

Office Correspondence

FEDERAL RESERVE BOARD

Date: March 16, 1935

~~Governor Eccles~~

From: ~~Mr. Wyatt, General Counsel~~

Subject: ~~Further Argument against Banker Representation on the Body having Final Authority over Open Market Operations~~

REQUIREMENTS SECTION
MAR 23 1935
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I respectfully submit herewith two additional memoranda on the above subject, which I believe deserve your most serious consideration: (1) A memorandum based on the history of the creation of the Federal Reserve Board and the denial of banker representation thereon with quotations from Senator Glass' book "An Adventure in Constructive Finance"; and (2) another based on quotations from Senator Glass' committee report on the original Federal Reserve Act.

The first, I believe, could be used with telling effect.

I think the second would also be quite effective; but I drafted it some time ago and submitted it to Dr. Goldenweiser with a suggestion that it might be incorporated in our brief. He felt that it would be unsafe to use quotations from Glass' committee report on the original Federal Reserve Act, because that report contains so many arguments against other features of the bill, such as the abolition of the eligibility requirement and the abolition of collateral for Federal reserve notes. Dr. Goldenweiser may be right about this; but we can explain away those other arguments by showing that the theory underlying the eligibility and collateral requirements are not in accordance with the facts and with the experience we have gained since the Federal Reserve Act was passed.

I sincerely believe that you would make a fundamentally important mistake if you should yield an inch on the question of banker representation on the body having final authority over the open market policy.

Respectfully,

Walter Wyatt,
General Counsel.

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TO VEST FINAL AUTHORITY OVER OPEN MARKET OPERATIONS IN THE FEDERAL
RESERVE BOARD IS CONSISTENT WITH THE ORIGINAL FEDERAL
RESERVE ACT. 10

To concentrate in the Federal Reserve Board the ultimate authority over the open market policy of the Federal Reserve System is in accordance with the purpose and intent of the original Federal Reserve Act. This is clearly shown by the following pages in the report on the original Federal Reserve Act submitted to the House of Representatives by Mr. Glass, on behalf of the Banking and Currency Committee, under date of September 9, 1913 (pp. 16, 18, 19, 42, 46 and 53):

" * * * In order that the banks may be effectively inspected, and in order that they may pursue a banking policy which shall be uniform and harmonious for the country as a whole, the committee proposes a general board of management intrusted with the power to overlook and direct the general functions of the banks referred to. To this it assigns the title of 'The Federal reserve board'. * * * "

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" * * * The only factor of centralization which has been provided in the committee's plan is found in the Federal reserve board, which is to be a strictly Government organization created for the purpose of inspecting existing banking institutions and of regulating relationships between Federal reserve banks and between them and the Government itself. Careful study of the elements of the problem has convinced the committee that every element of advantage found to exist in cooperative or central banks abroad can be realized by the degree of cooperation which will be secured through the reserve-bank plan recommended, while many dangers and possibilities of undue control of the resources of one section by another will be avoided. Local control of banking, local application of resources to necessities, combined with Federal supervision, and limited by Federal authority to compel the joint application of bank resources to the relief of dangerous or stringent conditions in any locality are the characteristic features of the plan as now put forward. The limitation of business which is proposed in the sections governing rediscounts, and the maintenance of all operations upon a footing

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of relatively short time will keep the assets of the proposed institutions in a strictly fluid and available condition, and will insure the presence of the means of accomodation when banks apply for loans to enable them to extend to their clients larger degrees of assistance in business. It is proposed that the Government shall retain a sufficient power over the reserve banks to enable it to exercise a directing authority when necessary to do so, but that it shall in no way attempt to carry on through its own mechanism the routine operations of banking which require detailed knowledge of local and individual credits and which determine the actual use of the funds of the community in any given instance. In other words, the reserve-bank plan retains to the Government power over the exercise of the broader banking functions, while it leaves to individuals and privately owned institutions the actual direction of routine.

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"In this section provision has been made for the creation of a general board of control acting on behalf of the National Government for the purpose of over-seeing the reserve banks and of adjusting the banking transactions of one portion of the country, as well as the Government deposits therein, to those of other portions. * * * "

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" * * * The power granted in subsection (d) to fix a rate of discount is an obvious incident to the existence of the reserve banks, but the power has been vested in the Federal reserve board to review this rate of discount when fixed by the local reserve bank at its discretion. This is intended to provide against the possibility that the local bank might be establishing a dangerously low rate of interest, which the reserve board, familiar as it would be with credit conditions throughout the country, would deem best to raise."

The power of carrying on the regular routine every-day business of the Federal reserve banks and of determining the local policies was entrusted to their respective boards of directors, but the Federal Reserve Board was created as "a general board of management" entrusted with the

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power to overlook and direct the general functions of the banks in order that the Board, on behalf of the Government, might retain some power over the exercise of the "broader banking functions" affecting the country as a whole.

The authors of the Federal Reserve Act apparently considered the fixing of discount rates as one of the more important of the "broader banking functions" affecting the country as a whole and, therefore, in section 14(d) of the Federal Reserve Act, specifically gave the Federal Reserve Board the power of final determination of the discount rates of the twelve Federal reserve banks.

Experience has demonstrated that at times the open market policy of the Federal Reserve System has a more important effect than the discount rates of the Federal reserve banks and it is clear that the same authority which is given the final determination of discount rates should be given the power to make final decisions regarding the open market policy of the Federal Reserve System.

The open market policy is a matter affecting the country as a whole and is not a mere matter of local concern which should be left to the determination of the local boards of directors of the twelve regional banks.

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