

Memo

The Hoover Commission on Organization of the Executive Branch of the Government, which was set up under an Act of Congress approved July 7, 1947, made its studies of the various Federal departments and agencies through task forces, one of which devoted special attention to the Federal Reserve System.

This task force, which was headed by Robert R. Bowie of the faculty of Harvard Law School, obtained the services of George L. Bach, head of the Departments of Economics and Industrial Administration of Carnegie Institute of Technology of Pittsburgh, Pennsylvania, to make a detailed study. Mr. Bach produced a report evidencing high quality and comprehensive appreciation of the problems involved. He realized fully the underlying importance of the purposes and functions of the Federal Reserve System. Upon the basis of this report, Professor Bowie and one of his associates discussed with me the recommendations which they proposed to make to the Hoover Commission and gave me the privilege of commenting upon them. The task force report as presented to me was so interesting and its recommendations were so important that I felt it essential to express my views very definitely on certain features, some of which I shall mention.

One of these was a proposal that the powers of the Federal Open Market Committee be transferred to the Board of Governors. Although the present setup was established by the Banking Act of 1935, it was a compromise, as I have taken pains to point out elsewhere, in order to accomplish not only the passage of the legislation as a whole, but to bring about essential improvements.

I naturally felt that the proposal was a further step in the right direction. It was supported by experience as well as by the principles of organization involved. While the Board of Governors has the responsibility and the authority for determining within statutory limitations the amount of reserves that shall be carried by member banks at the reserve banks, for the discount rates charged by the reserve banks on advances to member banks, and for the general regulation and supervision of the lending operations of the reserve banks, the responsibility and authority under existing law for policy with respect to dealing in the government security market known as "Open Market Operations" is vested in the Federal Open Market Committee. These operations have become an increasingly vital part of federal reserve policy. In practice they are the means through which the debt management policies of the government are largely effectuated and the supply of reserves available to member banks is expanded or contracted. They are also the means through which an orderly and stable market for government securities is maintained.

While the members of the Board of Governors constitute a majority of the members of the committee, i.e. 7 out of 12, the other 5 are presidents of reserve banks. It would seem on the face of it that the Board of Governors is the dominant factor in the committee but it is also equally apparent that, if there should be differences of opinion among the membership of the committee, policy could be determined by 7 members who might be at variance with the policies determined by a majority of the

Board of Governors in the field of its responsibilities.

I pointed out that those opposed to the proposal because they favored the existing plan might with good reason sometime ask that all major policy functions of the Board be transferred to the Open Market Committee. What this might leave for the Board of Governors as such would not be clear but would certainly be inadequate to justify its continued existence. However, I said, there would be no justification for continuing and expanding governmental powers in a body of men in part appointed by the President of the United States and confirmed by the Senate and in part by the directors of the reserve banks, two thirds of whom are in turn elected by one half of the commercial banks of the country. The entire banking system and the public are entitled to the assurance that federal authority exercised over them is vested in a completely and exclusively governmental body whose personnel is selected in the same manner as all others exercising governmental functions. This would be in accordance with the principle laid down by President Woodrow Wilson.

This line of thought led me to make an additional comment upon the general question of policy with respect to the manner in which governmental powers in relation to banking should be exercised in the Federal Reserve System. It has been increasingly evident that there is opposition on the part of banking organizations and by supervisory agencies in the Federal and State governments to the grant of greater powers to the Board or to any consolidation of existing agencies of the Federal government. Nevertheless divided authority and responsibility is incompatible with the best conception of proper administration of governmental functions relating to the banking system. In so far as the reserve banks play a part in this problem it should be emphasized that the presidents of the reserve banks are their chief executive officers, appointed by their boards of directors with the approval of the Board of Governors for five year terms. They are not directors of the banks and they are not vested with policy-making authority, except in so far as they may serve upon the Open Market Committee.

It seemed to me that the logic of the situation led to the point that if it should be felt that the functions of Reserve bank presidents should include any of the general policy functions of the Board of Governors, with the right which some have claimed to make direct representations to the Congress (a right which Carter Glass stated was vested in the Board), it would follow that both the Board of Governors and the Open Market Committee should be abolished and that the 12 presidents of the reserve banks as such should constitute the Board of Governors of the Federal Reserve System. It would also follow in such circumstances that, instead of being elected by their directors and their salaries being fixed by the directors with the approval of the Board of Governors in Washington, they should be appointed by the President of the United States and confirmed by the Senate, with their terms and salaries fixed by the Congress, as in the case of other governmental agencies. Then they would be responsible directly to Congress for the policies of the system in accordance with the intention of the Federal Reserve Act and related legislation. If they were not willing to accept this logical conclusion, they were not entitled to be vested with governmental powers.

However, I did feel justified, and so stated in offering a suggestion as to the Federal Advisory Council, that instead of its being composed as at present of bankers selected by the boards of directors of the reserve banks it should be composed of the presidents of the reserve banks. ~~Continuous~~ Board consultation with reserve bank officials is on a regular continuing basis and the Presidents' Conference serves as a convenient vehicle for consultation and analysis of common problems. The decentralized reserve bank structure provides channels of contact between the monetary authorities and banking, business, and the public for effectuating credit and supervisory policies. As an aid to policy making the reserve banks are an invaluable means for obtaining information and ascertaining attitudes throughout the nation. On the other hand in practice, the Advisory Council has tended to represent the larger metropolitan banks, primarily those doing a correspondent banking business. Members have been selected almost exclusively from such banks, notwithstanding the fact that 75 per cent of all member banks are small banks. In some districts the same representation has existed for long periods of years. This is particularly undesirable when the council member represents the interests of his own type of institution rather than a broader public interest. Since the presidents of the reserve banks are constantly in touch with the banks of their districts, small as well as medium and large, and since it is one of the responsibilities of the presidents to keep informed as to credit conditions throughout their districts as well as to contribute in the Presidents' Conference to the working out of the operating problems of the reserve system as a whole, the reserve bank presidents as a group could serve more effectively the purpose originally conceived for the Advisory Council in the enactment of the Federal Reserve Act. In this way statutory recognition could be given to the idea that there should be continuing consultation between the Board and the presidents on important policy determinations and their position would be more truly in accord with the functions which they are best suited to perform.

It is also interesting, in the light of developments which took place shortly before this book went to press, with respect to the conflicting views of the Treasury and the Federal Reserve on debt management problems, that one of the questions which arose in connection with the task force report was the question of the desirability of including representation of the Treasury in the membership of the Board of Governors and, without reviewing the details of my comments, I might quote the following phrases which in the light of subsequent developments seem almost prophetic as to a problem that has arisen without direct Treasury representation:

"The question of its freedom from political or Treasury influence would be injected into the situation. The Treasury naturally desires to finance the public debt as cheaply as possible and at times in the past followed policies having that end in view without full regard for long-range economic and monetary consideration. It is preferable in such circumstances to maintain the official separation of the Board so that its advice to the Treasury in fiscal matters may in its inception be free from Treasury influence."

Another point that came up in the discussion was the question of

ownership of stock of reserve banks and a suggestion that the Federal Reserve System should buy up the outstanding stock. While I had no objection to this, I pointed out that it, standing alone, would not be a matter of very much importance. However, in political circles and elsewhere proposals have been made from time to time that the government should take over the ownership of the federal reserve banks, as has been done in most other countries, notably the stock of the highly respected Bank of England under a Socialistic regime. I pointed out that the existing system of stock ownership of the reserve banks provides for what is in effect merely a nontransferable membership certificate, the investment in which yields a limited, statutory rate of return, and that any equity would belong to the government in case of liquidation. It would be very undesirable, however, to transfer the stock ownership to the Treasury. This would introduce political questions wholly different from any involved in the retirement outright of the stock of the reserve banks. The latter proposal could easily be adopted without any impairment whatsoever of the ability of the Reserve System to perform its functions and without in any way affecting the existing procedure of election of directors of reserve banks. The real question is what if any change would be made in the powers of the Reserve System and particularly in the status of the Board of Governors. The implications are far reaching and imperil the continuance of the private banking system.

Another subject upon which I commented but as to which I need not here repeat my views because I have dealt with the subject extensively elsewhere in this book, was the diffusion of bank supervision and regulation among various Federal agencies. I pointed out that this should be lodged in one place, to bring to an end the confusion, division and conflicts of Federal authority, jurisdiction and responsibility in the banking field, the reasons for which are set out in the Annual Report of the Board of Governors for 1938.

I also called attention to the necessity for determination of the true status of the Reconstruction Finance Corporation, which was not originally intended by Congress to be a permanent agency of government operating in peacetime as well as wartime.

At the conclusion of my comments I emphasized the desirability of statutory definition of the objectives of federal reserve policy, a mandate for this purpose having been embodied in the Banking Act of 1935 in the form in which it passed the House of Representatives although it was dropped in the final enactment of the legislation.

I am more than ever convinced in the light of later and more recent developments that sooner or later Congress must review the organization and functions of the Federal Reserve System and must define more precisely its powers if it is to be enabled to meet its full responsibility for natural <sup>and</sup> credit and monetary policy, as I am sure the Congress originally intended.