(1)

MEMORANDUM RELATIVE TO CHICAGO RATE CONTROVERSY

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Memo showing changes of past 2 mos in Stock Exch loan a/c as reported to us - divided
(a) Loans by Mr. banks
(b) " " other banks.
(c) " " " lenders.

last year

Memo showing changes in S. Exch call money rates last 2 months -

Compared with year ago

Memo. showing changes in (Mr Bank) our gold reserve last two months by weeks -

compared with year ago.

Memo. showing sterling dollar rates last 3 months.

last year

Total net gold imports this year to date.

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59.5
48.74

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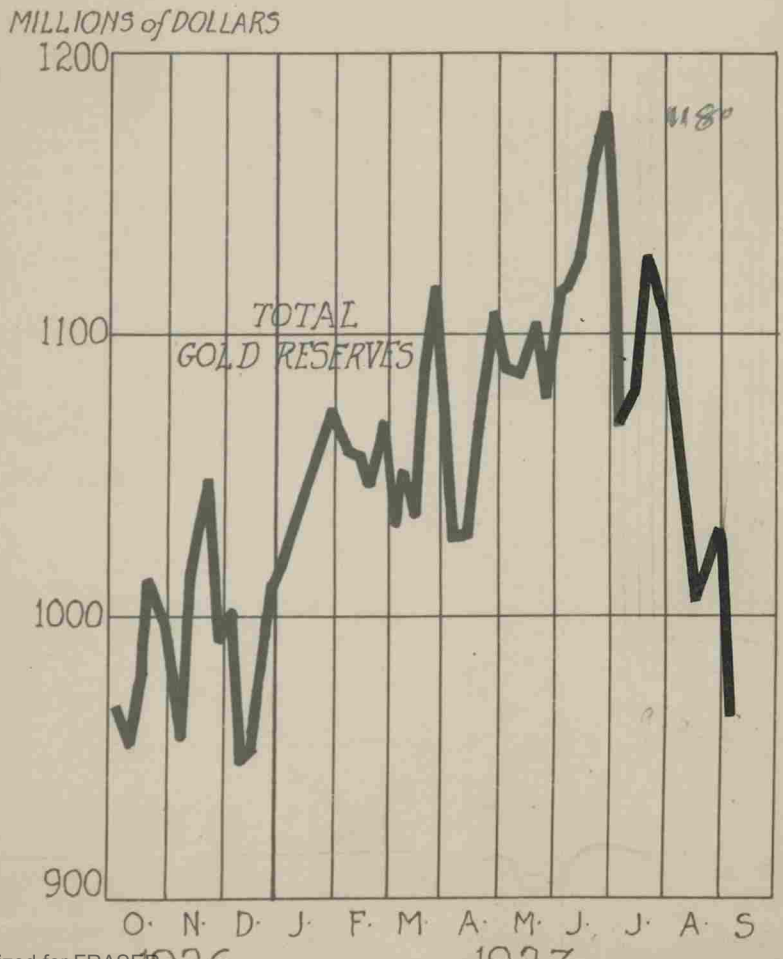
CHANGES IN GOLD RESERVES

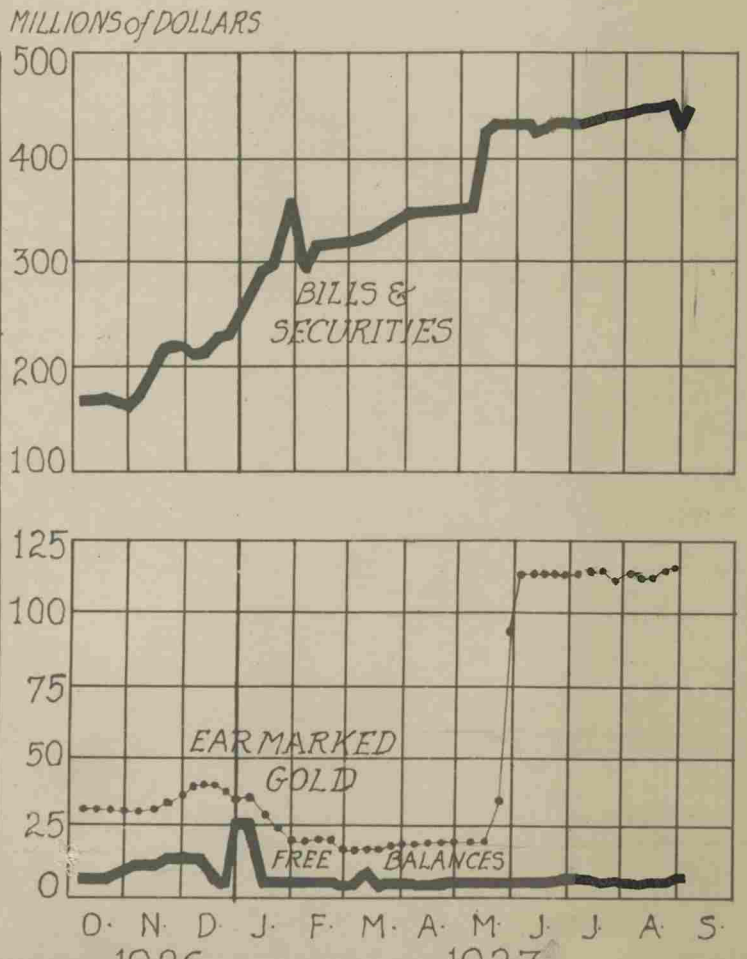
F.R.B. of NEW YORK

(FIGURES IN MILLIONS OF DOLLARS)

MONTH OF	CHANGES IN GOLD RESERVES									TOTAL GOLD RES.	TOTAL RES.	RES. %	NET GAIN or LOSS (IMP., EXP., EAR MARKING
	TRANSFERS			CERT. & COIN		TOTAL NET EXPORTS OR IMPORTS 2nd DIST.	MUT. GOLD CERT. SHIPPED	REDEMPTION FUND	NET CHANGE	END OF PERIOD			
	ORD. COMM'L*	F.R.B.	TREAS.	NET REC. OR PAYMNTS	EARMARKING								
August 1926	+ 43	- 29	+ 59	- 14	+ 22	- 28	- 14	- 5	+ 34	1,002	1,028	80.8	- 6
September	+ 5	- 39	+ 95	- 25	- 2	- 20	- 16	- 6	- 8	994	1,019	82.0	- 22
October	- 29	+ 6	+ 61	- 13	0	- 2	- 22	- 7	- 6	988	1,011	81.4	- 2
November	+ 12	- 26	+ 37	+ 10	- 17	- 5	- 20	- 6	- 15	973	997	78.0	- 22
December	- 95	- 17	+146	- 17	+ 1	+ 2	- 25	- 6	- 11	962	984	76.4	+ 3
Jan. 1927	+ 20	- 35	+ 32	+ 36	+ 29	+ 40	- 27	- 7	+ 88	1,050	1,082	83.9	+ 69
February	+ 12	- 26	+ 15	0	+ 3	+ 13	- 20	- 6	- 9	1,041	1,073	81.7	+ 16
March	- 61	- 25	+226	0	- 1	+ 1	- 25	- 6	+109	1,150	1,181	87.9	0
April	- 64	- 8	+ 29	- 20	- 1	+ 4	- 22	- 6	- 88	1,062	1,093	84.1	+ 3
May	+ 31	+ 15	+ 80	+ 2	- 97	+ 27	- 20	- 7	+ 31	1,093	1,125	85.7	- 70
June	- 115	- 34	+241	- 20	- 2	+ 7	- 21	- 6	+ 50	1,143	1,177	87.7	+ 5
July	- 8	- 27	+ 38	- 29	0	+ 8	- 23	- 7	- 48	1,095	1,127	87.2	+ 8
August	- 77	+ 15	+ 35	- 14	+ 1	+ 5	- 23	- 7	- 65	1,030	1,057	82.1	+ 6
WEEK ENDED													
Sept. 7, '27	-- 81	+ 32	+ 2	- 12	- 1	0	- 4	- 1	- 65	965	989	76.2	- 1

*Includes Federal Reserve Notes shipped.





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Scales: left 70
upper right #6
lower " 55

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Sept. 11. 1927

The Chicago Rate Controversy -

This memorandum is prepared solely for the use of Mr J. S. Alexander - new 1927 member of the Federal Advisory Council - ~~so that he may be prepared to~~ to aid in the discussion of the above matter at the Council meeting to be held in Washington on Sept. 16th 1927. This statement and the documents attached are confidential, not to be published, entered in any record of the meeting nor distributed to the members. Mr Alexander will use his own discretion in making references to or reading from the papers.

The discussion will be confusing unless care is exercised to separate the three ~~the~~ district questions involved, to wit -

1st The merits of the policy of lower discount rates.

2d The general method employed to adopt a system policy of lower rates

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Before discussing the ~~the~~ merits of the policy ~~adopted~~ it ~~may or will~~ is necessary to refer to some erroneous current reports as to the motives which may have actuated the Federal Reserve Bank of New York. - Those which have currency are mainly:-

(a) To aid the Treasury's program for the 15th Sept. financing

(b) To aid the Bank of England

(c) To support stock speculation

As to (a) When Mr. Mellon first took office in March 1921 he held the view that our rates were too high and might be reduced. He was probably right - but never urged that view. It was discussed more than once early in 1921. From that time to the present neither he nor his assistants have ever urged, requested ~~nor~~ or suggested any change of rate - ~~nor~~ or any policy as to open market operations. We have always considered it our duty as ~~A~~ Fiscal agent to keep the Treasury fully informed as to [illegible] and have done so. It has always

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~~for Eastern~~ ~~Plo[illegible]~~ ~~were [illegible] Minneapolis.~~

?

At the time of the July 27. meeting, when a change was to be proposed - and in Mr. Mellon's absence, - the matter was reported to Mr. Mills, then acting Secy. but he refrained from ~~Comment~~ advice even, ~~save to~~ and said that he would observe the policy of not interfering with any Treasury consideration. He attended the meeting in Mr. Mellon's absence, - and when asked by me if he cared to discuss the subject of rates and open market policy, - he declined on the ~~[illegible]~~ ground that the Treasury should not attempt to influence the decision. So far as the Federal Reserve Bank of New York is aware, the Treasury under Mr Mellon has scrupulously pursued this policy of non interference.

(b) The relations between the F. R. Bank of N.Y. and the Bank of England are little understood and frequently misrepresented. It has been our purpose and policy to aid in the ~~restoration~~ resumption of stable monetary conditions, stable exchanges, and the reestablishment of the gold standard in Europe. ~~So~~ ~~one will deny that the~~ We are convinced that this policy is sound and aids the restoration of trade and prosperity, - the preservation of our markets abroad - and full Em[illegible] prosperity at home. This

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been any obligation, Express or implied, to aid the Bank of England when such aid is incompatable with our domestic welfare. Any suggestion to the contrary must be based upon ignorance of the facts as to our relations to Europe, Especially to London, - in monetary and credit matters. Since 1924 and 1925 it has been in the power of the F.R. Bank of N.Y. at any time, by rate advances and by a dear money policy - to break down the very structure of stability we have been striving to erect. Withdrawal of foreign balances by American banks, closing our markets to foreign loans, ~~forcing~~ causing large exports of gold to New York, and forcing dangerously high bank rates in Europe, - could easily destroy all that has been accomplished. The penalty for us would be a recurrance of disordered exchange, and a loss of our export trade, - no less in food stuffs and cotton than in manufactured goods. Europe and the Bank of England are dependent upon us, - not we upon them - and unless we recognize that fact, - and avoi[illegible] [illegible] destructive policy - we [illegible]

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and considering also a generally lower level of interest rates.

consequences about as serious as those we could inflict.

(c) It is hardly necessary to refute a charge that we aim to promote speculation or protect the speculator. But I have no hesitation in expressing some views on this puzzling complication in our situation. There is no doubt that the liquidation of 1920 & 1921 - and the ~~inflation~~ depreciated value of the dollar still ~~left~~ remaining after liquidation was concluded - left both fixed interest and equity investments below their real values, considering the still reduced ~~value~~ purchasing power of the dollar, that is gold. During the past few years a gradual - and latterly a rapid - readjustment of these values has been under way. It has been much accelerated by the enormous savings of the country, producing an unsatisfied demand for investments - urgently reinforced by the release of from $500,000,000 to a billion dollars of funds each recent year for reinvestment, due to the repayment of the Government war loans. The same development occurred ~~was true~~ to a less extent in the real estate and building boom which reached its climax last year. These readjustments were bo[illegible] take pla[illegible]

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and to be largely financed by borrowing. ~~Whether the Stock~~ Fixed interest ~~obligations~~ investments have grown, advanced and become more readily stabilized; but speculation as was to be expected - has been centered upon Common Stocks - although recently both the rate of advance of prices and of growth of loans have been somewhat reduced. The real question is whether we should ignore all other objectives of policy and direct our efforts solely to checking stock speculation. If so we are forced to the choice either of high rates or of some form of direct action. It is our opinion that either course would involve grave risks which could not be supported on the ground of our primary responsibility which is not the stock market and if successful in reducing the speculative losses has had other consequences as above and later suggested - too hard to face. The Federal Reserve System has no more been organized to regulate the prices of stocks than it was to regulate the prices of cotton or real estate or pig iron or wages or rents. And during most of the last two years there has been no speculation and the price [illegible]

One great peril to the F. R. System is the assumption, by the System, or by the Public - that it can manage or regulate or in some way Control these isolated and special movements, such as Speculation in Stocks or real Estate, or advances or declines in individual commodities. Individual prices. The demand that we shall curb Stock Speculation is one manifestation of this tendency. Once we submit to this demand - we must submit to all others and our responsibilities will crush us. The pending bill attempting to charge us with the duty of price Control is no less an ~~part of this~~ Evidence of this tendency.

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As to 1st Merits of the rate change –

The justification of our policy is to be found in ~~four~~ or ~~five~~ simple facts. ~~principles~~.
One is that we are dependent upon Europe for a market for our marginal production of export goods, – mainly Cotton, wheat, meats, oils and copper, automobiles.
Another that we shall lose that market if monetary disorder, exchange troubles, high interest rates ~~[illegible]~~ and price declines abroad force liquidation there.
A third is that we cannot sell our surplus abroad during these years of recovery, without extending credit.
~~And finally~~ A fourth is that Europe already has heavy obligations to meet in the U.S. for war loan payments and the service of private loans – no less in fact than a billion dollars a year
And finally – that a restrictive credit policy will force gold shipments to this country in default of other means of payment.

Let us briefly examine these facts. ~~principles~~ –
The first is illustrated by Cotton, the most important export we have. Last year we grew our largest crop on record, 18,000,000 of which we exported 11,000,000 bales, within

two
a million and a half of this years total estimated crop, - and one half of our exports went to England. Had the world not been able to borrow about one and one quarter billion dollars here, we could not have sold all that cotton. ~~Had we~~ This applies equally to the meat ~~products~~ animals which consume the corn crop - and ~~the~~ automobiles and other export goods, - upon which the Chicago district largely depends for its prosperity.

No discussion of the adverse influence of monetary disorder upon international trade is necessary before a meeting of bankers. On that subject the world has expressed an unanimous opinion. A depreciation ~~of the~~ in the values of Europe's currencies after the good progress made toward stability would mean a brief period of artificially stimulated exports, by Europe, curtailment of our exports and then collapse - not to mention the alarm which would arise.

The need for credit aid to Europe during reconstruction is shown by simple facts. In the last few years we have loaned over $5,000,000,000 net abroad

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and during that period have had no net exports of gold. The only way the borrowed dollars could be used was to spend them in buying American goods, ~~or taking gold~~ ~~No gold has been taken~~. So except for the balances left with our banks, — all this borrowed money has been used to pay for our goods and had we not loaned it (unless they had been paid for in gold) the goods would have been unsold. We have maintained a lending market at reasonable rates and kept our trade going and our people employed.

The liquidation of war obligations ~~and~~ to our government and meeting service of loans privately held calls for gross payments of about a billion dollars a year, — less what applies to securities re-purchased by foreign investors, — some fraction of the whole. Pending the gradual restoration of trade, elevation of living standards, increased capacity to consume, and increased exports by Europe — these payments are now possible only by borrowing, mainly in the U.S. That is only possible if rates relationships here and abroad are such as to

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make borrowings not only possible, but not so costly as to impoverish the debtors. In time the adjustments of ~~trade~~, production and trade and of services to be paid for — or possibly even readjustment of debts, will enable these payments to be made without unsupportable strain on central bank reserves. But in these years of recovery our credit is not only needed but essential and undue curtailment means a stoppage of payment and disaster.

Finally — if credit is restricted in the U.S. and other means of payment for new goods and old debts fail — we shall be paid in gold to the extent gold can be spared. So far we have succeeded in avoiding a ~~[illegible]~~ perilous gold inflation — and we can probably continue to do so if we are fairly liberal as well as careful in lending. Once we stop we will drain Europe of large amounts of gold, inflation here will be unavoidable and we shall then face another period of world wide monetary disorder, Europe drained of gold, we shutted with it.

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There are decided advantages to be gained other than those relating to our trade, by deferring the test as to whether War debts can be met without break down of monetary systems. The Dawes plan has so far proved to be a success, but it must be remembered that the entire payment so far made by Germany has been borrowed abroad, mostly here, - and even 25% or more in excess of those payments. The fourth annuity year just commenced will likely impose no strain which cannot be met. In the 5th year commencing Sept 1928 the full payment of $625.000.000 is to be made - and then the test will arise. If Germany cannot pay her creditors they may not be able to pay us. The plan provides means for certain capital payments which can be employed to ameliorate the burden. Political considerations indicate that an adjustment of that character will be unlikely until the German, French, and American Elections all occurring in 1928 are out of the way. So a policy which maintains the present Equilibrium is justified on that account also, as well.

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It will naturally be asked - What relation has all this to the Chicago (which also applies to the Phila & San Francisco Co) discount rate. The answer is in the New York money rates and their relation to the London rates mainly.

With the Chicago rate at 4% & NY at 3½, we can expect, and believe we now observe three tendencies.

1st Bank balances carried in New York tend to move to higher rate districts -

2d Interior banks, (and other borrowers also) tend to increase borrowings in NY. where rates have now somewhat declined -

3d Money employed in Stock Exch. loans, with the rate now 3½ % tends to be drawn home to the interior - Especially by member banks which at this season need to borrow from the Res. Bank.

This all tends to accentuate the usual Seasonal demand on New York banks - impairs their reserves, - forces larger borrowing from us - and must cause higher rates for money than can be continued supported without forcing advances in discount rates above. The duration of these tendencies is shown in the attached table and diagrams

at least two or three

Discussions with the officials of European Central Banks, as well as our own observations, convinced us that the importance of rates the relative rate level between N.Y. and London and some of the Continental money centers is greater than is generally understood. For some months after we advanced our rate to 4%, Sterling and Continental exchange rates were maintained above their gold export points. But this was largely due to our loans to foreign borrowers. Early this year, however, an unreasonable drain upon European reserves started and so far this year we have imported net about $145,000,000 of gold. As the season of active exports of American products for cotton approaches, it appears that very much larger imports of gold were likely. We learned that the heads of two important Continental banks of issue were consulting the Bank of England regarding a policy of rate advances on that account.

Our rate reduction at least deferred and possibly prevented general advances abroad. (Insert A) If the drain on New York from other parts of the Country caused such advances as to much increase the pressure differential of 1% between

New York and London money rates, — we will either be forced to buy large amounts of securities in New York so as to reduce rates, — or take in more of Europe's gold — until finally they are forced to advance discount rates. Our policy would then fail.

It must not be understood that the Chicago rate is itself fatal to our policy. We could adjust our plans to meet a 4% rate there. But it will be easier now that they have reduced.

(1) Insure

Finally — we have a great advantage in our 3½ rate in case an advance later becomes necessary. Marking up rates from a 4% starting point would be much ~~safe~~ more dangerous that if we start from the 3½% level.

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Weir

(1) Evidence was and is still accumulating that there is some slowing down of business in certain lines notably iron and steel - beyond the usual seasonal recession. This is usually a condition in which rate reductions can do no harm and may be helpful. Also reducing our seasonal exports would greatly accelerate a business recession.

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As to 2d - The method employed to adopt a system of lower rates.

This will involve narrating the events of the last few months.

On a meeting of the Open Market Com. was held in Wash. at which the whole situation was reviewed and it was decided to purchase, as needs appeared ~~from time to time~~ - not over $100 000 000 of Securities, the program to terminate Aug. 1st. We have rarely held a meeting where discussion and exchange of views was more complete and it fully covered the European problem. The situation was also set out in writing, and the statement has been sent to all naval Banks and the F.R. Board.

Between and we had meetings in New York with Gov Norman of the Bank of England, Dr. Schacht of the Reichsbank, Dr Rist and Monsieur Ricard of the Bank of France and reviewed the entire situation with them. Gov. Crissinger and all the members of the Open Market Com. spent a day in Newyork, with these gentlemen and discussed the situation fully. Gov de Voorhees heard all of the discussion took part in it and then reviewed it separately with the others

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F.R.

of the Board of New York.

The gentlemen from abroad met our directors separately and at meetings and our directors heard all aspects of the problem discussed. They then spent a day, , in Washington and discussed the situation with members of the Federal Reserve Board. Nothing was concealed and all those responsible were called into conference, given opportunity to ask questions — and all questions asked were freely answered by our visitors.

Finally as our ~~Open market~~ authorization to make open market purchases was expiring on Aug. 1st a meeting of the Committee was held in Wash. all Group Present on July 27th In addition the Governors of the F.R. Banks of Kansas City, St Louis, and Minneapolis attended — and the Chairman from Atlanta. Again a written memorandum was submitted, and a discussion lasting all day ~~was~~ covered the entire subject. No more complete or enlightening Exchange of views could have been possible — The position of the F.R. Board of New York was briefly as follows:— We were convinced that the time was at hand when we should

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reduce on rate to 3½%. We felt that to make the reduction effective we might need to purchase additional securities, - say $ 50,000,000 - We invited the Boards to discuss our rate proposal without reserve - We did not suggest that other banks should reduce their rates. Gov. Crissinger, supported by the members of the board, did suggest that the change should first be made in the middle west. We ~~said it is~~ stated that it was not material to us who reduced first - ~~but~~ even essential that all should reduce. We felt it would be most helpful and was possibly necessary for some other reductions to be made - especially Boston, Phila, Cleve. and Chicago. We would wait & reduce first as might be agreed.

About three months ~~was~~ has been devoted to these meetings and no change in prices, ~~has~~ by the System has ever been canvassed more thoroughly than was this one (Exhibit B)

The meeting was unanimous as to a reduction in New York - Governor McDougal opposed a rate reduction in Chicago, and Governors Norris and Young ~~the~~ as to the directors in Philadelphia and

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As to 3rd The particular method employed in the Case of Chicago.

There may be little gained by discussing the meaning of the law as to rate changes. At best it is indefinite. I have never been willing to believe that Congress intended the F.R. Board to initiate rate changes - but on the other hand no formula appears for cases where changes having been disapproved, a new rate must be fixed, or where a new rate can be fixed if an existing rate is not changed by the directors. Congress would hardly have required the vote of five out of Seven members to enforce re-discounts between reserve banks, an infrequent and relatively unimportant occurance, and then give unlimited authority to initiate changes of discount rate, our most important act, - by vote of a majority only.

This has been a matter of controversy from the start. Early in 1915 the Gov. of the Minn Reserve Bank, by order of his directors reported to a meeting of the Governors that the F R Bd had attempted to force a

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* reduction in their rate. The Governor ~~Boards~~ passed a resolution unanimously protesting and suggesting testing the question in the Courts. This never became necessary - but it was told that an opinion possibly informal was asked of the then Atty General who did not sustain the Board. This I have never had Confirmed nor has such an opinion ever been published.

In 1919, for practically the Entire year, and with increasing insistence in the Autumn, the F.R. Bk of Ny. advised and urged rate advances. The Board never approved our doing so - clearly their right - but then also the opinion of the Atty Gnl was asked and Solicitor King wrote an opinion upholding the Board's contention that they could initiate a change. The Board's Counsel rendered a similar opinion.

In 1915 the F.R.Bk. of Ny. obtained an opinion from John G. Johnson of Phila who as I recall held that the Board could only initiate a change where a Reserve Bank was recalcitrant as to a rate policy.

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all attached herewith

In 1920 ~~1919~~ White & Case rendered an opinion that the Board under its General Supervisory Powers, could initiate a rate change. These opinions can be had if desired.

The nearest case to initiating a change by the Board of which I had knowledge was also in Chicago where the Directors on learning of the Board's intention, acted promptly enough so that an issue was avoided.

In the present instance our relation to the Chicago rate change has already been explained. Save on one point. After seven or eight banks had reduced their rates, Gov. Crissinger telephoned me that Chicago had declined to do so, that the Board had disapproved the Continuance at 4% and at a meeting to be held on Tuesday Sep. 6th proposed to make their rate 3½%. I ~~advised~~ stated to him that I hoped the Board would not do so — as I doubted the wisdom of that course as well as the Board's power. Tuesday morning he phones me that the Board would act that morning. I suggested that Mr.

was in Ny, and asked when they could not wait one day — until he reached Washington, when the full Board would be available. He asked me to see Mr. Mellon & get his views. This required time to go up town, which I did & explained the situation fully to Mr. Mellon and asked his views. He said he hoped the Board would await his return Wednesday morning — and he would see the Governor at once on his arrival. When I phoned this to Gov. Crissinger soon after 12 o'clock (after 11 Wash. time) he said the board had already acted, the vote was being ~~sent~~ or would be sent and he thought it would add to the difficulty were he to report any such action to the Secy. I did ask him to think it over again if not too late.

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The F. R. Act is lamentably lacking ~~indefinite~~ in separating and defining the respective powers of the Board and the Banks. It would be far better, however, to find means of adjusting differences now, just now, - than to attempt a series of Amendments such as may result from this Controversy, or ~~to~~ than to attempt arbitrary action which invites Controversy which is detrimental to the System.

My own judgment is that the Board is too detached from Scenes of Operation and from operating problems, money markets and all the Complexities of the business to wisely initiate discount and open market Changes of ~~Rates~~ or attempt their Execution. A nice balance can best be found after more experience If the Act must be changed — then a limited power to initiate say upon a specified number of votes, and in Cases where an individual bank is recalcitrant, - might be granted to the Board.

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There is one point upon which there must be no misunderstanding. It has been too frequently published in recent Chicago bank articles to be ignored.

There is no desire and never has been any attempt by the Federal Reserve Bank of New York, to dominate the Board or the System. We have in the past and shall in the future, urge views upon our associates as we expect them to do with us. We are ready to submit our individual views to the authority of the Board where it is clear the Board has authority; - and I know of no case where we have failed to conform to System policies, even when our individual views were contrary to those of the other Reserve Banks. The Practical question is how policies are to be adopted and then executed. Our views are clear enough. Expressing the problem in one extreme there is the choice of complete Centralization of power to initiate policy and direct its execution in the F.R. Board, - or at the other extreme, - complete de-Centralization, with power in each bank to conduct its business in each district in a water tight

Compartment, with no System Policy! Either would be fatal to the System.

The Plan has gradually Evolved, so as to Escape Either danger, of arriving at Policies by agreement at meetings of the Governors and Chairmen, or of Committees of those and other officers. The most important Committee is the one on open market investments. This Com. was first appointed by the Conf. of Govts - but in 1923 the Board arbitrarily, without previous notice dismissed the Committee and reappointed the same men as a Com. with largely the same functions, but with an attempt to subject it completely to the Boards Control. That was a mistake which ~~[illegible]~~ caused much unnecessary controversy and friction, though the feeling ~~but which~~ is now much improved.

My position as chairman of that Com. has seemed to everyone necessary, as the Ny. bank, in the ~~[illegible]~~ principal money ~~and~~ security and foreign exchange market, - must execute most of the orders.

The choice here again is for the Ny. to ignore the other Reserve Banks, [illegible] its own policy, [illegible]

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Subject itself to some supervision and enjoy with other Res. Banks, some sort of Co-operation in a System Plan, through Committee supervision.

This latter we have done as scrupulously as possible, - repeated inquiry of members of the Com. and of the banks not represented on the Committee convinces us that they are satisfied and approve not only the Plan but the way the New York bank executes the Committees wishes and directions.

This Committee now has supervision of

(a) all open market purchases & sales of Government securities save strictly intra district transactions with members.

(b) all purchases and sales of bills

(c) The distribution of the two investments between the Reserve Banks

(d) all foreign accounts (banks of issue) which are ratably divided.

(e) all investments for foreign accounts

(f) and as a matter of courtesy, and develop & execute changes in New York rate of disc

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probably has more effect upon other districts than their changes have in New York, — we have never, since the Committee came into existence, made a change of rate without first consulting the Committee either at a meeting, or by letter or by telephone.

(f) All special foreign transactions such as the credits to the Bank of England, Bank of Belgium and Bank of Poland —

(g) All gold transactions abroad

(h) because the [illegible]

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New York

THE CHICAGO RATE CONTROVERSY

This memorandum is prepared solely for the use of Mr. J. S. Alexander - New York member of the Federal Advisory Council - to aid in the discussion of the above matter at the Council meeting to be held in Washington on September 16, 1927. This statement and the documents attached are confidential, not to be published, entered in any record of the meeting, nor distributed to the members. Mr. Alexander will use his own discretion in making references to or reading from the papers.

The discussion will be confusing unless care is exercised to separate the three very distinct questions involved, to wit -

1st. The merits of the policy of lower discount rates.

2nd. The general method employed to adopt a system policy of lower rates.

3rd. The particular method employed in the case of Chicago.

But before discussing these questions it is necessary to refer to some erroneous current reports as to the motives which may have actuated the Federal Reserve Bank of New York. Those which have currency are mainly, -

(a) To aid the Treasury's program for the 15th September financing.

(b) To aid the Bank of England.

(c) To support stock speculation.

As to (a). When Mr. Mellon first took office in March, 1921, he held the view that our rates were too high and might be reduced. He was probably right - but never urged that view. It was discussed more than once early in 1921. From that time to the present neither he nor his assistants have ever urged, requested, or suggested any change of rate, or any policy as to open market operations. We have always considered it our duty as Fiscal

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Agents to keep the Treasury fully informed as to our policy and have done so. It has always been initiated free of Treasury suggestion or influence, and we have never proposed or volunteered policies beneficial to Treasury financing which were not based upon sound consideration of Federal Reserve policy. At the time of the July 27 meeting of the Open Market Committee, when a change was to be proposed, the matter was reported to Mr. Mills, then Acting Secretary in Mr. Mellon's absence, but he refrained from advice even, and said that he would observe the policy of not interfering with any Treasury consideration. He attended the meeting in Mr. Mellon's absence, and when asked by me if he cared to discuss the subject of rates and openmarket policy, he declined on the ground that the Treasury should not attempt to influence the decision. So far as the Federal Reserve Bank of New York is aware, the Treasury under Mr. Mellon has scrupulously pursued this policy of non-interference.

As to (b). The relations between the Federal Reserve Bank of New York and the Bank of England are little understood and frequently misrepresented. It has been our purpose and policy, so far as might be possible consistent with our own position, to aid in the resumption of stable monetary conditions, stable exchanges, and the reestablishment of the gold standard in Europe. We believe that this policy is sound and not only aids in the restoration of world trade and prosperity, but particularly in the preservation of our own markets abroad, and full employment and prosperity at home. There has never been any obligation, express or implied, to aid the Bank of England or any foreign bank of issue when such aid is incompatible with our domestic welfare. Any suggestion to the contrary must be based upon ignorance

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of the facts as to our relations to Europe, especially to London, in monetary and credit matters.

But since 1924 and 1925 it has been in the power of the Federal Reserve Bank of New York at any time, by rate advances and by a dear money policy - to break down this very structure of stability we have been striving to erect. Withdrawal of foreign balances by American banks, closing our markets to foreign loans, causing large exports of gold to New York, and forcing dangerously high bank rates in Europe, could easily destroy all that has been accomplished. The penalty for us would be a recurrence of disordered exchange, and a loss of our export trade - no less in food stuffs and cotton than in manufactured goods. Europe and the Bank of England are dependent upon us - not we upon them - and unless we recognize that fact and avoid a hostile or destructive policy we shall suffer consequences about as serious as those we could inflict.

As to (c). It is hardly necessary to refute a charge that we aim to promote speculation or protect the speculator. But I have no hesitation in expressing some views on this puzzling complication in our situation. There is no doubt that the liquidation of 1920 and 1921 and the depreciated value of the dollar still remaining after liquidation was concluded, left both fixed interest and equity investments below their real values, considering the still reduced purchasing power of the dollar, that is, gold, and considering also the generally lower level of interest rates prevailing. During the past few years a gradual, and latterly a rapid, readjustment of these values has been under way. It has been much accelerated by the enormous savings of the country, producing an unsatisfied demand for investments, urgently

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reinforced by the release of from $500,000,000 to a billion dollars of funds each recent year for reinvestment, due to the repayment of the Government war loans. The same development occurred to a less extent in the real estate and building boom which reached its climax last year. These readjustments were bound to take place and to be largely financed by borrowings. Fixed interest investments have now greatly advanced and become more nearly stabilized; but speculation as was to be expected, has been centered upon common stocks, although recently both the rate of advance of prices and of growth of loans have been somewhat reduced. The real question is whether we should ignore all other objectives of policy and direct our efforts solely to checking stock speculation. If so, we have the choice either of high rates or of some form of direct aggressive action. It is our opinion that either course would involve policies which could not be supported on the ground of our primary responsibility, which is not the stock market, and if successful in reducing the speculation would have had other consequences, as above and later suggested - too grave to face. The Federal Reserve System was no more organized to regulate the prices of stocks than it was to regulate the price of cotton or real estate or pig iron or wages, or rents. And during most of these last two years, there has been no commodity speculation and the price level has declined.

One great peril to the Federal Reserve System is the assumption, by the System, or by the public, that it can manage or regulate or in some way control these isolated and special movements, such as speculation in stocks or real estate, or advances or declines in prices of individual commodities. The demand that we should curb stock speculation is one manifestation of this tendency. Once we submit to this demand, we must submit to all

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others and our responsibilities will crush us. The pending bill attempting to charge us with the duty of price control is no less an evidence of this tendency.

As to 1st. Merits of the Rate Change.

The justification of our policy is to be found in four or five simple facts. One is that we are dependent upon Europe for a market for our marginal production of export goods, mainly cotton, automobile, wheat, meats, oils, and copper.

Another that we shall lose that market if monetary disorder, exchange troubles, high interest rates and price declines abroad force liquidation there.

A third is that we cannot sell our surplus abroad during these years of recovery without extending credit.

A fourth is that Europe already has heavy obligations to meet in the United States for war loan payments and the service of private loans, no less in fact than a billion dollars a year.

And finally, that a restrictive credit policy will force gold shipments to this country in default of other means of payment.

Let us briefly examine these facts. The first is illustrated by cotton, the most important export we have. Last year we grew our largest crop on record, 18,000,000 bales, of which we exported 11,000,000 bales, within two million and a half of this year's total estimated crop,-and one-half of our exports went to England. Had the world not been able to borrow about one and one-quarter billion dollars here that year, we could not have sold all that cotton. This applies equally to the meat animals, which consume the corn crop, and automobiles and other export goods, upon which the Chicago district largely depends for its prosperity.

No discussion of the adverse influence of monetary disorder upon inter-

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national trade is necessary before a meeting of bankers. On that subject the world has expressed a unanimous opinion. A depreciation in the values of Europe's currencies after the good progress made toward stability would mean a brief period of artificially stimulated exports by Europe, curtailment of our exports and then collapse - and world wide alarm.

The need for credit aid to Europe during reconstruction is shown by simple facts. In the last few years we have loaned over $5,000,000,000 net abroad, and during that period have had no net exports of gold. The only way the borrowed dollars could be used was to spend them in buying American goods. So except for the balances left with our banks, all this borrowed money has been used to pay for our goods. Had we not loaned it the goods would have been unsold, unless they had been paid for in gold. We have maintained a lending market at reasonable rates and kept our trade going and our people employed.

The liquidation of war obligations to our Government and meeting service of loans privately held calls for gross payments of about a billion dollars a year, - less what applies to securities repurchased by foreign investors, - some fraction of the whole. Pending the gradual restoration of trade, elevation of living standards, increased capacity to consume and increased exports by Europe, these payments are now possible only by borrowing, mainly in the United States. That is feasible only if rate relationships here and abroad are such as to make borrowings not only possible, but not so costly as to impoverish the debtors. In time the adjustments of production and trade and of services to be paid for - or possibly even readjustments of debts, will enable these payments to be made without unsupportable strain on

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central bank reserves. But in these years of recovery our credit is not only needed but essential, and undue curtailment means a stoppage of payment and disaster.

Finally, if credit is restricted in the United States and other means of payment for new goods and old debts fail, we shall be paid in gold to the extent gold can be spared. So far we have succeeded in avoiding a perilous gold inflation, and we can probably continue to do so if we are fairly liberal as well as careful in lending. Once we stop we will drain Europe of large amounts of her gold, inflation here will be unavoidable and we shall then face another period of worldwide monetary disorder - Europe drained of gold, we glutted with it.

There are decided advantages to be gained other than those relating to our trade, by deferring the test as to whether war debts can be met without break-down of monetary systems. The Dawes plan has so far proved to be a success, but it must be remembered that the entire payment so far made by Germany has been borrowed abroad, mostly here, and even 25 per cent or more in excess of these payments. The fourth annuity year just commenced will likely impose no strain which cannot be met. In the fifth year commencing September, 1928, the full payment of $625,000,000 is to be made, and then the test will arise. If Germany cannot pay her creditors, they may not be able to pay us. The plan provides means for certain capital payments which can be employed to ameliorate the burden. Political considerations indicate that an adjustment of that character will be unlikely until the German, French, and American elections, all occurring in 1928, are out of the way. So a policy which maintains the present equilibrium in the meantime is justified on that account as well.

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It will naturally be asked - what relation has all this to the Chicago (which also applies to the Philadelphia and San Francisco) discount rate. The answer is in New York money rates and their relation mainly to London rates.

With the Chicago rate at 4 per cent., and New York at 3 1/2, we can expect and believe we now observe three tendencies.

1st. Bank balances carried in New York tend to move to higher rate districts.

2nd. Interior banks (and other borrowers also) tend to increase borrowings in New York, where rates have now somewhat cheapened.

3rd. Money employed in Stock Exchange loans at 3 1/2 per cent tends to be drawn home to the interior - especially by member banks, which at this season need to borrow from the Reserve Bank.

This all tends to accentuate the usual seasonal demand on New York banks, impairs their reserves, forces larger borrowing from us, and may cause higher rates for money than can be continued without forcing advances in discount rates abroad. The operation of these tendencies is illustrated in the following chart and table. The chart on reserves indicates that the Second District lost 188 million dollars to other districts between July 1 and September 7.

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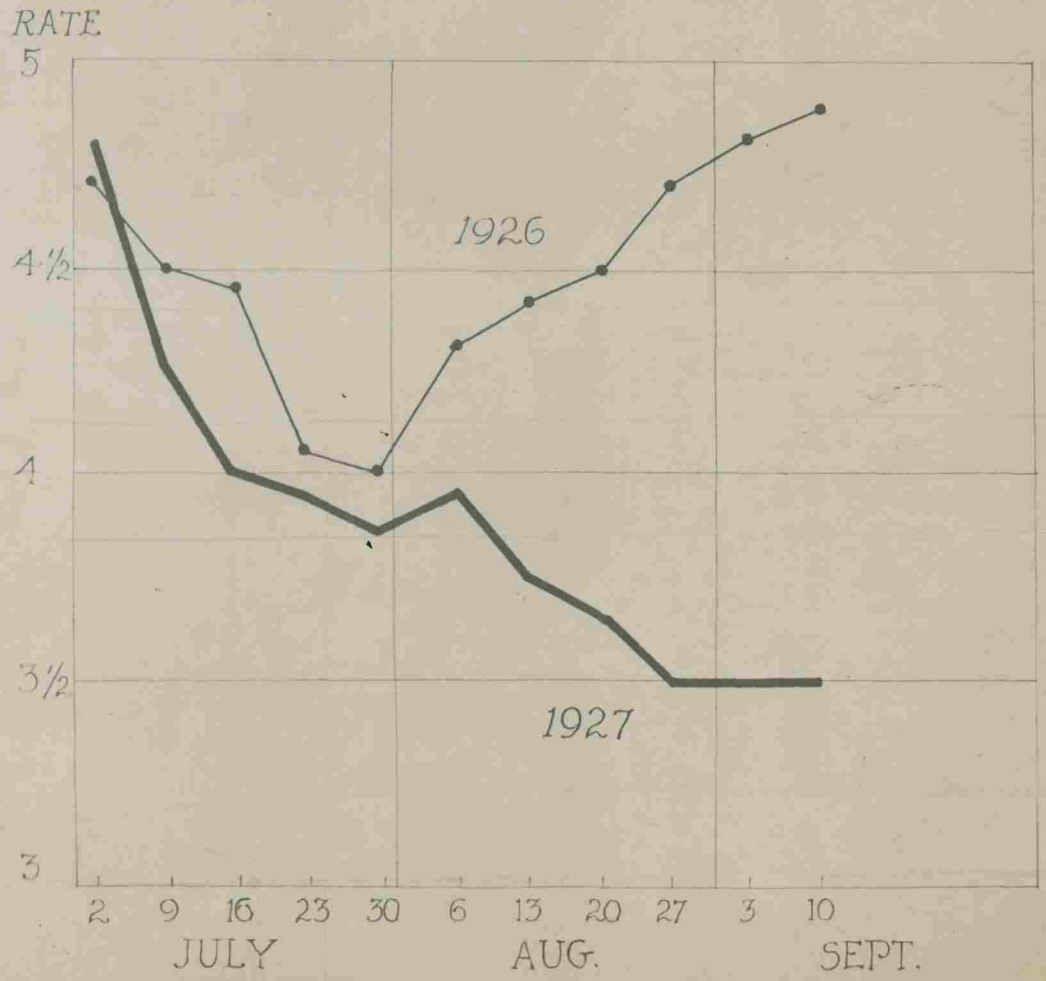
Gold Reserves, Federal Reserve Bank of New York.



Average Call Money Rate (Renewal).

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Loans to Brokers and Dealers - Secured by Stocks and Bonds

(000 Omitted)

1927	For Own Account	For Account out-of town Banks	For Account of Others	Total
July 6	$1,105,949	$1,155,799	$864,579	$3,126,327
13	991,498	1,204,315	863,466	3,059,279
20	981,769	1,202,644	874,561	3,058,974
27	1,047,608	1,187,441	906,144	3,141,193
Aug. 3	1,109,556	1,189,518	872,771	3,171,845
10	1,063,670	1,216,369	910,290	3,190,329
17	1,022,037	1,248,136	918,796	3,188,969
24	1,000,961	1,246,848	920,265	3,168,074
31	1,045,669	1,222,914	915,475	3,184,058
Sept. 7	1,046,074	1,238,325	921,900	3,206,299
1926				
July 7	1,019,298	951,852	631,638	2,602,788
14	932,813	1,016,148	652,296	2,601,257
21	954,368	1,018,361	648,223	2,620,952
28	933,881	1,014,859	653,302	2,602,042
Aug. 4	994,572	1,024,766	669,379	2,688,717
11	936,741	1,089,093	692,498	2,718,332
18	918,775	1,104,676	718,937	2,742,388
25	941,544	1,072,654	717,012	2,731,210
Sept. 1	991,437	1,096,091	668,746	2,756,274
8	963,901	1,134,421	664,707	2,763,029

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Discussions with the officers of at least five or six European central banks, as well as our own observations, convince us that the importance of the relative rate level between New York and London and some of the continental money centers, is greater than is generally understood. For some months after we advanced our rate to 4 per cent, thus reducing the differential to roughly 1/2 per cent, sterling and continental exchange rates were maintained above their gold export points. This was largely due to our loans to foreign borrowers. Early this year, however, an unseasonable drain upon European reserves started, and so far this year we have imported net about $145,000,000 of gold. As the season of active exports of American food products and cotton approached it appeared that very much larger imports of gold were likely. We learned that the heads of two important continental banks of issue were consulting the Bank of England regarding a policy of rate advances by all three on that account. Our rate reduction at least deferred and possibly prevented general advances abroad.

Something of the influence of our rate reduction may be seen in the strength of sterling this August and September compared with a year ago. The average monthly rates have been as follows:

	1926	1927
July	4.8589	4.8518
August	4.8540	4.8563
September (1-10)	4.8514	4.8574

If the drain on New York from other parts of the country causes such advances as to much reduce the present differential of 1 per cent between New York and London money rates, we will either be forced to buy large amounts of

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securities in New York so as to reduce rates, or take in more of Europe's gold - until finally they are forced to advance discount rates. Our policy would then fail.

It must not be understood that the Chicago rate is itself fatal to our policy. We could adjust our plans to meet a 4 per cent rate there. But it will be easier now that they have reduced.

Evidence was and is still accumulating that there is some slowing down of business in certain lines, notably iron and steel and automobiles, beyond the usual seasonal recession. This is usually a condition in which rate reductions can do no harm and may be helpful. A reduction of our seasonal exports would greatly accelerate a business recession.

Finally, we have a great advantage in our 3 1/2 per cent rate in case an advance later becomes necessary. Marking up rates from a 4 per cent starting point would be much more dangerous than if we start from the 3 1/2 per cent level.

As to 2nd. The Method Employed to Adopt a System Policy of Lower Rates.

This will involve narrating the events of the last few months.

On May 9 a meeting of the Open Market Investment Committee was held in Washington, at which the whole situation was reviewed, and it was decided to purchase, as need appeared, not over $100,000,000 of securities, the program to terminate August 1. We have rarely held a meeting where discussion and exchange of views was more complete and it fully covered the European problem. The situation was also set out in writing, and the statement has been sent to all Reserve Banks and the Federal Reserve Board.

Between June 28 and July 20 we had meetings in New York with Governor Norman of the Bank of England, Dr. Schacht of the Reichsbank, and Dr. Rist and Monsieur Ricard of the Bank of France, and reviewed the entire situation with

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them. Governor Crissinger and all the members of the Open Market Investment Committee spent a day in New York with these gentlemen, and discussed the situation fully. Governor McDougal heard all of the discussion, took part in it, and then reviewed it separately with the officers of the Federal Reserve Bank of New York, even to point of himself suggesting that Governor Strong or Mr. Harrison go to Chicago to discuss the whole matter with his directors.

The gentlemen from abroad met our directors, individually and at meetings, and our directors heard all aspects of the problem discussed. They spent a day, July 7, in Washington and discussed the situation with members of the Federal Reserve Board. All those responsible were called into conference, given opportunity to ask questions, and all questions asked were freely answered by our visitors.

Finally, as our authorization to make open market purchases was expiring on August 1, a meeting of the committee was held in Washington, all being present, on July 27. In addition the Governors of the Federal Reserve Banks of Kansas City, St. Louis, and Minneapolis attended, and the Chairman from St. Louis. Again a written memorandum was submitted, and a discussion lasting all day covered the entire subject. No more complete or enlightening exchange of views could have been possible. The position of the Federal Reserve Bank of New York was briefly as follows: We were convinced that the time was at hand when we should reduce our rate to 3 1/2 per cent. We felt that to make the reduction effective we might need to purchase additional securities, say $50,000,000. We invited those present to discuss our rate proposal without reserve. We did <u>not</u> suggest that other banks should reduce their rates. Governor Crissinger, supported by other members of the Board, <u>did</u> suggest that

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the change should first be made in the Middle West. He stated that it was not material to us who reduced first - nor even essential that all should reduce. We felt it would be most helpful and was possibly necessary, for some other reductions to be made - especially Boston, Philadelphia, Cleveland, and Chicago. We would wait, or reduce first, as might be agreed.

The meeting was unanimous as to a reduction in New York. Governor McDougal said his directors would not then be in favor of a rate reduction in Chicago and certainly would not take the lead, though they might follow if conditions changed. Some of the other governors expressed the view that local conditions alone did not then justify lower rates, but that as a matter of general system policy they favored a reduction. Still others favored reduction in their banks on both grounds.

When Governor Crissinger and the members of the Open Market Committee were in New York, Governor Crissinger suggested that he and I should visit Cleveland and Chicago for the purpose of meeting the directors of those two banks and explaining the situation personally. He raised the question again either by telephone or when I was next in Washington. I thought it over, consulted my associates here, and decided that it would be unwise for me to appear before the directors of any other Reserve Bank for the purpose of discussing a rate change by that bank, and accordingly wrote Governor Crissinger, copy of my letter on that subject being among those accompanying this memorandum.

Over three months has been devoted to these meetings and no change of policy by the System has ever been canvassed more thoroughly than was this one. For convenience of reference a chronology of the discussions is inserted here.

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Chronology of Events Leading to Rate Reductions

May 9, a meeting of the Open Market Investment Committee was held in Washington at which a memorandum was submitted discussing this whole situation, and this resulted in the authorization of purchases of $100,000,000 Government securities in the open market, of which, however, only about $30,000,000 were purchased.

June 28, Dr. Rist and M. Ricard of the Bank of France arrived in New York, having come for the purpose of discussing the whole central bank problem and the relations between the European and American money markets.

July 1, Governor Norman of the Bank of England and Dr. Schacht of the Reichsbank arrived in New York for the same purpose. Following the arrival of these gentlemen continuous discussion took place as we immediately left New York and spent five or six days at a private house on Long Island.

July 6, Messrs. Norman, Schacht, Rist, Ricard and Strong went to Washington and spent most of July 7 in discussion with the members of the Federal Reserve Board, lunching with them at the Hotel Willard.

July 8, the members of the Open Market Committee, Messrs. Harding, Norris, Fancher, McDougal and Strong, together with Governor Crissinger, spent the day in New York, most of it devoted to a discussion of these same subjects with Messrs. Norman, Schacht and Rist. Thereafter the visitors from abroad left on different dates, the last, Governor Norman, sailing on July 20.

July 27, a meeting of the Open Market Investment Committee was held in Washington for the purpose of reviewing the whole rate situation, especially in the light of the meetings previously held, and also because the authority to purchase securities up to $100,000,000 was expiring on August 1. In addition to all the members of the Open Market Investment Committee and the members of the Federal

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Reserve Board then in Washington (Dr. Miller and Mr. Cunningham were away) there were present Governors Young of Minneapolis, Bigge of St. Louis, Mr. Martin, chairmanof the Federal Reserve Bank of St. Louis, and Dr. Burgess + Mr. Harrison of the Federal Reserve Bank of New York. Governor Bailey was in Washington the day previous when Governor Strong was also there, in order to discuss the situation with the Federal Reserve Board, and left at once for Kansas City as his meeting occurred the following day and he had to return in order to lay the matter before his directors. At this meeting of the Open Market Investment Committee a memorandum was submitted similar to the one submitted at the meeting of May 9.

Following this discussion, on July 29, the Federal Reserve Bank of Kansas City reduced its rate to 3 1/2 per cent. A few days later the Federal Reserve Bank of Boston reduced its rate, requesting the Federal Reserve Board to make the announcement simultaneously with the announcement of the rate reduction in New York when that occurred.

On August 5, the Federal Reserve Bank of New York reduced its rate to 3 1/2 per cent, and that reduction, together with the Boston rate was announced on the same day.

The other changes were made in the following order:

Cleveland,	August	6
Dallas,	"	12
Atlanta,	"	13
Richmond,	"	16

On September 7, two meeting days having elapsed in Chicago, the Federal Reserve Board reduced the Chicago rate to 3 1/2 per cent and announced it.

On September 8, Philadelphia reduced.

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On September 10, San Francisco reduced.

September 9 and 10, Governor Strong was in Washington on other matters having to do with the Treasury Department, his visit there having been arranged by Mr. Parker Gilbert prior to the action by the Federal Reserve Board in reducing the Chicago rate, and his visit there was not a result of the Board's action or in any way related to it.

September 12 Minneapolis reduced.

As to 3rd. The particular method employed in the case of Chicago.

There may be little gained by discussing the meaning of the law as to rate changes. At best it is indefinite. I have never been willing to believe that Congress intended the Federal Reserve Board to initiate rate changes. But on the other hand no formula appears for cases where changes having been disapproved, a new rate must be fixed, or where a new rate can be fixed, if an existing rate is not changed by the directors. It does seem, however, that Congress would hardly have required the vote of five out of seven members of the Board to fix rates for rediscounts between Reserve Banks, an infrequent and relatively unimportant occurrence, and then give unlimited authority to initiate changes of discount rate, our most important act, by vote of a majority only.

This has been a matter of controversy from the start. Early in 1915 the Governor of the Minneapolis Reserve Bank, by order of his directors, reported to a meeting of the Governors that the Federal Reserve Board had attempted to force a reduction in their rate. The Governors passed a resolution unanimously protesting, and suggested testing the question in the courts. This never became necessary, but I was told that an opinion, possibly informal, was asked of the then Attorney General who did not sustain the Board. This I have never had confirmed nor has such an opinion even been published.

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In 1919, for practically the entire year, and with increasing insistence in the autumn, the Federal Reserve Bank of New York advised and urged rate advances. The Board never approved our doing so, clearly their right, but then also the opinion of the Attorney General was asked and Acting Attorney General King wrote an opinion upholding the Board's present contention that they could initiate a change.

In 1915, the Federal Reserve Bank of New York obtained an opinion from John G. Johnson of Philadelphia, who, as I recall, held that the Board could not initiate a change but could determine a rate different from one established by a bank and sent to the Board for review.

In 1920, White and Case rendered an opinion that the Board, under its general supervisory powers, could initiate a rate change. These opinions are attached.

The nearest case to initiating a change by the Board of which I have heard, was also in Chicago where the directors, on learning of the Board's intention, acted promptly enough so that an issue was avoided.

In the present instance our relation to the Chicago rate change has already been explained save on one point. After seven or eight banks had reduced their rates, Governor Crissinger telephoned me that Chicago had declined to do so, that the Board had disapproved the continuance at 4 per cent, and at a meeting to be held on Tuesday, September 6, proposed to make their rate 3 1/2 per cent. I stated to him that I hoped the Board would not do so as I doubted the wisdom of that course as well as the Board's power. Tuesday morning he 'phoned me that the Board would act that morning. I suggested that Mr. Mellon was in New York and asked whether they could not wait one day until he reached Washington, when the full Board would be available. He asked me to see Mr. Mellon and get his views. This required time to go uptown, which I did, explained the situation fully to Mr. Mellon and asked his views. He said he hoped the Board would await his return Wednesday morning, and he would see the Governor at once on his arrival. When I 'phoned this to Governor Crissinger soon after 12 o'clock (after 11 Washington time) on that Tuesday he said that the Board had already acted, the wire was being or would be sent, and he thought it would add to the difficulty were he to report my talk with the Secretary. I did ask him to think it over again if not too late.

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The Federal Reserve Act is lamentably lacking in separating and defining the respective powers of the Board and the Banks. It would be far better, however, to find means of adjusting different views just now than to attempt a series of amendments such as may well result from this controversy, or than to attempt arbitrary action which invites controversy which is detrimental to the System.

My own judgment is that the Board is too detached from the scenes of operation and from operation problems, money markets and all the complexities of the business to wisely initiate changes of discount and open market policy or attempt their execution. A nice balance can best be found after more experience. If the Act must be changed - then a limited power to initiate, - say upon a specified number of majority votes, and only in a case where an individual bank is recalcitrant, - might be granted to the Board.

There is one point upon which there must be no misunderstanding. It has been too frequently published in recent Chicago press articles to be ignored.

There is no desire and never has been any conscious attempt by the Federal Reserve Bank of New York to dominate the Board or the System. We have in the past and shall in the future, urge views upon our associates, as we expect them to do with us. We are ready to submit our individual views to the authority of the Board where it is clear the Board has authority, and I know of no case where we have failed to conform to System policies, even when our individual views were contrary to those of the other Reserve Banks. The practical question is how policies are to be adopted and then executed. Our views are clear enough. Expressing the problem, in one extreme there is the choice of complete centralization of power to initiate policy and direct its execution in the Federal Reserve

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Board, - or at the other extreme, complete decentralization, with power in each bank to conduct its business in each district in a watertight compartment, with no System policy! Either would be fatal to the System.

The plan has gradually evolved, so as to escape either danger, of arriving at policies by agreement at meetings of the Governors and Chairman, or of Committees of those and other officers. The most important committee is the one on Open Market Investments. This committee was first appointed by the Conference of Governors, but in 1923 the Board arbitrarily, without previous notice, dismissed the committee, and reappointed the same men as a committee with largely the same functions, but with an attempt to subject it completely to the Board's control. That was a mistake which caused much unnecessary controversy and friction, though there now exists a much better working understanding. My position as chairman of that committee has seemed to everyone necessary, as the New York bank, in the principal money, security and foreign exchange market, must execute most of the orders.

The alternative here again is for the New York bank to ignore the other Reserve Banks, develop and execute its own policy, or subject itself to some supervision and enjoy with other Reserve Banks some sort of cooperation in a System plan, through committee supervision.

This latter we have done as scrupulously as possible. Repeated inquiry of members of the committee and of the banks not represented on the committee convinces us that they are satisfied and approve not only the plan but the way the New York bank executes the committee's wishes and directions.

This committee now has supervision of -

(a) All open market purchases and sales of Government securities, save strictly intra-district transactions, with member banks.
(b) (But even transactions with members, the Federal Reserve Bank of New York voluntarily makes a part of the committee account).

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(b) All purchases and sales of bills.

(c) The distribution of these two investments between the Reserve Banks.

(d) Operation of all foreign accounts (banks of issue) which are ratably divided.

(e) All investments for foreign account.

(f) All special foreign transactions, such as the credits to the Bank of England, Bank of Belgium, and Bank of Poland.

(g) All gold transactions abroad.

(h) And as a matter of courtesy, and because changes in the New York rate of discount probably have more effect upon other districts than their changes have in New York, we have never, since the committee came into existence, made a change of rate without first consulting the committee either at a meeting, or by letter, or by telephone.

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JAN 2 1923
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OF NEW YORK

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FEDERAL RESERVE BOARD

WASHINGTON

March 4, 1920

Subject: Recommendations covering changes in discount rates.

Dear Sir:

Since the Board no longer considers recommendations for changes in discount rates at Federal Reserve Banks upon a stated day each week, and is at all times prepared to consider such recommendations in its regular meetings, it is requested that the practice be discontinued of sending to the Board each Wednesday a code telegram submitting your recommendations regarding discount rates in your district.

The instructions regarding reports to the Board each Wednesday with respect to discount rates, contained in the Board's letters of December 14, 1918, and August 7, 1919, (X-1307, "Rates of Discount", and X-1645, "Additional Code Word for use in Discount Rate Telegrams") are accordingly revoked, and hereafter, the Federal Reserve Banks will advise the Board only when submitting recommendations for changes in the prevailing discount rates for the review and determination of the Board. When recommendations are forwarded by wire, the code suggested in the Board's letter of December 14, 1918 (X-1307) should be used.

Very truly yours,

W. T. Chapman

Secretary.

Mr. Pierre Jay,
Chairman, Federal Reserve Bank,
New York, N. Y.

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C O P Y

February 2, 1920.

Dear Governor Harding:

At the last meeting of our directors the proceedings in regard to the establishment of the rates of discount which were announced by this bank on January 22 were reviewed and considered, particularly with respect to the new minimum rate of 5 1/4% for the purchase of acceptances in the open market, which was fixed by the Board not only without recommendation from or consultation with our directors or officers, but as far as our officers can remember we had had no previous intimation from the Board that it felt our buying rate was too low.

The discount market which centers in New York City is a delicate affair, the resultant of adverse interests and made up of many elements, including national and state banks, private bankers, branches of foreign banks, discount houses and bill dealers. Stability is one of its essentials and, while it must necessarily fluctuate with the demand for money, yet it is important that such fluctuations should be reasonably gradual. **********
****

Our directors, accordingly, ask me to request the Board to reduce the minimum buying rate to 5% in order that there may be an element of flexibility available should it be considered advisable, from time to time, to buy very short prime import bills at somewhat less than 5 1/4%.

In sending the Board this request our directors have asked me to express to you their unanimous feeling that whatever may be the legal powers of the board in respect of fixing rates, it is desirable, if the interest and services of responsible directors are to be retained, that there should be a continuance of the practice heretofore followed of arriving at discount rates by cooperation between the bank and the Board which seems to them to be the procedure indicated by the wording as well as the spirit of the law.

Very truly yours,

Pierre Jay

Chairman.

Hon.W.P.G.Harding,
Governor,Federal Reserve Board,

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FEDERAL RESERVE BOARD

WASHINGTON

X-1307

December 14, 1918

SUBJECT: Rates of Discount.

Dear Sir:

You have been reporting to the Board weekly, on form No. X-877, rates of discount prevailing in your district and your recommendations as to what changes, if any, should be made. As you know, the Board requested that in order to have all reports considered at the Board meeting on Thursday, your report be in its hands each Wednesday, and carry your recommendations of rates for the succeeding week.

The Board has decided to discontinue the use of these mail reports, and requests that recommendations of changes be sent in by telegraph on each Wednesday. If it is desired to continue in effect prevailing rates, a telegram to that effect should be sent, so that the rate situation in your district may be before the Board constantly. In telegraphing changes recommended, kindly identify the various classes by the code words shown in form X-877, as follows:

	DISCOUNTS					Trade Acceptances:	Open Market Purchases.
CODE WORDS:	DAIS	DEAN	DINE	DOOR	DUAL / DRUM: Secured by US certificates of indebtedness or Liberty Loan bonds	DALE	DYRE: DOVE
Maturities in days	Within 15 days including member banks' collateral notes	16 to 60 days inclusive	61 to 90 days inclusive	Agricultural and live stock paper over 90 days	1 to 60 days inclusive / Within 15 days including member banks' collateral notes	1 to 60 days inclusive	61 to 90 inclusive: All maturities

Kindly acknowledge receipt.

Respectfully,

W.P.G. Harding

Governor

The Chairman,
Federal Reserve Bank,
New York, N. Y.

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To be forwarded to reach the Federal Reserve Board not later than Thursday a.m. each week.

Date
New York, N. Y., December 11, 1918

Federal Reserve Board,
Washington, D. C.

Sirs:

I have the honor to forward the recommendation that no change be made in the existing discount rates for the vote of our directors, for the week ending Thursday, December 19, 1918.

(signed) R. M. Gidney
Asst. Federal Reserve Agent and
Chairman of the Board

I have the honor to request that the following rates be approved by the Federal Reserve Board for the Federal Reserve Bank of _____

to become effective Friday morning _____ 191____

- -

DISCOUNTS

CODE WORDS	DAIS	DEAN	DINE	DOOR	DUAL	DRUM	DALE	DYRE	OPEN MARKET PURCHASES
Maturities in days	Within 15 days including member banks' collateral notes	16 to 60 days inclusive	61 to 90 days inclusive	Agricultural and live stock paper over 90 days	Secured by U.S. certificates of indebtedness or Liberty Loan bonds: Within 15 days including member banks' collateral notes	16 to 90 days inclusive	1 to 60 days inclusive	61 to 90 days inclusive	

and so forth

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FEDERAL RESERVE BOARD

WASHINGTON

December 6, 1917.

Dear Sir:

Inclosed herewith is a table showing the discount rates which have been approved by the Federal Reserve Board as of December 4th. This table shows the changes which were made by all the Federal Reserve Banks at the suggestion of the Board, except in the case of the Federal Reserve Bank of New York, which, because of conditions of a local character, has asked that action be deferred until December 15th.

The table will show greater uniformity in the rates established by the eleven banks which have acted than has existed heretofore. It has been the desire of the Board to simplify the rate schedule and the means of acting upon changes in rates. There are only two schedules for fifteen day paper, one for commercial paper and collateral notes secured by commercial paper, (including commodity paper and trade acceptances) and the other for collateral notes and customers' paper secured by Government securities. Heretofore there were four rates, as some banks charged a different rate for a note secured by commercial paper than for fifteen day commercial paper discounted, and some had a rate one-half per cent higher for member banks' customers' notes secured by Government securities than for a collateral note secured in the same way. Some banks had a special quotation for the fifteen day trade acceptances.

In telegrams which were exchanged between the Board and the banks some confusion has arisen because of difficulty in describing the character or maturity of the paper to which the rate referred. In order to avoid this in the future there has been inserted in the table a code word at the head of each classification of paper, and hereafter in telegraphic correspondence regarding rates these code words will be used. An additional code word has been inserted for bankers' acceptances, and two additional code words appear for commodity paper having from 16 to 60 days and from 61 to 90 days to run, for use by such banks as still maintain a quotation for this kind of paper, although for the time being the rates are the same as on ordinary commercial paper. The fifteen day rate for commodity paper shall remain merged with the fifteen day rate for commercial paper, even though a special rate for longer time commodity paper be reestablished later on.

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It should be understood that fifteen day trade acceptances will be taken under whichever classification may be the lower. To illustrate, one of the banks has a trade acceptance rate of 3½% for 1 to 60 days and a fifteen day commercial paper rate of 4%. Fifteen day trade acceptances will according be taken by that bank at 3½%. At another bank the rate is 3½% for trade acceptances from 1 to 60 days and 3% for fifteen day commercial paper. In that case the trade acceptance would be taken at the commercial paper rate of 3%. The Board is of the opinion that when commercial paper or trade acceptances have run down to fifteen days, the difference in classification is not of sufficient importance to warrant a special quotation.

Very truly yours,

Governor.

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FEDERAL RESERVE BOARD

WASHINGTON

January 27, 1915,

My dear Governor Strong:

I have your letter of January twenty-sixth inclosing clipping from the Annalist and copies of telegrams concerning changes in discount rates sent to you from time to time by our Secretary's office with the Board's approval.

I was sorry to have the Governors raise this question of interpretation of the law and thought that the Board had made its point of view entirely clear. Inasmuch, however, as you revert to this matter, I think it necessary to state that since the conference with the Governors the Board has fully discussed the question raised by you on their behalf and I repeat to you what was stated at the meeting, and in doing so am voicing the opinion of all the members of the Board.

The rights and duties of the Board are fully expressed in the law. It is our function to review and determine the rates. We may review and determine the rates of the Federal Reserve Banks at any time, just as much as it is incumbent upon us, when we think it our duty to do so, to require one Federal Reserve Bank to rediscount for another. To concede that the Board should have the right only to review rates when Federal Reserve Banks shall indicate their willingness to make a change, would not only be abdicating a power, but would be neglecting a duty which has clearly been imposed upon us. There cannot be any doubt that it is our function to use our influence in regulating rates to such an extent as it may be necessary to bring the various Federal Reserve Banks into harmonious relation and cooperation with each other, and to exercise such influence

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or power in such a way as may be indicated by the requirements of any district, or the entire country, and by its relationship to the world markets. The law clearly contemplated a central authority as a means of coordinating the twelve banks under a comprehensive policy, and the Board has determined to act upon these lines.

As you stated, you and I certainly are not very far apart in this matter. We all have only one thing in mind, and that is to achieve the best possible results, and I am convinced that when once the system will be well under way and when normal times will be re-established, the rates will originate in their natural way in the districts and that normally the Board's function will rather be to approve than to indicate rates.

Under no circumstances, however, can the Board consider for a moment failing to insist on its legal right to suggest changes in rates or to review and determine them whenever this should be required, for the best of all.

The question is of such importance that I thought that I should express myself fully and clearly upon the subject.

Very truly yours,

(signed) Paul M. Warburg

Benjamin Strong, Jr., Esq.,
Governor, Federal Reserve Bank,
New York.

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(signed) Paul M. Warburg

Benjamin Strong, Jr., Esq.,
Governor, Federal Reserve Bank,
New York.

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(2)

REPORT OF OPEN MARKET INVESTMENT COMMITTEE
BY WEEKS FROM JUNE 29 to AUG. 31

CORRESPONDENCE WITH MEMBERS OF COMMITTEE
AND OTHER FEDERAL RESERVE BANKS
RE TRANSACTION IN OPEN MARKET A/C

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(2)

OPEN MARKET INVESTMENT COMMITTEE

MEETING - MAY 9, 1927

and

MEETING - JULY 27, 1927

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(4)

CORRESPONDENCE WITH PHILADELPHIA AND CHICAGO FRBANKS

RELATIVE TO LOWERING OF REDISCOUNT RATE

(File copies - F.R.B. New York)

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CABLES AND CORRESPONDENCE

with

FOREIGN BANKS OF ISSUE RE REDISCOUNT RATE

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(6)

SAMPLES OF CORRESPONDENCE WITH OTHER FEDERAL RESERVE BANKS

RELATIVE TO FOREIGN CREDITS.

(a) Correspondence relative to negotiation of and participation in credit extended to National Bank of Belgium.

(b) Correspondence relative to negotiation of and participation in credit extended to Bank Polski.

(c) Correspondence relative to opening an account with a foreign correspondent.

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(7)

EXTRACTS FROM ARTICLES OF ASSOCIATION OF

CHICAGO CLEARING HOUSE ASSOCIATION

and

NEW YORK CLEARING HOUSE ASSOCIATION

RELATIVE TO INTEREST ON DEPOSITS.

(a) Article XI Section 3 as amended.

(b) Copy of resolution adopted January 28, 1920 by Chicago Clearing House Association in regard to payment of interest on bank deposits.

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Mr Harrison

(8)

CONFERENCE OF GOVERNORS - January 20 - 23, 1915.

(a) Extract from Minutes of Secretary of Governors Conference regarding action taken on the subject of initiation and establishment of discount rates by Federal reserve banks.

(b) Memorandum of Governor Strong, Chairman of the Governors Conference, regarding oral report to Joint Conference.

(c) Extract from stenographic record of Governors Conference covering that part of discussion relating to initiation and establishment of discount rates.

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(9)

OPINIONS RELATIVE TO RIGHT OF FEDERAL RESERVE BOARD TO

INITIATE CHANGES IN DISCOUNT RATES.

X (a) Opinion of John G. Johnson dated February 16, 1915

(b) Opinion of Alex. C. King, Acting Attorney General, dated December 9, 1919.

X (c) Opinion of White & Case dated February 25, 1920.

X To Mr. Hamlin Fed Res Board 9/16/27
who told Mr. Alexander that Gov. Strong
authorized him to say that I
(H.P.) should deliver them to
Mr Hamlin.

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COPIES OF CORRESPONDENCE RELATIVE TO PURCHASE

AND SALE OF GOLD AND STERLING EXCHANGE. -

1927

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