Amounts in millions]

	1935	1940	1945	1950	1953
Loans:					
Commercial and industrial	(1)	7,178	9,461	21,776	27,082
Agricultural	(1)	1,281	1,314	2,823	4,867
Real estate	3,323	4,468	4,677	13,389	16,566
Other loans to individuals (largely consumer)	(2)	(2)	2,361	10,049	14,373
Other [3]	11,396	5,467	7,951	4,359	5,154
Valuation reserves (deduct)	(4)	(4)	(4)	−672	−960
Total loans	14,719	18,394	25,765	51,723	67,082
U. S. Government securities	13,275	17,063	88,912	60,986	62,381
Other securities	6,841	7,099	7,131	12,113	14,333
Cash and other assets	16,092	28,163	35,736	41,730	46,841
Total assets	50,927	70,720	157,544	166,552	190,638
	Percentage of total assets				
Loans:					
Commercial and industrial		10.2	6.0	13.1	14.2
Agricultural		1.8	.8	1.7	2.6
Real estate		6.3	3.0	8.0	8.7
Other loans to individuals (largely consumer)		(2)	1.5	6.0	7.5
Other [3]		7.7	5.1	2.6	2.7
Valuation reserves (deduct)	(4)	(4)	(4)	−.4	−.5
Total loans	28.9	26.0	16.4	31.0	35.2
U. S. Government securities	26.1	24.1	56.4	36.6	32.7
Other securities	13.4	10.1	4.5	7.3	7.5
Cash and other assets	31.6	39.8	22.7	25.1	24.6
Total assets	100.0	100.0	100.0	100.0	100.0

[1] Not reported separately before 1938.
[2] Not reported separately before 1942.
[3] Includes loans for purchasing and carrying securities, to banks, and all other loans.
[4] Not reported before 1948; valuation reserves were deducted previously from each class of loans.

Mr. PATMAN. You didn't understand me to say all the banks. I said certain banks over the country.

The CHAIRMAN. I think, Mr. Patman, that the aggregate might be important.

Mr. PATMAN. Certainly, I know what it is, it is about $69 billion of loans and $60 billion of Government securities. But if they didn't have those Government securities they would be anxious to make more loans.

Anyway, I won't pursue that further.

The CHAIRMAN. May I suggest that you yield to me further? I found out the other day, in talking with my own banker, how they are facing the competition of Federal savings and loan associations on that matter of 2½ percent interest. You can order at a bank a hundred dollar savings certificate, which bears, I think, 2 percent interest, if it is less than 90 days, and if it is more than 90 days it draws 2½ percent. They are doing a splendid business on that. It has brought in millions of dollars of savings. Of course, none of us have anything against the Federal savings and loans, but I think we have had a little concern about this competition, and the banks seem to be meeting it all right.

Mr. PATMAN. Certificates on their savings?

The CHAIRMAN. Yes, and it is insured. Much to my surprise and pleasure it is insured by the FDIC.

Mr. PATMAN. I knew that at the time that time deposits went up greatly demand deposits hardly increased, in the last few months. Time deposits have greatly increased, have they not, Mr. Martin?

Mr. MARTIN. Time deposits are up.

Mr. PATMAN. The system explained by the chairman is considered a time deposit, I assume, where they make that investment in that certificate?

Mr. MARTIN. Yes.

Mr. PATMAN. That is a time deposit?

Mr. MARTIN. Yes.

The CHAIRMAN. I think that this particular bank is paying 1½ percent on time deposits, but you may leave an order with the bank that when you have accumulated, say, a hundred dollars in your savings account that you can purchase a certificate.

Mr. PATMAN. Is 2½ percent permitted under your regulations?

Mr. MARTIN. That is correct.

Mr. PATMAN. Up to 2½, but not beyond that?

Mr. MARTIN. That is right.

Mr. PATMAN. Thank you, Mr. Chairman.

There is one thing about this investment. For a bank to claim that it has an interest and owns a part of the Federal Reserve System, or Federal Reserve bank, because it has an investment in the Federal Reserve bank, which it was permitted to make, and on which it earns 6 percent annually and cumulative, is just as unreasonable as to say that because Mr. Wolcott, the chairman, has invested in his own bank in his own hometown, that he owns a part of that bank. That is not true. He doesn't.

There is one other point. An investigation of tax-exempt securities was made while you were working with our committee, Mr. Martin, and it was disclosed that a large part of the investments made by the Federal Reserve bank were tax-exempt and at that time it was felt that you were going to change those tax-exempts to taxable.

Was that ever done, where banks now pay taxes like anyone else on their investments in the Federal Reserve banks?

Mr. MARTIN. I don't know what the status of that is.

Mr. CHERRY. We found a peculiar situation through an enactment of a statute back in 1942, certain stock certificates issued by Federal Reserve banks, after that date, were taxed, and those issued before that date were untaxed.

Mr. PATMAN. That is right.

Mr. CHERRY. The Congress has never seen fit to change that.

Mr. PATMAN. What about the Federal Reserve Board calling them and changing it?

Mr. CHERRY. It is not a matter of regulation.

Mr. PATMAN. I think probably it is. We discussed it at the time, and I was convinced that the Federal Reserve Board could change it any time they wanted to.

Mr. MARTIN. We will pursue a study of that.

Mr. PATMAN. All right, sir; although I am not asking that you take any action. The only interest I have is that some people holding these nontaxable certificates or investments have been raising sand about tax exemptions of the other fellow, and it just doesn't seem reasonable or consistent. I thought perhaps the holders of this tax-exempt privilege would be clamoring to give it up so they would be in a more consistent position in opposing others who have similar privileges. I am not asking that anything be done about it. The object of my questions was for information only in view of prior discussions.

Mr. MULTER. Mr. Chairman, may we have made a part of our hearings pages 54 and 55 of the report of the Board of Governors of the Federal Reserve System for the year 1953, as released in March 1954? It is headed "Board of Governors Income and Expenses."

The CHAIRMAN. Without objection, it will be included in the record.

(The data referred to above is as follows:)

BOARD OF GOVERNORS—INCOME AND EXPENSES

The following table, showing the income and expenses of the Board for the year 1953, has been prepared from the Board's accounts, which are maintained on an accrual basis of accounting:

Operating fund, Jan. 1, 1953		$557, 962. 86
Income:		
Assessments on Federal Reserve banks	$4, 099, 800. 00	
Sale of Federal Reserve Bulletin	13, 446. 12	
Sale of other publications	15, 707. 99	
Miscellaneous	7, 234. 72	4, 136, 188. 83
Total		4, 694, 151. 69
Expenses:		
Salaries	[1] 3, 033, 930. 61	
Retirement contributions:		
Regular	[1] 230, 875. 97	
Special	21, 906. 80	
Supplemental death benefit	14, 730. 22	
Traveling expenses	223, 213. 11	
Postage and expressage	26, 203. 67	
Telephone and telegraph	60, 331. 76	
Printing and binding	156, 342. 05	
Stationery and supplies	34, 037. 50	
Furniture and equipment, including rental	44, 735. 14	
Books and subscriptions	13, 543. 26	
Heat, light, and power	37, 039. 80	

See footnote at end of table, p. 58.

Expenses—Continued			
Repairs and alterations (building and grounds)		$76, 972. 20	
Repairs and maintenance (furniture and equipment)		10, 750. 27	
Medical service and supplies		1, 516. 02	
Insurance		5, 290. 78	
All other:			
Surveys of Consumer Finances	$149, 960. 22		
Other survey and research projects	15, 350. 00		
Cafeteria (net)	41, 145. 27		
Legal and consultant fees and expenses	16, 804. 52		
Borrowed Federal Reserve bank personnel	2, 831. 37		
Official dinners, receptions, etc.	[2] 2, 960. 30		
Miscellaneous	19, 044. 90	248, 096. 58	$4, 239, 515. 74
Operating fund, Dec. 31, 1953			454, 635. 95

[1] Salaries and retirement contributions exclude approximately $81,500 and $8,240, respectively, which were charged direct to cafeteria and leased-wire operations.
[2] Includes expenditures of $1,120.42, contributed by the Board of Governors for 2 luncheons and a dinner at meetings of Treasury Department savings bond program volunteer workers.

In addition to the foregoing, the Board received the following reimbursements in 1953 for expenditures which it makes on a reimbursable basis:

Printing Federal Reserve notes	$10, 721, 441. 80
Leased-wire service (telegraph)	232, 541. 97
Currency Redemption Division (Office of the Treasurer of the United States)	200, 000. 00
Federal Reserve Issue and Redemption Division (Office of the Comptroller of the Currency)	140, 300. 27
Leased telephone lines	9, 658. 79
Miscellaneous	10, 666. 38

The accounts of the Board for the year 1953 are being audited by the public accounting firm of Arthur Andersen & Co., whose certificate was not available in time for publication in this annual report. When this audit is completed, copies of the certificate will be forwarded to the Banking and Currency Committees of the Senate and of the House of Representatives, respectively.

Mr. MULTER. May we also have made part of our record the report of Arthur Anderson & Co., dated March 5, 1954?

Mr. PATMAN. It is not very long, Mr. Chairman.

The CHAIRMAN. What part of the report, Mr. Multer?

Mr. MULTER. I think we ought to have the whole report.

Mr. PATMAN. It is such a milestone in the history of the Federal Reserve System, being the first audit that has ever been filed by a Federal Reserve bank or the Board of Governors, or the Federal Reserve Board during the 40 years, that I certainly think it deserves to be included.

Mr. MULTER. The last sentence on page 55 of the report reads:

When this audit is completed, copies of the certificate will be forwarded to the Banking and Currency Committees of the Senate and House, respectively.

I think that report should be included in the record to complete the picture, along with Mr. Martin's explanations of the discrepancies.

The CHAIRMAN. I assumed that the requirements had been met by transmittal to the Banking and Currency Committee. However, the report may be inserted in the record.

Mr. MULTER. Thank you, sir.

The CHAIRMAN. I think perhaps, also, in view of the fact that the audit is going in, that we should also include the explanatory matter offered by Mr. Martin in connection with the discrepancies to which you called attention.

Mr. MULTER. I assumed that that would be done.

The CHAIRMAN. Without objection, that will be inserted in the record when received.

(The material referred to is as follows:)

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, FINANCIAL STATEMENTS AS OF DECEMBER 31, 1953, TOGETHER WITH AUDITORS' CERTIFICATE

ARTHUR ANDERSEN & CO.,
Washington, D. C., March 5, 1954.

To the Board of Governors of the Federal Reserve System:

We have examined the balance sheet of the Board of Governors of the Federal Reserve System as of December 31, 1953, and the related statement of income and expenses for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying balance sheet and statement of income and expenses present fairly the financial position of the Board of Governors of the Federal Reserve System as of December 31, 1953, and the results of its operations for the year then ended, and were prepared in conformity with generally accepted accounting principles.

ARTHUR ANDERSEN CO.

Balance sheet—Dec. 31, 1953

ASSETS

	At cost	Reserve for depreciation	
Cash in Federal Reserve Bank of Richmond			$711, 921. 29
Petty cash			800. 00
Miscellaneous receivables and travel advances			24, 346. 58
Stockroom and cafeteria inventories, at cost			15, 505. 39
Property and equipment:			
Land	$737, 180. 30		
Land improvements	10, 939. 15		
Building	3, 794, 645. 24		
Furniture and equipment	451, 230. 89	$234, 507. 84	
Automobiles	15, 388. 36	10, 091. 25	
			4, 764, 784. 85
Total	5, 009, 383. 94	244, 599. 09	
Total			5, 517, 358. 11

LIABILITIES AND FUND BALANCE

Accounts payable			$123, 622. 62
Employee Federal income taxes withheld			109, 942. 75
Accrued payroll			110, 859. 47
Fund balance:			
Property and equipment fund		$4, 764, 784. 85	
Operating fund:			
Balance Dec. 31, 1952	$444, 039. 33		
Excess of expenses over income, per accompanying statement	035, 890. 91		
Balance Dec. 31, 1953		408, 148. 42	
			5, 172, 933. 27
Total			5, 517, 358. 11

NOTE.—The Board provides for depreciation of furniture and equipment and automobiles, but depreciation of the building has not been recognized in the accounts inasmuch as the Board deems a provision for such depreciation as unnecessary since funds for replacement of the building will be obtained, when required, from outside sources.

Statement of income and expenses for the year ended Dec. 31, 1953

Income:	
Assessments against Federal Reserve banks	$4, 099, 800. 00
Bulletin sales	13, 446. 12
Other publications sales	15, 707. 99
Miscellaneous receipts	7, 234. 72
Total	4, 136, 188. 83
Expenses (see exhibit):	
Salaries	2, 948, 850. 92
Retirement contributions	260, 842. 29
Traveling expenses	223, 213. 11
Postage and expressage	26, 203. 67
Telephone and telegraph, including leased wire operations (net)	60, 331. 76
Printing and binding	156, 342. 05
Stationery and supplies	37, 933. 02
Equipment rental	23, 103. 01
Provision for depreciation	23, 598. 17
Books and subscriptions	13, 543. 26
Heat, light, and power	37, 039. 80
Repairs, maintenance, and alterations	87, 722. 47
Insurance	5, 290. 78
Consumer Finances Surveys	168, 413. 05
Corporate Financial Trends	5, 000. 00
Retail Credit Survey	10, 000. 00
Legal and consultant fees and expenses	16, 804. 52
Borrowed Federal Reserve bank personnel	2, 831. 37
Audit expenses applicable to Board's accounts	2, 693. 55
Loss from operation of cafeteria (net)	41, 145. 27
Other	21, 177. 67
Total	4, 172, 079. 74
Excess of expenses over income	35, 890. 91

Salaries and retirement contributions exclude approximately $85,000 and $8,500, respectively, which were charged direct to cafeteria and leased wire operations.

Expenses, by divisions, for the year ended Dec. 31, 1953

	Total	Offices of members of the Board	Office of the Secretary	Legal Division	Office of the Solicitor	Division of Research and Statistics	Division of International Finance	Division of Examinations	Division of Bank Operations	Division of Personnel Administration	Division of Administrative Services: General	Division of Administrative Services: Building	Office of Defense Loans	Office of the Controller
Salaries	$2,948,850.92	$263,853.87	$165,175.37	$129,804.28	$6,793.67	$742,727.19	$257,813.55	$406,502.64	$276,194.38	$88,661.22	$368,811.60	$187,069.39	$29,424.02	$26,019.74
Retirement contributions	260,842.29										260,842.29			
Traveling expenses	223,213.11	9,342.72	205.28	215.89	1,684.81	8,957.63	2,489.50	192,525.72	5,588.93	2,006.08	196.55			
Postage and expressage	26,203.67					25.70	.18	432.72	11.70		25,726.32	7.05		
Telephone and telegraph	60,331.76	4,469.81	1,953.71	1,624.58	113.35	7,571.87	2,244.40	2,528.46	3,064.47	1,150.34	34,532.57	607.45	290.05	180.70
Printing and binding	156,342.05	1,212.08	1,649.02	501.12	915.43	13,643.30	2,034.88	4,762.59	6,285.47	503.97	124,437.51	84.80	91.33	220.55
Stationery and supplies	37,933.02	5,142.66	2,268.09	580.92	26.59	4,408.97	1,192.23	2,682.74	3,630.47	538.66	10,295.49	6,947.04	54.77	164.39
Equipment rental	23,103.01							108.00			22,995.01			
Provision for depreciation	23,598.17	2,501.18	1,716.92	551.11		4,430.08	1,017.43	635.90	1,441.37	487.52	10,286.74		84.79	445.13
Books and subscriptions	13,543.26	509.97	59.25	4,164.40	80.00	7,931.20	204.98	207.86	111.20	136.67	126.77	4.00	.46	6.50
Heat, light, and power	37,039.80											37,039.80		
Repairs, maintenance, and alterations	87,722.47	2,867.16	481.60	188.27	15.85	2,062.98	536.19	199.44	552.28	177.64	3,016.53	77,496.26	27.19	101.08
Insurance	5,290.78							95.88			5,154.65			40.25
Consumer Finances Surveys	168,413.05					168,413.05								
Corporate Financial Trends	5,000.00					5,000.00								
Retail Credit Survey	10,000.00					10,000.00								
Legal and consultant fees and expenses	16,804.52	6,261.92			8,058.23	400.00			2,084.37					
Borrowed Federal Reserve Bank personnel	2,831.37			144.33	2,687.04									
Audit expenses applicable to Board's accounts	2,693.55										2,693.55			
Loss from operation of cafeteria (net)	41,145.27										41,145.27			
Other	21,177.67	1,429.92	286.67	267.61	177.11	2,569.74	39.40	5,425.40	9.00	4,170.09	4,796.19	2,006.04		.50
Total	4,172,079.74	297,591.29	173,795.91	138,042.51	20,552.08	978,141.71	267,572.74	616,107.35	298,973.64	97,832.19	915,057.04	311,261.83	29,972.61	27,178.84

There follows, for the record, a reconciliation of the statements of income and expenses of the Board of Governors of the Federal Reserve System for the year ended December 31, 1953, as appear on page 54 of the annual report of the Board for 1953 and as shown in the report submitted by Arthur Andersen & Co. transmitted to the committee by Chairman Martin's letter of April 28, 1953. In addition, there is attached a statement containing explanations for the differences between these statements.

The statement appearing in the 1953 annual report was prepared from the Board's books preliminary to the completion of the examination made of the Board's books for 1953 by Arthur Andersen & Co.

During the course of this examination, Arthur Andersen & Co. suggested orally that the Board's form of accounting be revised to enable them to submit a report on as nearly a commercial type basis as possible, including provision for depreciation. This suggestion was reviewed and adopted. The Board thereupon revised its accounting as of December 31, 1953, so that expenses for all account classifications were reconciled with the amounts in the certified statements submitted by Arthur Andersen & Co.

It should be pointed out that the suggested changes were not intended by Arthur Andersen & Co. as a criticism of the manner in which the Board maintained its accounts on the former basis but represented only a change in the form of accounting, namely to a form which would better lend itself to the certification of a commercial-type balance sheet for the Board. Other than to effect the revised form of accounting, Arthur Andersen & Co. suggested no material adjustments in the Board's books.

Reconciliation of the statements of income and expenses for the year ended Dec. 31, 1953, in the Board's annual report for 1953 and in the report submitted by Arthur Andersen & Co.

	Statement		Differences	
	In Board's annual report	Submitted by auditors	Increase	Decrease
Income	$4,136,188.83	$4,136,188.83		
Expenses:				
Salaries	3,033,930.61	2,948,850.92		$85,079.69
Retirement contributions	267,512.99	260,842.29		6,670.70
Traveling expenses	223,213.11	223,213.11		
Postage and expressage	26,203.67	26,203.67		
Telephone and telegraph	60,331.76	60,331.76		
Printing and binding	156,342.05	156,342.05		
Stationery and supplies	34,037.50	37,933.02	$3,895.52	
Furniture and equipment (including rental)	44,735.14			
Equipment rental		23,103.01		
Provision for depreciation		23,598.17	1,966.04	
Books and subscriptions	13,543.26	13,543.26		
Heat, light, and power	37,039.80	37,039.80		
Repairs, maintenance, and alterations	87,722.47	87,722.47		
Medical service and supplies	1,516.02			1,516.02
Insurance	5,290.78	5,290.78		
All other:				
Surveys of consumer finances	149,960.22	168,413.05	18,452.83	
Other survey and research projects	15,350.00	15,000.00		350.00
Cafeteria (net)	41,145.27	41,145.27		
Legal and consultant fees and expenses	16,804.52	16,804.52		
Borrowed Federal Reserve bank personnel	2,831.37	2,831.37		
Official dinners, receptions, etc	2,960.30			2,960.30
Audit to expenses applicable to Board's accounts		2,693.55	2,693.55	
Miscellaneous	19,044.90			19,044.90
Other		21,177.67	21,177.67	
Total expenses	4,239,515.74	4,172,079.74		67,436.00
Excess of expenses over income	103,326.91	35,890.91		67,436.00

EXPLANATIONS OF DIFFERENCES BETWEEN STATEMENTS APPEARING IN BOARD'S ANNUAL REPORT AND IN REPORT SUBMITTED BY ARTHUR ANDERSEN & CO.

Salaries (decrease of $85,079.69)

This decrease is due to an adjustment covering the 1952 portion of the biweekly payroll for period December 21, 1952, through January 3, 1953. This adjustment was necessary to place the Board's accounts on an accrual basis for salaries, reducing salary expense in 1953 by that part of the payroll earned by the employees of the Board during the calendar year 1952.

Retirement contributions (decrease of $6,670.70)

This expense is related to salary expense, and the adjustment was necessary for the same reason as stated in "Salaries," above.

Stationery and supplies (increase of $3,895.52)

This amount was transferred from "Furniture and equipment" expense in order to exclude from that account all expense for items not to be depreciated.

Furniture and equipment (increase of $1,966.04)

A separate account was set up in the report submitted by the auditors for equipment rental ($23,103.01) for the same reason as the adjustment in "Stationery and supplies," above, i. e., to eliminate from "Furniture and equipment" the expense of items not to be depreciated.

The balance remaining in the amount shown in the Board's annual report ($21,632.13) was then eliminated from this account, $17,489.61 being capitalized as items to be depreciated, $3,895.52 being transferred to "Stationery and supplies," as explained above, and $247 being adjusted out as it was a 1952 expense under the accrual basis of accounting.

The amount of the depreciation provision for 1953 ($23,598.17) was then established as an expense in the report submitted by the auditors, thus completing the step necessary to place furniture and equipment expense on a depreciation basis.

Repairs, maintenance, and alterations

These expenses are shown in two accounts in the Board's annual report, whereas the report submitted by the auditors shows a combined figure. There is no difference in amount between them.

Medical service and supplies (decrease of $1,516.02)

This expense was combined in "Other" expenses on the report submitted by the auditors, with no change in amount.

Surveys of consumer finances (increase of $18,452.83)

This increase results from adjustments at the beginning of the year and at the end of the year to place this expense on an accrual basis. The amount shown in the Board's annual report represents the actual cost of the 1953 survey whether the cost was incurred in 1952 or 1953. The amount in the auditors' report includes the cost of the 1953 survey that was actually incurred in 1953 and the amount of the 1954 survey that was incurred in 1953.

Other survey and research projects (decrease of $350)

The report submitted by the auditors transfers $350 of this expense to "Other," as they considered that part of the expense as not being strictly a survey or research project.

Official dinners, receptions, etc. (decrease of $2,960.30)

The report submitted by the auditors included this in "Other" without change in amount.

Audit expenses applicable to Board's accounts (increase of $2,693.55)

This amount was included in "Miscellaneous" in the Board's annual report. The report submitted by the auditors set this expense up as a separate item without change in amount.

Miscellaneous (decrease of $19,044.90)

This appears in the Board's annual report statement. It is also included in the report submitted by the auditors but under different headings. Of the total, $2,693.55 was transferred to "Audit expenses applicable to the Board's accounts" (see above), and $16,351.35 was included in "Other" without change in amount. These changes were made as a matter of preference, only.

Other (increase of $21,177.67)

This appears in the report submitted by the auditors, and results from the retitling, without changes in amounts, of accounts appearing in the Board's annual report, as follows:

Medical service and supplies	$1, 516. 02
Other survey and research projects	350. 00
Official dinners, receptions, etc	2, 960. 30
Miscellaneous	16, 351. 35
Total	21, 177. 67

PAYMENTS OF INTEREST ON FEDERAL RESERVE NOTES

The Board's press statement of April 23, 1947, announced adoption of a policy under which the Reserve banks would pay approximately 90 percent of their net earnings after dividends to the Treasury. The question has been raised as to why the interest payment for the year 1953 was not 90 percent of net earnings after dividends. (It was 89.465 percent.)

The whole tenor of the Board's statement of 1947 was that the interest payment was in lieu of payment of a franchise tax. The franchise-tax provision of the law, which was repealed in 1933, read as follows:

"After the aforesaid dividend claims have been fully met, the net earnings shall be paid to the United States as a franchise tax except that the whole of such net earnings * * * shall be paid into a surplus fund until it shall amount to 100 percent of the subscribed capital stock of such bank, and that thereafter 10 percent of such net earnings shall be paid into the surplus."

The surplus of two of the Federal Reserve banks, Dallas and San Francisco, was below their subscribed capital stock at the end of the year 1953. Accordingly, in computing the interest payments to be made by these 2 banks, amounts sufficient to bring their surplus up to 100 percent of subscribed capital were deducted. A summary of the interest payments for 1953 follows:

Net earnings after dividends		$382, 905, 824. 95
Deduct amounts necessary to bring surplus to 100 percent of subscribed capital at—		
Dallas	$1, 177, 144. 51	
San Francisco	1, 095, 700. 02	
		2, 272, 844. 53
Amount subject to 90-percent payments		380, 632, 980. 42
90 percent of this total would be		342, 569, 682. 38
Interest payments made totaled		342, 567, 984. 63

The difference of about $1,700 between payments made and exactly 90 percent of net earnings after dividends and after allowing for building up the surplus of the Federal Reserve Banks of Dallas and San Francisco arises from the fact that the interest rate established is carried 4 places beyond the decimal point. This interest rate is then applied to the average daily amount of Federal Reserve notes outstanding in excess of gold certificates pledged with the Federal Reserve agent as collateral.

The CHAIRMAN. Are there further questions of Mr. Martin?

If not, thank you very much, Mr. Martin.

We will now call Dr. Burgess, who has a brief statement.

You may proceed with your statement, without interruption, and the members may have some questions at the conclusion of your statement.

STATEMENT OF W. RANDOLPH BURGESS, DEPUTY TO THE SECRETARY OF THE TREASURY

Mr. BURGESS. I believe copies of the statement have been distributed.

On behalf of Secretary Humphrey, I am glad to appear before you today to present the views of the Treasury Department in support of H. R. 8729. This bill would extend until June 30, 1956, the present authority of the Federal Reserve banks to purchase securities directly from the Treasury in amounts not to exceed $5 billion outstanding at any one time.

Secretary Humphrey requested the enactment of this bill in his letter to the Speaker of the House of Representatives on March 9, 1954. The bill has been endorsed by the Board of Governors of the Federal Reserve System.

To give a word of history about this particular piece of legislation, prior to 1935, Federal Reserve banks could purchase Government obligations either in the market or directly from the Treasury. From 1935 until 1942, however, this authority was restricted to open-market transactions under the Banking Act of 1935. In 1942 the authority of the Federal Reserve banks to purchase securities directly from the Treasury was restored, but a limit of $5 billion was placed on the amount outstanding at any one time. The $5 billion authority was granted initially only through 1944, but the Congress has extended it from time to time so as to provide continuous direct borrowing authority ever since. The present authority was granted for 2 years and expires June 30, 1954.

The purpose of this direct borrowing authority is to help the Treasury and the Federal Reserve System work together in minimizing the disturbing effects on the economy of short-run peaks in Treasury cash receipts and disbursements, particularly around the time of quarterly income-tax payments. These short-run movements of funds are large, and precise estimates of their day-to-day patterns are often difficult. During the last 2 weeks of March, for example, Treasury deposits totaled $10 billion—a figure larger than the entire Federal budget for the full year 1940. Sound financial management requires that such a tremendous flow of funds be handled as smoothly as possible. This direct borrowing authority represents a useful fiscal mechanism for the Treasury and the Federal Reserve and its use has avoided unnecessary financial strains on the money market on a number of occasions.

Treasury borrowing from the Federal Reserve banks under this authority is used infrequently and then only for short periods. During the past 12 months, for example, direct borrowing has been confined to three periods. Outstanding borrowing exceeded $1 billion on only 1 day and the securities were retired just as soon as tax receipts came in. A table showing the recent use of the direct borrowing authority is attached.

The Treasury and the Federal Reserve have never used the direct borrowing authority on any other basis than to meet temporary requirements of this nature, and have no intention of doing so. While it has never been necessary to use as much as $5 billion, we recommend continuation of the present $5 billion authority to give the Federal Reserve and the Treasury sufficient flexibility to cover emergency situations as they arise.

Thank you, Mr. Chairman.

The CHAIRMAN. I assume, Mr. Burgess, that you desire to include in the record the appendix with respect to direct borrowing from Federal Reserve banks that you appended as a part of your statement and, without objection, it may be inserted in the record.

Mr. BURGESS. We thought it might be helpful, Mr. Chairman.

(The material referred to is as follows:)

Direct borrowing from Federal Reserve banks

[Certificates of indebtedness special series bearing interest at the rate of ¼ of 1 percent per annum]

[In millions]

Date	Amount borrowed	Amount retired	Balance
Total from 1942-51	$5,388	$5,388	
1952—January 22	55		$55
January 23		33	22
January 24		22	
March 17	811		811
March 18		369	442
March 19		131	311
March 20	27		338
March 21			338
March 22			338
March 23 [1]			338
March 24		149	189
March 25		19	170
March 26		156	14
March 27	109		123
March 28		123	
June 16	472		472
June 17	64		536
June 18		123	413
June 19		164	249
June 20		18	231
June 21		61	170
June 22 [1]			170
June 23		96	74
June 24		27	47
June 25		47	
September 15	103		103
September 16	154		257
September 17		36	221
September 18	21		242
September 19		108	134
September 20			134
September 21 [1]			134
September 22		128	6
September 23		6	
1953—March 18	110		110
March 19		6	104
March 20	85		189
March 21			189
March 22 [1]			189
March 23	144		333
1953—March 24		$147	$186
March 25		123	63
March 26		14	49
March 27		49	
June 5	$196		196
June 6			196
June 7 [1]			196
June 8	178		374
June 9	117		491
June 10		40	451
June 11		93	358
June 12	148		506
June 13			506
June 14 [1]			506
June 15	493		999
June 16	173		1,172
June 17		349	823
June 18		459	364
June 19	628		992
June 20			992
June 21 [1]			992
June 22		84	908
June 23		300	608
June 24		312	296
June 25		296	
1954—January 14	22		22
January 15	147		169
January 16			169
January 17 [1]			169
January 18	154		323
January 19	101		424
January 20		101	323
January 21		17	306
January 22		23	283
January 23			283
January 24 [1]			283
January 25		80	203
January 26		200	3
January 27		3	
March 15	134		134
March 16	56		190
March 17		190	
Total to date	10,090	10,090	

Public Law 405, approved June 23, 1952, extends until July 1, 1954, the authority granted Federal Reserve banks to buy Government securities directly from the Treasury Department.

NOTE.—These figures are net. During the period prior to June 15, 1943, it was the custom for the Treasury to take up a security daily and to issue a new security for either the increased or decreased amount as the case may be. The reason for stating on a net basis is to avoid a padding of the figures due to this method of handling the account.

[1] Sunday.

The CHAIRMAN. Are there questions?

Mr. MULTER. Mr. Chairman.

The CHAIRMAN. Mr. Multer.

Mr. MULTER. Mr. Burgess, have you had an opportunity to review the way this authority was used in the years prior to your coming with the Treasury?

Mr. BURGESS. It just happens, Mr. Representative, that I was 18 years as an operating officer of the Federal Reserve bank in New York, and during the years from 1930 to 1936 I was the manager of the system open market account, so that this was my particular responsibility. So I have it very vividly in mind.

Mr. MULTER. Is it safe to say that in the time that you have been with the Treasury this authority has been used approximately and generally speaking the same as it had been before?

Mr. BURGESS. Yes.

Mr. MULTER. And I am sure you wouldn't be here urging it if you didn't think this was an authority that should be granted?

Mr. BURGESS. That is right.

Mr. MULTER. Is there any reason why we should continue doing it on a temporary basis rather than writing it into the law permanently¿

Mr. BURGESS. I wouldn't feel very strongly about that. The only thing is that an authority of this sort gives an opportunity for us to come before this committee, which I always enjoy, Mr. Multer, and to review our operations and tell you what we are trying to do.

This kind of authority could be misused. This is the kind of thing that central banks in other countries have gotten into trouble over, and I think it is a good thing to review it once in a while, that is all.

Mr. MULTER. Let me ask you the question that I am sure Mr. Patman will ask if I don't: The banks today, pursuant to an expressed direction of the Congress, are no longer paying interest on demand deposits?

Mr. BURGESS. That is correct.

Mr. MULTER. The United States Government has very large demand deposits with all the banks?

Mr. BURGESS. Well, not with all, but with most of them; that is right.

Mr. MULTER. With most of them?

Mr. BURGESS. That is right.

Mr. MULTER. I trust you won't think it is a snide remark when I say that during the Democratic administration funds were left on deposit both in Democratic-controlled and Republican-controlled banks, and when the administration changed, in some instances these funds were taken from Democratic-controlled banks and placed in Republican-controlled banks.

Mr. BURGESS. Mr. Congressman, to the best of my knowledge and belief, that is not true.

Mr. MULTER. If I gave you some specific examples will you look into it and find out why it was done?

Mr. BURGESS. I will be very happy to.

Mr. MULTER. I don't have any instances in New York City, but I do have as to the Middle West. I know you wouldn't stand for that, nor do I think, would any other high official of the Department of the Treasury.

Mr. BURGESS. That is correct.

Mr. MULTER. But I don't think our Government deposits, or any other deposits, should be handled on that basis.

Mr. BURGESS. May I explain how these deposits are created and withdrawn? They are created as a result of actions that the banks take, either in collecting taxes from their customers, in behalf of the Government, and the Government leaves them on deposit on a formula, on a regular mechanism, or when the bank purchases Government securities, either for itself or on behalf of its customers, those deposits are left in. They are then withdrawn ratably, on a percentage basis, so that there can be no discrimination in the character of withdrawals.

Now, there are certain other deposits that are given banks, general depositaries, on the basis of special service that they render, either as an operating facility for an Army camp or something of that sort, where it is a matter of negotiation as to how much deposit you leave with them as compensation.

But if you have cases, Mr. Congressman, we would be very happy to look into them and give you a report on them.

Mr. MULTER. I know that some banks have lost their Government deposits and others have all of them. I know there is nothing wrong with the financial condition of the banks from which the funds were taken.

Mr. BURGESS. There must be some explanation; if you will give me the case I will look into it.

Mr. MULTER. Coming back to the question of interest on demand deposits: These deposits are used in large part by the banks to purchase Government bonds from time to time, are they not?

Mr. BURGESS. About not quite half of them arise in that manner. That is, they subscribe to Government bonds, and then they give the Government a deposit credit on their books. That is, the liabilities go up here and the assets up here.

Mr. MULTER. So while at the same time the deposits they have in Government funds pay no interest, they are getting interest on Government bonds which they purchase in effect with those deposits?

Mr. BURGESS. My only qualification of that is the word "bonds." These all have to be short term, because these deposits turn over very rapidly. They don't hold them more than 10 days to a month, so they cannot employ them in anything except pretty short securities unless they sell them again as soon as the funds are drawn.

Mr. MULTER. What is the average daily balance of the United States Government in banks?

Mr. BURGESS. Well, I can give it to you for 2 years, Mr. Congressman.

In the calendar year 1953 these balances averaged $3,839 million. In 1952, the figure was $4,268 million. That is, we have been operating with rather smaller balances than was true with the previous administration.

Mr. MULTER. Do you have any opinion as to whether or not we ought to take out of the law that prohibition against interest on demand deposits?

Mr. BURGESS. My own personal view is that I would leave it as it is. Of course, it applies to all demand deposits across the board.

Mr. MULTER. That is right.

Mr. BURGESS. The reason the Congress took that out was following the great mass of bank failures in 1933, and before that, and the Congress felt that banks were competing so much for deposits that they were paying higher rates of interest than they could afford, so they didn't accumulate enough surplus and capital to protect them when the time of pressure came, and so some of the bank failures were probably due to that fact, and they felt also, I think, that if the banks didn't pay interest on demand deposits that the borrower would get his money a little cheaper, and I think that is probably true.

Mr. MULTER. Since we enacted the law we have set up the FDIC, and although I was in the minority, the majority of this committee and the majority of the Congress cut down the assessments for FDIC because they felt the reserves were adequate.

With that protection, don't you think we can go back to letting the banks compete freely as to whether they will or will not pay interest, and, if so, how much?

Mr. BURGESS. Well, one could question whether the reserves are adequate. The FDIC has about a billion and a half dollars of funds. The capital position of the banks of the country, while it is adequate at present, is not as large as it used to be in relation to their deposits. I think the average for the country as a whole is around 8 percent of the deposits. That isn't a very big capital ratio.

Mr. MULTER. Would you say that we ought to go back to what the assessment was originally in FDIC instead of continuing at the lower rate?

Mr. BURGESS. You are up against this problem there: If you increase the assessment and take more money away from the banks that way, you leave them less money to accumulate capital. So where you put it in one cushion you take it out of another.

My own belief is that the primary cushion for the protection of banks is their own capital funds, and that depends on their earnings.

Mr. MULTER. As a matter of fact, since we cut the assessment, instead of that going into the capital funds most of the banks have been paying it out as dividends?

Mr. BURGESS. I think it would be very interesting to put the figures in the record on that because my recollection is different from yours.

Mr. MULTER. I would like to have them.

Mr. BURGESS. The average bank is paying out something like 50 percent of its earnings, and, of course, that works two ways, too: As the country grows, banking facilities to serve the country have to grow, so bank capital has to grow along with it.

Now, some of that growth comes from retention of earnings. Other capital has to come from the sale of your capital stock in the market. Now, if you don't pay adequate dividends you cannot sell more stock, and, as a matter of fact, banks have had a good deal of difficulty in selling the amount of stock in the market that they would like to to build up their capital position. So there again you are between the two horns of a dilemma.

Mr. MULTER. I think there is one place where we certainly ought to lean to the conservative side.

Mr. BURGESS. I agree.

Mr. MULTER. It is not the same as the average business enterprise. This is a quasi-public, if not actually public, enterprise, with a very decided public interest.

Mr. BURGESS. I think the Comptroller of the Currency and the Federal Reserve System and the State bank examiners criticize a bank to their directors, if they pay out too much of their earnings in dividends, so the public does have some check on that.

Mr. MULTER. Thank you, Mr. Burgess.

The CHAIRMAN. Are there further questions?

Mr. PATMAN. Mr. Chairman, I wonder if you want to continue now? It will take me 30 minutes or an hour.

The CHAIRMAN. Then I think we had better recess until next week.

Mr. PATMAN. Can't we work this afternoon or tomorrow?

The CHAIRMAN. Why don't we see how far we can go, Mr. Patman?

Mr. OAKMAN. Mr. Patman, would you yield for just one question?

Mr. PATMAN. Certainly.

Mr. OAKMAN. Are not the banks now handling the sale and redemption of all savings bonds?

Mr. BURGESS. Yes.

Mr. OAKMAN. And are the banks allowed a fee or charge for this service?

Mr. BURGESS. Mr. Oakman, I am glad you raised that question. The banks do a great deal of service.

Mr. OAKMAN. I know they do.

Mr. BURGESS. For these deposits. They collect income-tax checks, they do sell savings bonds, they don't get any pay for selling savings bonds, they do get a fee for redeeming them, with a maximum of 15 cents a bond, and it goes down as the quantity increases. But they do an enormous amount of service for the Treasury and for other Government agencies. It amounts to a very substantial amount of work.

Mr. OAKMAN. They get nothing for the sale?

Mr. BURGESS. That is right.

Mr. OAKMAN. But when they redeem them they get a maximum of 15 cents per bond, and that drops down?

Mr. BURGESS. That is right.

Mr. OAKMAN. These savings bonds now total about $36 billion in the hands of the public?

Mr. BURGESS. Yes, the series E.

Mr. OAKMAN. Aren't they held by close to 36 million different people?

Mr. BURGESS. I think 40 million would be a better figure.

Mr. OAKMAN. And the sale of bonds is now exceeding redemption by a considerable amount?

Mr. BURGESS. That is correct.

Mr. OAKMAN. Thank you, Mr. Patman.

Mr. PATMAN. If the amount received by the banks is not sufficient I hope it is raised because I certainly want to see the banks properly and justly compensated for every service they render.

I believe in the private banking system, and I want to see them make a profit, because without a profit they cannot continue very long.

Now, you mentioned capital of the banking system a while ago, Dr. Burgess. Isn't it a fact that most of the capital comes from retained earnings?

Mr. BURGESS. That is true.

Mr. PATMAN. And over a long period of time that has been true, hasn't it?

Mr. BURGESS. Yes; although the amount obtained from the sale of stock has been a substantial element in it.

Mr. PATMAN. Would it be asking too much of you to give us a statement, say, over a period of 10 years, showing the additional new money that has been put into the private banking system?

Mr. BURGESS. I think we can do that. We can make a good estimate, anyway.

Mr. PATMAN. As distinguished from retained earnings?

Mr. BURGESS. Yes.

(The information requested above is as follows:)

New Cash Capital Brought Into the Commercial Banking Systems of the United States Over the Ten Year Period Ending December 31, 1953

During the 10-year period ending December 31, 1953, new cash capital derived from the sale of new issues of capital stock was brought into the commercial banking systems of the United States in the amount of $1.2 billion. This amount is exclusive of new capital stock issues sold by State chartered banks which were not members of either the Federal Reserve System of the Federal Deposit Insurance Corporation. Such banks, commonly referred to as nonmember, noninsured State banks, are relatively few in number (577), had total resources as of December 31, 1953, of only $2.7 billion, and it is believed that the amount of new cash capital raised by them over the past 10 years may safely be considered as negligible.

The new cash capital coming into the commercial banking system from the sale of new stock over the 10-year period under review amounts to about 20 percent of the total increase in capital accounts. The remainder of the increase, $4.6 billion, represents retained earnings.

The following schedules provide data on the amounts of new cash capital raised in each of the past 10 years by types of banks, and reveal whether the shares were sold by operating banks to augment existing capital structures or by newly organized banks to provide their initial capital structures. The figures include the premiums in excess of par value, i. e., the full price at which the shares were marketed.

National banks

Number of national banks in the national banking system 4, 864
Total resources of all national banks as of Dec. 31, 1953 ...... $110,100,000,000

[Amounts in thousands of dollars]

Year	Capital stock sold by operating banks	Capital stock sold by newly organized banks	Total	Year	Capital stock sold by operating banks	Capital stock sold by newly organized banks	Total
1944	80,458	1,364	81,822	1950	110,519	2,870	113,389
1945	68,677	3,542	72,219	1951	153,373	2,310	155,683
1946	51,469	5,112	56,581	1952	93,112	3,372	96,484
1947	18,974	3,703	22,677	1953	80,776	6,580	87,356
1948	27,628	2,647	30,275				
1949	19,163	2,782	21,945	Total	704,149	34,282	738,431

State chartered banks, members of the Federal Reserve System

Number of State chartered member banks 1, 887
Total resources of all State chartered member banks as of Dec. 31, 1953 .... $54, 200, 000, 000

[Amounts in thousands of dollars]

Year	Capital stock sold by operating banks	Capital stock sold by newly organized banks	Total	Year	Capital stock sold by operating banks	Capital stock sold by newly organized banks	Total
1944	10,164	765	10,929	1950	22,115	1,618	23,733
1945	50,697	2,010	52,707	1951	31,847	200	32,047
1946	15,452	1,423	16,875	1952	44,001	772	44,773
1947	8,868	1,215	10,083	1953	43,299	4,555	47,854
1948	16,163	1,580	17,743				
1949	17,858	2,785	20,643	Total	260,464	16,923	277,387

State chartered banks not members of the Federal Reserve System but members of the Federal Deposit Insurance Corporation

Number of nonmember insured State banks 6,685
Total resources of all nonmember insured State banks as of Dec. 31, 1953 .... $27,000,000,000

[Amounts in thousands of dollars]

Year	Capital stock sold by operating banks	Capital stock sold by newly organized banks	Total	Year	Capital stock sold by operating banks	Capital stock sold by newly organized banks	Total
1944	$6,433	$2,140	$8,573	1950	$8,788	$6,517	$15,255
1945	16,929	5,019	21,948	1951	10,503	7,501	18,004
1946	16,649	8,301	24,950	1952	14,709	7,314	22,023
1947	12,792	6,717	19,509	1953	18,382	10,887	29,269
1948	10,254	4,712	14,966				
1949	9,971	6,701	16,672	Total	125,360	65,809	191,169

Recapitulation

[Figures in thousands]

Type of bank	Capital sold by operating banks	Capital sold by newly organized banks	Total
National banks	$704,149	$34,282	$738,431
State member banks	260,464	16,923	277,387
State nonmember insured banks	125,360	65,809	191,169
Total	1,089,973	117,014	1,206,987

Mr. PATMAN. Mention was made a while ago of the fact that one of the reasons that the interest rate was taken off of demand deposits was because of the cutthroat competition existing between banks at the time, and I well recall that. But wasn't the main reason for changing the law to compensate the banks for the premium they would have to pay on insuring bank deposits? Wasn't that a consideration at the time? You know it was argued then that the banks were going into a new program, and the banks were going to have to pay premiums for the insurance of their deposits. As a part compensation for the banks in doing that we relieved them of paying interest on demand deposits. In other words, the two arguments were used. One was cutthroat competition, which is not a good one, because of all the people who should not complain about cutthroat competition it should be the banks.

You agree to that, don't you?

Mr. BURGESS. No, I don't.

Mr. PATMAN. They can solve that.

Mr. BURGESS. Of course, I am all for competition.

Mr. PATMAN. Yes, but now you are in a position to make it soft for the bankers, and you say they are not capable of competing.

Mr. BURGESS. Well, here is the thing they are competing on now: The banks are now competing, the banks I know, to get loans and to make loans at favorable rates. And that is a pretty good thing for them to be competing on.

Mr. PATMAN. That is principally in large amounts, isn't it?

Mr. BURGESS. No. There are undoubtedly some banks of the sort you mentioned to Mr. Martin, who sit back and don't go after loans, but most of the fellows I know are competing as hard as they can to get business.

Mr. MERRILL. Will you yield?

Mr. PATMAN. I yield.

Mr. MERRILL. Isn't it true that small-loan departments of banks and consumer credit departments in many banks are two of the fastest growing branches of the banking industry?

Mr. BURGESS. That is correct.

Mr. MERRILL. And they are definitely small loans to small people; right?

Mr. BURGESS. That is correct. The bank I was associated with was one of the first to do a good big job on that. But that has grown very rapidly, so that I would say that certainly two-thirds of the banks of the country have these small-loan departments.

Mr. MERRILL. And the competition is very keen there, isn't it?

Mr. BURGESS. Very keen.

Mr. MERRILL. In other words, the banks are fighting hard to serve the little people on these small loans, as I understand it?

Mr. BURGESS. That is correct.

Mr. PATMAN. That is a very fine, healthy thing. I am glad to see them do that.

Of course, in the aggregate I don't think it runs into too much money. But, Dr. Burgess I am anxious to get your answer to this question: Isn't it a fact that in changing the law, making it unlawful for banks to pay interest on demand deposits, that one of the principal considerations for that was that the banks were taking on a new obligation with the FDIC, which would require them to pay a premium charge each year to protect those deposits, and for that reason they shouldn't be required to pay interest on deposits?

Mr. BURGESS. Well, now, you are asking me to draw on my somewhat distant memory, on the motives of the distinguished Senator Carter Glass.

Frankly, I would have to go back and look over those records before I could answer that question truthfully.

Mr. PATMAN. I think you will find that that was the principal consideration.

Now, if that is true, since the banks have gotten their assessments reduced to practically nothing now, there would be some reason why you should restore the payment of interest on demand deposits, which I am not advocating at this time. I am not sure it would be the right thing to do. But the reason that prompted it, I think, has been removed, the principal reason.

Mr. BURGESS. Well, I would have some question about that.

Mr. PATMAN. I have read a lot of your speeches, Dr. Burgess, and you have made some mighty fine speeches.

Mr. BURGESS. Thank you very much.

Mr. PATMAN. In one speech you made in 1952, towards the end of the year, you referred to the fact that—

> The usefulness of the bank of issue is exactly in doing unpopular things at the right time. The wise Government knows this and leaves these unpopular jobs to the bank of issue.

You remember that statement, I assume?

Mr. BURGESS. Yes.

Mr. PATMAN. You made it in more speeches than one, I notice, and it is a fine statement.

You also stated, in this particular speech:

> The Reserve System was created because the experience of other countries had shown that the management of money carried huge power for good or evil and was not something to be left wholly in private hands or made a football of politics.

Now, you were really placed in charge of the monetary policy of this administration, were you not, Mr. Burgess?

Mr. BURGESS. No, sir.

Mr. PATMAN. Isn't it a fact that you came to Washington in the latter part of 1952 and conferred with a lot of people around here and told them you would be the principal one in charge of monetary policy?

Mr. BURGESS. No, sir; I took a position as adviser to the Secretary of the Treasury on certain rather specific monetary matters.

Mr. PATMAN. Well, you did come to Washington, though, in December, and you caused an announcement to be made here on December 19, I believe, that the present Federal Reserve Board, of course, would stay on, and Mr. Martin would remain on as Chairman?

Mr. BURGESS. I am sure, sir, I never made any such statement.

Mr. PATMAN. Well, the President announced it but didn't you authorize or request it?

Mr. BURGESS. No, sir.

Mr. PATMAN. I shouldn't use the word "authorize" with the President, but I mean it was on your recommendation that that was done?

Mr. BURGESS. No, sir.

Mr. PATMAN. But, anyway, you did confer with Mr. Martin and you conferred with him at different times and over a long period of years, I assume, because I assume from your connection and his that you must have been thrown together frequently?

Mr. BURGESS. I am an old friend of Mr. Martin.

Mr. PATMAN. What is your position now in the Treasury? What is your position with reference to the Secretary of the Treasury?

Mr. BURGESS. I am Deputy to the Secretary, and I do the jobs that he assigns to me.

Mr. PATMAN. He wrote me a letter and told me what your duties were.

Mr. BURGESS. Yes.

Mr. PATMAN. You have the same duties that he has, the way he outlined it. So you must be right up at the top of the Treasury totem pole.

Mr. BURGESS. Well, I have a chart of the organization, if you would like to have it in the record.

Mr. PATMAN. In other words, it is the Secretary and then you and Mr. Folsom are on an equal rank, I believe?

Mr. BURGESS. More or less. We don't go in for——

Mr. PATMAN. You don't go in for rank?

Mr. BURGESS. For protocol.

The CHAIRMAN. Just a minute. Your question assumes Mr. Burgess says that he is on equal rank with the Secretary and Mr. Folsom and he and the Secretary are of equal rank. That is according to your question.

Mr. PATMAN. No; I didn't put it that way. It is easily explained. He referred to a chart. And I happen to know about the chart.

The CHAIRMAN. Well, I wanted it explained before it went into the record in that way.

Mr. PATMAN. Anyway, when he referred to the chart, I read the chart, and the chart put the Secretary first, and Mr. Burgess and Mr. Folsom next, over certain departments, and I was referring to that.

Now, last year you did confer closely with the Federal Reserve on monetary policies being put into effect?

Mr. BURGESS. That is correct.

Mr. PATMAN. And the Federal Reserve carried out the policies that you recommended?

Mr. BURGESS. No, sir.

Mr. PATMAN. In what respect did they fail?

Mr. BURGESS. No, sir. We didn't recommend a policy to the Federal Reserve System. That is their job. Our job is debt management, and we were very careful to keep within our respective prerogatives.

Mr. PATMAN. Did they fail to do things that met with your approval in the first part of 1953?

Mr. BURGESS. I was in general sympathy with what they did.

Mr. PATMAN. The Open Market Committee, in particular?

Mr. BURGESS. I wouldn't say in particular. I would say the whole system.

Mr. PATMAN. The whole system?

Mr. BURGESS. They were carrying forward, Mr. Congressman, exactly the same policies they carried forward in 1952, on credit restraint. In fact, they had begun to exercise more vigorous credit restraint in 1951, they carried that forward into 1952 and into 1953.

Mr. PATMAN. In your statements you have often said, too, and I refer back to the statements you made that the unpopular thing should be done by somebody else. You referred to that several times, and you also referred in some of these speeches to the fact that every one of these members of the Board were appointed by President Truman, in most instances; you say the preceding administration, and Mr. Martin, the present Chairman, was appointed by Mr. Truman.

Did you have in mind these other statements that you were making that the unpopular thing should be done by the other crowd?

Mr. BURGESS. Not specifically; no, sir.

Mr. PATMAN. But Mr. Martin, suppose he had changed his policy and was not in favor of going forward on this hard-money policy, would you have recommended his continuance as Chairman?

Mr. BURGESS. I don't think that would have been within my prerogative.

Mr. PATMAN. I think it would, Dr. Burgess. I think that you would have been called upon. If you knew that he had changed his policy and was not going to continue the policy of letting interest rates go up and the bonds down, would you have recommended his continuation as Chairman of the Board?

Mr. BURGESS. I think that is a very hypothetical question.

Mr. PATMAN. All right, but they carried forward the same policies, you said. The truth is the policies started back in 1947; isn't that right, when they broke the short-term rate? The short-term rate was three-eighths of 1 percent over a long period of time?

Mr. BURGESS. That is right.

Mr. PATMAN. The first break on that was in early 1947, wasn't it?

Mr. BURGESS. That is right.

Mr. PATMAN. At that time you organized that Federal-debt-policy committee, didn't you?

Mr. BURGESS. Well, I have forgotten exactly the time.

Mr. PATMAN. I think it was. I wondered if you had anything to do with them breaking that rate? Were you in favor of it?

Mr. BURGESS. I don't think I had the slightest thing to do with it.

Mr. PATMAN. Were you in favor of them making the rate higher?

Mr. BURGESS. I think it was a wise thing to do.

Mr. PATMAN. To make it higher?

Mr. BURGESS. Now, wait, to begin a process of some restraint on credit expansion. That was a time of great inflation.

Mr. PATMAN. In other words, that permitted the interest rates to go up on short term, but didn't interfere with long term at that time?

Mr. BURGESS. That wasn't the point of it. The point was that the value of money in the United States was cut in half, from before the war until last year, and a lot of that took place after the war, a postwar inflation, and any central bank that didn't do something about that was derelict in its duty.

Mr. PATMAN. Anyway, they commenced a policy in 1947 and in 1948 I believe they did some more, and Mr. Eccles said in his book that he was promised by Mr. Truman that he would be reappointed Chairman of the Board of Governors, and he wondered why he was not appointed Chairman of the Board of Governors. Did you know, Dr. Burgess, that the reason why he wasn't was because he had violated what Mr. Truman felt to be his understanding and promise that he would hold that rate?

Mr. BURGESS. I am sure I knew nothing about that.

Mr. PATMAN. You didn't know that?

Mr. BURGESS. No.

Mr. PATMAN. Well, I didn't get it from Mr. Truman either, and I didn't get it from Mr. Eccles. But putting 2 and 2 together and adding them all up I think the conclusion is inescapable that when Mr. Eccles permitted that rate to go up against Mr. Truman's instructions, why, naturally, he didn't feel obligated to reappoint him Chairman of the Board and he didn't, when the question came up in 1948.

But you do know that Mr. Truman opposed the so-called accord in the early part of 1951, do you not, Dr. Burgess?

Mr. BURGESS. No, I don't know that.

Mr. PATMAN. You don't know that?

Mr. BURGESS. No.

Mr. PATMAN. I thought the statements that he made would indicate that.

Mr. BURGESS. Well, I know that before that time there was a meeting of the Federal Reserve Board with the President, but Mr. Truman never told me certainly that he opposed the 1951 accord. I never heard that precisely.

Mr. PATMAN. Of course I knew that you were in close touch with the situation because that was your business, and I thought that was your general understanding at the time, from what you read in the press, and statements from the President and from the Board, that there was a conflict of opinion.

Mr. Burgess. I appreciate the compliment as to my all-wisdom, but I wasn't that close to the situation.

Mr. Patman. Well, I think if anybody in the United States was close to it you would be, Dr. Burgess. I think you have been close to the Federal Reserve System now for about 30 years.

Mr. Burgess. I was with them for 18 years and tried to keep in touch with the System after that time.

Mr. Patman. You have made some statements recently, in fact beginning about 18 months ago, about extending the debt, long-term debt. Do you have in mind there extending the debt to the extent that you will eventually get the bonds out of the banks?

I believe in one of your speeches you mentioned they should not be in the banks.

Mr. Burgess. No, I don't think I ever said they should be out of the banks. I did indicate that I thought we would have a more wholesome situation if the banks held somewhat less of the debt and more of it were more widely distributed. I think that coincides with what you have expressed yourself. That can't be done too rapidly, and I don't think you will ever get to a point where the banks don't hold some of the public debt.

Mr. Patman. But you think they hold too much of it now?

Mr. Burgess. I think somewhat too much. That is a relative matter. I wouldn't want to try to pin it down too closely.

Mr. Patman. But don't you think there is something in what I said in my questioning of Mr. Martin, that the banks have gotten so much of the debt that they are less anxious to render service to people who want loans for small amounts considered?

Mr. Burgess. I think that may be true of a few banks, Mr. Patman. I don't think it is true of very many. It is a danger. It is one of the dangers of having too much of the debt in the hands of the banks, that some banker who is a bit lazy would sit back and not do his job, but I think that competition takes care of that in 99 percent of the cases.

Mr. Patman. Do you anticipate any payment on the national debt soon?

Mr. Burgess. Any decrease in the debt, downpayment?

Mr. Patman. Yes.

Mr. Burgess. Of course, that is a question of the budget.

Mr. Patman. I know it is, and Congress in particular.

Mr. Burgess. And we budgeted for a deficit this year, and a deficit for next year. Of course, we hope we will get to the time when there is no deficit and when we begin paying something off on the debt; that depends on a great many different circumstances, the world situation, and our defense program particularly.

Mr. Patman. Evidently you were not too anxious to make any payments on the debt or you would have permitted some of the taxes to remain in effect and use that money to pay on the debt.

Mr. Burgess. Well, Mr. Congressman, that is a question of judgment as to how much, how fast you can do these things. We have cut spending $5 billion in 1 year and $7 billion in another. It is a very considerable influence on the business situation. And it was the judgment of the administration that in order to keep the thing from hitting business too hard it was wise to let the people have some of that money back in the form of reduced taxes rather than to go all the way and balance the budget and start cutting down the debt.

Mr. PATMAN. Alexander Hamilton is credited with saying that a national debt is a national blessing, and Andrew Jackson is credited with saying that a national debt is a curse to the Republic.

Do you agree with either one of those statements and, if so, which one?

Mr. BURGESS. Well, I think it is rather academic. We will have a national debt for a long time to come. I wouldn't worry about our situation, if we didn't have any; I think we would get along pretty well.

Mr. PATMAN. Suppose we were to issue a capital levy and pay off the national debt over a period of 10 years. What would be the effect on our economy?

Mr. BURGESS. I think that would be very destructive of people's initiative and incentive, to feel that we felt it was right to take away people's capital. That is going pretty far.

Mr. PATMAN. Of course, I was just using that—that is a rather brutal way of doing it—but suppose we raised income taxes and paid it off over a period of 10 years, or 15 years. Don't you think it would be in the direction of a severe deflation?

Mr. BURGESS. I agree with you, yes.

Mr. PATMAN. And isn't it a fact, Dr. Burgess, that our capitalistic system being as it is, that we might as well be realistic and recognize that without debt we cannot have prosperity?

Mr. BURGESS. Well, I wouldn't make as broad a statement as that, but I think I would say, from where we are now, we cannot undertake to pay off this debt in 10 years or any such period, beause it would be too much of a shock.

Mr. PATMAN. In fact, if we didn't have debts we wouldn't have any money.

Mr. BURGESS. No, I wouldn't—you mean if there weren't any debts, public or private?

Mr. PATMAN. That is right.

Mr. BURGESS. Well, we would find some other way to do it.

Mr. PATMAN. We would be reduced to barter?

Mr. BURGESS. I think we could still have a money system.

Mr. PATMAN. We would have to change our system. What I am talking about is our present capitalistic system, which we are all in favor of—I am in favor of it, you are in favor of it—yet under that system, without debts, we could not expand our economy.

Mr. BURGESS. Well, without getting into great flights of imagination, I quite agree, that under our system as it works if we are going to have progress and move along, people have to borrow to go ahead and do things.

Mr. PATMAN. And then if the people don't borrow money, and the banks do not lend money, and the local governments do not borrow money, it might be that the Federal Government would have to have deficit financing for the purpose of creating debts to expand our economy; is that right?

Mr. BURGESS. That is possible.

Mr. PATMAN. In other words, somebody has got to create debts, either public or private.

I have a lot of things here, Mr. Chairman, but Dr. Burgess has been so gracious about answering questions that I don't think I will burden the committee or Dr. Burgess by asking questions on these other matters.

The present Federal Reserve System, the bank directors, being elected, 6 of them, by the private banks—which gives them the balance of power, there being 9 in all, 3 of them elected by the Board of Governors—don't you think that gives the private banking system too much power over the volume of money and interest rates?

Mr. BURGESS. No, sir; I don't. In the first place, the powers of the local Reserve banks, as you indicated, are limited by the Board in Washington.

Also I sat for 15 years at the meetings of the board of directors of the Federal Reserve bank in New York, and I had a chance to watch it. And the businessmen, who are elected by the banks, in fact, don't regard themselves as under obligations to carry out any policies that the banks dictate. In the first place, to get the right kind of man you have to be pretty persuasive. They don't go in with any obligation at all. The obligation is all the other way

Then these businessmen, generally speaking, like easy money. Businessmen like low money rates. Bankers tend to like higher rates. But you have always had, on those boards of directors—and I saw it work—you have always had a majority of businessmen including some college professors, and so on—the bankers are always in the minority there, so that you have a balance on the question of whether to raise the discount rate or not. The majority of those boards would be on the side of making credit freely available.

So that you have a balanced point of view on those boards. And I think, watching it in action, that is a very wholesome kind of thing. They represent a variety of businesses, of points of view, so that they bring together really a public point of view rather than just the banker point of view.

Mr. PATMAN. Don't you agree, Dr. Burgess, that the 1935 act substantially changed the Federal Reserve System?

Mr. BURGESS. Yes; but it is easy to exaggerate that. I operated in it as an operating officer before that act, and afterward, and the difference in actual operation wasn't very great.

Mr. PATMAN. Well, before the act, the local banks really had some power, and since the act the power is in the Board of Governors.

Mr. BURGESS. I don't agree with that.

Mr. PATMAN. Well, name me a power.

Mr. BURGESS. First of all the discount rate. The act says the discount rate shall be fixed by the local Federal Reserve banks, subject to review and determination by the Board.

Mr. PATMAN. That is right.

Mr. BURGESS. Just what that law means has always been a matter of dispute, but, in practice, the local board acts and then the Federal Reserve Board approves.

Now, another power is the question of loans to member banks, the definition of what is eligible collateral, that is always a question of judgment, and as a matter of fact, the bank can at times refuse to make loans—they very seldom do, but they do the equivalent, of getting a bank in, and saying "Now, you are overborrowing, you have got to cut back." That is a very substantial power.

Mr. PATMAN. Sure, it is.

Mr. BURGESS. That is a very substantial power.

Mr. PATMAN. Now, No. 3.

Mr. BURGESS. Of these powers?

Mr. PATMAN. Yes, sir.

Mr. BURGESS. Well, there is the power of bank supervision. They have the power to examine these banks and to make recommendations to their boards of directors if they think something needs to be done.

Mr. PATMAN. But you mean they send out examiners?

Mr. BURGESS. Yes, with the national bank examiner or with the State bank examiner, when he does his job.

Mr. PATMAN. That is three. Do you know of another one?

Mr. BURGESS. Well, they make recommendations to the Comptroller of the Currency, with respect to new bank charters. That is a recommendation, not an action.

They handle this great mass of currency that we spent so much time discussing today, under system rules and regulations, it is true, but it leaves them still an optional area as to how those things work out. On check collections, they have similarly an administrative power, all of which is done by the operating officers of the bank subject to the determinations of its own board of directors.

These are all subject to regulations by the Federal Reserve Board.

On the major policy matters, the Federal Reserve Board has a veto power, or power of control.

Mr. PATMAN. You mentioned the handling of the currency. Now, as I understand the actual handling of the currency, the money that is in the vaults of the Bureau of Engraving and Printing, in the form of Federal Reserve notes, issued for the 12 Federal Reserve banks, that is only gotten out under order of the Comptroller of the Currency; is that right?

Mr. BURGESS. The Comptroller of the Currency actually issues the currency to Federal Reserve agents, but he has very little authority regarding its issue.

Mr. PATMAN. Well, doesn't he actually approve of it?

Mr. BURGESS. Well, it is the Comptroller who technically releases that.

Mr. PATMAN. To the Federal Reserve banks?

Mr. BURGESS. That is right. Releases it first to the Federal Reserve agent in the Federal Reserve bank, who represents the Government, and so far it is still in the possession of the Government.

Mr. PATMAN. Until he takes it out and delivers it to the bank?

Mr. BURGESS. Until he delivers it to the bank and takes collateral for it.

Mr. PATMAN. I understand that, Dr. Burgess. But from the time that that money is delivered to the bank and put into circulation is there ever any report made back to the Treasury, as to what happens to that money from then on?

Mr. BURGESS. Well, each Federal Reserve bank has a daily statement of its currency outstanding, and so forth.

Mr. PATMAN. That is their statement. Does any audit include that? Does any audit follow that money? For instance, last year, there were $7 or $8 billion delivered to the Federal Reserve banks.

Is there any audit made, in subsequent years, to determine what happened to that money?

Mr. BURGESS. In the first place you have the daily reports.

Mr. PATMAN. That is not an audit.

Mr. BURGESS. That shows how much money is outstanding.

Mr. PATMAN. That is right.

Mr. BURGESS. Nobody knows precisely who has money in actual circulation.

Now, the Federal Reserve banks are each of them subject to a very careful audit by the agents of the Federal Reserve Board who go into each bank and very carefully examine it, count the cash and securities, and so forth. Is that what you meant?

Mr. PATMAN. Yes, I wanted to know if anybody makes a report back to the Treasury, that released the money. Here, for instance, over a period of years, let us say the Treasury released a hundred billion dollars to the Federal Reserve banks. What kind of reports have they gotten back to give an accounting for that money?

Mr. BURGESS. These statements would show how much is put into circulation. Then the money that is unfit, is retired, and comes back to us, so we have a trace of that. So we really follow that thing, and follow it pretty much through.

Mr. PATMAN. But there is no audit by the Treasury, or any Government agency?

Mr. BURGESS. Oh, yes; the Federal Reserve Board——

Mr. PATMAN. I know, but they don't make a report to Congress on it.

Mr. BURGESS. I wouldn't dare say about that.

Mr. PATMAN. No, they haven't made any report to Congress on it. In other words, I suspect over $150 or $200 billion worth of Federal Reserve notes have gone from the Bureau of Engraving to the Treasury, to the Federal Reserve banks, and so far as I am able to ascertain there has never been any accounting of that money back to the Treasury that released it.

Mr. BURGESS. Oh, yes, we know what has become of that.

Mr. PATMAN. Except from their statements.

Mr. BURGESS. No, when it is worn out it comes back to us for redemption.

Mr. PATMAN. I know, but that is——

Mr. BURGESS. So that of the $200 billion, say, $170 billion, or what have you, has come back, and we have checked it off, we have destroyed it.

Mr. PATMAN. That is the only accounting you have, is where it becomes useless as money?

Mr. BURGESS. What more do you want? We know when it is issued to the Federal Reserve bank, we know when the Federal Reserve bank issues it to the public, we know when the public brings it back to the Federal Reserve bank, we know when the Federal Reserve bank puts it back in the agent, and we know when the agent sends it back to us for redemption, so we have pretty good control.

Mr. PATMAN. I was talking about the auditing part solely.

Mr. BURGESS. Well, we count this money. We make a count of the money when it comes in. And the Federal Reserve Board sends its examiners to these banks and makes a check count of all the money they have. So it is pretty comprehensive.

Mr. PATMAN. The powers which you mentioned here, which are important that the local banker performs, is the discount rate?

Mr. BURGESS. Yes.

Mr. PATMAN. Which can be, of course, overridden by the Board of Governors?

Mr. BURGESS. Yes.

Mr. PATMAN. And the other is the supervision of collateral and loans to banks. Is that right?

Mr. BURGESS. Well, of the loans, themselves.

Mr. PATMAN. But it happens, Dr. Burgess, that you named two powers that are not in use at all, now, you might say, are they?

Mr. BURGESS. They are in use.

Mr. PATMAN. The discounts are practically nil.

Mr. BURGESS. Very small, but they were up to a billion dollars last year.

Mr. PATMAN. Even that is small. What I mean is it is not enough of a tail to wag the dog, or anything like that. It is not enough to have any bearing. The only bearing, the way I view it, of a discount rate now, is strictly psychological. Do you agree to that?

Mr. BURGESS. No, I think it has a very important psychological effect, but it has a real effect, because these people know that if they do borrow it will have to carry certain rates, so that affects the actual rates they charge. Of course, psychology gets into the practice, as well.

Mr. PATMAN. Mr. Chairman, would it be all right if I asked Dr. Burgess some questions in written form, and have him answer them that way?

The CHAIRMAN. I am sure it would be.

Mr. PATMAN. I know it is getting late, and I sympathize with the chairman. He has been patient to stay here and listen to this, I know what he has gone through all during this year, and I don't want to impose on him or the witness, and the hour is late, so I will do that.

Thank you, Mr. Chairman, and Dr. Burgess.

The CHAIRMAN. If there are no further questions, we want to express our appreciation to you, Dr. Burgess, for your patience in standing by and waiting to give us your views.

We will stand in recess until 2:15, in the hope that we might be able to get a quorum so as to be able to go into executive session on these bills at that time.

(The following data was submitted to the committee by W. Randolph Burgess, Deputy to the Secretary of the Treasury:)

METHOD OF ACCOUNTING FOR ISSUE AND RETIREMENT OF FEDERAL RESERVE NOTES

1. Notes printed by the Bureau of Engraving and Printing are delivered to a vault in the Treasury Department under the joint custodianship of the Secretary of the Treasury and the Comptroller of the Currency.

2. The Comptroller of the Currency establishes an accounting control over the notes by Federal Reserve bank of issue and by denomination.

3. Notes are shipped by the Comptroller of the Currency to the Federal Reserve agents upon acquisition approved by the Federal Reserve Board.

4. When the notes are shipped for the account of a Federal Reserve agent the Comptroller of the Currency charges the account of the Federal Reserve agent and reduces the reserve stock account.

5. The Reserve bank obtaining notes must pledge with the Federal Reserve agent an amount of collateral at least equal to the amount of notes issued. This

collateral may consist of gold certificates, United States Government securities, and eligible short-term paper discounted or purchased by the Reserve bank. The amount of notes which may be issued is limited by the statutory requirement that the Reserve bank maintain gold certificate reserves of not less than 25 percent of its notes in actual circulation.

6. Federal Reserve agents issue notes to the Reserve banks upon application and deposit of collateral and submit reports of such transactions to the Comptroller, who records the transactions in his accounts, which are maintained according to (1) Reserve bank of issue and (2) denomination.

7. Notes unfit for further circulation are sorted by the Reserve banks according to bank of issue and denomination, canceled, cut in two longitudinally, and shipped to the Treasurer of the United States for redemption. The lower halves are shipped first. On advice of receipt of the lower halves, the upper halves are shipped to the Treasurer for delivery to the Comptroller.

8. The Treasurer notifies the appropriate Reserve agent and the Comptroller of the notes redeemed. The Comptroller records the redemptions by bank of issue and by denomination.

9. Reserve agents furnish daily reports to the Federal Reserve Board of transactions in Federal Reserve notes. These reports are forwarded by the Board to the Comptroller of the Currency, who checks such reports against the accounts maintained by him. The accounts maintained by the Comptroller insure his ability to account for the amount of notes from time of receipt by him to time of destruction. Federal Reserve Board examiners and Reserve bank auditors audit notes held by Federal Reserve agents at which time they procure verification of related transactions from the Comptroller of the Currency based on his accounts.

10. As required by law, unissued notes held by the Federal Reserve agent are under joint custody and control of the Federal Reserve bank and the agent. Federal Reserve agents are agents of the Federal Reserve Board. Therefore, the responsibility for securing and maintaining sufficient collateral, and for the issuance of notes by Reserve agents, is in the final analysis a responsibility of the Federal Reserve Board.

11. Information regarding the amount of outstanding Federal Reserve notes and collateral pledged with the Federal Reserve agents is published weekly by the Federal Reserve Board. Data on Federal Reserve notes are included in the monthly Federal Reserve Bulletin and in the Circulation Statement of United States Money, published monthly by the Treasury Department. They are also included in the balance sheets of the several Federal Reserve banks, as published in the Federal Reserve Board's annual report to Congress.

(Whereupon, at 12:50 p. m., the committee adjourned.)

×