

RESPONSIBILITY FOR FEDERAL RESERVE POLICIES: 1927-1929

It has been stated that mistakes committed by the federal reserve system from 1927 to 1929 were due to the Federal Reserve Board. The 1927 easy money policy was initiated by the New York reserve bank to encourage domestic business and strengthen European exchanges. The policy was successful in achieving these objectives, but it gave a dangerous impetus to stock market speculation. In the first half of 1928 the reserve banks took vigorous action to restrain speculation with some success, but in the last half of the year they relaxed their efforts and bought a large amount of acceptances. Early in 1929 the Reserve Board took the lead and recommended "direct action" to restrict speculative loans. The reserve banks then recommended rate increases. Differences were not as to aims but as to methods. The lesson from this experience is that authority and responsibility for national credit policies should be concentrated in a single, independent, disinterested public body having a national viewpoint.

The recent amendments to the Federal Reserve act gave rise before their final enactment by Congress to pronounced differences of opinion among observers of federal reserve policy and also among spokesmen of various schools of banking and financial thought. More particularly, there was an acute controversy with regard to the location of the responsibility for the exercise of the open-market authority in the federal reserve system.

These discussions have sharpened interest in federal reserve history, and especially in those episodes that throw light upon the wisdom with which the system's open-market powers have been exercised in the past. The greatest interest, as might naturally be expected, has been shown in the episode covering the period 1927-1929. Many commentators, reviewing the policies of the federal reserve system during this period, have passed a severe judgment upon them.

Not all these commentators, however, have confined themselves to criticism of federal reserve policies. Some of them have undertaken in addition to fix the responsibility for what has been variously characterized as the "misdirected management" and the "unfortunate mistakes"¹ of the system during the period 1927-1929. Their tendency, in the main, has been to ascribe the errors of judgment and faults of policy during that period to the Federal Reserve Board; and the view has been frequently expressed that, as between the federal reserve banks and the Federal Reserve Board, the banks were right and the Board was wrong.

This view, as I shall undertake to show, is based upon partial and misleading information. The critics who condemn the Federal Reserve Board and exculpate the federal reserve banks do so either through lack of knowledge or in disregard of the following pertinent facts:

(1) That the Board's action in reducing the discount rate of the Federal Reserve Bank of Chicago in 1927 was in pursuance of a system policy initiated by the Federal Reserve Bank of New York and concurred in by all but one of the federal reserve banks;

¹ See, for example, page 52, *The Great Depression*, by Professor Lionel Robbins of the University of London, and editorial, "Testimony on the Banking Bill" in the *New York Times* of June 2, 1935.

(2) That the federal reserve banks took no action to check the growing tide of speculation between July 13, 1928, and February 14, 1929; and

(3) That the first formal proposal for an increase in the discount rate from 5 to 6 per cent came to the Board on February 14, 1929, after the Federal Reserve Board had sent to all federal reserve banks under date of February 2, 1929, and had made public on February 7, 1929, a statement which undertook to curb speculative excesses by a method which has come to be known as "direct action."

Let it be admitted at the outset that as a straight proposition of law, so far as concerns the Federal Reserve Board, it must share the responsibility for any action taken by a federal reserve bank, whether mistake or other-

PHYSICAL VOLUME OF INDUSTRIAL PRODUCTION

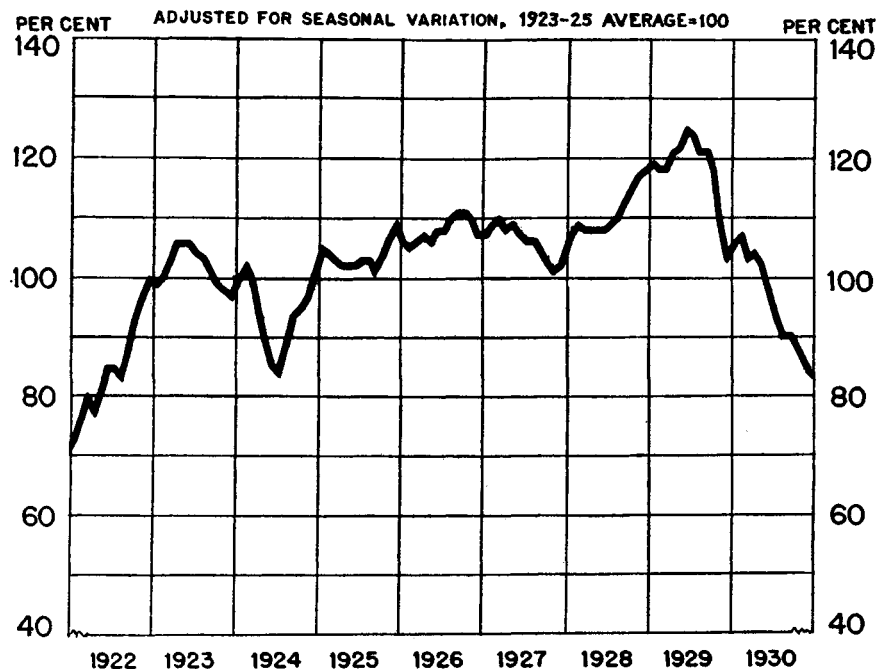


CHART 1

wise, with respect to discount rates and open-market policies. Under the terms of the Federal Reserve act, no change in discount rates proposed by the federal reserve banks and no open-market policy proposed by the Federal Open Market Committee can be put into effect until it has been approved by the Federal Reserve Board; but it is clear that action originates with the federal reserve banks. The responsibility for initiative vests in them. The primary responsibility is, therefore, theirs; the secondary and ultimate responsibility is the Board's. This must be borne in mind in any attempt to locate in any other than a formal and legal sense the actual

responsibility for errors charged to the federal reserve system in the critical period 1927 to 1929.

It is because of the bearing that a truer and fuller understanding of the manner in which the federal reserve banks and the Federal Reserve Board have discharged their respective responsibilities has upon pending banking legislation that a clearing up of these misapprehensions takes on urgency.

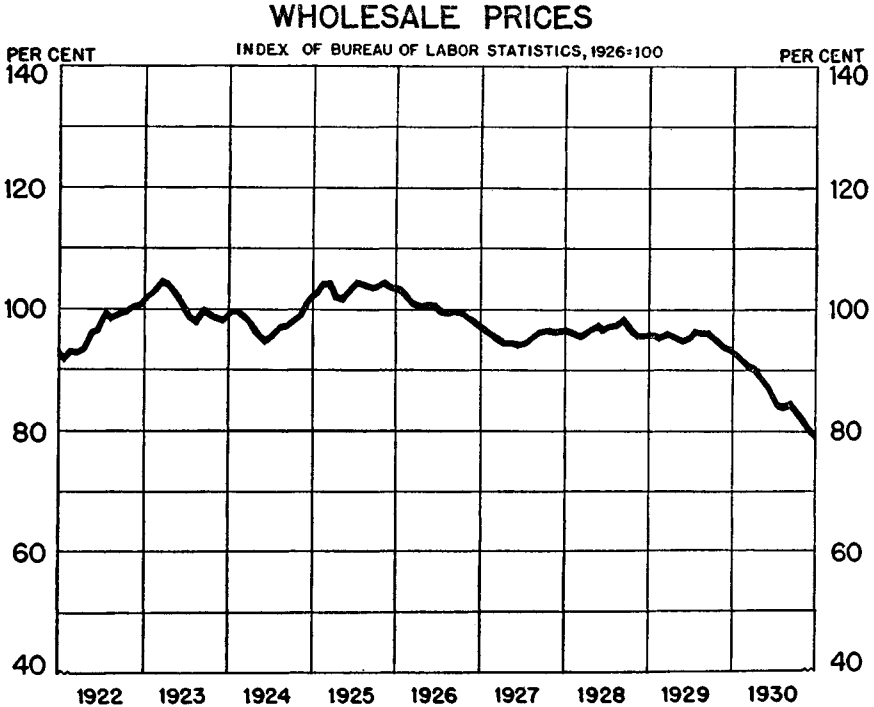


CHART 2

at this time. And it is because of this that I here propose to recite as briefly as I can the facts which are essential to an understanding of the course of federal reserve policy during the period 1927 to 1929. I shall endeavor to do this in a way that will make it easy to distinguish statements of fact from any comment I may offer on the facts.

To facilitate brevity of exposition and to focus attention more quickly upon the material points I shall state and answer a series of questions.

(1) What was there in the economic and financial situation in 1927 that caused the adoption by the federal reserve system of an easy money policy during that year?

The record shows that in the summer of 1927 there appeared a downward tendency in industrial production (Chart 1) and that commodity prices (Chart 2), which had been declining since the autumn of 1925, were at

the lowest level in five years. There was apprehension that this downturn in business might foreshadow the coming of a depression. A marked decline in production and employment in the durable goods industries did, in fact, develop in the last half of the year.

In addition to disquieting domestic factors in the economic situation in 1927, the European monetary and financial situation, particularly as it

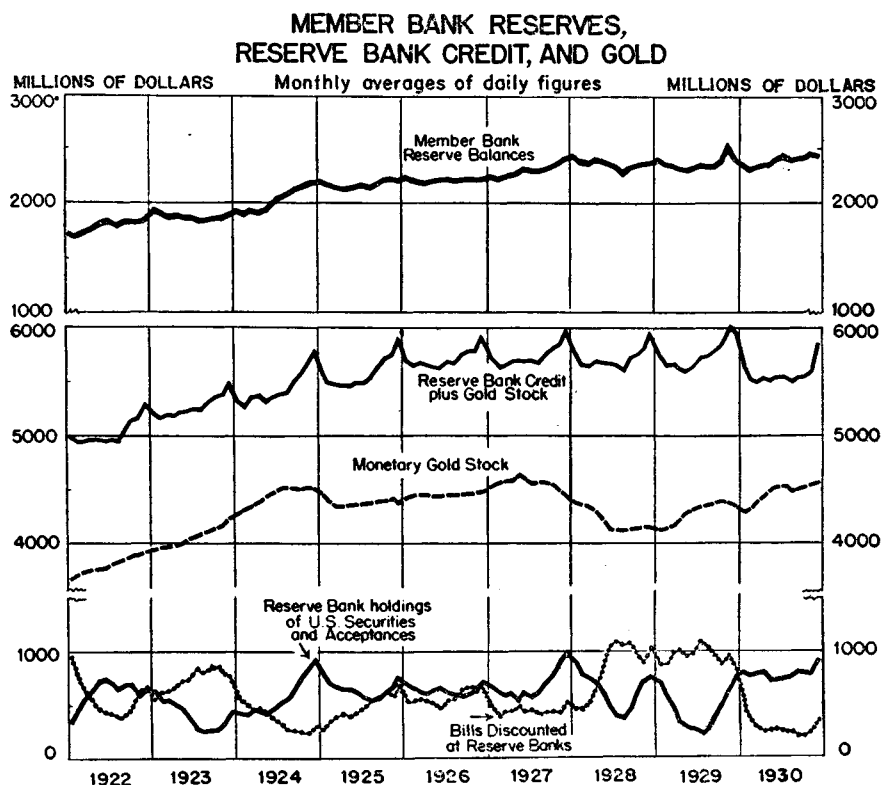


CHART 3

might affect the United States, was far from satisfactory. European currencies, and particularly sterling, were showing weakness. It was feared that this would interfere with sales of our agricultural products in the autumn months. Considerable concern was also felt regarding the position of the gold standard in those European countries which had already restored it and also regarding the prospects of its early and successful restoration in others which had the matter under consideration.

(2) What were the objectives of the policy then developed?

It may be said that the objective of federal reserve policy in 1927 was to set in motion such forces as the system could command to counteract the

recessionary forces which were in evidence. To this end there was developed and adopted a policy of easing both the domestic and the international financial situation by purchasing securities in the open market and by reducing discount rates, thus cheapening the cost of credit to borrowing member banks.

To relate the sequence of these open-market operations and discount

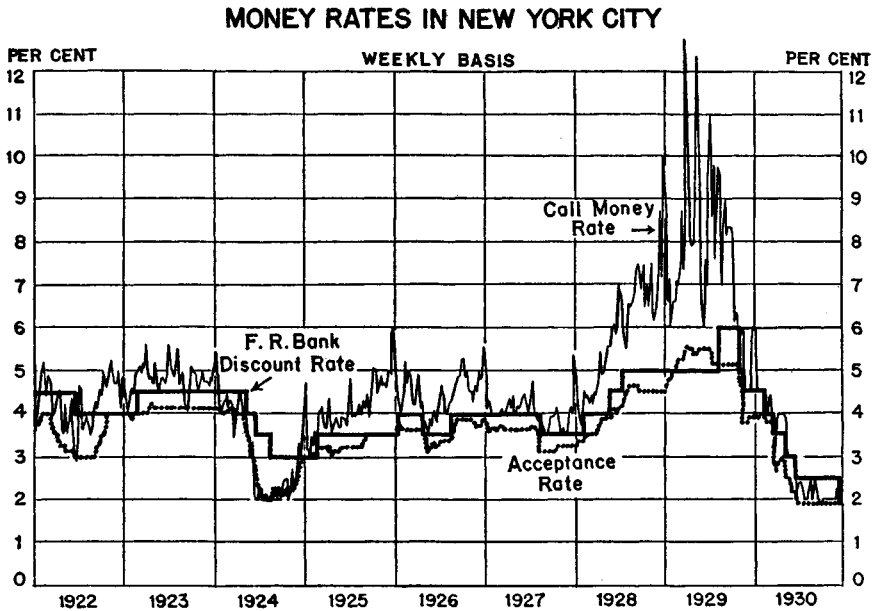


CHART 4

rate changes, without going into too much detail, the following summary will suffice:

The policy began in May, 1927, with purchases of United States government securities by federal reserve banks, which carried their holdings from \$300,000,000 in May to \$600,000,000 in December. As a result of these operations member banks were able to meet gold withdrawals of \$200,000,000 and to increase their reserve balances by over \$100,000,000 without being under the necessity of increasing their borrowings from the reserve banks (Chart 3). Discount rates at all the reserve banks were reduced from 4 to 3½ per cent during the third quarter of the year.

Money rates in the open market soon declined (Chart 4), sterling exchange advanced, and in time there was a considerable outflow of gold from the United States to other countries.

(3) Was the policy successful in achieving its objectives?

It was. The tide of business recession or depression, whichever it was,

was arrested toward the end of the year 1927. The production curve turned sharply upward and, except for a halt of short duration in the spring of 1928, maintained a steady ascent until the summer of 1929 (Chart 1). Prices of farm and related products showed a marked rise in the latter part of 1927 and in 1928 the general level of wholesale prices was characterized by relative stability (Chart 2). The European currencies, notably sterling, strengthened and, in general, tension in the European financial situation was considerably relieved.

So far, then, as the policy of mid-summer 1927 was instrumental in resisting the forces of business depression, stimulating production, giving stability to the price level, and strengthening foreign currencies, it must be pronounced to have been successful. Were this all that there was to the episode, it might be regarded, as many felt disposed to regard it at the time, as a brilliant exploit in central bank policy and as a demonstration of the reasonableness of the belief, which existed in the minds of many economists and others at the time, that through well conceived and well timed monetary policy the terrors of the business cycle could be largely if not wholly removed and price stability and economic prosperity be insured under the operation of the federal reserve system. It will not be forgotten that by many the opening of the year 1928 was heralded as the beginning in these respects, as well as in many others, of a "new era."

Unfortunately the 1927 policy of the federal reserve had other effects beside those which were sought and intended. In the light of the longer perspective in which we can now view these other and further effects they stand out as the larger and more serious consequences of the policy then initiated and pursued. But before leaving the year 1927 there is a further question with reference to it which remains to be considered.

(4) Who proposed the policy pursued?

The policy above outlined was originated by the New York Federal Reserve Bank, or more particularly by its distinguished governor, the late Benjamin Strong. Brilliant of mind, engaging of personality, fertile of resource, strong of will, ambitious of spirit, he had extraordinary skill in impressing his views and purposes on his associates in the federal reserve system. His ideas began to develop in the spring of 1927, but his program was not shaped until after conferences with representatives of the three great European central banks, who visited the United States in the summer of that year. This program was then presented to the federal reserve system in informal conferences with federal reserve bank governors, proposed to the Federal Reserve Board and approved by it, and participated in by the federal reserve banks with dissent on the part of only one. The Federal Reserve Bank of Chicago was reluctant to fall in line with the reductions of discount rates that were being made at the other reserve banks, and its rate was finally reduced by the Federal Reserve Board.

The general policy adopted at the time, therefore, was a system policy, conceived and initiated by the governor of the New York Reserve Bank, but approved at a meeting in July participated in by the Open Market Committee, which consisted of five reserve bank governors, by members of the

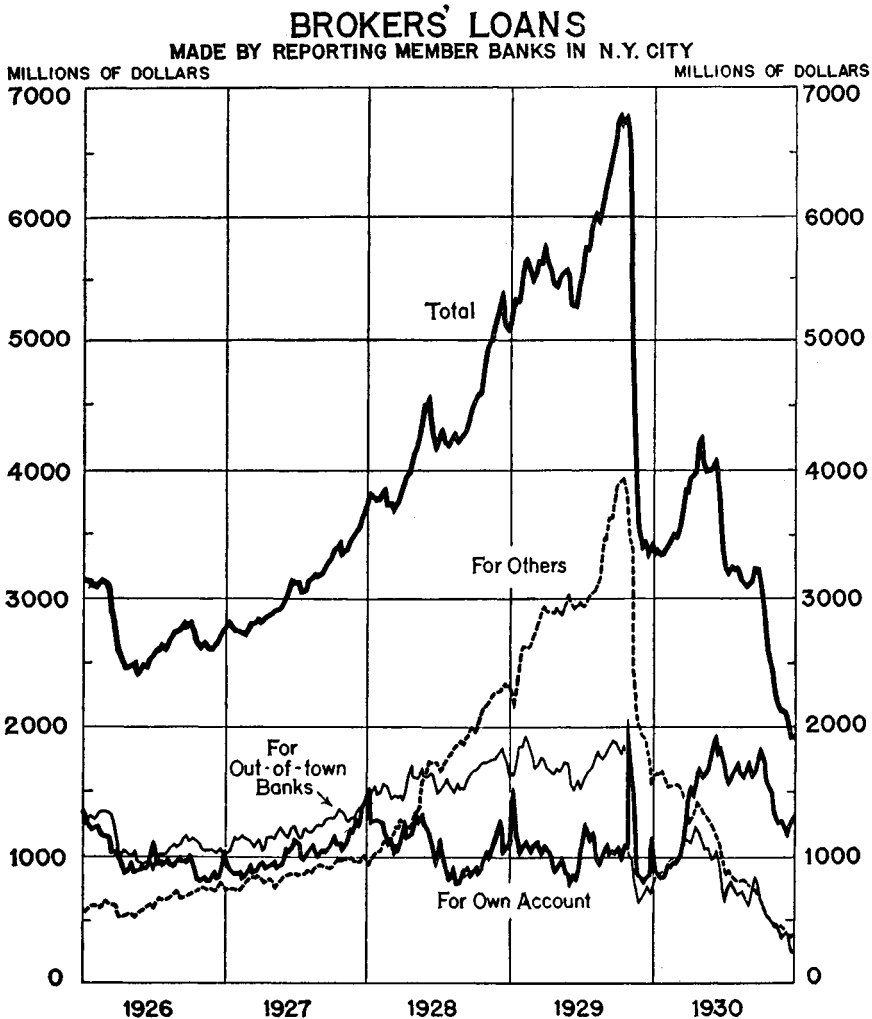


CHART 5

Federal Reserve Board, and by two governors and one chairman of mid-western reserve banks. It was not, as might be inferred from the *Times* editorial, a policy either developed or imposed by the Board on the reserve banks against their will. It was distinctly a *reserve bank policy*.

The Federal Reserve Bank of Kansas City reduced its rate from 4 to 3½ per cent on July 29; other federal reserve banks reduced their rates in quick succession, St. Louis on August 4; Boston and New York on August 5; Cleveland on August 6; Dallas on August 12; Atlanta on August 13; and Richmond on August 16. The directors of the Chicago bank, the second largest bank in the system, delayed action until the Federal Reserve Board reduced its rate on September 7, in accordance with the system policy. Thereafter, the Federal Reserve Bank of Philadelphia reduced its rate on September 8; San Francisco on September 10; and Minneapolis on September 13.

The reductions in discount rates, except in the case of Chicago were authorized by the boards of directors of the respective federal reserve banks and approved by the Federal Reserve Board. The action of the Board in reducing the rate at Chicago was taken after funds began to move away from districts in which rates had been lowered, a development which appeared to jeopardize the achievement of the general objective of the system's policy, a necessary part of which was the maintenance of easy conditions in the New York money market.

(5) What further results ensued?

Effects of cheap and abundant credit during the autumn of 1927 were not limited to stimulating business and production and to sustaining the price level and the European exchanges. Cheap credit gave a further great and dangerous impetus to an already overexpanded credit situation, notably to the volume of credit used on the stock exchanges (Chart 5), and to a further rapid upward flight of security prices (Chart 6). In consequence, the federal reserve system was confronted toward the end of the year 1927 with the problem of getting control of the fund of credit which it had been instrumental in placing in the market and keeping it within the bounds of safety lest an uncontrollable and disastrous speculative situation should develop. In consonance with this attitude the federal reserve system abandoned the policy it had been pursuing of offsetting exports of gold by the restoration of a similar volume of credit to the money market through the purchase of United States government securities, and allowed exportations of gold to exert their tightening effect on the money market. The effect, however, in the situation then existing was not very considerable. The stock market expansion had acquired too much momentum. It was evident that its pull was too strong to be counteracted by gold withdrawals.

An added factor of adverse character arose out of the exigencies in connection with the conversion of the Second Liberty Loan. The Treasury found that actual cash outgo for redemptions in connection with its refinancing program outran its current cash intake and was, therefore, carried by the federal reserve banks for a period of about a month on overdraft in

varying amounts up to as much as \$200,000,000, with an average during the period of about \$70,000,000, thus neutralizing to that extent the policy of the reserve banks.

Total loans and investments of member banks during the second half of the year 1927 showed a pronounced upward movement. There was an active demand for funds in security markets, both in connection with specu-

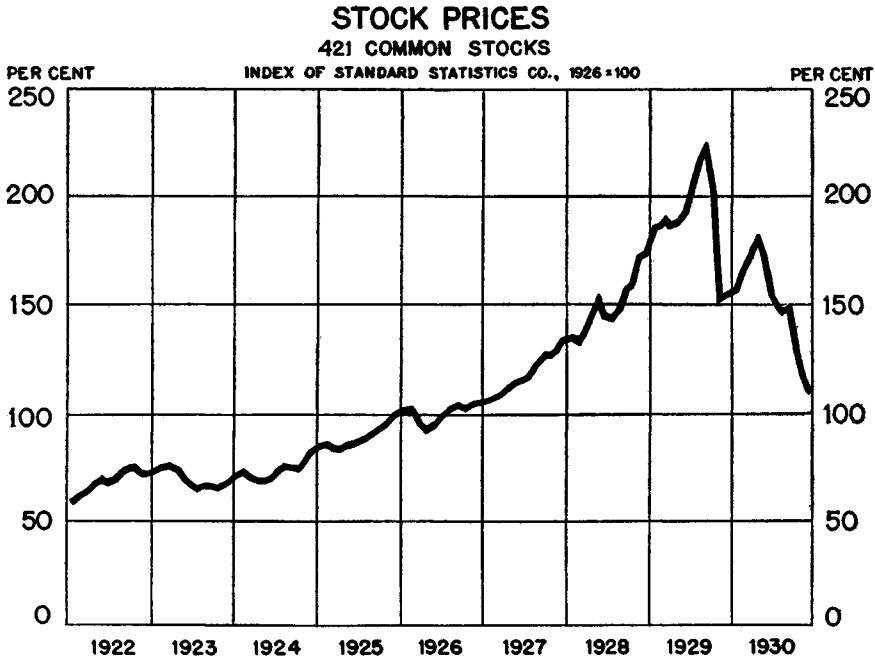


CHART 6

lative trading and with the issuance of new securities. There being an abundance of loanable funds, with no considerable demand for loans from business, the funds held by the banks went into investments and loans on securities. Bank loans to security brokers in New York increased during 1927 by about \$600,000,000 (Chart 5).

Restrictive Policy in First Half of 1928

In the first half of 1928 the reserve system took successive measures to check the further expansion of bank credit. Approximately \$400,000,000 of United States government securities were sold from the system's holdings. Discount rates were raised from 3½ per cent to 4 per cent by all federal reserve banks between January 25 and March 1, to 4½ per cent between April 20 and June 7, and to 5 per cent by 8 banks in July. Sales of securities

by the reserve banks and further loss of gold, amounting to \$250,000,000, forced member banks to borrow at the reserve banks. Bills discounted rose to over \$1,000,000,000 for the first time since 1921 (Chart 3). Call loan rates rose to over 6 per cent by the middle of the year. The increase in brokers' loans by banks was definitely checked (Chart 5). Those by New York City banks for their own account declined considerably. Brokers' loans by non-banking lenders, however, attracted by high rates, increased more rapidly than before. The rise in stock prices was interrupted early in the year and again in mid-summer, but these were but brief interruptions (Chart 6). Thereafter evidence was accumulating that the speculative boom had become so entrenched and was exercising such a pull that an increase in the cost of bank funds appeared to be no longer sufficient to check it and more extraordinary forms of control had to be considered.

Under conditions existing in previous stock market booms the measures adopted by the reserve system might have been sufficient to check the speculative expansion, but this was a new situation. In the first place, the astonishing increase in the earnings of large corporations and the extremely low rates of interest at which money could be borrowed appeared to supply a basis for the high prices that were being paid for stocks of companies whose earnings were rising and whose dividend disbursements, not only through extra dividends but through regular dividends, were far above the going price of money. To put the matter bluntly, the market was actively engaged in recapitalizing the values of securities on the basis of exceptional earnings and artificially low interest rates for money. Second, the fact that banks could in an emergency rediscount, as was not the case in stock market booms of the pre-federal reserve period, inclined the banks to feel that they could expand in the assurance that in case of need they could turn to the reserve banks for assistance; and third, the supply of non-banking funds available for "street loans" was larger than on any previous occasion. Consequently, whereas in earlier periods call money rates in a crisis rose to 20, 40, and even 100 per cent, in the first half of 1928 the rate did not rise above 8 per cent. Higher levels were reached later, but never over 20 per cent, and that for only a few hours.

Passive Policy in the Last Half of 1928

No further measures of restraint were adopted by the federal reserve system in the latter half of 1928. This was due in part to the expectation, based on previous experience, that the seasonal demands for funds in themselves would act as a tightening and restraining influence. There was also some fear that with money rates at the prevailing high levels crop-moving and other business activities might be severely handicapped.

These expectations were not realized owing to developments in the acceptance market. The reserve bank buying rate for bankers' acceptances had

been advanced, but at $4\frac{1}{2}$ per cent was still below the discount rate. There was a heavy demand for acceptance credits at the time, and metropolitan banks were able to obtain reserve bank funds at rates below the discount rate through the creation of acceptances and their sale to the reserve banks. The banks, therefore, were able to expand their security loans without going further into debt at the reserve banks. In fact, the purchase by the reserve banks in the New York money market of acceptances in large volume enabled the member banks actually to reduce their indebtedness to the reserve banks at the very period when restraint of speculation should have continued to be reserve bank policy (Chart 3). Brokers' loans by both banks and others increased rapidly (Chart 5) and bank loans on securities to others than brokers also increased. Stock prices rose rapidly (Chart 6). Money rates on acceptances and commercial paper did not rise in this period but rates for "street loans" rose sharply, reflecting the intensity of the demand for such loans (Chart 4).

In the face of these developments, the federal reserve system failed to pursue affirmatively the policy of restraint adopted in the early part of 1928. Taking the period from mid-summer of 1928 until the early days of February, 1929, the policy pursued by the federal reserve system may be characterized in the light of all that is known now, and much of which was visibly in process then, as a policy lacking in strong conviction with regard to current developments profoundly affecting the federal reserve system, the banking system, and the economic and financial condition of the country.

In attempting to locate and assess responsibility for the delay and inactivity of the federal reserve system during the second half of the year 1928, the incontrovertible fact is that during this period as well as during the preceding year the leadership of the federal reserve system rested with the Federal Reserve Bank of New York. There is no attempt here to deny the responsibility of the Federal Reserve Board, without whose sanction no steps could be undertaken. But the responsibility of the Board was secondary. Its mistake was in waiting too long before assuming active leadership in firm intervention in the situation. A partial explanation for the hesitancy on the part of the Board at this time, in the absence of proposals for action from the reserve banks, may be found in the Federal Reserve act itself and in the tradition that had grown up in the system. This tradition was that initiative in credit policy should originate with the federal reserve banks, and that the Board's function ordinarily should be to approve or disapprove proposals brought forward by the banks.

In the critical situation which developed in the second half of the year 1928 the Board followed the course of waiting for proposals by the reserve banks to be submitted to it for review. No such proposals were made. It is true that on some occasions the Board had assumed a more positive attitude

in the matter of the determination of discount rates, but on the last occasion on which it had aggressively intervened (the reduction of the Chicago rate in 1927) the reaction, both in public and governmental circles, had been generally unfavorable.

That the responsibility of the Federal Reserve Board was great, I should be the last to deny. But it erred chiefly in following the more customary course indicated by the law and by practice rather than adopting a bolder course which might have been possible under the law but was not clearly made the Board's responsibility.

Looking at the matter in a practical way, it will be recognized, and it should not be overlooked in this connection, that the unfavorable public reaction to the assumption by the Board in the Chicago rate controversy in 1927 of authority to force rate action by federal reserve banks was not calculated to stimulate its sense of responsibility for appropriate and timely federal reserve policy. There is a great difference between the power to initiate action and the authority to review proposals after they have been made.

No one can tell whether the policies of the federal reserve system in 1927 and 1928 would have been different had the Board had full responsibility for action. But it is abundantly clear that acceptance by the Board of aggressive easing action proposed by the New York Federal Reserve Bank in 1927 and of complete abandonment of restraining action in the second half of 1928 proves that the Board, under the established tradition, was first too quick to fall in with a daring and dangerous proposal and later too slow to assume the leadership which was needed and was lacking at a most critical time. It is my belief that, if the Board had had full responsibility in the matter, it would not have adopted so readily the easing program of 1927 and would have acted more promptly in assuming leadership after July, 1928.

But be this as it may, as things then were in the second half of 1928 the Board looked to the federal reserve banks for the initiation of further measures of restraint and the banks, in turn, depended on the leadership of the Federal Reserve Bank of New York. And New York's leadership proved to be unequal to the situation.

An inquiry why federal reserve bank leadership erred during this period would make an illuminating and most instructive contribution to the problem of how to secure a more continuously effective leadership and responsibility in federal reserve administration. One observation may be made and that is that the supercharged atmosphere of the country's great financial and speculative center is not one which can be said to be conducive to sustained detachment of mind and interest or to a clear perspective with regard to current developments and their implications when the tempo is as swift as it was in this period of optimism gone wild and cupidity gone drunk.

However this may be, it is a fact that while the attitude of the federal reserve banks was one of tolerance and temporizing and the federal reserve system as a whole was, as I have elsewhere stated, "drifting" in the midst of a perilous situation that called for intervention, the Federal Reserve Board was growing more and more anxious at the course of developments. Ultimately its anxiety reached a point where it felt that it must itself assume the responsibility of intervening in the dangerously expanded and expanding speculative situation menacing the welfare of the country. This it did early in February, 1929.

Board's Direct Action Policy in 1929

On February 2 the Board directed a letter to the federal reserve banks and on February 7 it issued a statement to the public carrying the substance of the letter previously addressed to the banks, in which, after expressing its anxiety with regard to current developments, it laid down an interpretation of the Federal Reserve act under which it was stated:

The Federal Reserve Board neither assumes the right nor has it any disposition to set itself up as an arbiter of security speculation or values. It is, however, its business to see to it that the federal reserve banks function as effectively as conditions will permit. When it finds that conditions are arising which obstruct federal reserve banks in the effective discharge of their function of so managing the credit facilities of the federal reserve system as to accommodate commerce and business, it is its duty to inquire into them and to take such measures as may be deemed suitable and effective in the circumstances to correct them; which, in the immediate situation, means to restrain the use, either directly or indirectly, of federal reserve credit facilities in aid of the growth of speculative credit.

This interpretation was the basis of what soon came to be known as the policy of "direct pressure." It was, in brief, a method of exercising restraint upon the speculative credit expansion then in process by restricting the borrowings from the federal reserve banks by those member banks which were increasingly disposed to lend funds for speculative purposes.

It should be particularly emphasized and noted that not until the Board thus declared its own attitude and the position which it deemed appropriate for the federal reserve system as a whole did the federal reserve banks come forward with proposals for discount rate action looking to restraint of credit. It was on February 14, twelve days after the Board's warning letter, that the Federal Reserve Bank of New York submitted to the Federal Reserve Board its recommendation that its discount rate be raised to 6 per cent. This was the first proposal for an advance in discount rates to reach the Board after the 5 per cent rate was established in July of the preceding year.

Thereupon an acute controversy extending over a period of months developed between the federal reserve banks and the Federal Reserve Board

with reference to the respective merits of the policies of control through discount rate advances and through "direct pressure." It is the theory of discount rate advances that they increase the cost of credit to borrowing member banks and thus tend to restrain borrowings. In ordinary circumstances, and especially when the discount rate of a reserve bank is abreast of or above going money rates in the market, the method of controlling an expanding situation through discount rate increase has frequently proved efficacious. But in such a situation as existed in the opening months of 1929 with the rate for call money fluctuating between 6 and 20 per cent, it would have been necessary to step up federal reserve bank rates to unprecedented levels in order to catch up with the rapid ascent of rates in the open-money market. To have done that would have involved damaging disorganization of the whole structure of commercial money rates, with economic consequences that could not be accurately foretold and might easily in the then existing situation have proved disastrous. A prompt and energetic stepping up of the discount rate in the earlier stages of a pronounced credit and speculative expansion might have been relied upon to exercise an effective restraining and corrective influence, but when the rate of speculative expansion had attained such speed and the thirst for credit had attained such intensity as was the case at the beginning of the year 1929 and earlier, control through discount rate increase, to put the matter mildly, is at best to be regarded as a frail reliance and a dubious expedient.

In the circumstances which existed at the time when the Board made its announcement with regard to "direct pressure," the speculator did not ask what was the cost of money but whether he could get it at any price. The increase of rate might even have been a relief to the speculative market inasmuch as it would have carried the suggestion, whether so intended or not, that money would be forthcoming from the federal reserve banks so long as the stipulated price for it was paid. "Direct pressure," on the other hand, works as the name indicates, by direct control of member banks instead of indirectly through money rates. As applied in 1929, it put the member bank, which was seeking federal reserve credit facilities in order to support or increase its extensions of credit for speculative uses, under pressure by obliging it to show that it was entitled to accommodation, and leaving undisturbed such member banks as were borrowing in the usual course from their federal reserve banks for meeting commercial requirements. It was, in brief, a method of exercising a discriminating control over the extension of federal reserve credit such as the purely technical and impersonal method of bank rate could not do. "Direct pressure," furthermore, is a more flexible method of control, capable of easy adjustment, if circumstances should demand. By comparison, the discount rate is a more formal device, and one that in a rapidly shifting scene is rigid and clumsy. Pressure can easily be increased or diminished through direct action. Change

of discount rate, because it is a more formal and public proceeding, takes on the aspect of a signal indicating change of direction or change of policy, and therefore is less likely to be invoked promptly as soon as indications of changes in the situation become discernible. To put it bluntly, though not elegantly, control by rate action in a speculative gale of such fury as swept the United States in 1929 is a good deal like spitting against the wind.

The Board's opinion that "direct pressure" would afford not only a method more appropriate in the circumstances than a discount rate increase but also one likely to prove highly successful in putting an effective pressure upon the hitherto expanding volume of speculative credit was vindicated by the influence this policy exerted shortly after the beginning of its application.

From the beginning of February until the end of May brokers' loans by reporting member banks declined by about \$650,000,000; and although brokers' "loans by others" continued to increase, the total of brokers' loans showed a net decline in this period (Chart 5). Money rates increased sharply (Chart 4). Stock prices, which had been rising rapidly, fluctuated within a comparatively narrow range (Chart 6).

By the middle of June it became apparent that in the then existing psychological and economic situation continuance of unremitting pressure on the market, particularly with the known heavy financial requirements of many leading industrial undertakings at the approaching end of the fiscal year, might precipitate a catastrophe. The Board, after a conference with a delegation of New York reserve bank directors, decided to relax for the time being but not to abandon its "direct pressure." It was moreover then becoming evident that the stock market was reaching a point where it would collapse of its own weight, and that the principal concern of the federal reserve system should be to prepare itself to help the banks and the country to absorb the imminent shock as soon as it occurred.

It is not without significance in current discussions as to the proper distribution of authority between the banks and the Board, that during the tension occasioned by the acute differences over the leadership of the federal reserve system in the six months following the Board's declaration of its position of February 2, 1929, the five members of the Board who took the responsibility of formulating the attitude and policy for the federal reserve system were opposed by a minority of their own membership, including the Secretary of the Treasury, the governor and the vice-governor, by the twelve federal reserve banks and, finally, by the Federal Advisory Council and many, but by no means all, of the largest member banks. This was a formidable opposition. Nevertheless the Board adhered to its position, firm in its conviction that it was pursuing the only proper and effective course of action, belated though it was, which was open to the federal reserve system at the time. That it did not err in its judgment from a public point of view seems

sufficiently established by the fact that several of the most important amendments written into the Banking act of 1933 with regard to the federal reserve system were based upon the attitude of the board as expressed in 1929 and the procedures then developed. This was a ratification by the Congress of the United States of what had been undertaken by the Board in the early months of 1929 in the face of determined resistance.

The Lessons of This Experience

Looking at the record of this period 1927-1929, as thus briefly recited, certain conclusions, I believe, will suggest themselves to anyone who is seriously interested in drawing from this chapter of federal reserve experience lessons which are pertinent to any future discussion of the modification of the federal reserve system brought about by the Banking act of 1935. More particularly, these lessons have a bearing on that phase of the new legislation which would provide a more definite concentration of authority over the open-market policy of the federal reserve system.

The first of these lessons clearly points to the inadvisability of a division of responsibility in a matter of such vital national moment. Whatever might be said for the former system theoretically, it did not, in its actual working, produce a satisfactory result, as the 1927-1929 experience appears clearly to demonstrate; and it did not do it, in my opinion, because the responsibility was divided.

Unity of responsibility, my experience with the federal reserve system has convinced me, is essential to the ceaseless concern and vigilance which are necessary for timely and vigorous action in matters of central banking policy and administration. I would put the matter this way:

(1) The authority to initiate policies carries with it the opportunity to exercise leadership and involves a far greater degree of responsibility than the mere authority to approve or disapprove policies initiated by others.

(2) The body which initiates a policy should be under obligation to watch its consequences and to inaugurate a change whenever circumstances make it advisable. In other words, responsibility should be continuous.

(3) The judgment of the bankers or of officers of federal reserve banks regarding national credit policies has proved itself not to be infallible, and they cannot always be trusted to reverse their policies promptly when the public interest requires such action.

(4) The authority to initiate national credit policies should be concentrated in a single body which should have definite responsibility to the public not only for the initiation of policies but also for following them through, watching their effect and initiating changes or modifications when the public interest requires.

This brings us, in conclusion, to the question in what body should such authority and responsibility be concentrated.

It is my conviction that it should be lodged in a body, no matter how constituted, having a national viewpoint and owing undivided allegiance to the general public interest. Its judgment should not be warped by the viewpoint of any particular section of the country or by the special interests of any particular group. It should be an impartial, independent body with a keen and continuous sense of public duty and a point of view sufficiently detached to avoid having its judgment as to long-time policies swayed by the popular clamor of the moment.

A. C. MILLER

Federal Reserve Board