To Mr. Eccles

From Mr. Edmiston

A GOVERNMENTAL CENTRAL BANK vs. THE PRESENT FEDERAL RESERVE SYSTEM.

THE QUESTION OF OWNERSHIP AND CONTROL OF THE FEDERAL RESERVE SYSTEM

In reading over the writings of the commentators at the time of the organization of the Federal Reserve System, it is remarkable to notice that there was very little comment at the time about the question of having the Federal Reserve Banks owned by the Government and have the control of the system vested in a Governmental agency with complete power to appoint the local Boards of Directors of the banks, and through them the local officers who were to carry out the daily business of administration. Seemingly there was no question at that time but that the Reserve Banks should be owned by the member banks of the system. In Congressional debates and in committee chambers this same attitude appears to have been taken with almost no attention given to the possibility that complete Governmental ownership and control might be advantageous. Perhaps the reason was that such a drastic departure would obviously have had no chance of passage.

Arguments in Favor of Private Ownership
of the Federal Reserve Banks

First, the main argument favoring private ownership of the banks revolves about the fear that if there is ownership by the Government, the banks will be used for improper purposes by a management which is under the control of politics. If there is private ownership and at least a partial direction of the banks by stock holders, namely by member banks, there is provided a partial check to a misuse of Federal Reserve facilities. In other words, the Federal Reserve Banks by their great power over the monetary and credit structure may have a tremendous influence for bad as well as for healthy control. In order to ward off disastrous policies, as for example inflation and easy money which is always quite attractive to unscrupulous politicians, sufficient checks and balances should be inserted to keep such ill-advised actions from going into effect. Even though this type of organization means a sacrifice of speedy action in initiating measures designed to control the credit situation from one phase of the business cycle to another, it is worth while in order to prevent the more dangerous conditions which might otherwise be present continually. Also, if the Reserve Banks are owned by the member banks and the latter appoint a majority of the local Boards of Directors, the Banks maintain a considerable freedom of action under the presentlaws and a large measure of control over the credit policies of the Board, particularly in the matter of open market operations where the law definitely gives particular Reserve Banks the power to refuse to purchase Government securities which have been authorized by the Board. The Board in practice confers with the officials of the Reserve Banks in matters of policy changes and is often swayed by their views. This is held to be desirable because it keeps the Federal Reserve Board from setting up arbitrary and unwise policies.

Second, it is held by some that it would be "Un-American" to impose a body for control from the top without giving the banks who must abide by the decisions of this Board a voice in policy determination. Of course, at present the member banks do not have any appointive power in connection with members of the Federal Reserve Board itself, but because of their relation to the local boards of the Federal Reserve Banks they do exert considerable influence in the policies which are followed by the Reserve system as a whole, and at least nominally, initiate changes in credit policy.

Third, the experience of bankers who are daily meeting the public and coming in contact with the credit needs of commerce and industry is valuable in the conduct of central bank operations and therefore the bankers should be represented in some way at the central bank. There has never been any real question but that the public should be well represented on the authority for control, but still there is a feeling that the banks themselves should have a certain amount of independent power to elect representatives of their own choosing to the management of the system.

Fourth, it is possible that there would be definite conflicts as to the aim of a Government controlled body and one that is partially privately controlled. Whereas the latter would be primarily interested in maintaining sound credit conditions, a purely Government body would perhaps be more influenced by Government financing and tend to be dominated by the Treasury. The Treasury when hard pressed in its necessary financing is extremely interested in getting as low rates as possible. Therefore, it would be to the interest of the Treasury to have close cooperation on the part of the central bank to maintain easy money conditions in the money markets of the country. At the same time, sound credit conditions might dictate a firm money policy on the part of the central banking authorities. Thus even though the Treasury is aided temporarily by the Reserve banks' easy-money policy the country is adversely affected later when the inevitable crash comes. Some observers have maintained for example that the easy-money policy of the Federal Reserve in 1927 was in large part responsible for the later troubles in 1929.

Fifth, finally there are many who maintain that we have not reached the state of economic knowledge which admits of a highly centralized control. It is better under these circumstances to provide sufficient checks and balances in order to keep the Federal Reserve authorities from taking strong and vigorous action. Instead, it is wise that the Board should be hesitant and follow the general trend of the market and ease somewhat the transition from one phase to another. This of course is a defeatist philosophy, but it is, I think, quite prevalent in many quarters.