

The Report of the Commission on Money and Credit

I - Introduction

The Commission on Money and Credit was established in 1958 to study the financial and monetary structure of the United States for the purpose of determining whether it adequately serves America's major economic objectives. In the course of its investigations, it examined the activities and policies of the Federal Reserve System, the fiscal and debt management policies of the Treasury, the work of private and federal credit institutions, and the important problems involved in the coordination of monetary, credit and fiscal action. The Commission was able to complete the task which it had assigned itself and to issue its final report within three years of its appointment (1).

The Commission was entirely private in character having no relationship to the federal government or to any governmental unit. It differed in this respect from the National Monetary Commission (2), whose studies helped with the drafting of the Federal Reserve Act, and from the Radcliffe Committee, which issued its report in August, 1959 (3). Both of these were governmental bodies.

The establishment of the Commission had its origins in suggestions, frequently made, that the American financial system stood

in need of general review. President Eisenhower, himself, in his state of the Union Message on the 10th of January, 1957, asked the Congress for specific authority to appoint a committee for the purpose of investigating "the nature, performance, and adequacy of our financial system". The failure of the Congress to act upon this and other recommendations prompted the Committee for Economic Development (a private research organization) to undertake, on its own responsibility, the establishment of a monetary commission (4).

The Committee for Economic Development did not itself appoint the members of the Commission on Money and Credit but entrusted this task to a special selection committee of ten persons, associated for the most part with universities and research organizations. The selection committee was authorized to appoint a commission with not less than 15 nor more than 25 members. It initially selected 18 members who were thought to have the requisite qualifications from the point of view of individual capacity, ability and knowledge, but later increased the membership to 25 in order to include economic "liberals" and representatives of labor organizations and other economic groups (5). This change, which altered the membership from a fairly well-knit and homogeneous to an extremely diversified, heterogeneous group, prompted the resignation of Alan Sproul, who, for some years, had been President of the Federal Reserve Bank of New York and who, himself, on many occasions, had advocated the establishment of a monetary commission. He became convinced that the larger group was too heterogeneous and too lacking in basic knowledge of the monetary and credit system to produce a constructive document. The larger membership, he declared, had caused the Commission on Money and Credit to compromise widely divergent points of view and "to produce a doubtful package of recommendations" (6).

(1) *Money and Credit, Their Influence on Jobs, Prices and Growth*. The Report of the Commission on Money and Credit. Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1961, 285 pp.

(2) *National Monetary Commission*. Senate Document No. 243, 62nd Congress, 2nd Session, January 9, 1912. Washington: Government Printing Office, 1912.

(3) *Committee on the Working of the Monetary System. Report*. London: Her Majesty's Stationery Office, 1959, 375 pp.

(4) Cf. *Announcement of a National Commission on Money and Credit*. Committee for Economic Development. Printed by Committee for Economic Development, 711 Fifth Avenue, New York 22, New York, May, 1958.

(5) *Review of Report of the Commission on Money and Credit*. Hearings before the Joint Economic Committee. Congress of the United States. Eighty-seventh Congress, First Session Pursuant to Sec. 5(a) of Public Law 304 (79th Congress) August 14-18, 1961. Washington: U.S. Government Printing Office, 1961, pp. 399-402.

(6) *Ibid.*, p. 480.

Through the course of its deliberations the Commission on Money and Credit had as many as 27 members, of whom only 22, by reason of deaths and resignations, served continuously. The chairman (Frazar B. Wilde) and the Vice-Chairman (H. Christian Sonne) were themselves appointed by the chairman of the Committee for Economic Development (Donald K. David). The Commission was assisted in its labors by an Advisory Board of thirteen members, composed largely of academicians and by a large research staff. The members of the Commission were divided into some seven task forces, with overlapping membership, to consider as many aspects of the American monetary and credit system. A member of the research staff was assigned to each task force, whose duty it was to prepare documents for its consideration. The tentative conclusions of the task forces were, in turn, considered by the whole Commission which changed or amended them as it saw fit for inclusion in the final report. The Commission held no hearings, as did the Radcliffe Committee, but caused about 110 technical papers to be prepared by outside experts to assist it with its work (7).

The expenses of the Commission which ranged between 1½ and 2 million dollars (8) were financed, in large part, by the Ford Foundation and, in small part, by the Committee for Economic Development and the Merrill Foundation. This heavy cost contrasts with the expenditures of about 60 thousand dollars by the Radcliffe Committee. It should be noted that the quality of the two reports bears no relationship to the funds expended.

Unlike the Radcliffe Report, that of the Commission on Money and Credit did include dissenting opinions. An effort was made to reduce these to a minimum but even so there was a very large number.

II - National Economic Goals

The Commission on Money and Credit early came to the conclusion that a nation's economic policy is an integrated whole and that both private enterprise and government have major and complementary roles in achieving national economic goals (9).

(7) *Ibid.*, pp. 474-476 for a list of the technical reports.

(8) *Ibid.*, p. 398.

(9) *The Report of the Commission on Money and Credit*, op. cit., p. 7.

These goals, as listed by the Commission, are three in number: reasonable price stability, low levels of unemployment and adequate economic growth (10). The Commission asserted that the one is not necessarily inconsistent with the other; the extent of compatibility will be influenced by the particular measures which are adopted to achieve these aims.

Unlike the Radcliffe Report, which freely admitted the possibility of conflict between the various objectives of monetary policy and the need to establish priorities, the Commission on Money and Credit tended to deny both the threat of conflict and the necessity to select one goal in preference to another. A member of the Commission, J. Cameron Thomson, in testifying before the Joint Committee on the Economic Report declared that the attainment of one goal is helpful if not essential to the attainment of the others (11). The Commission itself recommended that the Congress amend the Employment Act of 1946 and the Federal Reserve Act in such manner that these three goals will be recognized as the economic objectives of the United States (12). In commenting upon this suggestion, Professor Wallich of Yale University pointed out that the Employment Act was, at the time of its enactment, interested primarily in problems of employment and not of growth and that economic goals change with time and should not be endowed with permanence (13).

A goal of great significance, omitted from its list by the Commission, is the urgent need to bring American's balance of payments into equilibrium and to defend the foreign exchange value of the dollar. To be sure the Commission included a chapter on "International Monetary Relations", which conveys the impression that it was an afterthought and not part of the initial agenda. In this section, the Commission admitted that action taken to rectify the imbalance in the balance of payments might not be consistent with its basic objectives. The cost of adopting corrective monetary and fiscal measures might, it continued, have such an adverse effect on employment and growth that other means should be sought (14).

(10) *Ibid.*, p. 12.

(11) *Review of the Report of the Commission on Money and Credit*, op. cit., p. 359.

(12) *The Report of the Commission on Money and Credit*, op. cit., pp. 263-264.

(13) *Review of the Report of the Commission on Money and Credit*, op. cit., p. 422.

(14) *The Report of the Commission on Money and Credit*, op. cit., p. 227. As Professor Smithies points out the Commission eschews the use of classical medicine for international

The implied conclusion is that devaluation of the dollar, under these circumstances, is inescapable.

The first national economic goal, reasonable price stability, means, according to the Commission, the avoidance of sustained moderate price increases or of rapid increases of limited duration. Even mild increases should be avoided as long as costs in terms of other objectives are not excessive. The Commission did not define the adjectives "moderate", "rapid" or "mild" but did say that the United States should aim at a better record than that achieved after the Korean war (15).

The Commission enumerated the various factors working for and against price stability in the decade of the 1960's and concluded that those working in the direction of price stability might prove the more powerful. Tending in the direction of continued inflation were such factors as the national policy of maintaining high-level production and employment, the rigidity of wages and prices, the fact that cyclical price increases are not offset by cyclical declines, the continuous increase in the price of services and the failure of management and labor to share gains in productivity with the consumer. Tending in the direction of greater price stability were such factors as excess plant capacity, enhanced foreign competition and a decline in the liquidity of financial institutions and of corporate enterprise (16).

One wishes that he could be quite as sanguine as the Commission in its forecast that the forces working in the direction of price stability may be powerful enough to offset those working in the direction of price increases. Political pressures for higher prices are very strong. These include the recurrent demands of strong trade unions that wages rise beyond increases in productivity, the demands of the agriculturalist for subsidies, and the desire of many an industrialist to be protected against foreign competition. If the United States is to enjoy price stability, the prices of the products of those industries experiencing rapid increases in productivity must

purposes, if its use interferes with domestic objectives. The Commission defends its position on the ground that growth is compatible with international balance, since growth is accompanied by increased productivity which increases international competitiveness. Cf. SMITHIES ARTHUR, "The Commission on Money and Credit", *The Quarterly Journal of Economics*, Vol. LXXV, No. 4, November, 1961.

(15) *Ibid.*, pp. 13-14 and p. 23.

(16) *Ibid.*, pp. 22-23.

decline to offset the increases occurring in the field of services, where productivity gains are small or non-existent (17). This has not happened. The attainment of price stability also presupposes that monetary policy does not provide an environment in which cost-push inflation can occur. Unfortunately the Federal Reserve System is under constant pressure to increase the money supply and to maintain an easy money policy.

Low levels of unemployment (18), the Commission's second goal, were defined as those at which the number of unfilled vacancies is about the same as the number of unemployed (19). In the opinion of the author, the acceptance of this definition will produce inflation of the cost-push variety. The skills demanded by the unfilled vacancies are not likely to be matched by those of the unemployed. Unfilled vacancies are not always to be found in centers of unemployment. Of great importance is the fact that, if the number of unemployed be adjusted by those who are out of work by reason of structural changes in the economy, the number who are cyclically unemployed will fall below the number of job opportunities. The consequence is a shortage of workers and increased pressure upon the labor markets. The Commission did modify its definition to some extent by declaring that attempts to reduce unemployment below 4 per cent of the labor force by sole reliance on monetary, credit and fiscal measures will cause a rise in the Consumer Price Index (20).

The Commission wisely did not adopt any specific goal for economic growth, contenting itself with the statement that it was not unreasonable to expect growth to take place at an annual rate of from 3½ to 4½ per cent (21). It gave needed emphasis to the point that inflation is not a prerequisite to growth and that growth is the product of the whole social fabric (22).

(17) *Review of the Report of the Commission on Money and Credit*, op. cit., Testimony of Professor Wallich, p. 432.

(18) Stated initially as high levels of employment. *The Report of the Commission on Money and Credit*, op. cit., p. 9.

(19) *Ibid.*, p. 28.

(20) *Ibid.*, p. 39.

(21) *Ibid.*, pp. 31 and 37.

(22) *Ibid.*, pp. 32 and 44. Later in the volume, pp. 143-144, the Commission could not make up its mind whether growth would be accelerated by the adoption of a fiscal policy which would reduce consumption and increase saving for private capital formation or by a fiscal policy which would increase consumption and which in turn would justify higher levels of capacity.

This chapter in the Commission's report would have been strengthened by recognition of the fact that the three goals it accepts are not necessarily consistent (23) and that priorities must be established and by recognition, too, that the United States faces a deteriorating balance of payments position and that, in consequence, it can not, in the future as in the past, remain a good member of the international community and follow autonomous monetary and fiscal policies. These omissions divorce the section from the realities of economic life — how great is the separation is perceived by comparing this particular section with the correlative passages in the Radcliffe Report.

III - Private Financial Institutions

The Commission on Money and Credit made a number of proposals for change in the structure of private financial institutions (24). These were advanced for several reasons: to safeguard

(23) The Commission endeavored to reconcile the three goals but its attempts to gain the best of all possible worlds were not successful.

(24) *Ibid.*, Chapter Six. It is the task of this reviewer to analyze the report of the Commission on Money and Credit in so far as it concerns the national aspects of the banking and financial organization of the United States. Before proceeding with my assignment, it might not be amiss, by way of background, to outline briefly the structure of the American banking system.

In contrast to the branch systems prevalent in other nations, the banking system of the United States is a unit type. The typical bank, chartered either by federal or state law, is a small institution having no branches and catering to the credit needs of a single locality. The large metropolitan institution, visited by travellers on their trips to the United States, with billions of dollars of assets and rendering a great variety of services, is not typical. A change, however, is taking place. There are about 16 states which permit statewide branch banking, another 16 which permit branch banking over limited areas and 18 which, on the whole, confine banking activities to a single office. Where it is permitted, branch banking is increasing rapidly. Thus, while the number of individual commercial banks has fallen since the end of World War II (1945 to 1959) from 14,713 to 14,004, the number of branches has grown from 4,168 to 10,238. The consequence is that, despite a rapid growth in population, population per banking office has increased only slightly (*Annual Report of the Federal Deposit Insurance Corporation for the Year Ended December 31, 1960*, p. 30).

Of the 13,472 commercial banks in existence at the end of 1960, 4,530 were chartered by federal law (national banks) and the remainder 8,942 by state law. National banks must belong to the Federal Reserve System and, in addition, 1,664 state banks have elected to join (*Federal Reserve Bulletin*, October 1931, pp. 1197 and 1199). All but a few commercial banks are members of the Federal Deposit Insurance Corporation which insures deposits in any single account against loss due to failure up to \$10,000.

The relative absence of branch banking in the United States has caused many devices to come into being in order to coordinate banking activities. These include, for example,

the funds belonging to depositors and stockholders, to promote economic growth and to moderate cyclical fluctuations in economic activity. Private financial institutions were defined to include commercial banks, mutual savings banks, savings and loan associations, credit unions, finance, mortgage and loan companies, life insurance companies, other insurance companies, private pension funds, investment companies, personal trust departments and security brokers and dealers. The Commission pointed out that the relative position of these institutions had greatly altered over time in response to changes in credit needs and economic conditions (25).

In order that private financial institutions might make their maximum contribution to *economic growth*, the Commission recommended that restrictions now regulating the investment of savings funds be liberalized, that federal charters be made available for mutual savings banks, that national banks and also state banks be

correspondent bank relations. Smaller banks have deposits with larger banks and they, in turn, with still larger institutions. Small banks share loans with large banks and rely upon them for credit and investment advice. The devices include, too, the development of various money markets peculiar to the United States such as the commercial paper market and the market for federal funds which have for their purpose the dissemination of funds over the nation. They include, too, the establishment of bank holding companies which own and control a number of unit banks in the same state as that in which the holding company is domiciled or in different states. Finally unit banking, by reason of its proneness to failure, has over the years given rise to a net work of governmental controls and supervisory agencies, intended to strengthen the banking system and to set criteria for good bank management.

In addition to commercial banks, the United States, as do other nations, possesses a host of financial intermediaries. Among these are the mutual savings banks, operating for the most part in the Eastern states; credit unions or cooperative banks; savings and loan associations, which have exhibited a sharp rate of growth in the post-war period; and life insurance companies, which are the largest of all of the intermediaries. Also to be included are the private pension funds and the investment trusts.

A very significant change since the end of the Great Depression has been the establishment of a host of federal credit institutions for the purpose of extending or guaranteeing loans at home or abroad. Another significant development, of course, has been the growth of the federal debt and of federal trust funds.

The central banking system in the United States consists of the twelve Federal Reserve Banks, controlled and coordinated by the Board of Governors in Washington. This type of central banking system has strange attributes of its own, evolving as it did from the peculiarities of the American commercial banking structure (cf. pp. 13 to 21).

At first sight the financial system of the United States seems to be a very complicated one. Aside from the matter of unit banking, it is probably no more complicated, however, than that of many other nations. It is this financial structure which the Commission on Money and Credit set about to study and, in consequence of its studies, to propose changes within the scope of its broad objectives of national economic policy.

(25) *Ibid.*, p. 155.

permitted to have branches within "trading areas", that present statutes regulating interest paid on the savings and time accounts of commercial banks be put on a "stand-by-basis" and that they be extended to include savings banks and savings and loan associations, that present statutory reserve requirements pertaining to time and savings deposits be repealed. In order that private financial institutions might make their maximum contribution to *economic stability*, the Commission recommended that federal deposit insurance be made available for all savings banks and savings and loan associations, that membership in the Federal Home Loan Banks be made more attractive to thrift institutions, that federal tax laws be changed in order to insure competitive equality among financial institutions, that the examinations of commercial banks be concentrated in the Federal Reserve System, that there be a unified authority at the federal level for the examination of all federally insured savings and loan associations and mutual savings banks, and that private pension funds be brought under control.

Although many of these recommendations are technical in character and of little interest outside of American financial circles, there are several which are basic in character and which warrant general discussion. One of the most important proposals suggests that the National Banking Act be amended to permit national banks to establish branches within "trading areas" and that state banking laws be similarly revised. There is little doubt that the inability of American commercial banks to establish branches over fairly wide geographical areas (save in a few states) has hampered the inter-regional flow of funds, has intensified geographical differences in rates of interest and has impeded the financing of credit needs.

The original National Banking Act of 1863 permitted national banks to conduct their business at offices, presumably at branches established at the will of the bank. The 1864 revision changed the plural of the word "offices" to the singular. Whether this change was intentional or inadvertent is not known (26), but the courts ruled that in the absence of explicit legal provision, national banks lacked the authority to establish branches. In full recognition of the advantages of branch banking, many proposals were made over the years to amend the national banking act so that national banks

(26) MYERS, MARGARET G., *The New York Money Market*, New York: Columbia University Press, 1931, p. 231.

might establish branches. Thus the Indianapolis Monetary Commission of 1898 (a private group interested in banking reform) recommended that national banks be permitted to establish branches under such rules and regulations as might be prescribed by the Comptroller of the Currency with the approval of the Secretary of the Treasury (27). Although this suggestion was not embodied in legislation, students of banking continued to be convinced that branch banking was in the country's interest. The first draft of the Glass Bill (the forerunner of the Federal Reserve Act), submitted to President Wilson in February, 1913, permitted national banks, under rules and regulations to be established by the Comptroller of the Currency, to establish branches within the Federal Reserve District in which the parent bank was located (28). This provision, however, was omitted from the Federal Reserve Act itself. Later in 1928 the Comptroller of the Currency, Mr. John W. Pole recommended that national banks be permitted to establish branches over "trade-areas" (29). This suggestion, like the earlier ones, was not adopted (30).

At present, national banks may establish branches only in accord with the laws of the particular state in which the national bank exists. Despite this limitation, a serious one, the trend is strongly in the direction of branch banking. The proposals of the Commission on Money and Credit that commercial banks should be permitted to establish branches over "trading areas" is a constructive one and would give the country a better banking system. A "trading area" was defined by one member of the Commission as a geographical area that embraces the natural flow of trade from an outlying geographical territory to and from its metropolitan

(27) *Report of the Monetary Commission of the Indianapolis Convention*. Chicago: The University of Chicago Press, 1898, p. 71.

(28) WILLIS, H. PARKER, *The Federal Reserve System*. New York: The Ronald Press, 1923, p. 1537.

(29) CHAPMAN, JOHN M. and RAY B. WESTERFIELD, *Branch Banking*. New York and London: Harper and Brothers Publishers, 1942, p. 112. Those interested in the history of branch banking in the United States should consult this work as well as the one entitled: *Concentration of Banking* by JOHN M. CHAPMAN, published by the Columbia University Press, 1934. These are the standard works in the field.

(30) At the time of the collapse of the banking system, 1933, many hoped that President Roosevelt would avail himself of the opportunity afforded by the crisis to recommend changes in the national banking act which would permit branch banking over relatively large geographical areas. This he refused to do, giving as his reason that on one occasion he had delivered a speech at his home in Hyde Park, New York, against branch banking.

center (31). This was essentially the definition of Comptroller of the Currency Pole. Another member of the Commission defined a "trading area" as that area attached to a Federal Reserve Bank or branch. If this definition were accepted, the nation would be divided into some 36 trading areas, inasmuch as there are twelve Federal Reserve Banks and twenty four branches of these Reserve Banks. Since these areas, in many instances, cut across state lines, only national banks, possessing federal charters, unless state laws were drastically changed, could establish branches over the whole of these areas. In consequence the national banking system would come to displace state banks which indeed was the intent of the 1863 law as well as that of 1865, which levied a 10% tax on the bank notes of the state banks.

If, in consequence of a change in basic statutes, all commercial banks were eventually to become national banks, there would be little purpose in concentrating, as the Commission suggests, authority to examine banks in the Federal Reserve System. Through the natural processes of evolution this would gradually come to be concentrated in the office of the Comptroller of the Currency, the chartering authority for national banks. There would seem little reason to burden the Reserve System, charged with the heavy responsibilities of monetary policy, with the added onerous duties of bank examination.

Why is it, one may quite logically ask, that laws restricting branch banking have not been liberalized in view of numerous proposals in this direction. The reasons are several. There has been intense opposition to legal change on the part of the management of the small banks and especially on the part of their presidents, who prefer the title of "president" to that of branch manager. There has been intense opposition, too, on the part of state banks which realize that their existence as state banks, is threatened. Again, many individuals are fearful that branch banking will not only create a "money monopoly", an octopus of financial power, but that branch banking will drain funds away from local communities. Both of these arguments, which are hoary with age, are disproved by experience in branch banking countries, and yet they have recently been resuscitated by Congressman Patman,

(31) *Review of the Report of the Commission on Money and Credit*, op. cit., p. 278.

Chairman of the Joint Committee on the Economic report (32). The opposition to branch banking which is largely an emotional one, has been able to thwart the efforts of many groups over a long period of time to liberalize existing laws.

Closely related to this proposal and equally constructive is the one, which suggests that the same branching privileges, which are given to commercial banks, be conferred on federally chartered mutual savings banks and savings and loan associations. If they were granted this power, they would be in a position to compete more effectively for thrift accounts and to finance more adequately local credit requirements. Thrift institutions would be able to play a more important role in eliminating sectional interest rate differentials.

The recommendation that federal charters be available for mutual savings banks would likewise provide the country with a better financial system. They are now organized under state law and exist for the most part in the northeastern states, where they were introduced in the early years of the last century. If federal charters were available, they could be established in any state and, if branch banking privileges were granted, they could operate over trade areas.

The proposal that reserves against the time and savings deposits of commercial banks be eliminated and that commercial banks have the same flexibility in investing their time and savings deposits as do savings banks and savings and loan associations is defensible only if time and savings deposits be explicitly defined and if segregation of assets against time and savings deposits be required (33). Strict definition of time and savings deposits is essential if an abuse, which arose in the 1920's is to be avoided. Commercial banks then induced their customers to shift deposits from the demand to the time category in order to release reserves for credit expansion. The deposits shifted were in essence demand deposits and should have remained in that category.

The suggestion has frequently been broached that commercial banks be required to segregate assets against their time and savings accounts. The Glass Bill (the House of Representatives version of the Federal Reserve Act) which was adopted by the House on

(32) *Ibid.*, p. 307.

(33) Cf. statement by Stanley H. Ruttenberg, a member of the Commission in special comment on p. 162 of *The Report of the Commission on Money and Credit*.

September 18, 1913, provided for the establishment of savings departments of national banks. Assets were to be segregated from other assets and the Federal Reserve Board was authorized to exempt the savings departments from any and every restriction upon classes or kinds of business laid down in the National Bank Act (34). If, as the Commission recommends, commercial banks are to be accorded the same investment privileges with respect to their time and savings accounts as other thrift institutions, the argument for segregation seems irrefutable.

IV - The Federal Reserve System

The older central banks, the Sveriges Riksbank, the Bank of England, and the Bank of France were founded before modern credit economies had developed. Initially they were essentially commercial banks, which, over time, gradually evolved into central banks. The Bank of England probably was not fully aware of its changed status and of its responsibilities as a central bank until after the crisis of 1857. Had the charters of the first or second United States Banks been extended, they, too, would have evolved into full fledged central banks. In that case the United States might now have a banking system akin to that existing in France. The central bank with its many branches would have been surrounded by satellites of commercial banks.

As it was, the Federal Reserve System was established (1914) after the credit system of the United States had, in its principal features, reached full development. The commercial banking system, then as now, was a dual system, consisting of banks chartered by the states and by the federal government. The fact that the Federal Reserve System was superimposed upon an already existing and somewhat complicated commercial banking system explains many of its peculiarities.

The Federal Reserve System can be viewed as a three tiered edifice. At the base are the member banks, which own the stock

(34) WILLIS, *The Federal Reserve System*, op. cit., pp. 1634-5. This provision was dropped from the final bill.

(35) The member banks must subscribe for stock equal to six percent of their capital and surplus but actually purchase an amount equal to but three percent.

of the Reserve Banks (35) and which elect six of its nine directors (36). Next are the Reserve Banks themselves, always in active touch with the member banks of the District and with regional business developments. And finally, as the apex is the Board of Governors, whose seven members are appointed by the President of the United States, with the advice and consent of the Senate, for terms of 14 years each.

The distribution of powers and responsibilities have evolved over time in response to the changing role of the policy instruments of central banking and in response to changing political and economic developments. Thus:

The Board of Governors has complete control over changes in the reserve requirements of member banks and changes in margin requirements on security loans.

The Board of Governors shares with the Federal Reserve Banks control over the discount rate. The sharing of this power is in actual fact more nominal than real inasmuch as the Board of Governors exercises final power. The local reserve banks vote changes in the discount rate subject to the review and determination of the Board of Governors. However, if a Reserve Bank does not establish a rate which meets with the approval of the Board of Governors, the Board may on its own initiative effect a change in the regional discount rate.

The Open-Market Committee, which was established in formal form in the Banking Act of 1935, has complete control of open-market operations. The Committee consists of the seven members of the Board of Governors plus five representatives of the twelve Federal Reserve Banks. The New York Federal Reserve Bank, by reason of its strategic location in the money market, is always represented on this Committee.

In the absence of compelling reasons to the contrary, the structure of the Federal Reserve System, as it has evolved over the past fifty years, should be continued. Changes are justified only if they strengthen the System. The Commission on Money and Credit did not adhere to this precept but proposed many changes, some of which are desirable, others picayune and still others of decided detriment to the banking structure.

To discuss first the changes, which concerned the base of the structure. The Commission recommended: 1) that all insured com-

(36) The remaining three directors are appointed by the Board of Governors.

mercial banks be required to become members of the Federal Reserve System (37); 2) that the capital stock of the member banks be retired and membership be evidenced by non-earning certificates, say, of \$ 500.00 for each bank (38); 3) that reserve requirements against demand deposits be identical for all member banks (39); 4) that existing statutory reserve requirements against savings and time accounts be repealed (40); and, 5) that all powers of bank examination be vested in the Federal Reserve System (41).

As we suggested above, no change should be proposed unless it is in the best interests of the banking system. Compulsory membership for all insured commercial banks is in that category. This would not only enlarge the base of the America's central banking system, but it would also preclude banks from giving up their membership in order to escape from the reserve requirements of the System which are often higher than state requirements and, in addition, it would force all banks to pay checks drawn upon them at par.

The other proposals are either of doubtful character or justify much more study. From the beginning, member banks have had to own stock in the Reserve System. The stock is non-transferable and may not be hypothecated. Each member bank has only one vote, irrespective of the amount of its stock ownership. The amount of stock owned is proportioned to the size of the bank but voting is on a democratic basis. This arrangement has worked well and there is no demand for change on the part of the commercial banks. The only clamor for change comes from those who think that it subjects the Reserve System to private control. This is not true. The Reserve System is a public institution and is no more subject to private control than was the Bank of England when it had private stockholders (42).

The proposals relating to member bank reserve requirements stand in need of more study. At the present time the cities of the

(37) *The Report of the Commission on Money and Credit*, op. cit., p. 77.

(38) *Ibid.*, p. 91.

(39) *Ibid.*, p. 69.

(40) *Ibid.*, p. 69.

(41) *Ibid.*, pp. 174-175. This proposal has been discussed earlier in this article, p. 34.

(42) Cf. testimony of Matt S. Szymczak, former member of the Board of Governors of the Federal Reserve System, in *Review of the Report of the Commission on Money and Credit*, op. cit., p. 63.

United States are divided into two categories, reserve cities and country towns (43). Member banks located in the reserve cities are required currently to hold reserves equal to 16½ per cent of demand deposits and member banks in country towns, 12 per cent. All member banks are required to hold reserves equal to 5 per cent of time deposits. The reserves consist of cash on hand and balances with the Reserve Banks. The Board of Governors is empowered to change these reserve requirements within certain minimum and maximum limits and was first given this power in 1933 as a means of sterilizing the influx of gold, which followed upon the devaluation of the dollar.

For many years the problems associated with member bank reserve requirements have been subject to intensive study and various proposals have been made for change. One would relate the reserve requirements in part to deposit velocity (44). Another would establish higher reserve requirements against the demand deposits of banks (correspondent bankers' balances) than against other demand deposits. The Commission on Money and Credit, as indicated above, proposed that reserve requirements against demand deposits for all classes of member banks be made uniform and that they be eliminated against savings and time deposits. The Commission owed its readers an explanation of the reasons which impelled it to adopt this particular method of fixing member bank reserve requirements as opposed to other proposals. It is also extremely doubtful whether reserve requirements against savings and time deposits should be dropped until, as we mentioned earlier, these deposits are carefully defined and until provision is made for the segregation of assets against them.

The proposals of the Commission on Money and Credit concerning the Reserve Banks would degrade them to the status of branches, with no effective voice in the determination of central banking policy. Those who drafted the original Federal Reserve Act looked upon the Reserve Banks as autonomous or semi-autonomous institutions, whose activities would be coordinated but not controlled by the Board of Governors. The statement was frequently made that the United States, which was as large in area as Western Europe, required, as did Western Europe, a number of central

(43) That is after July 28, 1962.

(44) Cf., *Nineteenth Annual Report of the Federal Reserve Board*, 1933, pp. 260-285.

banks. Experience soon demonstrated, particularly in World War I, that the concept of semi-autonomous central banks was unworkable. The Federal Reserve Bank of New York under the vigorous leadership of the late Governor Strong assumed leadership of the entire System. The dominance of the New York Bank eventually evoked resentment and induced those who drafted the Banking act of 1935 to shift much power to the Board of Governors. Even after the change was made the Reserve Banks continued as important institutions, with the New York Bank as *prima inter pares*.

The Federal Reserve Banks have considerable authority. They participate in the establishment of the discount rate, they select the Federal Advisory Council, they elect five members of the open-market committee, they may examine member banks, they establish standards for the loans extended to member banks and for the discounting of their paper.

The role that the Reserve Banks play in the establishment of discount rates may, from a legal point of view, be more nominal than real. The role, however insignificant legally, is of great importance psychologically. Changes are voted upon by the directors, who discuss the issues involved and who in consequence feel that they are actively participating in the formulation of policy. They have a feeling of "belonging", they develop an understanding of the Federal Reserve System, of its problems and policies, they stand ready to defend it against demagogic attacks. For this reason I would oppose the change proposed by the Commission on Money and Credit that a fully discretionary, uniform rediscount rate be established for all Federal Reserve Banks (45). This suggestion takes away what little authority the Reserve Banks now possess.

Another proposal concerns the Federal Advisory Council, which is now elected by the Reserve Banks and which was established by the original Reserve Act. The early draft of the act had provided for a Federal Reserve Board or Commission selected in part by the directorates of the Federal Reserve Banks (46). This provision, if it had been adopted, would doubtless have resulted in Federal Reserve Boards of higher average calibre than those which actually existed. It was sacrificed to the scruples of Mr. Bryan, Secretary of the State in the Wilson cabinet. The central coordinating

(45) *The Report of the Commission on Money and Credit*, op. cit., p. 66.

(46) WILLIS, *The Federal Reserve System*, op. cit., pp. 1538-9.

mechanism became a board of Presidential appointees (47). In the endeavour to provide for banker participation in the new central banking system, the Federal Advisory Council was established, with as many members as there are Federal Reserve Districts. The directors of each Reserve Bank select annually a member of the Council, which meets at least four times a year in Washington and which may confer directly with the Board of Governors and make such recommendations on monetary and credit policies as it pleases (48). The Reserve Banks have traditionally selected commercial bankers as members of the Federal Advisory Council, although the Act does not require that this be done and does not stipulate the qualifications of the person who is selected.

The Commission on Money and Credit proposes a change in the method of choosing the Council and suggests that the Board of Governors select the membership from a list of nominees presented by the Reserve Banks. The Council, as reconstituted, would meet not four times a year but only twice. This proposal represents another effort, picayune in character and childish in nature, to subordinate the Reserve Banks completely to centralized authority in Washington (49).

The most important recommendation of the Commission is that which would do away with the present Open-Market Committee and centralize all open-market powers in the Board of Governors (50). As Alan Sproul stated in an eloquent and forceful statement to the Joint Economic Committee, "the Federal Open-Market Committee has become the heart of the Federal Reserve System; cut it out and you have a skeleton" (51). He explained that it is a unique development in central banking, that it is composed of men who have statutory responsibilities and who are public servants in every real sense. Those who represent the Reserve Banks on the Committee have direct contact with the money markets, particularly is this true of the representative of the Federal Reserve Bank of New

(47) *Ibid.*, p. 715.

(48) *The Federal Reserve Act as Amended to November 1, 1946*, Section 12.

(49) For statement by Alan Sproul, cf., *Review of Report of the Commission on Money and Credit*, op. cit., p. 481. Also see testimony by Mr. Szymczak, p. 64.

(50) *The Report of the Commission on Money and Credit*, op. cit., p. 90.

(51) *Review of the Report of the Commission on Money and Credit*, op. cit., p. 482. Mr. Sproul's statement is to be found on pp. 479-484. Cf. also Mr. Szymczak's statement, p. 61.

York. The Open-Market Committee, as now constituted, "is the forum where representatives of the constituent parts of the System — the Reserve Board and the Reserve Banks — meet as individuals and equals, bearing identical responsibilities under law to decide questions of high monetary policy". With this statement, I am in emphatic agreement. Eliminate the Open-Market Committee and the morale of the System is destroyed. The Reserve Banks will not be able to attract men of competence, vision, imagination and dedication (52).

Instead of eliminating the Open-Market Committee, the author of this review would entrust it with all of the central banking powers now possessed by the Board of Governors. If this were done the Open-Market Committee would "review and determine" the discount rates established by the Reserve Banks, would have power to alter member bank reserve requirements and to change margin requirements on security loans.

Having advanced proposals which would emasculate the Reserve Banks, the Commission on Money and Credit then paid the Presidents of the Reserve Banks a left-handed compliment by proposing that the law formally constitute them as an advisory conference (53). The Presidents of the Reserve Banks have met together regularly for years. "The sanction of tradition and long practice", to quote again from Mr. Sproul's statement, "has given it a place and stature in the working of the Federal Reserve System, to which statutory recognition can neither add nor detract" (54).

The proposals of the Commission on Money and Credit which concern the Board of Governors of the Federal Reserve System, the apex of the central banking system, are that the membership of the Board be reduced from seven to five (55), that the term of office be reduced from fourteen to ten, that the occupational and geographical qualifications for Board members be eliminated (56), that the Chairman and Vice-Chairman be designated by the President from among the Board's membership to serve for a four-year

(52) It is inexplicable that not one commercial banker on the Commission on Money and Credit saw fit to include a dissenting footnote to this suggestion.

(53) *The Report of the Commission on Money and Credit*, op. cit., p. 89.

(54) *Review of the Report of the Commission on Money and Credit*, op. cit., p. 482.

(55) *The Report of the Commission on Money and Credit*, op. cit., p. 87.

(56) *Ibid.*, p. 88.

term coterminus with that of the President (57) and that the Chairman should be the chief executive officer of the Board (58).

Will these proposals for change in the Federal Reserve Act result in a better central banking system? Will they result in the appointment to the Board of Governors of men of ability, independence of mind and dedication? Are the changes justified?

Legislation can never guarantee that men of high calibre will be appointed to the Board of Governors. Much depends on the attitude of the President. If he looks upon the Board, as a haven for "lame ducks", as at least one President did, if the Senate complacently confirms the nominations, and if public opinion is uninterested, the calibre of the membership of the Board will sink to abysmal levels. If the President desires to have a Board which will unquestioningly adapt its policies to those of the Treasury Department and the Council of Economic Advisers, the members will be colorless individuals, of passive character and mediocre talents.

While legislation by itself can not guarantee an able Board of Governors, the Commission's proposals for change in the Federal Reserve Act work in the opposite direction. The reduction in membership means that the members of the Board, already overburdened, will be shouldered with still additional duties (59). Synchronizing the terms of office of the Chairman and Vice-Chairman with that of the President tends to make the Board politically minded and oriented. The terms of office were increased from ten to fourteen years by the Banking Act of 1935 in the effort to convert the Board into what was then called a "Supreme Court of Finance". Reducing the terms of office reverses this decision. The Chairman of the Board is now the chief executive officer and the proposal of the Commission that he be declared so by legislative fiat is gratuitous (60).

The proposals of the Commission on Money and Credit would, if adopted, destroy the Federal Reserve System as an effective

(57) *Ibid.*, p. 87.

(58) *Ibid.*, p. 88.

(59) Cf., Mr. Szymczak's testimony, *Review of the Report of the Commission on Money and Credit*, op. cit., pp. 61-62.

(60) *Ibid.*, pp. 61-62.

central banking system. How ironic it is that this Commission may itself be the instrument for the destruction of an effective Federal Reserve System, in as much as it has been compared so frequently to the National Monetary Commission of fifty-five years ago, whose labors helped in the drafting of the Federal Reserve Act. The recommendations of the Commission would reduce the Federal Reserve Banks to mere agencies of the Board of Governors. Their activities would center on such routine matters as the issuance of currency, the collection of checks, the handling of deposit accounts. Only in the field of bank examination would the regional banks reach the level of policy formation. With activities reduced to a deadening routine, able men will not be attracted to the Reserve Banks.

Moreover the proposals tend in the direction of making the Board of Governors subservient to the President, to his economic fancies, fads and whims. Admittedly a Federal Reserve System must direct its policies towards broad national objectives. Controversy does not concern the objectives but the means of attaining them. For example President Truman and his Secretary of the Treasury, John Snyder, were certain in January 1951 that the means included a continued pegging of bond prices. The Federal Reserve System was itself convinced that continued pegging would prevent the attainment of national goals and worked hard and successfully for its elimination. Monetary policy came into its own.

With the federal debt as large as it is and with federal deficits a frequent occurrence, administrations in power are apt to favor cheap money policies and to convince themselves that these are in the public interest. It will take a strong Federal Reserve System, supported by an alert and vigilant public opinion to stand against political pressures of this character. The Federal Reserve System will not be able to withstand political pressures if the Commission's proposals are adopted.

V - Fiscal Policy

The Commission on Money and Credit made a general rather than a detailed analysis of fiscal policy. It believed that its major task concerned monetary and credit policies and that a detailed analysis, involving the tax structure, for example, was not germane

to its main purpose (61). In studying fiscal policy, the Commission did so from two points of view: the relation of fiscal policy to economic stabilization and to economic growth.

Discretionary fiscal policy, the Commission pointed out, had not been employed to counter postwar business cycles (62). Consequently the so-called automatic fiscal stabilizers had to shoulder the burden. These result principally from the size and relative importance of individual and corporate income taxes in the American federal tax system, from sharply progressive personal income tax rates, from unemployment compensation and social security benefits (63). The United States government derives about 70 per cent of its revenues from individual and corporate income taxes — a situation probably without parallel in any other nation. The Commission reported that corporate income tax rates were most sensitive to changes in national income. Others in descending order were personal income taxes, sales and excise taxes, payroll taxes and property taxes. Built-in flexibility offset from one-third to two-fifths of cyclical changes occurring in Gross National Product. The Commission reported that while the automatic stabilizers do cushion the cyclical declines in income and do aid in bringing about recovery, they may retard expansion on the upswing. In consequence they may be a mixed blessing (64).

The Commission studied ways and means of making fiscal policy more effective as a counter-cyclical force. It rejected expenditure changes as a means towards this end (65) pointing out: that expenditures should not be guided primarily by economic stabilization criteria, that they should be geared to the long-run requirements of the economy, and that frequent revisions in expenditures entailed serious administrative difficulties.

Main reliance, therefore, must be placed on the counter cyclical impact of changes in federal revenues. Here the Commission recommended a formula tax plan, for changing the first bracket rate of the personal income tax (66). Small changes would, the

(61) *The Report of the Commission on Money and Credit*, p. 121.

(62) *Ibid.*, p. 122.

(63) *Ibid.*, p. 123.

(64) *Ibid.*, pp. 123-125.

(65) *Ibid.*, p. 139. Cf. also testimony of Mr. Robert R. Nathan, *Review of Report of the Commission on Money and Credit*, p. 162.

(66) *Ibid.*, pp. 136-137.

Commission declared, produce large changes in revenues. Thus a one percentage point decline would reduce revenues by one billion dollars. Consumers would spend, so it was estimated, 80 percent of this amount (67). A member of the Commission declared that a deficit which, in recession, emerges from a wilful reduction in tax rates has a much more important effect than one which results from the automatic operation of the built-in stabilizers (68).

The concrete proposal was that the Congress delegate to the President of the United States power to raise personal income tax rates on the first bracket from 20 per cent (the current rate) to 25 per cent and to lower it from 20 to 15 per cent. Before doing so, the President must issue an economic alert. The duration of the change would be limited to six months, unless it were extended by the Congress. Also the decision of the President would be subject to a Congressional veto. His decision to raise or to lower taxes would have to lay before Congress for sixty days and would then take effect only if there were no concurrent resolution of disapproval.

This suggestion, as Professor James M. Buchanan of the University of Virginia pointed out to the Joint Economic Committee, fails to serve the national interest (69). It is based on the presumption that we know much more about aggregate economic fluctuations than we do and that we have certain knowledge as to the precise timing and magnitude of the action to be taken. It is based on the misconception that the President knows what is best for the country and will act intelligently and courageously. This father-image of the President is quite false. He responds to political pressures, as does any elected official. He will be quick to lower tax rates but slow to raise them. Debt management policy which is under the control of the Executive has not on the whole

(67) *Ibid.*, pp. 134-135.

(68) *Review of the Report of the Commission on Money and Credit*, p. 192. Testimony of Mr. Robert R. Nathan.

(69) *Ibid.*, pp. 175-176. A member of the Commission, Theodore O. Yntema, in a dissenting footnote, stated that the analysis in this chapter of the stabilizing power of the federal budget was inadequate. He called attention to the importance of inventory cycles in business cycle fluctuations, commenting that temporary changes in tax rates can not be made quickly enough to deal with inventory fluctuations. *The Report of the Commission on Money and Credit*, p. 125.

served the interests of economic stabilization in the post-war period. It is doubtful whether discretionary tax policy would be any more successful.

If the formula tax plan had been in effect through the post-war period it would probably have destabilized the economy. Thus, President Truman would doubtless have raised tax rates towards the end of 1948 (70). His Council of Economic Advisers was in favor of this action and recommended to Congress that a rise was desirable (71). Fortunately Congress, whether by reason of inertia or political opposition to President Truman, did not do so. Well that it did not, for business activity turned down a few months after the Council had made its recommendation. Had tax rates been raised, followed shortly there after by a decrease, the economy would have been subjected to a disturbing impact. Monetary policy may, on the contrary, be changed quickly without an equivalent disturbing effect. It does not have the same immediate impact on individuals and is not subject to the same widespread publicity and discussion.

Again if the formula tax plan had been in effect, President Eisenhower would have been subject to irresistible pressure to lower tax rates in mid-1953 (72). Many advocated that the President recommend to Congress that this action be taken. Arthur F. Burns, then Chairman of the Council of Economic Advisors, opposed a general tax reduction by Congress on the ground that the economy had great resiliency and would recover by its own effort. The economy did indeed quickly recover and the recession of 1953 was shortly followed by the high level activity of 1954 and 1955. Had a general reduction in tax rates occurred, the boom and subsequent recession might have been intensified.

The Commission's proposal is divorced from political realities and has no economic justification. It is divorced from political realities in as much as it fails to recognize the fact that President, though eagerly reducing tax rates, will resist efforts to bring about

(70) In *The Economic Report of the President to the Congress* dated January 7, 1949, President Truman recommended legislation which would increase government revenues from taxation by 4 billion dollars (p. 10).

(71) *Ibid.*, pp. 38-39.

(72) Over and above the reduction in tax revenues provided by relinquishing the excess profits tax and by the reduction of personal income tax, already scheduled for January 1, 1954.

a rise (73). The time will never seem opportune for a tax increase any more than the time is ever opportune for a significant lengthening of the public debt. It is not justified economically since the automatic stabilizers have themselves largely succeeded in divorcing personal income from production (74). Declines in production are not, as they were prior to World War II, accompanied by declines in income. Cumulative declines seem impossible.

The Commission devoted most of the chapter on *Fiscal Policy* to problems of economic stabilization; it gave little space to questions of growth. In its compressed discussion, it contented itself in the main with the suggestion that Congress should determine what expenditures are conducive to growth and should enact a program of such expenditures on a five year basis (75). It recommended that public policy should be directed towards promoting technical progress and basic research.

It did point out that federal tax policy should be favorable to growth and proposed that someone undertake a basic review of the tax system. This review, it suggested, should give particular attention to the relationship of depreciation rules and the taxing of capital gains to economic growth. It needs to be borne in mind, however, that the taxes which are in general conducive to growth (indirect taxes) are not those which have a stabilizing effect on the economy (corporate and personal income) (76).

The central idea in the chapter on fiscal policy is the formula tax plan. It was proposed as an indispensable means of short-run stabilization. Instead of doing so, it will, if enacted into law, accentuate cyclical fluctuations and stimulate inflationary pressures. Taxes will be lowered early in recession and raised, if at all, late in the boom. The measure will be used in the effort to perpetuate the boom. The result may be continuous inflation. The measure

(73) In his State of the Union message, January 11, 1962, President Kennedy asked for power to lower personal income tax rates. He did not request correlative power to increase these rates.

(74) Cf. BURNS, ARTHUR F., "Progress Towards Economic Stability". *The American Economic Review*. Volume 2. Number One. March 1960.

(75) *The Report of the Commission on Money and Credit*, pp. 150-152.

(76) Cf. statement of George Terborgh in *Fiscal Policy Implications of the Economic Outlook and Budget Developments*. Hearings before the Sub-committee on Fiscal Policy of the Joint Economic Committee, Congress of the United States, Eighty-Fifth Congress, First Session Pursuant to Sec. 5 (a) of Public Law 304. United States: Washington Government Printing Office, 1957, pp. 145-148.

may also be used as a means of bending the Federal Reserve System to the will of the administration. If the Board of Governors fails to do its bidding, threat will be made that tax rates will be reduced, with the consequence that our central banks will be faced with the task of financing the enlarged deficit.

VI - Debt Management

Problems of the public debt and its management, stated the Commission on Money and Credit, are closely linked to those of monetary policy and concern not the whole of the federal debt but only that part held by the public (77). On the 31st of October, 1961, the total federal debt amounted to \$296 billions of which \$213 billions were held by the public. The balance was owned by government agencies, government trust funds and the Federal Reserve Banks. The debt held by the public can itself be broken down into marketable, \$162 billions and non-marketable, \$51 billions. If one assumes that the proportionate amount of debt held by government agencies, government trust funds and the Federal Reserve Banks will remain constant, and that the proportionate amount of non-marketable debt which is held by the public will also remain constant, problems of public debt management concern simply the marketable debt held by the public. One can not, of course, put trust in this assumption. The amount of debt held by the government trust funds may decline and will do so unless the inflow of the funds obtained from social security taxes equals the outflow. Even the amount held by the Federal Reserve Banks may decline, if the central banking system promotes credit expansion through the lowering of reserve requirements rather than through open-market operations. And the public itself may reduce its ownership of the non-marketable debt. A conservative approach is to assume that problems of public debt management concern the whole debt.

The total federal debt, the Commission concluded, does not now constitute a burden on the economy. It has increased since the end of the war but has declined sharply in terms of total debt,

(77) *The Report of the Commission on Money and Credit*, pp. 94-95.

(78) *Ibid.*, p. 94.

federal and private (78). The debt is widely held so that there are no income distribution effects resulting from interest payments (79). Interest payments themselves have declined in terms of Gross National Product, which itself has risen sharply in terms of current dollars by reason of inflation and real economic growth. Inflation has been the principal factor reducing the burden of the debt, but, of course, at the expense of creditors.

The Commission recommended, and wisely so in my judgment, that the debt should not be insulated from market forces (80). It opposed the compulsory holding of the debt by commercial banks, i.e., opposed a secondary reserve requirement. It favored the elimination of the debt and interest rate ceilings (81). It also favored the advanced refunding of the maturing debt and suggested that the Treasury should experiment in the sale of long-term obligations on an auction basis (82). It favored the imposition of minimum margins on loans secured by the public debt in the effort to prevent private speculation (83).

The management of the public debt, the Commission pointed out, may retard or assist monetary policy. It should be managed in the interests of stability and growth (84). Before this can be achieved, the further shortening of the marketable debt should be arrested.

The average maturity of the marketable debt has fallen more than 50 per cent since the close of World War II and at the end of October, 1961, stood at four years and seven months. The time never seems opportune for a lengthening of the debt — in time of prosperity it is feared that the lengthening may check the boom and in time of recession that it may stifle the forces of recovery. In consequence the marketable debt becomes ever shorter. To the

(79) *Ibid.*, p. 97.

(80) *Ibid.*, p. 101.

(81) *Ibid.*, p. 113. The statutory debt limit was established at \$285 billions by Act of Congress approved on June 30, 1959. From July 1, 1961 to June 30, 1962 a temporary \$13 billion increase is effective, making the present limit \$298 billions. On July 1, 1962, in the absence of further legislation, it will revert to \$285 billions. President Kennedy has requested an increase in the debt ceiling to \$308 billions. The interest rate ceiling established in 1918, prevents a coupon rate exceeding 4 1/4 percent on Treasury securities of five years or greater maturity.

(82) *Ibid.*, p. 115. The Treasury has begun the practice of refinancing Treasury issues before their maturity.

(83) *Ibid.*, p. 117.

(84) *Ibid.*, p. 99.

extent that the Eisenhower administration was interested in floating long-term bonds, it was hampered, on occasion, by the existence of the interest rate ceiling. The Kennedy administration is enabled to circumvent this handicap by a ruling on the part of the President's brother, the Attorney General, that long-term bonds bearing a coupon rate of 4 1/4 per cent may be issued at a discount.

The Commission recommended that the debt be lengthened in periods of boom, in order that the Treasury may achieve a better maturity distribution (85). It ventured no opinion as to an optimum maturity distribution. Once a better maturity distribution were achieved, whatever this might be, the Commission concluded that the debt could then be so managed as to make a contribution to economic stability.

The maturity distribution is so skewed that the federal government should not confine its efforts in lengthening the debt simply to periods of prosperity. It must use every occasion to do so and, in the process, must place the debt with individual and institutional investors. The maturity and ownership distribution are closely linked. Long debt is held by investors, short debt by liquidity holders. As the American debt has shortened it has gravitated from the hands of investors into those of liquidity holders (86).

The Commission on Money and Credit did not, as did the Radcliffe committee, view debt management as the very center of monetary control (87). It concluded, on the contrary, that primary responsibility for achieving economic stability rested with monetary and fiscal policy (88). It did suggest that growth might be promoted by the issuance of savings bonds at competitive rates as a means of promoting thrift and of augmenting savings (89). Individuals, however, have not since the end of the war favored savings bonds as an investment medium. Higher interest rates were to be obtained on the shares of savings and loan associations and protection against inflation was to be found in the issues of investment trusts. The Commission did not favor the issuance of index bonds as a means of awakening the interest of investors in federal securities.

(85) *Ibid.*, pp. 103 and 105.

(86) The liquidity holders are state and local governments, corporations, and foreign commercial, central banks and governments.

(87) *Committee on the Working of the Monetary System*, p. 224, par. 603.

(88) *The Report of the Commission on Money and Credit*, p. 105.

(89) *Ibid.*, p. 107.

On the whole, the Commission minimized the role which public debt management may play in promoting economic stability and growth. In doing so it failed to recognize the important function of debt management in achieving national economic goals and failed to benefit from the experience of other nations, notably Canada and the United Kingdom.

VII - Summary and Conclusions

The Report of the Commission on Money and Credit was prepared under two severe handicaps. First, it had no specific task as, for example, did the National Monetary Commission of 1908. It was free to wander over the whole field of monetary, credit, fiscal and budgetary policies and did so with few inhibitions. Second, the members of the Commission were, on the whole, devoid of expert knowledge of the fields which they studied and, in addition, represented widely divergent and heterogeneous points of view. In consequence, the Report has the diffuseness of a general review and lacks the sharp focus of a specific assignment. This diffuse character is further aggravated by the variegated background of the members of the Commission. To be sure the technical papers have not as yet been published; it is possible that they may provide some of the depth which is lacking.

It is with a distinct air of disappointment that one completes the reading of the Report. Viewed against any absolute standard, it could have been much better; viewed against the perspective of the diverse membership of the Commission, it is perhaps not surprising that the Report sank to the level of dull mediocrity.

What then are the weaknesses in the Report? First, there is the assumption that the three economic goals selected by the Commission are immutable and compatible. There is little or no discussion of the need to establish priorities or of the conditions under which one goal may give way to another. The defense of the foreign exchange value of the dollar as a possible goal receives scant attention. The implication is that should America's deteriorating balance of payments interfere with the attainment of the trinity of goals, the dollar is to be sacrificed (90).

(90) Cf. SMITHIES, "The Commission on Money and Credit", *op. cit.*

Again the Report suffers from the absence of a unifying theme. The unifying theme in the Radcliffe report was the continuous emphasis placed on liquidity. It was through changes in liquidity that economic goals, whatever they might be at the moment, were to be achieved. The discussion of this topic may not have been carried to a completely logical conclusion. But, at least, there was an attempt and, not a wholly unsuccessful one, to provide an underlying and unifying theme. There is no such underlying or unifying theme in the Report of the Commission on Money and Credit. The Report skips about, discussing in disjointed fashion a large number of topics and making as many recommendations. Some of these proposals, such as those relating to branch banking, would, I believe, improve the financial system; others, such as those relating to our central banking system, would have a decidedly detrimental effect. There is no real integration of subject matter. This, the Commission might have accomplished, had it approached its task from the point of view of studying the needs and peculiarities of various credit markets, such as those involved in the financing of the credit requirements of business enterprise, of agriculture, of the consumer and of urban real estate. Such surveys could have been followed by an evaluation of the services of existing institutions and the desirability of altering them or of introducing new ones. The methods used in the financing of economic activity and the type of debt which is currently being monetized in the financing of such activity could have been appraised in relation to the various goals of policy (91).

In discussing the ways and means of attaining national economic goals, the Report is, in many instances, disappointingly superficial. Thus there is no discussion of the effect of a high federal budget even though balanced, in causing inflationary pressures. Only brief mention is made of the important role of selective credit controls in monetary policy. There is no discussion of the appropriate role of commercial banks in the financing of credit needs as opposed to that of the financial intermediaries. The implication of the Report is that there is no basic difference between credit and savings. Indeed there is no real discussion of the role which thrift or interest rates may play over the next decade. The Commission did not

(91) Cf. Footnote by H. Christian Sonne, a member of the Commission, on pp. 4-5, of *The Report of the Commission on Money and Credit*.

really grapple with the problems arising from the power of monopolistic trade unions to influence costs and prices.

In discussing the means which might be used to reduce cyclical swings, the Report was equally cursory. It did not seem to recognize the great complexity of the cycle. It assumed that diagnosis can be accurately and quickly made and that the results of the policies which are adopted can be foretold (92). It seemed to take the point of view that the spigot of purchasing power can be turned off and on at will and that the release of purchasing power will have certain predeterminable effects.

The prescriptions suggested by the Commission would, in my opinion, intensify the cycle instead of mitigating it. These include a reduction in the first bracket income tax rates as soon as income declines (93). Restrictive action, on the other hand, on the upward sweep of the cycle must not be taken too soon. Only when the upturn is definitely under way (the expression is not defined) would the tax cut be rescinded. Federal Reserve policy would move only gradually and continually in a restrictive direction (94). Government expenditures might, the Commission hastened to add, possibly be slowed down. In extremis, selective credit controls over consumer and mortgage credit might be employed. Emphasis is all on quick action on the downturn and slow action on the upturn. But if this is the action which is taken how can we obtain those cyclical declines in prices which will offset the cyclical increases and which are necessary to give us a stable price level?

The Commission's proposals would destroy the Federal Reserve System as an effective instrument of monetary and credit policy. The elimination of the Open-Market Committee would, as Mr. Sproul declared, cut the heart from the System. It would be destined to become a bureau of the Treasury Department. In the post-war period, the Reserve System has often been the only defender of the dollar. It was the only agency which worked for an unpegging of bond prices. Fiscal policy has been of little value in protecting the dollar and debt management has worked in the opposite direction.

(92) Cf. Statement by Theodore O. Yntema, a member of the Commission on p. 242, of *The Report of the Commission on Money and Credit*.

(93) *The Report of the Commission on Money and Credit*, p. 253.

(94) *Ibid.*, p. 254.

The Commission seems to believe that if power were concentrated in the executive branch of government, more could be accomplished in achieving the goals of national economic policy. It would concentrate such power not only by emasculating the Reserve System but also by delegating powers to the President to make tax changes, by charging him with the duty of issuing the Economic Indicators (now issued by the Joint Economic Committee) and by the further suggestion that he should sound economic alerts whenever he deems that the economy is not achieving its goals (95). In its concluding chapter the Commission seems to have forgotten its own initial statement that private enterprise has itself an important role to play in attaining these goals.

The influence which the Report may have on legislation is problematic. It has been discussed by the Joint Economic Committee and later will doubtless be discussed by those committees of the Congress, whose responsibility it is to introduce legislation by way of implementing the recommendations. Congress may seize upon those proposals which would graft inflation on the economy and reject those, such as branch banking, which would give the country a better financial structure. If this proves to be true, it would have been better had the Report never been issued.

New York.

B. H. BECKHART

(95) *Ibid.*, pp. 272-273.