Memo Given to President 11/3/34

Pres't 11/7/34

DESIRABLE CHANGES IN THE ADMINISTRATION
OF THE FEDERAL RESERVE SYSTEM.

1. Relation of monetary management to business stability. Fluctuations in production, employment and the national income are determined by changes in the available supply of cash and deposit currency, and by the rate and character of monetary expenditures. The effect of an increased rate of spending may be modified by decreasing the supply of money, and intensified by increasing the supply of money. Experience shows that without conscious control, the supply of money tends to expand when the rate of spending increases and tends to contract when the rate of spending declines. Thus, during the depression the supply of money instead of expanding to moderate the effect of decreased rates of spending, contracted, and so intensified the depression. This is one part of the economy in which automatic adjustments tend to have an intensifying rather than a moderating effect. If the monetary mechanism is to be used as an instrument for the promotion of business stability conscious control and management are essential.

2. Present possibilities of monetary control. At the present time main reliance must be placed upon increased governmental and private expenditures to bring about a rise in the national income. The most important role of monetary control at the moment is assuring that adequate support is available whenever needed for the emergency financing involved in the recovery program.

3. Role of monetary control in the future. Two supremely important duties are likely to devolve upon the reserve administration in the near future. The first is assuring that a recovery does not result in an undesirable inflation. The second is assuring that a recovery is not followed by a depression.

4. Desirable changes in the administration of the Federal Reserve System. In order to endeavor, with some prospects of success, (a) to render prompt support for the emergency financing in case of need, (b) to prevent the recovery from getting out of hand, and (c) to prevent the recurrence of disastrous depressions in the future, it is, in my opinion, essential that the authority of the Federal Reserve Board should be strengthened in the following ways:

1. Complete control over the timing, character and volume of open market purchases and sales of bills and securities by the reserve banks should be conferred upon the Federal Reserve Board.

2. Governors of the individual Federal Reserve Banks should be appointed annually by their Boards of Directors subject to the approval of the Federal Reserve Board.

5. Necessity for strengthening the authority of the Federal Reserve Board. Although the Board is nominally the supreme monetary authority in this country it is generally conceded that in the past it has not played an effective role, and that the system has been generally dominated by the Governors of the Federal Reserve Banks. As a consequence, the Board has not commanded the respect and prestige to which its position would apparently

entitle it, nor has membership on the Board been as highly desired as it should be to attract the necessary talent. The great disparity in salaries has also contributed to this condition. This has led to the unfortunate result that banker interest, as represented by the individual Reserve Bank Governors, has prevailed over the public interest, as represented by the Board.

The relatively minor role played by the Board can, in my opinion, be attributed to its lack of authority to initiate open-market policy, and to the complete independence of the Reserve Bank Governors.

6. Open market operations. Far and away the most important instrument of reserve policy is the power to buy and sell securities in the open market. In this way reserves, on which deposits are based, may be given to or taken away from member banks. It is not too much to say that who possesses this power controls the banking system, and, in large measure, the supply of money.

In the present administrative organization the power to initiate open market policy rests with the reserve banks. The Federal Reserve Board possesses only the power to approve or disapprove. Thus, the effective power over money rests with the individual reserve banks and not with the Board. However much the Board may desire an energetic buying or selling policy it is powerless to initiate such a policy. On the other hand, the reserve banks' ability to carry out the policy is dependent on the Board. It should be noted that the Bank Act of 1933 effected no real change in this respect. From 1930 to 1933 the Open Market Policy Committee was composed of the twelve Federal Reserve Bank Governors. At present the Federal Open Market Committee is likewise composed of the twelve Governors and hence is dominated by the same men who were responsible for the policy followed during the depression. The Governors, by the very nature of their appointments, duties and associations, cannot help but be profoundly influenced by a narrow banking rather than a broad social point of view.

There is no reason to suppose that this administrative organization which functioned so badly in the past, will function any better in the future. The diffusion of power and responsibility, the root cause of the trouble, remains. Over one hundred individuals are responsible, in various degrees, for the formulation of policy. Obviously the more people there are who share the responsibility, the less keenly any one of them will feel any personal responsibility for the policies adopted. It is therefore almost inevitable that such a loosely knit and cumbersome body as the Federal Reserve Administration should be characterized by inertia and indecisive action generally. Moreover, a complete stalemate resulting from a disagreement of the reserve banks and the Board is always possible. To correct this condition reform must be in the direction of concentrating authority and responsibility for control into the hands of a small policy formulating body.

7. Appointment of Governors. As the System has developed the Governors, who are not even mentioned in the Act, have attained positions of major importance in influencing policy. Moreover, they are entirely independent of the Board. If the power of approval of appointments of the Reserve Bank

Governors were conferred on the Board, the possibility of lack of co-operation and friction would be obviated in the future, while the prestige of the Board would be enhanced.

8. Agitation for central banking. The adoption of these suggestions would introduce certain attributes of a real central bank capable of energetic and positive action without calling for a drastic revision of the whole Federal Reserve Act. Private ownership and local autonomy are preserved, but on really important questions of policy authority and responsibility are concentrated in the Board. Thus, effective control is obtained, while the intense opposition and criticism that greets every central bank proposal is largely avoided.

November 3, 1934