

# MONEY AND BANKING



By HORACE WHITE

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**NEW EDITION**

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## PREFACE TO THE SIXTH EDITION

When we were requested by the publishers to undertake the revision of Mr. White's famous volume *Money and Banking* we thought that we would merely bring the historical narrative up to date, and we so planned our task. Some of our friends and colleagues in other universities suggested, however, that we should do more than that. They thought that an effort should be made to add enough new material so that it might be used as a textbook. This advice we have followed, and we hope that our efforts have not been unsuccessful.

In many ways it would have been easier, perhaps, to write a completely new volume. Those who know Mr. White's book as it appeared in earlier editions will, we hope, sympathize with the great difficulties presented in reorganizing, revising, and enlarging some of his chapters. Probably one third of the book remains as Mr. White left it in his last revision in 1914. Chapters III, IX-XI, and XVIII-XXI remain practically as he wrote them. Chapters V-VIII, XII-XIV, XXIII-XXX, and XXXII are new.

The names of publishers of those books listed for reference purposes which are still being printed have been supplied. Other books, although out of print, are doubtless to be found in libraries, etc.

As the work of revision progressed, our respect for the industry and scholarship of Mr. White increased steadily. How he managed to keep so closely in touch with what was happening in so many portions of the world was a continual source of amazement to us. We have, therefore, endeavored not to modify his major conclusions in any drastic manner. In some cases, however, it seemed necessary to do so, and we must assume the responsibility and gracefully accept the criticism which may be directed against us.

Mr. White was an advocate of "hard money," an ardent believer in the gold standard, and the soundest of sound-money men. Because we do not feel quite so certain or confident as he regarding the meaning of "sound" money and how to secure it, we hope that were he alive today he would not be too critical of what we have done. Most of us probably feel that we know less about monetary and banking theory today than we thought we did in 1929. We cannot but wonder what Mr. White would think had he lived through the chaos of the past five years.

Yet, all was not quiet, secure, and peaceful in the realm of money and banking during the years of Mr. White's active work. We have reprinted the major part of the prefaces which he wrote for the five editions through which this volume progressed. May we ask you to read these prefaces carefully? They describe in a brief form the monetary and banking perplexities of 1896, 1902, 1908, 1911, and 1914. We believe you will be impressed, as we were, by the clearness with which they reveal that seldom in our history have we been free from vexing problems of a monetary and banking nature. No wonder that upon occasion Mr. White expressed himself in no uncertain terms.

We deem it a rare privilege to have been permitted to undertake this task. It has been a fascinating one and from our point of view eminently worth while. We endeavored to make a revision which we thought would interest our own students. Whether we have been successful is not for us to decide.

C. S. T.  
L. A. F.

## PREFACES TO THE EARLIER EDITIONS

### PREFACE TO THE FIFTH EDITION

The fourth edition of this work was printed in 1911. It was occasioned by the publication of the plan for currency reform proposed by Senator Aldrich, chairman of the National Currency Commission. That plan was not put in the form of a bill for enactment by Congress. Mr. Aldrich himself soon thereafter ceased to be a member of the Senate; the Republican party, in the elections of 1910, lost control of the House of Representatives; and the plan slumbered. The national election of 1912 gave the Democratic party control of both legislative and executive branches of the government. Congress took up the banking and currency question, and framed and passed the Federal Reserve Act of December 23, 1913. The national banks of the country have accepted the plan, and the process of organizing the new system is now on foot. It will doubtless be in practical operation before the end of the present year.

In the movement of public opinion which has led to this action, three significant steps have been taken. In the Aldrich-Vreeland Act of 1908 asset currency was authorized, although none has actually been issued. In the plan of the National Monetary Commission a central bank system was outlined and indorsed, although not distinguished by that name, and provision was made for the eventual abandonment of bond-secured currency altogether. In the Federal Reserve Act a series of central banks has been provided for and made compulsory, and the same abandonment of bond-secured currency has been formulated. Finally, the government has taken supreme control of the Federal reserve system by means of a board at Washington City, appointed by the President of the United States. This does not mean control of the national banks in their separate capacity. Still less does it mean control of the state banks and trust companies, which now constitute about one-half of the banking power of the country.

H. W.

MARCH, 1914

### PREFACE TO THE FOURTH EDITION

During the past three years a marked change in public sentiment regarding the money question has forced its way into the national councils. In the act of May 30, 1908, the two houses of Congress, for the first time since the Civil War, agreed that a bond-secured currency was not the only kind of bank paper fit to circulate in the community. Although

no bank notes have been issued under the act, authority exists to issue them on the security of commercial paper owned by the banks and retained by themselves in associations formed for the purpose.

The preconceptions of the past having been shaken, other steps followed. A National Monetary Commission was formed, which has collected and published a mass of facts, of legislation, and of historical and general information on the subject of banking far exceeding in magnitude anything ever brought together heretofore in the world's history. Most, if not all, of this compilation is well worth its cost, for although no person can be expected to read the whole of it, all who are qualified to take part in the discussion, and in the working of framing monetary legislation, can readily find in it what they need.

Another indication of the drift of opinion is found in the act of Congress providing for the issue of bonds for the construction of the Panama canal, which are not available for security for national-bank circulation. These are the first bonds so issued since the national banking law was passed. It implies that the government now looks to the end of a bond-secured currency.

What is to take its place has not yet been decided. The chairman of the National Monetary Commission has outlined a plan for a Reserve Association of America, with a capital of \$300,000,000, which shall be the fiscal agent of the government and be owned by the national banks participating in proportion to their capital,—their shares not to be transferable. The American Bankers' Association has given a favorable reception to the plan through its Executive Council. Altogether there is now a fair prospect of legislation in some form which shall give us a flexible currency redeemable at all times in gold, and a loan market for commercial paper of standard grade which shall be available at a rate of discount uniform in all parts of the country where participating banks exist.

H. W.

## PREFACE TO THE THIRD EDITION

When the second edition of this work was published in 1902 the question of the standard of value, which had been in dispute for a quarter of a century, had been definitely settled in favor of gold. This was a long step toward stability in the medium of exchange, but some unsettled questions still remain.

There are \$346,000,000 of legal-tender notes outstanding. Whatever reasons there might have been for their existence in 1862 have long since passed away. They are a menace to the business interests of the country, an expensive kind of circulating medium, and a stumbling-block to currency reform. At every panic or unusual pinch in the money market we hear demands for fresh issues of legal-tender notes, and every movement in Congress for a more elastic bank-note system is met by similar de-

mands. The greenbacks ought to be put out of existence by redeeming \$150,000,000 of them with the gold now held for that purpose, and by canceling the rest as fast as they come into the Treasury, or by funding them in bonds to be sold at not less than par.

The Independent Treasury, established sixty years ago for the purpose of divorcing the government from the money market, has worked contrary to the intentions of its framers, and has resulted in abuses far greater than those which it was expected to correct. Thus we have seen public money, to the amount of hundreds of millions of dollars, deposited in banks without interest and distributed and redistributed among them according to the caprice or favoritism of the Secretary of the Treasury. Abuses more flagrant than any that were charged against the Bank of the United States in President Jackson's time are of common occurrence and pass almost unnoticed. The excuse for these transactions is that the keeping of public money locked up in the Treasury would be artificial contraction of the currency, that it would bring on a panic, and that it would be the greatest abuse of all. This plea is virtually an accusation against the government as a whole for looking at this growing evil slyly and without remedial action for twenty years.

We have a bank-note currency incapable of adjustment to the varying demands of trade. It is lacking in the element of elasticity which is the *raison d'être* of a bank's circulation. Such changes of volume as occur take place in long undulations, so that expansion does not become effective until after the immediate demand for it has ceased, and when the demand has ceased and contraction ought to follow, it is prevented or retarded by law. To retire \$100,000,000 of redundant notes requires eleven months' time under the present statute. The alternative is the exportation of gold or the heaping up of a surplus in the central reserve cities, thereby promoting unhealthy stock speculations. Both of these operations are going on at the present time. There is also a gorge of \$60,000,000 of bank notes in the Treasury now — notes sent in for redemption and actually redeemed, but which the clerical force of the department, although recently increased for this purpose, is inadequate to handle and to return to the issuing banks. This \$60,000,000 represents a call loan due from the banks to the government, a loan involuntary on both sides, and it has been growing for several months, although the government has been struggling like Laocoön to cast off the incumbrance.

This ironbound currency would have come to a timely end by the payment of the national debt had not its adherents devised a scheme for extending, for some thirty years, \$600,000,000 of bonds maturing in 1904, 1907, and 1908, thus putting an unnecessary burden of interest on the taxpayers and preventing the government from using its surplus to pay its debts. The existence of a growing surplus without such an outlet is a prolific source of demoralization, leading to ruinous extravagance in public expenditures. This is so grave a menace that one of the greatest

blessings to the country possible at the present time would be a Treasury deficit. This blessing we are likely to find soon.

The panic of 1907 brought the country to a realization of the fact that there is something radically wrong in our banking system. Business conditions in the United States in the period preceding the panic were not unlike those prevailing in the commercial world generally. Our resources were greater than those of any other country, yet ours was the only one afflicted by a general bank suspension. Why was the richest country in the world prostrated by the financial gale, while all others stood upright? Why did we remain prostrate two months, struggling desperately, with illegal shimplasters, to pay the wages of labor and to carry on retail trade? This question needs an answer before the next cycle of speculation comes to an end.

H. W.

NEW YORK, JUNE, 1908

#### PREFACE TO THE SECOND EDITION

The first edition of this work was published seven years ago. The intervening time has brought changes in our financial legislation, but still greater ones in public opinion.

The Civil War left us a legacy of monetary problems which might have received solution soon after the restoration of specie payments, had not the silver question been precipitated into the field of debate. At bottom this was a question whether gold or silver should be our standard of value, and until it was settled no question of lesser importance could gain the public ear. The election of 1896 settled it in favor of gold, — a fact attested in the gold standard act of March 14, 1900. This act is no longer called in question except by those who think that it falls somewhat short of its declared aims. Opposition to the principle embodied in it is no longer heard.

H. W.

NEW YORK, MARCH, 1902

#### PREFACE TO THE FIRST EDITION

On the 25th of February, 1862, the Government of the United States made its paper evidences of debt legal tender between individuals. The nation was thus sent upon the wrong road, and has been toiling in a wilderness ever since. In addition to the injustice which it wrought, the legal-tender act filled the public mind with misconceptions and delusions on the subject of money. So it came to pass that although we adopted irredeemable paper with the greatest reluctance, we were willing to flounder in it fourteen years after the supposed necessity for it had passed away. Then, partly by design, partly by chance, we resumed specie payments; but the people had, to a large extent, lost sight of the



fundamental principles of money. The misconceptions and delusions remained, the most dangerous and widely prevalent being the notion that mere quantity is a desirable thing, and that the Government can produce quantity and ought to.

It is the aim of this work to recall attention to first principles. For this purpose it has been deemed best to begin at the beginning of civilized life on this continent and to treat the subject historically. The science of money is much in need of something to enliven it. If anything can make it attractive it must be the story of the struggles of our ancestors with the same problems that vex us. The reader will find an abundance of these in the following pages. Indeed, a complete and correct theory of money might be constructed from events and experiences that have taken place on the American continent, even if we had no other sources of knowledge. This may be said of the science of banking also. All the wisdom and all the folly of the ages, as to these two related subjects, have been exploited on our shores within the space of less than three hundred years.

Very few persons, if any, are satisfied with our present monetary condition. While I write these lines a withdrawal of \$2,350,000 gold from the Treasury causes a fresh tremor and confusion of tongues. Everybody assures everybody else, and tries to assure himself, that it is of no consequence. Probably no harm will come of it, but why should it be noticed at all, except by a few dealers in foreign exchange? Because the public Treasury undertakes to maintain the ultimate gold reserve of the country, and because people doubt whether it can do so at all times. Are these doubts unreasonable? The only law on the statute book really effective for the discharge of this obligation was passed in 1862 for a different emergency, had been forgotten a quarter of a century, and was discovered by accident the last day in the afternoon. As regards the act of 1875 (under which gold was twice procured last year for the replenishment of the Treasury) it is a matter of dispute whether it is still in force, or whether it lapsed when specie payments were resumed. A dispute on such a question is itself an incentive to panic. Moreover, everything depends upon the mood and temper of the Administration for the time being whether such powers as the law confers shall be exercised wisely and promptly, or exercised at all.

Now suppose that the Government were out of the banking business altogether, its fiat money retired, and the Treasury restricted to its normal and proper business of collecting and disbursing the public revenue. In that case the duty of redeeming the paper circulation, and maintaining a sufficient gold reserve for the purpose, would devolve on the banks, and would be discharged automatically. The banks would learn by experience how large a reserve is required generally. In emergencies, when, for any reason, more should be required, they would obtain the means from their maturing bills receivable. This would come to them

either in the shape of their own circulating notes, thus lessening the call upon them for gold, or in gold itself, which the mercantile community would be obliged to procure and send in to them. Of course this implies a curtailment of discounts, but curtailment is not avoided under the present system. The curtailment in the panic of 1893 was as severe as it could ever be if the banks were solely responsible for the redemption of the paper circulation. But probably there would have been no panic at all at that time if the Government had been restricted to its proper business, and had not been issuing fiat money in large quantities.

It is thus apparent that the first step toward a rational system is the retirement and cancellation of the legal tender notes and the restriction of the Treasury to the duties for which it was originally and solely designed. When this is done the public mind will be so cleared that other reforms, and especially banking reform, may be hopefully undertaken.

Although banking is here treated historically, this volume must not be taken as a history of banking. I have merely selected such parts as serve to illustrate the principles of the science, to show what should be striven for and what avoided. The work of John Jay Knox, published after his death in Rhodes' *Journal of Banking*, was left in an unfinished state. If his life had been spared to give it the completeness and finish of his lesser work on "United States Notes" there would have been little left to be desired. Under the circumstances there is still room for such a work, which should be a coördination of facts and principles showing the movement of ideas.

My opinion is that the Scotch bank system is the best in the world and that we might borrow from it, as the Canadians have done, to our advantage. There are only ten banks in Scotland, but they have nearly one thousand branches, reaching every hamlet in the nation. Deposits are received and loans are made at each branch, but the branches pay out only the notes of the bank, which are redeemable at the head office. So it is necessary to have real money only in one place instead of perhaps one hundred different places. At the branches the bank's circulating notes answer the purposes of retail trade, while checks drawn against deposits answer all other purposes. Thus the maximum of business is done with the minimum of capital, which is the *raison d'être* of banking. In other words, credit has been systematized in Scotland to the last degree, and is found to answer all purposes so long as the paper sovereign can be converted into the gold sovereign at some convenient commercial center, at the pleasure of the holder.

I have been writing on these subjects in lectures and magazines several years. Thus the greater part of the chapters on the Gold Standard was published in a pamphlet in 1893, but it has been rewritten and important additions made. There may be some other passages that the reader has seen before, but the text is my own except where credit is given to others.

NEW YORK, AUGUST, 1895

H. W.

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## APPENDIX A

### PROPOSED BANKING ACT OF 1935

(As submitted to Congress)

The Banking Bill of 1935 was submitted to Congress early in 1935. It was sponsored chiefly by Governor Eccles of the Federal Reserve Board. Secretary of the Treasury Morgenthau and Comptroller of the Currency O'Connor complete the group which represented the administration in the attempt to secure passage of the bill. The bill had been debated in Congress some time before the President actively endorsed it.

The bill is very clearly divided into three parts, known as Titles I, II, and III. Title I deals exclusively with amendments to the Federal Deposit Insurance Law. Title II covers a variety of provisions increasing the powers of the Federal Reserve Board, and making the board more directly responsible to the administration through the agency of the President. Title III includes miscellaneous technical amendments to existing banking laws, most of which are of minor importance and against which there is very little criticism. On the whole, Title I is acceptable to all interested groups; therefore the controversy centers around Title II. The three titles will be considered in order.

#### TITLE I

1. In order to remain an insured bank under the Federal Deposit Insurance Corporation, a bank must become a member of the Federal Reserve System by July 1, 1937. (This provision is contained in an amendment to the Bank Act of 1933, which was passed in June, 1934.) Title II has a provision which waives the capital requirements for membership in the Federal Reserve System in the case of banks applying for Federal reserve membership which previously have been admitted to deposit-insurance benefits.

2. Deposits are insured only up to \$5000. The permanent provision of the previous law insured

100 per cent of the net amount not exceeding \$10,000

75 per cent of the amount by which such net amount exceeds \$10,000 but does not exceed \$50,000

50 per cent of the amount by which such net amount exceeds \$50,000

The temporary form of the previous law, which was extended for one year in June, 1934, insures deposits to a maximum amount of \$5000, as in this bill.

3. Each insured bank shall be assessed at the rate of one twelfth of 1 per cent per annum upon its total deposits. This assessment is based upon the average deposits as of the close of business of the last day of June and December of each year. It is important to note that this assessment is on the basis of total deposits, without any deductions for indebtedness of depositors or exemptions of any class of deposits. The board of directors of the Federal Deposit Insurance Corporation is authorized to fix a lower rate, or to provide for a refund, not to exceed 50 per cent, upon the last annual assessment. A lower assessment rate may be made for mutual savings banks.

4. In addition to the capital of the Federal Deposit Insurance Corporation, secured at the time it was organized, the corporation may, with the approval of the Secretary of the Treasury, issue its own notes, debentures, bonds, or any other such obligations in an amount not exceeding three times the amount received by the corporation in payment of its capital stock and of the first annual assessment upon insured banks.

5. The board of directors of the Federal Deposit Insurance Corporation may terminate the insured status of any bank which it believes to have knowingly or negligently permitted unsound banking practices. The deposits of any bank which voluntarily or involuntarily withdraws from the Federal Deposit Insurance Corporation shall continue to be insured for a period of two years, and the bank shall continue to pay annual assessments to the corporation.

## TITLE II

1. The President shall designate one of the six appointive members of the Federal Reserve Board as governor, and one as vice-governor. The bill further states that the President may terminate any designation as governor or vice-governor, and when this is done, such a person shall be deemed to have served the full term for which he was appointed. This last provision, perhaps, has caused more controversy and criticism than any other section of the bill. Critics point to this provision as making possible complete political domination of the Federal Reserve Board. The Supreme Court decision in the Humphrey case, May, 1935, would seem to prohibit the President from removing any appointive



member of the Federal Reserve Board other than the governor, who is treated separately in this bill, without showing due cause.

2. The President shall choose persons well qualified by education or experience or both as the six appointive members of the Federal Reserve Board. Originally (1913) the Federal Reserve Act stated that at least two members should have banking experience. Later the basis of selection was changed to one of a fair representation of financial, agricultural, industrial, and commercial interests, and of geographical divisions of the country. Not more than one of the appointive members shall be selected from any one Federal reserve district, except that this limitation shall not apply to the selection of the governor of the board. This bill increases the salary of the Federal Reserve Board members from \$12,000 to \$15,000 a year, together with necessary traveling expenses. This gives board members the same salary as the members of the President's cabinet. There is likewise a retirement-pension provision for each appointive board member who has reached the age of seventy, and who has served on the board for as long as twelve years. Such a person will receive \$12,000 a year for the remainder of his life. Those who have served for less than twelve years on the Federal Reserve Board will receive a pension upon retirement, but a smaller amount, depending upon the length of active service.

3. The membership of the Open-Market Committee is changed to five, consisting of the governor of the Federal Reserve Board, who shall be the chairman of the committee, two other members of the Federal Reserve Board selected by the board, and two governors of the Federal reserve banks selected by the governors of the Federal reserve banks. This committee is given complete control of open-market policies. In addition the committee is required to make recommendations to the Federal Reserve Board regarding the discount rates of the Federal reserve banks. The board apparently is not bound by the recommendations for rediscount-rate changes of the Open-Market Committee.

4. The position of the Federal Reserve Agent for each Federal reserve bank is abolished, and the governor is made chairman of the board of directors of the Federal reserve bank. (The agent formerly was chairman.) The governor, who is the chief executive officer of the Federal reserve bank, shall be appointed annually by the board of directors, subject to the approval of the Federal Reserve Board. He shall not take office until approved by the Federal Reserve Board, and upon approval he becomes one of the Class C directors of the bank.

5. Any Federal reserve bank may discount any commercial, agricul-

tural, or industrial paper and may make advances to any member bank on its promissory notes secured by *any sound assets* of such member bank. This amendment makes permanent an emergency provision contained in the Glass-Steagall Act which was used very little.

6. The Federal Reserve Board, in order to prevent injurious credit expansion or contraction, may change the reserve requirements to be maintained against time or demand deposits or both, by member banks in any or all Federal reserve districts and in nonreserve, reserve, and central-reserve cities.

7. The provisions under which a national bank may make loans on real estate are liberalized. The McFadden-Pepper Act of 1927 was the first step in the direction of liberalizing real-estate loans for national banks. The Banking Bill of 1935 provides that any national bank may make loans secured by first liens on improved real estate, including improved farm land and improved business and residential properties. For loans of three years' duration or less, the amount of the loan may not exceed 60 per cent of the actual value of the real estate offered for security. If, however, complete amortization is required within a period not exceeding twenty years, the loans may be made in an amount not to exceed 75 per cent of the actual value of the real estate offered for security. The bill further provides that real-estate loans of any one bank may total a sum equal to the total amount of the capital stock and the total unimpaired surplus of the bank, or a sum equal to 60 per cent of the bank's time and savings deposits, whichever is the greater. All real-estate loans continue to be subject to the general limitations relating to the amount of indebtedness of any one person to a national bank, that is, not more than 10 per cent of the bank's paid-up capital and surplus.

8. Each Federal reserve bank may issue Federal reserve notes, which shall be obligations of the United States, secured by a first and paramount lien on all assets of the issuing reserve bank. These notes shall be legal tender for all purposes. The requirement of 35 per cent gold certificates and lawful money as a legal reserve against Federal reserve bank deposits, and likewise the 40 per cent gold-certificate requirement against Federal reserve notes, are unaltered. It is not altogether clear from the bill whether specific assets of the reserve banks in addition to the gold certificates are pledged in order to provide a total backing of 100 per cent. This is probably of minor importance, since Federal reserve notes are given the first lien on all assets.

9. The Federal Reserve Board in its discretion may waive in whole

or in part the minimum capital requirements for Federal reserve membership for any insured state bank or trust company (insured by the Federal Deposit Insurance Corporation) applying for membership in the Federal Reserve System at any time before June, 1937. In the Bank Act of 1933 it was provided that state banks and trust companies situated in places with a population of less than 3000 must have capital of not less than \$25,000 in order to become Federal reserve members. Banks located in larger cities were required to have a larger minimum capitalization.

### TITLE III

Title III contains a number of miscellaneous provisions, only a few of which will be given here. No attempt will be made to list them in order of importance.

1. After July 1, 1937, shareholders in national banks will not be liable for more than their original investment. The Bank Act of 1933 stated that all new shares of national-bank stock would not carry double liability. This act applies to shares in existence before June, 1933.

2. Nonmember banks and private banks are permitted to deal in and underwrite investment securities to the extent permitted to national banks and state member banks.

3. No officer, director, or employee of any corporation or unincorporated association, no partner or employee of any partnership, and no individual primarily engaged in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail, or through syndicate participation, of stocks, bonds, or similar securities shall serve at the same time as an officer, director, or employee of any member bank except in special cases in which the Federal Reserve Board may allow such service by general regulations when, in the judgment of the Federal Reserve Board, it would not unduly influence the investment policies of such member bank or the advice it gives its customers regarding investments.

4. National and state member banks are permitted to buy and sell stock solely upon the order and for the account of customers.

5. No national bank shall be authorized to commence business until it shall have a paid-in surplus equal to 20 per cent of its capital, except that the Comptroller of the Currency may waive this requirement for a state bank converting into a national bank.

6. At least one tenth of the net earnings of a national bank must be paid into its surplus fund until the surplus is equal to its common capital.

7. Loans by member banks secured by obligations of the United

States shall not be governed by the limitation which prohibits a bank from making a loan to any one person in excess of 10 per cent of its capital and surplus.

8. Member banks may deduct from the amount of their gross demand deposits the amounts of balances due from other banks (except Federal reserve banks and foreign banks), including cash items with Federal reserve banks and other banks in the process of collection, checks on other banks in the same place, and exchanges for clearinghouses. The effect of this amendment would be to place in a more favorable position the banks having large deposits with other banks but holding on deposit only a relatively small amount of the funds of other banks.

9. Member banks are permitted to pay interest on demand deposits of funds of the United States, any territory, district, or possession thereof (including the Philippine Islands), or any public instrumentality or agency of the foregoing, with respect to which interest is required by law to be paid, and on demand deposits of trust funds, if the payment of interest with respect to such deposits is required by state law.

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

As was previously stated, Title II is the controversial section of this bill. The principal criticism is that the Federal Reserve System will be subjected to undue political influence because of the control which the President will have over the Federal Reserve Board, and especially over the governor. Another objection is that this bill deviates from the original principle of decentralized control. If there were assurance that the Federal Reserve Board would be as free from political pressure as, say, the Interstate Commerce Commission, then the latter objection would be less damaging.

There has been some agitation, principally from the administration, for a governmentally owned central bank in the United States. The pros and cons of a governmentally owned central bank will not be presented here, but it should be pointed out that some of the most successful central banks in foreign countries are not even owned by the commercial or joint-stock banks, but are owned and controlled by private persons.

**CHANGES IN THE BANKING ACT OF 1935****MADE BY SUB-COMMITTEE OF SENATE BANKING AND  
CURRENCY COMMITTEE**

After the House of Representatives had passed the Banking Act of 1935 in approximately the same form as given on the preceding pages, the Senate Banking and Currency Committee referred it to a sub-committee under the chairmanship of Senator Carter Glass. This sub-committee, after more than two months of hearings, made drastic changes in the bill as it was passed by the House and reported it back to the Senate Banking and Currency Committee on July 2, 1935. The Banking and Currency Committee, without a record vote, favorably reported the revised bill to the Senate.

The principal changes recommended by the Senate committee will be discussed in the order previously used. Most of the changes deal with Title II.

**TITLE I**

1. Only those banks with deposits of \$1,000,000 or more will be required to become members of the Federal Reserve System by July 1, 1937, in order to continue operating under the provisions of the Federal Deposit Insurance Corporation.

2. The one twelfth of one per cent assessment for participation in the insurance fund is to continue until the fund reaches \$500,000,000, after which the assessments will cease and will not be resumed until the fund has been impaired 15 per cent.

**TITLE II**

1. The present Federal Reserve Board is dissolved and in its place is substituted a body known as the Board of Governors, composed of seven members appointed by the President. The Secretary of the Treasury and the Comptroller of the Currency are not eligible to membership on this board. At least two of the members must be persons of tested banking experience, and not more than four of the members of the board shall be affiliated with the same political party. Members on the board are appointed for a term of fourteen years at an annual salary of \$15,000. A board member who has served a full term shall not be eligible for reappointment. A chairman and vice-chairman are appointed by the President to serve for terms of four years.

Members of the Board of Governors may be removed only for "cause." This provision is intended to remove the political pressure which might be brought to bear upon the Federal Reserve Board under the original act, where it was provided that the governor of the Federal Reserve Board might be removed by the President at will.

2. The chief executive officer of each Federal reserve bank is the president, who is appointed for a term of five years by the board of directors with the approval of the Board of Governors of the Federal Reserve System.

3. The Open-Market Committee is to consist of the seven members of the Board of Governors and five representatives of Federal reserve banks chosen annually by the twelve presidents of the Federal Reserve banks. No regional reserve bank is forced to participate in open-market operations as outlined by the Open-Market Committee.

4. The Board of Governors may not lower the present deposit reserve requirements for member banks, but it may increase them by as much as 100 per cent.

5. The Federal reserve banks may not buy bonds direct from the Treasury.

6. Each Federal reserve bank is required to restate its rediscount rate every two weeks, regardless of whether a change is recommended. These rates must be approved by the Board of Governors.

7. Real estate loans by member banks are more restricted than in the original form of the act. Real estate loans may be made only within the Federal reserve district, or within a one-hundred-mile radius of the bank. The loan may not be made for more than 50 per cent of the appraised value of the real estate offered as security, nor made for longer than a period of five years, except on a loan which provides for 50 per cent amortization within a period of not more than ten years.

### TITLE III

The principal change in this section grants permission for commercial banks to resume the function of underwriting securities. No mention was made of this phase of commercial banks' activity in the original draft of the Banking Act of 1935, but the Banking Act of 1933 prohibited all underwriting privileges.

1. Banks are permitted to underwrite single issues up to 20 per cent or not more than \$100,000, so long as this does not exceed 10 per cent of their unimpaired capital and surplus. A bank's aggregate underwritings

at any one time may not exceed 200 per cent of its unimpaired capital and surplus, and it is allowed to sell to customers, other underwriters, or correspondent banks.

If this provision is retained in the bill when it passes the Senate, then it will be necessary for a conference committee of the House and Senate to iron out the differences. It has been suggested that this provision may have been inserted in order that the Senate could yield on this point rather than on some others which it considers more important. This provision is likely to draw strong administrative criticism.

Although the revision was officially carried on by the sub-committee of the Senate Banking and Currency Committee, most commentators agree that it is principally the work of the sub-committee chairman, Carter Glass. Since Senator Glass was so active in drafting and securing passage of the original Federal Reserve Act of 1913, he is most interested in any changes affecting the provisions of that act. When the Banking Act of 1935 was first introduced, Senator Glass was most vehement in his criticism of it, but, although it was necessary for him to compromise on some points, he was in the main satisfied with it in its revised form.

## APPENDIX B

Important paragraphs from the decision of the Supreme Court of the United States (February 18, 1935) on the abrogation by Congress (June 5, 1933) of the gold clause in government bonds and private bonds and contracts.

### I. UNITED STATES GOVERNMENT BONDS

The question is necessarily presented whether the joint resolution of June 5, 1933 (48 Stat. 113), is a valid enactment so far as it applies to the obligations of the United States. The resolution declared that provisions requiring "payment in gold or a particular kind of coin or currency" were "against public policy," and provided that "every obligation, heretofore or hereafter incurred, whether or not any such provision is contained therein," shall be discharged, "upon payment, dollar for dollar, in any coin or currency which at the time of payment is legal tender for public and private debts."

This enactment was expressly extended to obligations of the United States; and provisions for payment in gold, "contained in any law authorizing obligations to be issued by or under authority of the United States," were repealed.

There is no question as to the power of the Congress to regulate the value of money, that is, to establish a monetary system and thus to determine the currency of the country.

The question is whether the Congress can use that power so as to invalidate the terms of the obligations which the government has theretofore issued in the exercise of the power to borrow money on the credit of the United States.

In attempted justification of the joint resolution in relation to the outstanding bonds of the United States, the government argues that "earlier Congresses could not validly restrict the 73rd Congress from exercising its Constitutional powers to regulate the value of money, borrow money, or regulate foreign and interstate commerce"; and from this premise, the government seems to deduce the proposition that when, with adequate authority, the government borrows money and pledges



the credit of the United States, it is free to ignore that pledge and alter the terms of its obligations in case a later Congress finds their fulfillment inconvenient.

The government's contention thus raises a question of far greater importance than the particular claim of the plaintiff. On that reasoning, if the terms of the government's bond as the standard of payment can be repudiated, it inevitably follows that the obligation as to the amount to be paid may also be repudiated.

The contention necessarily imports that the Congress can disregard the obligations of the government at its discretion and that, when the government borrows money, the credit of the United States is an illusory pledge.

We do not so read the Constitution. There is a clear distinction between the power of the Congress to control or interdict the contracts of private parties when they interfere with the exercise of its Constitutional authority, and the power of the Congress to alter or repudiate the substance of its own engagements when it has borrowed money under the authority which the Constitution confers.

In authorizing the Congress to borrow money, the Constitution empowers the Congress to fix the amount to be borrowed and the terms of payment. By virtue of the power to borrow money "on the credit of the United States," the Congress is authorized to pledge that credit as an assurance of payment as stipulated — as the highest assurance the government can give, its plighted faith.

To say that the Congress may withdraw or ignore that pledge is to assume that the Constitution contemplates a vain promise, a pledge having no other sanction than the pleasure and convenience of the pledgor. This Court has given no sanction to such a conception of the obligations of our government . . .

We conclude that the joint resolution of June 5, 1933, in so far as it attempted to override the obligation created by the bond in suit, went beyond the Congressional power.

The Question of Damages. In this view of the binding quality of the government's obligations, we come to the question as to the plaintiff's right to recover damages. That is a distinct question; because the government is not at liberty to alter or repudiate its obligations, it does not follow that the claim advanced by the plaintiff should be sustained.

The action is for breach of contract. As a remedy for breach, plaintiff can recover no more than the loss he has suffered and on which he may rightfully complain. He is not entitled to be enriched.

Plaintiff seeks judgment for \$16,931.25, in present legal tender currency, on his bond for \$10,000. The question is whether he has shown damage to that extent, or any actual damage, as the Court of Claims has no authority to entertain an action for normal damages . . .

Plaintiff demands the "equivalent" in currency of the gold coin promised. But "equivalent" cannot mean more than the amount of money which the promised gold coin would be worth to the bondholder for the purposes for which it would legally be used. That equivalent or worth could not properly be ascertained save in the light of the domestic and restricted market which the Congress had lawfully established.

In the domestic transactions to which the plaintiff was limited, in the absence of special license, determination of the value of the gold coin would necessarily have regard to its use as legal tender and as a medium of exchange under a single monetary system with an established parity of all currency and coins. And in view of the control of export and foreign exchange, and the restricted domestic use, the question of value, in relation to transactions legally available to the plaintiff, would require a consideration of the purchasing power of the dollars which the plaintiff has received. Plaintiff has not shown, or attempted to show, that in relation to buying power he has sustained any loss whatever.

On the contrary, in view of the adjustment of the internal economy to the single measure of value as established by the legislation of the Congress, and the universal availability and use throughout the country of the legal tender currency in meeting all engagements, the payment to the plaintiff of the amount which he demands would appear to constitute not a recoupment of loss in any proper sense but an unjustified enrichment. . . .

In the view that the facts alleged by the petition fail to show a cause of action for actual damages, the first question submitted by the Court of Claims is answered in the negative. It is not necessary to answer the second question.

## II. STATE AND LOCAL GOVERNMENT BONDS AND PRIVATE BONDS AND CONTRACTS

The question before the Court is one of power, not of policy. And that question touches the validity of these measures at but a single point, that is, in relation to the joint resolution denying effect to "gold clauses" in existing contracts . . .

## MONEY AND BANKING

When these contracts were made they were not repugnant to any action of the Congress. In order to determine whether effect may now be given to the intention of the parties in the face of the action taken by the Congress, or whether the contracts may be satisfied by the payment dollar for dollar, in legal tender, as the Congress has now prescribed, it is necessary to consider :

1. The power of the Congress to establish a monetary system and the necessary implications of that power.
2. The power of the Congress to invalidate the provisions of existing contracts which interfere with the exercise of its Constitutional authority.
3. Whether the clauses in question do constitute such an interference as to bring them within the range of that power . . .

The instant cases involve contracts between private parties, but the question necessarily relates as well to the contracts or obligations of states and municipalities, or of their political subdivisions, that is, to such engagements as are within the reach of the applicable national power.

The government's own contracts—the obligations of the United States — are in a distinct category and demand separate consideration.

Here, the Congress has enacted an express interdiction. The argument against it does not rest upon the mere fact that the legislation may cause hardship or loss. Creditors who have not stipulated for gold payments may suffer equal hardship or loss with creditors who have so stipulated. The former admittedly have no Constitutional grievances. And, while the latter may not suffer more, the point is pressed that their express stipulations for gold payments constitute property, and that creditors who have not such stipulations are without that property right . . .

The principle is not limited to the incidental effect of the exercise by the Congress of its Constitutional authority. There is no Constitutional ground for denying to the Congress the power expressly to prohibit and invalidate contracts although previously made, and valid when made, when they interfere with the carrying out of the policy it is free to adopt.

If the gold clauses now before us interfere with the policy of the Congress in the exercise of that authority, they cannot stand . . .

Despite the wide range of the discussion at the bar and the earnestness with which the arguments against the validity of the joint resolution have been pressed, these contentions necessarily are brought, under the dominant principles to which we have referred, to a single and narrow point.

That point is whether the gold clauses do constitute an actual interference with the monetary policy of the Congress in the list of its broad power to determine that policy . . .

The Congress is entitled to its own judgment. We may inquire whether its action is arbitrary or capricious, that is, whether it has reasonable relation to a legitimate end. If it is an appropriate means to such an end, the decisions of the Congress as to the degree of the necessity for the adoption of that means is final . . .

The Congress in the exercise of its discretion was entitled to consider the volume of obligations with gold clauses, as that fact, as the report of the House committee observed, obviously had a bearing upon the question whether their existence constituted a substantial obstruction to the Congressional policy.

The estimates submitted at the bar indicate that when the joint resolution was adopted there were outstanding seventy-five billion dollars or more of such obligations, the annual interest charges on which probably amounted to between three and four billion dollars.

It is apparent that if these promises were to be taken literally, as calling for actual payment in gold coin, they would be directly opposed to the policy of Congress, as they would be calculated to increase the demand for gold, to encourage hoarding and to stimulate attempts at exportation of gold coin . . .

The devaluation of the dollar placed the domestic economy upon a new basis. In the currency as thus provided, states and municipalities must receive their taxes; railroads, their rates and fares; public utilities, their charges for services. The income out of which they must meet their obligations is determined by the new standard. Yet, according to the contentions before us, while that income is thus controlled by law, their indebtedness on their "gold bonds" must be met by an amount of currency determined by the former gold standard.

Their receipts, in this view, would be fixed on one basis; their interest charges and the principal of their obligations, on another.

It is common knowledge that the bonds issued by these obligors have generally contained gold clauses, and presumably they account for a large part of the outstanding obligations of that sort. It is also common knowledge that a similar situation exists with respect to numerous industrial corporations that have issued their "gold bonds" and must now receive payments for their products in the existing currency.

It requires no acute analysis or profound economic inquiry to disclose the dislocation of the domestic economy which would be caused by such a

disparity of conditions in which, it is insisted, those debtors under gold clauses should be required to pay one dollar and sixty-nine cents in currency while respectively receiving their taxes, rates, charges and prices on the basis of one dollar of that currency . . .

The judgment and decree, severally under review, are affirmed.

### III. DISSENTING OPINION

Justice McReynolds, dissenting in all cases, said :

Mr. Justice Van Devanter, Mr. Justice Sutherland, Mr. Justice Butler and I conclude that, if given effect, the enactments here challenged will bring about confiscation of property rights and repudiation of national obligations.

Aquiescence in the decisions just announced is impossible; the circumstances demand statement of our views. . . .

† Just men regard repudiation and spoliation of citizens by their sovereign with abhorrence; but we are asked to affirm that the Constitution has granted power to accomplish both. No definite delegation of such power exists; and we cannot believe the farseeing framers, who labored with hope of establishing justice and securing the blessings of liberty, intended that the expected government should have authority to annihilate its own obligations and destroy the very rights which they were endeavoring to protect. . . .

The Federal government is one of delegated and limited powers which derive from the Constitution. "It can exercise only the powers granted to it." Powers claimed must be denied unless granted; and, as with other writings, the whole of the Constitution is for consideration when one seeks to ascertain the meaning of any part. . . .

Four cases are here for decision.

Two of them arise out of corporate obligations containing gold clauses — railroad bonds.

One is based on a United States Fourth Liberty Bond of 1918, called for payment April 15, 1934, containing a promise to pay "in United States gold coin of the present standard of value" with interest in like gold coin.

Another involves gold certificates, series 1928, amounting to \$106,300.

As to the corporate bonds the defense is that the gold clause was destroyed by the resolution of June 5, 1933, and this view is sustained by the majority of the Court.

It is insisted that the agreement, in the Liberty Bond, to pay in gold also was destroyed by the act of June 5, 1933. This view is rejected by the majority; but they seem to conclude that because of the action of Congress in declaring the holding of gold unlawful, no appreciable damage resulted when payment therein or the equivalent was denied.

Concerning the gold certificates it is ruled that if upon presentation for redemption gold coin had been paid to the holder, as promised, he would have been required to return this to the Treasury. He could not have exported it or dealt with it. Consequently he sustained no actual damage . . .

The authority exercised by the President and the Treasury in demanding all gold coin, bullion and certificates is not now challenged; neither is the right of the former to prescribe weight for the standard dollar. These things we have not considered. Plainly, however, to coin money and regulate the value thereof calls for legislative action. . . .

This Court has not heretofore ruled that Congress may require the holder of an obligation to accept payment in subsequently devalued coins, or promises by government to pay in such coins. The legislation before us attempts this very thing. If this is permissible, then a gold dollar containing one grain of gold may become the standard, all contract rights fall, and huge profits appear on the Treasury books. Instead of \$2,800,000,000 as recently reported, perhaps \$20,000,000,000, maybe enough to cancel the public debt, maybe more!

The power to issue bills and "regulate values" of coin cannot be so enlarged as to authorize arbitrary action, whose immediate purpose and necessary effect is destruction of individual rights. As this Court has said, a "power to regulate is not a power to destroy" (154 U. S. 362, 398).

But we must not forget that if this power exists, Congress may readily destroy other obligations which present obstruction to the desired effect of further depletion. The destruction of all obligations by reducing the standard gold dollar to one grain of gold, or brass or nickel or copper or lead will become an easy possibility.

Thus we reach the fundamental question which must control the result of the controversy in respect of corporate bonds. Apparently in the opinion of the majority the gold clause in the Liberty Bond withstood the June 5th resolution notwithstanding the definite purpose to destroy it.

We think that in the circumstances, Congress had no power to destroy

the obligations of the gold clauses in private obligations. The attempt to do this was plain usurpation, arbitrary and oppressive . . .

Congress may coin money; also it may borrow money. Neither power may be exercised so as to destroy the other; the two clauses must be so construed as to give effect to each. Valid contracts to repay money borrowed cannot be destroyed by exercising power under the coinage provision. The majority seem to hold that the resolution of June 5th did not affect the gold clauses in bonds of the United States.

Nevertheless we are told that no damage resulted to the holder now before us through the refusal to pay one of them in gold coin of the kind designated or its equivalent.

This amounts to a declaration that the government may give with one hand and take away with the other. Default is thus made both easy and safe!

Congress brought about the conditions in respect of gold which existed when the obligation matured. Having made payment in this metal impossible the government cannot defend by saying that if the obligation had been met the creditor could not have retained the gold; consequently he suffered no damage because of the non-delivery. Obligations cannot be legally avoided by prohibiting the creditor from receiving the thing promised.

Counsel for the government and railway companies asserted with emphasis that incalculable financial disaster would follow refusal to uphold, as authorized by the Constitution, impairment and repudiation of private obligations and public debts.

Their forecast is discredited by manifest exaggeration.

But, whatever may be the situation now confronting us, it is the outcome of attempts to destroy lawful undertakings by legislative action; and this we think the Court should disapprove in no uncertain terms.

Under the challenged statutes it is said the United States have realized profits amounting to \$2,800,000,000.

But this assumes that gain may be generated by legislative fiat. To such counterfeit profits there would be no limit; with each new debasement of the dollar they would expand. Two billions might be ballooned indefinitely — to 20, 30, or what you will.

Loss of reputation for honorable dealing will bring us unending humiliation; the impending legal and moral chaos is appalling.

## IV. PRESIDENT'S MESSAGE OF JUNE 27, 1935

Because of the fact that a number of suits were soon brought against the United States by holders of government bonds who believed that they could prove damage, President Roosevelt, on June 27, 1935, sent a message to Congress asking that body to withdraw the consent of the government to be sued upon its currency or securities. Several paragraphs from the message follow :

Before the termination of this session of the Congress, I believe that it is important that definite action be taken to eliminate any uncertainty with respect to the right of holders of gold clause bonds of the government to sue for payment either in gold or else in legal tender with an additional sum of 69 cents on every dollar.

To this end, I urge the withdrawal by the United States of its consent to be sued upon its currency or securities.

The question of the effect of the so-called gold clause, in the light of the monetary legislation of the 73rd Congress, came before the Supreme Court at the term just closed.

A suit for additional payment under existing circumstances, the court said, would "constitute not a recoupment of loss in any proper sense but an unjustified enrichment."

[Bonds of the United States containing gold clauses — all of them issued, sold and payable wholly within the United States — have been continuously quoted on the exchanges at no higher prices than bonds not containing such clauses. But the continuing possibility of actions by litigious persons leaves open the continuing possibility of speculation.]

There is no public interest, under these conditions, in permitting a handful of private litigants to exploit the general public in the hope of a wholly speculative private profit.

This conclusion will hold so long as the Congress adheres to its declared policy, now more than a third of a century old, to maintain the equal value of every dollar in the market.

I recommend, therefore, the enactment of legislation which will make clear that it is our fixed policy to continue to treat the bondholders of all our securities equally and uniformly, to afford any holder of any gold clause security, who thinks he could by any possibility sustain any loss in the future, an opportunity to put himself immediately in a position to avoid such future loss, and to remove all possibility of any suits designed



to hamper the government in administering the public debt and in financing its ordinary and emergency expenditures.

There is no Constitutional or inherent right to sue the government. On the contrary, the immunity of the sovereign from suit is a principle of universal acceptance, and permission to bring such suits is an act of grace, which, with us, may be granted or withheld by the Congress.

The courts, it is hardly necessary for me to add, will always be open to those who seek justice, but they were not established for use by a few to enrich themselves at the expense of the many, nor to enable a few to harass and embarrass sovereign action by the government when taken for the benefit of all.

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