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*THE MYSTERIES OF THE FEDERAL RESERVE SYSTEM**

The Federal Reserve System, hereinafter frequently referred to as FED, is fearfully yet wonderfully made. No one appears to know with certainty whether it is a private institution owned by the member banks or a federal government instrumentality belonging to the people of the United States.

In times past FED was generally regarded a private institution. More recently, for reasons which are the substance of this article, even the governors of the system have been stoutly contending that it is a governmental agency. They have, however, with equal vigor objected to every suggestion that it act as such.

So the mystery deepens.

It happens to be one in whose unravelling the American people have an almost limitless interest. For the Federal Reserve controls the money supply of the nation and is, therefore, in position to decide at what level the economy may operate. Furthermore, FED exercises a virtually unlimited power to create the country's money, ninety percent of which consists of Federal Reserve notes.

When the Federal Reserve Act was passed in 1913, Senator Robert Owen of Oklahoma was chairman of the Banking and Currency Committee in the United States Senate. He believed that his committee had recommended to the Senate legislation creating a government-owned institution whose main function was to be the creation of the nation's money for the benefit of all the people.

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Unfortunately, Senator Owen was handicapped by blindness, and some of his colleagues on the committee made changes in the bill which resulted in providing that the banks of the nation should own the capital stock of the Federal Reserve System while only giving *permission* to the Secretary of the Treasury to purchase such stock for the account of the government when, as, and if he so desired. That permissive opportunity has never been exercised. Senator Owen was crushed in spirit by this turn of events, as manifested whenever he related the story to the author of this article. I knew the former Senator well during the years I served in Congress.

Whatever the legal niceties inherent in the true nature of FED's status in its early years, there was never much doubt over the matter of its activity or over who controlled FED policies and actions. For FED did *not* act as a government instrumentality of the nation, nor were its policies and practices determined with the welfare of the nation in mind. Instead of that, the banks and bankers ran the FED and ran it for the benefit of the financial community in almost every respect.

A primary purpose of the act when originally passed was said to be to prevent ups and downs in economic activity–above all, to prevent recurrent periods of inflation and depression. The record of performance shows that in May, 1920, by a drastic increase in its rediscount rate, i.e., the rate of interest that FED charges banks when they borrow from it, one of the sharpest declines in business activity and one of the most dramatic collapses in prices were deliberately brought about. The result was a depression from which American farmers never recovered until the coming of World War II. Again, FED was in full possession of all its powers and faculties when the most disastrous depression in the nation's history broke over the country and its people in October, 1929. In each case there were bankruptcies and foreclosures aplenty. In each case the value of money increased sharply, and the value of all real wealth declined correspondingly. No matter who actually owned the Federal Reserve System, it acted in a manner diametrically against the welfare of the nation and its government and equally diametrically for the interests of the money-lenders and money-creators of whom FED itself was principal.

In consequence of such experience and practical evidence, there occurred periods of protest during which demand was made in Congress and throughout the nation for monetary reform. There was loud outcry that the Federal Reserve Act be repealed. There was even more vigorous and sustained demand that, since all the evidence indicated that FED considered itself a creature and servant of the banking system and not of the nation, its capital stock be purchased by the government from the banks and the System be made what Senator Owen had originally conceived it to be, namely, a central bank of issue *FOR* the United States.

Naturally, such agitation reached its height during the depths of the Great Depression. The recognized leader of the protest movement was–and always continued to be subsequently–Congressman Wright Patman of Texas. During the New Deal years, Patman's bill to nationalize the Federal Reserve boasted as many as 125 to 150 supporters in the House and a corresponding, though of course smaller, number in the Senate. This author was one of Congressman Patman's loyal supporters. The following excerpt from a speech delivered by myself in the House in June, 1938, indicates the thrust of the reformers' thinking at that time.

> All of us want to see America grow. All of us want a free economic system. All of us want to keep our democratic life. But, in order to do these things, we must have the kind of dollar of which the President has spoken, when he said, "A dollar which will have the same purchasing and debt-paying power a generation hence as it has today." In order to accomplish this, we must, first of all, determine to manage our monetary system in the public interest, and to restore to Congress its constitutional right to coin money and regulate its value. Various suggestions as to how to accomplish this and how to solve the dilemmas referred to above are now before Congress. Basic to them all is the national ownership of the capital stock of the 12 central Federal Reserve banks, in connection with which, incidentally, the Government would acquire clear title to $12,000,000,000 of gold, which title now technically vests in the Federal Reserve banks. The Patman bill–H.R. 7230–of which some 150 Democratic Members of the House are co-authors, provides for this. Equally basic, it seems to me, is the necessary assumption by Government of the right to create its own credit for the purpose of making secured loans and advances to industry, home builders, farmers, small-business men, and revenue-producing public works.

From the above passage it will be clear that many of us, at that time, believed that the Federal Reserve System was a privately owned institution and that if it were ever to exercise its vast powers in the public interest it was necessary for the government to buy the stock held by the banks. Our belief was surely justified by the record.

At this point, one widely held misconcpetion should be corrected. A great many people believe that when the federal government runs a deficit the government itself creates the amount of money represented by that deficit. Frequently, the remark is heard to the effect that one cause of our present inflation is that "the government has been running the printing presses to print a lot of money." The fact is that the United States Government has not created a single paper dollar since Abraham Lincoln did so to help finance the War between the States—and thus saved the taxpayers of following years several billion dollars in interest they would otherwise have had to pay. Except for that single instance, the government of the United States has never created, printed, or issued for itself and its people a single dollar.

Well, we do have money. How then does it come into existence? Let two unimpeachable authorities answer that question. First, Marriner Eccles, then chairman of the Board of Governors of the Federal Reserve System, in testimony before the Banking and Currency Committee of the House of Representatives on the Banking Act of 1935. Mr. Eccles testified:

> In purchasing offerings of Government bonds, the banking system as a whole creates new money, or bank deposits. When the banks buy a billion dollars of Government bonds as they are offered—and you have to consider the banking system as a whole, as a unit—the banks credit the deposit account of the Treasury with a billion dollars. They debit their Government bond account a billion dollars, or they actually create, by a bookkeeping entry, a billion dollars.

Second, President Eisenhower's Secretary of the Treasury Anderson in an interview with *U.S. News and World Report* on August 31, 1959:

> *Question:* Do you mean that banks, in buying Government securities, do not lend out their customers' deposits? That they create the money they use to buy the securities?
> *Answer* (by Secretary Anderson): That is correct. Banks are different from other lending institutions. When a savings and loan association, an insurance company, or a credit union makes a loan, it lends the very dollar that its customers have previously paid in. But when a bank makes a loan, it simply adds to the borrower's deposit account in the bank by the amount of the loan. The money is not taken from anyone else's deposit; it was not previously paid in to the bank by anyone. It's new money, created by the bank for the use of the borrower.

The banks—commercial banks and the Federal Reserve—create ***all*** the money of this nation, and the nation and its people pay interest on every dollar of that newly created money. Which means that private banks exercise unconstitutionally, immorally, and ridiculously the power to tax the people. For every newly created dollar dilutes to some extent the value of every other dollar already in circulation.

Money-creation is the greatest economic power known to man. That power ought always to be exercised in the interest of all the people, never for the sake of private gain of a privileged few.

Well, now our story turns a kind of corner. It appears that our agitation of the 1930s and early 1940s had some effect after all. For either that agitation or perhaps some divine intercession seems to have disturbed the consciences of the Federal Reserve bankers along about the mid-1940s. It is a reasonable guess that they began for the first time to face the fact that FED was in an intolerable and certainly indefensible position. FED—along with the commercial banks—was exercising a power, that of money creation and monetary control, which is properly an *exclusive prerogative of government*. Furthermore—and here lies the most flagrant abuse—FED was using this money-creating power to buy bonds of the Government itself and to collect interest on these bonds. By so doing, FED was violating the Constitution which vests in Congress, and in Congress alone, the power "to coin money and regulate the value thereof" (Art. I Legislative Dept., Sec. 8). At the same time FED was claiming, in effect, the right to do exactly as it pleased with its vast powers, unencumbered by responsibility to anyone—the President, the Congress, or the people. In other words, FED was claiming the opportunity to act as a private institution completely independent of the Government while exercising powers clearly governmental in character. Something just had to be done.

The first step was taken quietly, without any publicity or notice to anyone outside the inner circles. It had to do with the obvious injustice involved in the bond purchases. In the year 1947 FED began a policy of paying back to the United States Treasury a portion of its net income, almost all of which has come to consist of the interest collected on the FED's holdings of Government bonds and other evidence of the people's debt. This diametric change in policy was probably due to the belated recognition of the colossal injustice of a situation whereby FED was creating money against the credit of the United States and using that money to buy bonds of that same United States and collect interest on them. The payments at first were small, almost token ones. In 1947 only $75 million was paid to the Treasury while almost $100 million was put into FED's surplus account, $65 million absorbed in expenses, and $11 million paid in dividends to the shareholding banks. Five years later, in 1952, $292 million was paid to the Treasury, $46 million transferred to surplus, $104 million charged to expenses (unaudited by anyone, incidentally), and nearly $15 million paid in dividends to the banks. Since then payments to the Treasury—actually REpayments to the Treasury of part of what should have belonged to the Treasury all the time—have climbed steadily. In 1971, $3,356 million of interest collected on Government bonds was paid to the Treasury while a total of $460 million was taken into surplus, charged to expenses, or paid in dividends. The major reason for this very large increase in repayments to the Treasury has been, of course, the escalation of interest rates on Government securities.

On June 20, 1973, a letter to Senator Alan Cranston of California from the Board of Governors of the Federal Reserve System described the 1972 transactions as follows:

> Earnings on U.S. Government securities held by the 12 Banks of the Federal Reserve System amounted in 1972 to $3,771,209,607. These earnings provided the bulk of System income for the year—$3,792,334,523—as the enclosed press release indicates. Also, as the release indicates, $3,231 million was paid into the U.S. Treasury last year as "interest on Federal Reserve notes."

Just why FED calls its payments to the Treasury "interest on Federal Reserve notes" instead of repayment of interest collected on Government bonds is something of a mystery. For the amount paid to the Treasury all comes out of the interest received. We may guess, however, that FED is anxious to establish the conception that Federal Reserve notes are properly issued money of the United States. But the important point is that these repayments constitute clear admission on the part of FED itself that it has no moral, economic, or any other kind of right to any of the interest it collects on Government bonds. Perhaps in order to blur that tacit admission the governors of the Federal Reserve System have begun in very recent years to testify before Congressional Committees that FED is in fact an institution belonging to the U.S. Government, that the stock held by the member banks somehow does not represent equity ownership, and that in case of FED's liquidation all assets of the System would revert to the Treasury of the United States.

So the mystery deepens. For although rendering such testimony, these same governors continue stoutly to claim complete independence of all governmental control. They continue to assert FED's license to make decisions affecting the nation's entire economy in complete secrecy and without reference to either governmental policy or the needs of the nation. They continue to resist efforts of Congress even to have an audit of FED's books. Such an audit has NEVER been made. There cannot, either in decency or in logic, be a branch of the Government independent of all the rest. The present compromise—paying back to the Treasury part of the interest received on holdings of Government bonds—is not enough to justify the continuing complete independence of FED from control by the Congress and the Administration.

Especially is this true in view of the fact that FED has so often failed to act in the public interest and has sometimes appeared to act contrary to that interest. It is time the mystery of the Federal Reserve System was unravelled.

For one thing, if FED is, as the governors claim, a governmental agency and not an unconstitutional usurper acting illegally, then whenever FED creates money—as it does in order to purchase U.S. Government securities—that transaction would be a purchase by the Government of its own debt. Elementary logic would seem to dictate that in such a case the debt would be cancelled and the bonds destroyed—like burning a mortgage when it has been paid off. But this does not happen. The people are in debt as much as ever and are now paying interest to FED instead of to private banks. If we consider logic and simple justice, the fact that FED does return a large portion of the interest to the Treasury is, at the moment, beside the point. The clear principle involved is that once an agency of the Government has bought in a bond or other certificate of that Government's debt all interest payments on that portion of the debt should cease forthwith. To cite an instance: Had that been done, the national debt of the American people as of early 1975 would have been reduced by $93 billion, the amount of U.S. securities then held by FED. Moreover, adherence to the principle would alter one present practice whereby FED attempts to control the volume of money in circulation. For whenever FED wants to reduce the amount of money available in the banks for lending, FED sells Government securities to them. If FED were required to cancel all the bonds it purchased, then FED would have no Government bonds in its portfolio to sell. But the System has other powers that could be used, notably its power to increase reserve requirements in the banks. This would be equally, if not more, effective in reducing the ability of the commercial banks to create deposits on their books and lend them into circulation at interest. The banks would no doubt oppose such a change in method of monetary control because in that case they would not collect interest on bonds sold to them by FED. From the viewpoint of the nation, however, to increase reserve requirements would be a cleaner, more direct, and much better method for it would enable the national debt to be reduced whenever FED purchased Government bonds from the banks.

For many years and until the day of his recent death, Congressman Wright Patman of Texas had been trying to get legislation enacted that would require an audit of the FED's books. Since the expenses of FED are a substantial charge against its income, they directly affect the amount of repayments to be made to the Treasury. Clearly, then, the nation has a right to know whether those expenses are legitimate in amount. An audit would provide that information.

Finally, it is high time that the policies of FED be determined publicly and not in secret as at present, and that those broad policies be subject to control by Congress and the Administration. Recent history underlines this need, for the basic policy of FED since 1965 has been to force interest rates upward on the outworn theory that high interest rates will curb inflation. The simple fact is that they have done no such thing. They have instead shackled production, caused economic stagnation and unemployment, and made inflation greater still. It is not hard to see why these should be the results, for the cost of money enters into the cost of almost every item of production in the economy. The higher the interest rate, the more businesses must add to their prices, and the harder it is to finance production and thus to increase supply—which is the basic way to bring prices down. Also, bankruptcies become more frequent. Furthermore, it can be shown that inflation of prices has paralleled rising interest rates ever since FED boosted its rediscount rate by 12½% in December, 1965. From 1960 to 1965, price inflation was never more than 1.5% a year. Once the high interest policy went into effect, inflation began to climb and reached 6.2% in 1970. What is more still, be it noted that FED's 1965 change of policy was made over the vigorous protest of the President of the United States! Since 1970 inflation—and interest rates as well—have soared to the highest levels in history.

The policies of the Federal Reserve System should be forced to reflect the policies of the United States Government, of which FED claims itself to be a part. Time was when, for a brief period, this was the case. During the term of both the Roosevelt and Truman Administrations, including the World War II years when inflationary pressures were at their height, interest rates on Government debt were held at below 3%. Consequently, all interest rates remained reasonable, and the nation recovered well from the exactions of the greatest war in history. These results were brought about by a practice of FED's providing a market for low-yield Government securities whenever they could not be sold to other buyers. Had that policy been continued, the whole subsequent economic history of the nation would have been different. But the Eisenhower Administration turned FED loose—and interest rates too. They have been rising ever since, though never as sharply as since 1965. The result is an astronomical interest cost to the taxpayers on the national debt, a cost that now amounts to some

$60 billion a year. At Roosevelt-Truman rates, that figure would be less than half what it is, and some $25 billion or more a year would be available for constructive governmental programs, such as the development of clean sources of energy.

FED cannot have it both ways. Either it is a private agency in which case FED has no moral, legal, Constitutional, or economic right to create the money of the nation (neither do the commercial banks, but that is another story) or else it is a Government agency in which case FED must be made subject to control by Congress and the Administration in the public interest. The Federal Reserve System must, in short, cease to be a mystery.

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But suppose it did. Suppose FED did cease to be a mystery and were brought under the same type of control that Congress and the Executive Department exercise over Government agencies. Would that solve all the nation's pressing and deeply rooted problems? Hardly. On the other hand, a centrally important and up to now ill-used tool would at last be available for working toward such solutions. Everything would depend, of course, on the policies of the elected representatives of the people—the Congress and the President. And if the people were to wisely choose representatives of vision and courage, the following results among others could ensue:

(1) FED could be required to maintain a low-interest rate policy instead of its present one. The present intolerable drain on the resources of agriculture, industry, and individuals that high interest exacts could be eased. Prices could come down sharply as a result. Employment, especially in home construction, could be revived. Farming could be profitably carried on at substantially reduced cost.

(2) The Federal Reserve System could be required to do the job it was originally conceived to do, that is, to accommodate the economy of the United States with a proper monetary supply geared to economic growth. And this could be done without increase in the national debt. A properly audited FED could be compelled to pay back to the nation's Treasury not part but all of the income FED derives by creating the nation's money. As is the case for all other Governmental agencies, FED's necessary expenses would be provided by Congressional appropriation.

And whenever additions to the money supply were called for in order to bring the economy out of a recession, FED could be required to purchase non-interest bearing bonds of the United

States, thus cutting the nefarious knot that at present ties our money supply to a never-ending increase in the nation's debt.

(3) In order to moderate an inflation, a Government-controlled FED could be required to institute selective credit regulations and, if more action were needed, to raise reserve requirements in the commercial banks.

In summary, a Federal Reserve System brought under control by the elected officials of the United States could be run in the public interest instead of in that of the moneylending community as is now the case.