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TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE April 10, 1955

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TO Governor Eccles  
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FROM Herman Oliphant

I should like very much to have your reactions  
to the attached, particularly the concrete plan proposed.

*H. Oliphant*

In a conversation some days ago, Mr. Hoover's recent article on Regimentation was mentioned, and I was moved to express some opinions on a matter in which I felt very strongly. The Honorable Daniel C. Roper, who was present, suggested that I put them in memo form. In substance, they are:

Regimentation is not a new idea in finance. We have had it, in principle, if not in terminology, for the last thirty years. A close organization of financial affairs first became evident with the great activity of the war period. With all the large banks of the country having a resident vice president in New York, the New York bankers discovered that they were able to put over syndicates and underwritings of government securities with great speed and efficiency. This close cooperation of financial interests proved so successful in the placement of Liberty bonds, that the bankers sought to continue it after the war, to push their securities far afield. Every effort was made to direct all investment funds to the banker. The sign, "See Your Banker Before You Invest", became a familiar sight. Through the American Bankers Association, and particularly the Investment Bankers Association, a close knitting together of all bankers and security dealers was secured. As is well known, the same group that dominates the New York Stock Exchange dominates also the Investment Bankers Association. The investment bankers, better to control the field, fathered and supported the Better Business Bureau. This last organization theoretically had as its objective the keeping of crooks from the investment and commercial field, but in reality it has worked as a means of control - thwarting, in a measure, all projects not in the hands of the investment bankers or their associates. Here we have a system of complete credit regimentation, at the head of which is the New York Stock Exchange, which in turn, is entirely and completely dominated by the firm of J. P. Morgan.

Having secured this domination, Wall Street securities were fed out as the only safe, sane, liquid, etc., investment recognized by all worth while people, while all items of personal credit or matters of local enterprise were frowned upon. Having gathered all the funds of the nation into securities of their own manufacture and having the heaped-up liquid bank and corporation reserve in New York to play with, the banks entered on a stupendous gambling spree, to the entire neglect of local growth, local credit or local solvency. Indeed, for six months prior to the 1929 Panic, practically all local money was enticed into New York for lending at excessive call money rates. When the market broke, the New York brokers and New York banks, at the expense of all the rest of the United States, sold, ruining millions of investors of this country in order to save themselves or their institutions - liquidating at any cost.

Here is what Dean Swift wrote 200 years ago:

"Money, the life blood of the nation,  
Corrupts and stagnates in its veins,  
Unless a proper circulation  
Its motion and its heat maintains."

Money and credit (money's equivalent) are still the life blood of this or any other nation. Today there is no money available to the people and credit is refused because the applicant cannot present security which is more than the present equivalent of the money sought. The thought that the lender may trust the honest man and share faith in a promising enterprise has been entirely dissipated. There is hard and fast regimentation in favor of vested interests and monopolies which already both exclude and oppress, - the result of regimentation by private interests.

The New Deal

The purpose of the New Deal is to unregiment the finances of the nation, to free the individual so he may grow, expand and help build this country into yet greater things so that the whole standard of living may be raised to a much higher level. To do this, money and credit must be pumped to the grass roots; that is, to every community, large or small, and held there, to supply local needs and for the development of the resources and opportunities of that particular locality.

Let us look back at this broad country and see what has happened in the last thirty years. Take any average community in the South, North or West. Thirty years ago in every town there were one or two banks and from three to ten or more independent individual money-lenders. In every large city were countless neighborhood banks. One wanting to go in business, make an improvement, or an investment, or a business transaction in which a profit was anticipated, went to the little bank or to one of these lenders. Generally, if the borrower had any standing or persuasive ability, he secured from one of the sources the funds he required. Commercial and personal credit was available to all the people. It was under such circumstances and operations that our great South and West were built.

Perhaps twenty years ago we entered on a period of bank and credit expansion. New banks were formed, and they took in the old money lenders as their directors. After a vigorous expansion, a reaction set in. Some failed; there were consolidations, etc. In larger communities like Cleveland and Detroit, the small neighborhood bank disappeared, to be followed by discount companies with their exorbitant rates and commissions. Those in control of the big banks were no longer satisfied

with interest, and speculation became the order of the day, if not with the bank's funds directly, through closely affiliated corporations. Large borrowers were diverted to where commissions could be extracted. Often larger loans than necessary were granted with an eye to the commission and a representative of the bank came into the management of the borrower, through representation on his board of directors. Securities, whose final default was almost assured in their creation, were wished onto a trusting and unsuspecting public.

Small borrowers were forgotten. Ten years ago in Cleveland there was no place for a small borrower to go except the limited service of the Morris Plan Bank, in which banks the multiple endorsement requirements were often an embarrassment that prevented their use. All these things began to work to stifle small businesses and new undertakings. The Better Business Bureau and the investment banker looked askance on promotions. Little enterprises withered and died and no new ones took their place. The granting of credit on character or earning ability without collateral ceased. Then the Panic of '29 and the depression - and a country for five years without even the strained and limited credit of '29 available! The thousands upon thousands of new enterprises necessary to our country's well-being never were born. New enterprises that had been multiplying since the Civil War had culminated in the automobile, our greatest industry. For the lack of credit and promotional funds, there was nothing new entering the field to absorb workers freed by constant improvement in older industries. This was not from want of useful inventions or lack of enterprise on the part of our people, but entirely from the strangled credit situation.

What Has Been Done To Help Credit By This Administration

First, the banks themselves were rescued, many having the Government as a partner through preferred stock or debenture notes. This wise step, as was intended, restored a sadly shaken public confidence. The banks are in better condition than at any time for the last five years. However, they are still stifled by the bank regulations and examinations. Examinations that in the past have failed to detect weakness, as was shown by the collapse of last March 4, but examinations which seem to be to influence or force all banks to the basis of Wall Street loaning, that is, on collateral only. To make it easier for the examiners, loans are favored on securities, so far as possible, listed on the New York Exchange. Thus, perhaps unwittingly, has the examiner helped the Wall Street gambler and put a great handicap on local securities in small enterprises. The granting of personal credit has become a lost art. For a thousand persons who could borrow a thousand dollars at a bank twenty years ago, unsecured, it is doubtful if there are ten who can do the same thing today. Many local bankers of the present day were raised as bank clerks and know nothing about money lending except through the bank window. The man who comes there means nothing to him. What the applicant has in his hand is all they are concerned about, because they do not or cannot think of their real function as builders in their communities.

The second great effort on credit was the self-liquidating loans authorized by Congress. These have not been made either by the R.F.C., or later by Mr. Ickes, to any such extent as was evidently first intended by Congress, and practically none are being made now.

Next and last came loans to industry, first by the R.F.C. and later direct by the R.F.C. and Federal Reserve. It is common knowledge how little has been loaned. Under the law, loans can only be made to organizations formed well before the Act was passed. Lending to an industry more than a year old often means lending to a broken enterprise. If a good man comes to start a fresh undertaking, he is a better risk than the one who has failed. Criticism without suggestion is fruitless. The writer believes he has several constructive plans to offer, one or two of which are submitted below.

What Must Be Done

A banking organization, centralized as to control of policies but decentralized as to banking operations, must be evolved and built up on the foundations we already have. Centralized, in that it would take over the money-issuing powers of the Treasury and Federal Reserve and be forever controlled by the Government itself. It would be the fountain-head of all credit administration, leaving the actual dispensing of credit to individual banks. It is this writer's firm belief that a central bank without the power of issue should be set up in the capital of each State and that all reserves (bank and corporate) of institutions within its borders should be restricted to deposit in such bank. That such bank should administer estates and in general father, guide and protect the building up of the State. Such banks to be owned by the State and National Government together, but all linked for guidance and final control to a central authority under Federal control.

The twelve Federal Reserve Banks were intended to decentralize,

but instead they have been a convenient channel to more readily center all our cash credit and reserves in New York. What any Federal Reserve Bank has ever done to sustain, build up or foster the section of the nation in which it was located has had scant publicity, that is certain. What a blessing it was for the investor in Standard Oil when the Government slipped in and split the old company up, giving new blood a chance at management. The breaking away from New York or centralized control, the splitting up of some of the great enterprises, and the getting of personal credit into the farthest corners of this country, might bring us equal surprises in national growth and good health.

A Suggestion for Immediate Action Before Congress Should Meet

The Morris Plan has operating banks and investment organizations in seventy cities and twenty four states. It could be expanded to a bank in every small community. It has already had the aid of the R.F.C. The further aid of the Government would, the writer is certain, be well received. Its credit rules on multiple endorsements on character loans could be eased and in 90 days money could be put into circulation in hundreds of communities where enterprise is now completely strangled. If the Morris Plan were not acceptable, an amended plan, that was approved by the late T. Coleman DuPont, then President of the Morris Plan Bank Association some ten years ago, but never put into operation, could be made available either in conjunction with the Morris Plan Banks or any other institution of a similar nature.

The modified Morris Plan just referred to is an adaptation of a plan used by some of the cooperative associations in Denmark and the writer secured the details of its operation from the secretary of one of

Denmark's cooperative banks in London during a conference eleven years ago. The Morris Plan Bank, as it now operates, makes a charge for its money of something like 18 per cent, which places the banks where they are able to earn rather handsomely. It was the original plan of the Morris Plan Banks that they should be service organizations, building up the small man or relieving his distress. Mr. DuPont, then President of the Association, told the writer that they had overlooked their original purpose and had fallen into a desire for profits that had caused them to lose almost complete sight of the functions for which they are organized. Unquestionably, it is going to cost more for a bank to function and serve small loans than large ones. Denmark has an excess of funds and a shortage of borrowers. They worked out a plan whereby they would bunch their loans into groups of fifty or one hundred thousand and if those loans paid off promptly and the bank's profit was over the point set, a dividend in proportion to the borrowings was paid to the borrower. This was the plan upon which Mr. T. Coleman DuPont looked so favorably. In fact, he stated to the writer that if he were ten years younger he would devote his life to carrying out an organization based upon this plan. It would not be charity, it would pay its way, and would be of tremendous service in building up the small individual or enterprise into a self-sustaining and growing unit. Such an operation would go a long way in meeting our unemployment problem. It is well known today that there is no shortage in our wants or demands, the shortage is in our inability to earn or secure funds.

This modified Morris Plan would make the loaning of small sums,

that used to come naturally within the province of the country bank or small neighborhood bank in the city, again a sound and attractive operation. A thousand dollars loaned to a million ambitious, hard-working men would not be lost and would go a long way toward starting things and be surely more constructive than the same amount in the form of a dole, which latter alternative we apparently immediately face.

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GEORGE T. WEBB

Room 626-A  
R.F.C.

GENERAL COUNSEL  
TREASURY DEPARTMENT  
WASHINGTON

*M.W.*

April 25, 1935

Dear Eccles:

I was much interested in the comments on Webb's memorandum which you sent me under date of April 16. I fully appreciate the limitations in Webb's memorandum but I would be at a loss in attempting to react on the first part of these comments.

It would seem that their author was wholly unacquainted with the successful operation of the State Bank in North Dakota, for which Mr. Webb is largely responsible.

We are not going to get spectacular results from any one thing. What we need is a lot of results, whether spectacular or not, from a lot of things. The longer I am in Washington, the more I am impressed by the fact that what it suffers from most is the "one-cause-one cure" fallacy in dealing with social problems.

Sincerely yours,

*Harmon Oglethorpe.*

Honorable Marriner S. Eccles  
Governor-Federal Reserve Board  
Washington, D. C.

April 16, 1935.

TO: Mr. Oliphant  
From: Governor Eccles

Attached are some comments on the contents of  
the memorandum which you sent me under date of April  
10.

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*W. T. Webb*

COMMENTS ON MEMORANDUM

by  
George T. Webb.

My general reaction to the memorandum is distinctly unfavorable. Of course, we have had a decline in the volume of bank loans extended on the basis of the personal credit of the borrower. This simply reflects a change in the structure of business organizations from small-scale personal enterprises to large corporations. The decline in small businesses is due to many factors and not as the author of the memo seems to think solely to the improper use of banking resources. Obviously, a large established enterprise with access to the organized securities markets is able to obtain credit upon more favorable terms than the small enterprise which only has access to a local bank. The increasing competition of the large enterprise has made it more difficult for the small business to enter or to stay in the manufacturing and distributing fields and consequently the small business has become a poorer credit risk. For banks to deal in collateral loans and bond investments has only accelerated the trend to large scale enterprise.

The real issue at stake, however, is the protection of small-scale business and this should be argued as a matter of social policy rather than as a question of sound or unsound banking which only beclouds the issue. Undoubtedly large enterprises which wield great economic power to control production, employment, prices and rates of expenditures have tended to introduce instability into our system and intensified business fluctuations. On the other hand the system when operating smoothly makes possible large efficient production and

high national income. If we want a change in business organization, however, the way to attain it is by taxation or other methods, and not by arbitrary restriction on the loaning functions of commercial banks. Neither safety to depositors nor the control of the supply of bank money demands that banks shall extend credit on any particular class of asset.

Below are some comments upon the specific proposals which the author makes.

Plan for Establishing State Central Banks

It is difficult to comment upon the writer's specific plan for establishing in each State a central bank without the power of issue because of the extreme vagueness of the proposal. Other than the requirement that all reserves (bank and corporate) of institutions within State shall be deposited in such bank there is nothing to indicate what shall be the functions of the bank and how its operations shall be conducted. Why corporate reserves should be kept in the bank is not clear. If corporations were building up cash balances in the central bank, the commercial banks would suffer losses of deposits and reserve deficiencies would arise just in the same way as when currency is flowing into circulation or the Federal Reserve System is selling government securities. Obviously unless the new banks made loans to commercial banks or otherwise replaced the losses the only alternative would be a severe liquidation of commercial bank credit. It seems to me that the writer in making

this suggestion completely fails to understand the proper functions of a central bank. Moreover, he does not know how the movement of funds into and out of a central bank affects the reserve position of member banks and hence their ability to make loans and investments.

Moreover, the author states that the actual dispensing of credit is to be left to individual banks. Apparently he does not recognize the extreme fluidity of funds in moving from one section of the country to another. It is impossible for the central bank to make credit easy in one part of the country and tight in another. The only way this could be done would be to have a completely socialized banking system with all the loan and investing functions concentrated in a single institution.

There would seem to be no basis in logic or experience for placing the administration of all estates in the hands of the government owned State central banks.

#### The Plan for Modifying the Morris Plan Banks

I see no objection to the suggestion that Morris plan banks be established more widely throughout the country and that a method for disbursing excess profits to borrowers be inaugurated. So far as consumer credit is concerned, I think we should encourage efforts to make it more readily available, and that the commercial banks might well be expected to extend their operations in this field. The eligibility features of proposed banking bill should tend to make this type of paper more attractive to banks. However, I would

not expect any spectacular results at the present time. As long as consumer incomes are low and jobs are precarious it is unlikely that a great increase in borrowing would take place even if the terms were made more favorable.

April 16, 1935.

MM/lem