

SOME ASPECTS AND PURPOSES OF THE
COMPREHENSIVE HISTORY OF THE FEDERAL RESERVE SYSTEM

General approach and purposes

A. Some of the major objectives of the Comprehensive History

1. To gather and preserve all relevant information about the Federal Reserve System that could possibly bear on the evolution of the structure and functioning of the System.
2. To present a comprehensive analysis from an evolutionary point of view, tracing the development of ideas and showing the interrelationships of social attitudes, social and economic events, pressure groups, and personalities on the structure and functioning of the System.
3. Some things to be given special attention
 - a. One of the central interests of the entire study should be the methods and terms on which money has been made available to the banking system and the economy as a whole. This would include, of course, all major changes in the methods used, such as discounting and open market operations. But it would also give adequate attention to changes of policy represented by changes in methods of administration even though there was no change in the broad method of providing or extracting funds. This would require adequate attention to the whole question of location of control, the methods of administration, and the development of ideas by those who make policy.
4. Things to be avoided
 - a. This should not in any sense be considered an official history and the writer should feel perfectly free to criticize, evaluate, and interpret.
 - b. It should not be financial history in the narrow sense but should be a social history, giving due emphasis to intellectual and political, as well as the narrower economic and financial, philosophies and events.

B. Some of the specific topics and events that might be considered

1. The backgrounds of the Federal Reserve System
 - a. This should include a detailed analysis of all the conditions and thinking that led to the movement for financial reform and that influenced the form of the legislation finally enacted. This would include not only the legislative history and the conflicts in the Government accompanying the consideration of the legislation but should also include a consideration of the existing international monetary and financial relationships, the nature and structure of our own economy, the conflicts over broad

economic policies, the structure and functioning of our banking system, the economic theories underlying the various proposals, and the personalities that were involved in the whole movement.

- b. A similar study relating to the organization of the Federal Reserve Districts, of the Federal Reserve Board, and of the Federal Reserve Banks before the banks were actually opened for business.

2. Period of organization and growth - November 1914 to April 1917

- a. The whole process of determining the structure and organization of the Federal Reserve Banks, the selection of personnel for the Federal Reserve Banks, the division of control between the Federal Reserve Board and the Federal Reserve Banks, the location of control within the Federal Reserve Banks, the process of arriving at decisions as to the appropriate objectives of the Federal Reserve Banks for the longer run and for the existing situation, and the relationship between Federal Reserve operations and American foreign policy. Worthy of special consideration are not only longer term growth considerations, such as building of the prestige of the System, but the desirability of making earnings in order both to build prestige and to attract members.

3. War and inflation - 1917 to 1920

- a. A comprehensive analysis of the entire war financing program and of ideas relating to it and the relationship of the Federal Reserve to the whole process. The effect of the prevailing economic theory on the types of assistance given by the Federal Reserve to both public and private financing.
- b. In addition, adequate attention should be paid to such things as the effect of the war period on membership in the Federal Reserve System, the prestige of the Federal Reserve System, the relationship between the Treasury and the Federal Reserve, the tendency to concentrate power in the Federal Reserve Bank of New York, the subordination of the Federal Reserve Board in dealing with monetary problems, the growth of relations with foreign central banks and governments, the impact of this experience on the earlier philosophy of the Federal Reserve Act and of Federal Reserve policy, and contemporary ideas as to later developments.

4. The Federal Reserve and deflation - 1920 to 1921

Analysis of events during period and of Federal Reserve policies. A satisfactory treatment would include not only actual Federal Reserve actions but a close scrutiny of the changing role of Treasury financing, of basic philosophy and theory of the public at that time, and of the Federal Reserve officials. It would also include a detailed analysis of the process of decision-making and of the theories and objectives, explicit or implicit, of those who engage in the process.

5. The search for appropriate peacetime organizations and policies - 1921 to 1929

This period will have a number of themes and subthemes which are sometimes woven together and sometimes not. Among the major problems were the following:

- a. The struggle toward a basic philosophy of central banking: the conflict between the old commercial loan theory which would have prescribed a passive approach and the theory of positive control which would often require actions directly in conflict with those appropriate to the commercial loan theory.
- b. Changes in the methods of business financing and their impact upon the character of commercial-bank earning assets and upon the volume of brokers' loans. The need for secondary reserve assets as a factor in the growth of loans from non-banking lenders to the market.
- c. The role of gold in the System: the continued allegiance to the international gold standard as an ultimate ideal, coupled with actions that were, at least in the short run, in direct violation of the rules of the gold standard game but sometimes with the intent to reestablish the gold standard internationally.
- d. The frequent conflict of more immediate guides or objectives: the objective of reestablishing an international gold standard and of promoting recovery abroad, the accommodation of commerce, industry and agriculture at reasonable interest rates, a positive policy of stabilizing business conditions, price stabilization, the development of New York as an international financial center, the control of speculation on the stock exchanges.
- e. The evolution of instruments of Federal Reserve policy: changes in both the techniques and relative importance of instruments such as the discount rate, moral suasion of various types, open market operations, international stabilization credits, development of the "factor analysis" of the money market - member bank reserves and related items. This investigation will necessarily involve the procedures for arriving at decisions and the location of control.
- f. The process of decision-making and the location of control: this analysis will highlight the fact that the original theory of the Act - that there would be at least the possibility of separate credit policies for the various regions - came under closer scrutiny and was accompanied by many conflicts between the principles of centralized control and of regional autonomy. This involved not only the division of decision-making and control between the Federal Reserve Board and the regional Banks, but also the question as to whether and to what extent a centralized control should be exercised by the Federal Reserve Board or by centralized associations formed by the regional Banks. The weakening of the influence of the Federal Reserve Bank of New York and the increase of the influence of the Federal Reserve Board following the death of Strong.

6. Federal Reserve actions in a period of deflation and breakdown - 1929 to 1933

In analyzing this period the following important things should be stressed and interrelated:

- a. The prevailing philosophy of the public at large, the Government, and Federal Reserve officials as to the responsibility of the central bank and of the Government in dealing with conditions in such a period.
- b. "Sound money" beliefs carried over from pre-1914 days that "currency manipulation" should not be used in an attempt to bring about revival, overlooking the fact that a currency must necessarily be managed with respect to some criteria of stability when it is no longer managed with respect to the gold reserve.
- c. Lack of grasp of America's place in the world financial structure. Belief that the United States must adjust to world monetary conditions and could do little to determine them.
- d. The persistence of the belief that the United States could take no positive action to halt deflation even after the international gold standard had ceased to exist and most countries of the world had adopted national currency policies. International developments such as the cessation of foreign loans, international financial panics, breakdown of gold standards, wide changes in exchange rates, etc.
- e. Business cycle indoctrination which stressed the idea that the forces of depression were fundamentally nonmonetary and that monetary measures could play little part in bringing about recovery.
- f. On the other hand, there was a latent tradition, sometimes referred to as Bryanism, that monetary action was vital in restoring prosperity. But the monetary procedure contemplated was not primarily central banking procedure.
- g. The tradition of business cycle theory that depression was healing and beneficent and not degenerative and leading to crack-up. This tradition regarded deliberate monetary expansion to shorten the "recuperative" period as harmful.
- h. But with the deepening of the depression, the growing popularity of the belief that there were inherent forces in a capitalistic society making for stagnation and blocking the technical possibilities for much higher living standards. This point of view looked toward fundamental changes in the rules in the economic organization for the most part rather than monetary procedures.
- i. The decline in availability of bankable assets as the depression deepened, indicating the vulnerability to contraction of a monetary system that issues money against debts. The vicious circle of monetary contraction and the decline in the safety of debts

and the willingness to go into debt except by distress borrowers, proneness of American banking structure to failure, role of restrictive legislation, such as the collateral requirements behind Federal Reserve notes and restrictions of eligibility of paper for discount. The resulting lack of responsiveness of the economy to central banking measures for expansion.

- j. The diminishing tolerance of the economy for severe liquidation.
7. Federal Reserve policy from the banking crisis of 1933 to our entry into World War II - 1933 to 1941

The treatment of this period should trace the disillusion of the public and the despair that existing thinking and institutions could provide an adequate solution. It would combine a discussion of actual Federal Reserve policies with a description and analysis of the very important changes in the legislation relating to the Federal Reserve System. It would try to trace out all the lines of development that culminated in actual or proposed changes in the basic law and in the actual structure and operation of the System.

Early Recovery Period

- a. Belief that monetary measures must be mainly outside central banking procedures. (Preparation for the issue of script an extreme instance of blindness to central banking possibilities.) Due partly to lack of understanding of central banking; partly to the loss of prestige of the Federal Reserve during the crisis; and to the historical traditions regarding money of leading groups sponsoring monetary expansion. (For instance, looking back to bimetallism and to greenbacks in the Thomas Amendment.) Establishment of new institutions and procedures, such as deposit insurance, R.F.C., and so on.
- b. The loss of confidence in business leaders which came with the collapse resulted in greater receptiveness to reform legislation. The popular attitude that greed and dishonesty were in great part responsible for the collapse emphasized the necessity of "driving the money changers from the temples" and diverted attention from the monetary aspects of the collapse.
- c. Closely related was the idea that the failure to curb speculation by denying credit to speculators specifically was an important cause of the collapse. This belief led not only to reform legislation, but to the search for selective monetary controls; and it made central banking policy very sensitive to a rise of stock prices down to the present day.
- d. The continued misunderstanding of the place of the United States in the world financial structure was evidenced by some attempt at competitive devaluation. The problem of providing dollars was complicated by the protectionism of strong pressure groups.

Later Recovery Period

- a. Abandonment by the Administration of monetary action as an important means of increasing general demand, and greater emphasis upon fiscal policy, increase of farm income, and upon raising wages and other labor income by nonmonetary means.
- b. Foreign totalitarian influences on methods of maintaining prosperity. In such ideology central banks were mere agents through which governments exercised naked power. Liquidity as such was not viewed as an important means of regulating money outlay. The central core of their mechanism was power itself.
- c. Drop in interest rates to low level as the result of historical accident rather than deliberate action. The drop in long-term rates welcomed by the Federal Reserve. But the large excess reserves, which were mainly responsible for the drop, regarded as a potential danger of inflation. This fear of inflation in the midst of semidepression characterized the attitude of the Federal Reserve until Pearl Harbor.
- d. The shift in influence over monetary policy toward the Treasury. In part this was due to the new powers of the Treasury over reserves directly, but mainly it was due to the influence acquired by the Administration during the crisis and to the loss of prestige by the Federal Reserve during the depression and crisis.
- e. The policy of maintaining "orderly markets" in government securities materialized during the restriction of 1937. Though this did not imply pegging of rates, it marked a definite change from the ideas of the twenties, when short rates were supposed to be varied with respect to business conditions. After 1937 the Federal Reserve realized they would allow rates to drift within wide limits and would intervene only to prevent sudden changes. The Federal Reserve seemed by many to have become merely a check collection agency. This policy of drift was partly the consequence of the unfortunate events following the experiment in tightening in 1936-37.
- f. Pegging the Market: The policy of maintaining "orderly markets", though not at all contemplating the pegging of rates, prepared the way psychologically and developed a procedure for pegging. (The market became accustomed to the Federal Reserve's interventions for the purpose of affecting security prices as such.) The Treasury had decided on pegging many months before Pearl Harbor. The Federal Reserve did not object to the 2-1/2 per cent ceiling on the long-term rate, but objected to the rigidity of the pattern. The Federal Reserve Bank of New York would have preferred a higher long-term rate, but did not advocate raising the ceiling in the situation existing when the rate was pegged.

8. Federal Reserve policy during World War II - 1941 to 1945

- a. A thorough description and analysis of the role of the Federal Reserve in World War II finance should stress the contrast with World War I. The contrast should include differences in basic

philosophies as to the function of the Federal Reserve, differing techniques of supplying necessary money, differing philosophies as to the proper behavior of interest rates, differing reliances on monetary policy, fiscal policy, and direct controls, and differing estimates as to the nature of the problems which would have to be faced after the culmination of war.

- b. Some important changes arising out of this period: the tremendous increase in the national debt, the practice of pegging the price of Government securities, the shift of policy-making to the Treasury, the proof that a central bank can control interest rates, changes in the law to facilitate Treasury financing.
 - c. The Federal Reserve position was that credit expansion was inevitable during the War and that it was inflationary, but that raising rates would do little to prevent the expansion.
9. The search for appropriate peacetime organizations and policies - 1945 to 1954

This should include a contrast between the search which grew out of depression and the search which grew out of inflation. Very important background materials for a consideration of this period would include the continued fear of depression in the midst of inflation, the general demand that all the powers of Government be employed to prevent the recurrence of serious depression, the emerging popularity of fiscal policy as an instrument of economic stabilization, the widespread disillusionment as to the power of monetary policy to deal with unemployment and inflation, the greater tolerance of the public for direct controls as a means of obtaining objectives and its equal willingness to see their abolition at the earliest possible moment, a search for extension of powers to reconcile expanding money supply with control of inflation, support of the securities market with control of inflation, development of the concepts of rigidly controlled markets, free markets, and flexibly controlled markets.

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