Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date May 11, 1935.

To Mr. Clayton

Subject:

From Mr. Wyatt, General Counsel

O P O 2—8495

For your assistance in connection with the hearings before the Senate subcommittee, there is attached a comprehensive memorandum showing why final control over open market operations should be vested in the Federal Reserve Board alone.

Attachment.

THE OPEN-MARKET PROVISIONS OF THE BANKING ACT OF 1935 ARE CONSISTENT WITH THE UNDERLYING PRINCIPLES OF THE ORIGINAL FEDERAL RESERVE ACT.

To concentrate in the Federal Reserve Board the ultimate authority over the open-market policy of the Federal Reserve System is consistent with the purpose and intent of the original Federal Reserve Act. The "chief purposes" of the Act were stated by Mr. Glass, Chairman of the House Banking and Currency Committee on page 11 of the Committee Report dated September 9, 1913, as follows:

"Essential Features of Reform.

> The other plans before the committee or examined by it have likewise been found unsatisfactory - some for reasons analogous to those which made the Aldrich bill unacceptable, others because of defective detail, erroneous principle, or faulty construction. An effort was, however, made to ascertain the constituent elements of these measures and of the Aldrich bill, common to all, which should be recognized and provided for in any new plan because representing the fundamentals of legislation. It is believed that these are as follows:
>
> 1. Establishment of a more nearly uniform rate of discount throughout the United States, and thereby the furnishing of a certain kind of preventive against overexpansion of credit which should be similar in all parts of the country.
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> 2. General economy of reserves in order that such reserves might be held ready for use in protecting the banks of any section of the country and for enabling them to go on meeting their obligations instead of suspending payments, as so often in the past.
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> 3. Furnishing of an elastic currency by the abolition of the existing bond-secured note issue in whole or in part, and the substitution of a freely issued and adequately protected system of bank notes which should be available to all institutions which had the proper class of paper for presentation.

4. Management and commercial use of the funds of the Government which are now isolated in the Treasury and subtreasuries in large amounts.

5. General supervision of the banking business and furnishing of stringent and careful oversight.

6. Creation of market for commercial paper.

Other objects are sought, incidentally, in these plans, but they are not as basic as the chief purposes thus enumerated."

No one of the regional banks acting alone could furnish "a certain kind of preventive against over expansion of credit which should be similar in all parts of the country". Therefore, the Federal Reserve Board was created and given the power to require the twelve regional banks to "pursue a banking policy which shall be uniform and harmonious for the country as a whole".

There is abundant evidence that the framers of the legislation fully recognized that some of the purposes stated above should be under the control of the regional banks and that others should be under the control of a central organization. Although it was believed that such routine matters as the decision upon the extension of credit to a particular borrower or the discounting of a particular loan should be left to the judgment of the regional bank, it was clearly understood that important matters of policy which would have a profound effect upon the economic life of the entire nation should be vested in a national organization with a national viewpoint.

It should be observed, however, that this principle of centralizing control of the broad national functions of the Federal Reserve System in a Government board was not in the minds of the framers of the

Act during the early stages of its development but was first suggested by President Wilson in 1912 and later was accepted by the other men responsible for the enactment of the legislation. The circumstance under which President Wilson suggested the creation of the Federal Reserve Board "as a capstone" to the Federal Reserve System is related by Senator Glass, on pages 81 and 82, of his book "An Adventure in Constructive Finance".

> "December 26, 1912, was a desperately cold day. The snow at Princeton was two feet deep. Dr. Willis, the committee expert, had accompanied the chairman, prepared to answer or discuss any purely technical question that might be projected. I had made a written divisional memorandum of the bill I desired to outline to Governor Wilson. The latter had a severe cold and was propped up on pillows in bed. He had cancelled every other engagement for the day, and at once it was suggested that he let us come another time when he might be in better trim; but he insisted on proceeding with the business, so intent was he on a speedy and sweeping currency reform. For two hours the situation was reviewed and the chairman's memorandum dissected. Toward the end, Mr. Wilson announced it as his judgment that we were 'far on the right track'; but offered quite a few suggestions, the most notable being one that resulted in the establishment of an altruistic Federal Reserve Board at Washington to supervise the proposed system. We had committed this function to the Comptroller of the Currency, already tsaristic head of the national banking system of the country. Mr. Wilson laughingly said he was for 'a plenty of centralization, but not for too much'. Therefore, he asked that a separate central board provision be drafted, to be used or not, as might subsequently be determined, 'as a capstone' to the system which had been outlined to him."

In carrying out the plan originated by President Wilson for vesting important matters of national policy affecting the country as a whole in a Government board, the House Committee on Banking and Currency, in its report on the original Federal Reserve Act, made it clear that control over routine operations of banking was to be placed in the regional banks and that the determination of national policies was to be vested in the Federal Reserve Board. 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 and 42):

> " * * * In order that these 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. * * * 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 credit 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 overseeing 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. * * * "

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

The experience of the Federal Reserve System has demonstrated that the fixing of discount rates and the control of Open-market operations are correlative instruments of credit control and that the same principles which caused the framers of the Federal Reserve Act to grant final determination over discount rates to the Federal Reserve Board logically requires vesting of control of open-market operations in the same board. Section 14(d) of the original Federal Reserve Act vested final determination of the discount rate in the Federal Reserve Board by the following language:

> "Every Federal reserve bank shall have power:
> * * * * *
> "(d) To establish from time to time, subject to review and determination of the Federal Reserve Board, rates of discount to be charged by the Federal reserve bank for each class of paper, which shall be fixed with a view of accommodating commerce and business;"

The following statement regarding this section is made at page 53 of the House Report on the original Act:

> "* * * 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."

Although the language of section 14(d) making the power of the Federal Reserve banks to fix discount rates, "subject to review

and determination of the Federal Reserve Board" seems clear enough, the question was raised in 1919 as to whether the power of the Board was not limited to reviewing and approving or disapproving rates of discount made by the Federal Reserve banks. At this time it was contended that the Board had no power to initiate rates or to direct specific changes and alterations thereof. This question was submitted to the Acting Attorney General by Senator Glass, at that time Secretary of the Treasury, and, in an opinion rendered on December 9, 1919, Acting Attorney General Alex C. King held that the Board had the power to determine rates of discount and to require such rates to be put into effect by the Reserve banks. 32 Opinions of the Attorney General, page 81. In his Opinion, the Acting Attorney General stated the following:

> "It is quite evident that if the Federal Reserve Board is confined to the power to review and approve or disapprove rates of discount made by the Federal reserve banks, and is without power to itself direct specific changes, the words ' and determination' are wholly without significance. The very significance of the word 'determination' used in such a connection, carries with it the right to pass upon and to decide and fix, and thus determine what should be done. Coupling this with the power given the Federal Reserve Board to supervise the business of each Federal Reserve Bank, taking also into consideration the recommendations contemplated by the Advisory Council to the Federal Reserve Board in regard to discount rates, such power would be futile if such Federal Reserve Board could not, if agreeing to such recommendations direct them to be carried out. I think it is quite clear that the Federal Reserve Board is the ultimate authority in regard to rediscount rates to be charged by the several Federal reserve banks and may prescribe such rates.

* * * * * * *

"The scheme of the entire act is to have Federal reserve banks in different parts of the country so that their operations may be accommodated to the business needs of each section and to vest final power in the Federal Reserve Board, so as to insure a conduct of business by each bank which will not be detrimental to the carrying out of the entire plan. The powers of the Federal Reserve Board are therefore to be exercised in regard to each reserve bank as the conditions surrounding said bank may dictate, keeping in view the general purpose and plan of the Federal Reserve Act. Bearing in mind such general purpose, I am of the opinion that the Federal Reserve Board has the right under the powers conferred by the Federal Reserve Act, to determine what rates of discount should be charged from time to time by a Federal reserve bank, and under their powers of review and supervision, to require such rates to be put into effect by such bank."

The statement of the Acting Attorney General that the scheme of the entire Federal Reserve Act was to vest final power in the Federal Reserve Board over the operations of the Reserve banks "so as to insure a conduct of business by each bank which will not be detrimental to the carrying out of the entire plan" is especially significant. Subsequent experience, however, has demonstrated that the Federal Reserve Board would be powerless to carry out a plan of credit control through the determination of the discount rate without having the correlative power to control the open-market operations of the Federal Reserve System.

A recognition of the close relationship between open-market operations and control of the discount rate appears in the following passage from page 52 of the Report of the House Banking and Currency Committee upon the original Federal Reserve Act:

"It will have been observed that the transactions authorized in section 14 (section 13 of present Federal

Reserve Act) were entirely of a nature originating with member banks and involving a rediscount operation. It is clearly necessary to extend the permitted transactions of the Federal reserve banks beyond this very narrow scope for two reasons:

1. The desirability of enabling Federal reserve banks to make their rate of discount effective in the general market at those times and under those conditions when rediscounts were slack and when therefore there might have been accumulation of funds in the reserve banks without any motive on the part of member banks to apply for rediscounts or perhaps with a strong motive on their part not to do so.

2. The desirability of opening an outlet through which the funds of Federal reserve banks might be profitably used at times when it was sought to facilitate transactions in foreign exchange or to regulate gold movements."

A striking judicial recognition of the importance of open-market operations as an instrument of credit control and of the close relationship between such operations and the determination of the discount rate is found in the case of Raichle v. Federal Reserve Bank of New York, 34 Fed. (2) 910 (C.C.A. 2nd, 1929). In that case the plaintiff brought suit on August 6, 1928 to enjoin the Federal Reserve Bank of New York from (a) spreading propaganda concerning an alleged money shortage and increasing volume of collateral loans, (b) setting about to restrict the supply of credit available for investment purposes by engaging in open-market transactions through the sale of its securities, (c) raising the rediscount rate for its member banks in order to reduce the volume of security loans, and (d) coercing member banks to call collateral loans by declining to rediscount eligible commercial paper for such member banks.

The United States District Court dismissed the bill for lack of equity and the Circuit Court of Appeals sustained the action of the lower court. Although the decision of the Circuit Court of Appeals was based upon the fact that the Federal Reserve Board, which was not joined in the bill, was an indispensable party defendant, the court also rendered a decision upon the merits of the case. In its opinion, the court emphasized the interdependence of the discount rate and open-market operations in the following language:

> "The foregoing provisions enable the Federal Reserve Banks, without waiting for applications from their member banks for loans or rediscounts, to adjust the general credit situation by purchasing and selling in the open market the class of securities that they are permitted to deal in. The power 'to establish from time to time, subject to review and determination of the Federal Reserve Board, rates of discount to be charged by the Federal Reserve Bank,' appears in the act (12 USCA § 357) with the open market powers. The two powers are correlative and enable the Federal Reserve Banks to make their rediscount rates effective."

The court also passed upon the constitutionality of the grant of power to the Federal Reserve System to control the discount rate and open-market operations:

> "While it is alleged in the bill that the rediscount rate 'has been arbitrarily and unreasonably raised,' it was for the defendant, subject to the supervision of the Federal Reserve Board, to determine what would be a reasonable rediscount. It is not contended that the provision for fixing rates of discount is unconstitutional, nor would it seem even reasonable to argue that it is, after such decisions as First National Bank v. Fellows ex rel, Union Trust Co., 244 U.S. 416, 37 S. Ct. 734, 61 L. Ed. 1233, L.R.A. 1918C,

283, Ann. Cas. 1918E, 1169, and Westfall v. United States, 274 U.S. 256, 47 S.Ct. 629, 71 L.Ed. 1036 as well as the Legal Tender Cases, 110 U.S. 421, 4 S.Ct 122, 28 L. Ed. 204, Farmers' and Mechanics' National Bank v. Dearing, 91 U.S. 29, 23 L. Ed. 196, and McCulloch v. Maryland, 4 Wheat, 316, 4 L.Ed. 579."

In discussing whether the Federal Reserve Board was an indispensable party to the litigation, the court said:

"It is specifically empowered to regulate open market transactions, to review and determine rates of discount and to make reports as to conditions in the Federal Reserve System. In such circumstances, the Bank is, as to the matters complained of here, a governmental agency under the direction of the Federal Reserve Board. If the plaintiff prevailed in his contention the Bank would be enjoined from fixing a discount rate which the Board had presumptively directed. Such a situation under familiar principles renders the Federal Reserve Board an indispensable party to the suit. Alcohol Warehouse Corp. v. Canfield, 11 Fed. (2d) 214.

The above opinion contains an accurate analysis of the relationship between the discount rate and open-market operations and establishes clearly that the control of open-market operations falls within the class of Federal Reserve policies which affect the economic life of the entire nation. It is obvious therefore that since the underlying principle of the original Federal Reserve Act was to place the determination of national policies in the Federal Reserve Board, a Government body having a national viewpoint, and that since the control of open-market operations is such a matter of national importance affecting the economic life of the whole nation, this power should be vested in the Federal Reserve Board just as the power to determine the discount rate is vested in the Board.

Open-market operations of the Federal Reserve System, as they are known today, date from the year 1922. Prior to that time, practically all of the resources of the System had been utilized in supporting the Government's bond issues for the purpose of carrying on the war. This support was given by the Federal Reserve banks by discounting paper secured by Government obligations.

The liquidation of 1920 and 1921 caused a large scale repayment by member banks of their discounted paper and resulted in a sharp decline in the earning assets of the Federal Reserve banks. However, there was in the market a large amount of Government securities and in order to obtain enough earning assets to meet their expenses the Federal Reserve banks began to purchase these securities. Before many weeks had elapsed it was discovered that the purchases of Government obligations by the Federal Reserve banks was having an unforeseen but none the less profound influence upon the volume and cost of credit.

Naturally, most of the purchases were made in New York City which was the principal market for Government securities. It was observed, however, that the sellers of the bonds would deposit the amount paid therefor in New York banks and the banks would put the money to their account at the New York Federal Reserve Bank and would use it to extinguish their indebtedness to such Reserve bank. The payment of the member bank's indebtedness to the Reserve bank naturally resulted in a decrease of the earning assets of such Reserve bank so that the purchase of Government securities by a Federal

Reserve bank in the interior increased the earning assets of such Federal Reserve bank at the expense of the Federal Reserve Bank of New York. It was also observed that these uncoordinated purchases were upsetting the Government bond market and this was, of course, disturbing to the Treasury.

As a result of these observations it was decided at a conference of Governors of the Federal Reserve banks held in May, 1922, that the open-market operations of the Federal Reserve banks should be coordinated and, accordingly, a committee of five Governors was appointed to perform this function.

This committee functioned for about a year and during that time it was clearly observed that purchases of Government securities resulted in decreased discounts and in no increase in the total earning assets of the Federal Reserve banks taken collectively. As a consequence, the Conference of Governors of the Federal Reserve banks decided that "investment policy should give minor consideration to the question of earnings and constant consideration to the effects which open-market operations have upon the condition and the course of the money market and the volume of credit".

Realizing that open-market operations on a System basis would deprive the Federal Reserve Board of the power of effective credit control through the determination of the discount rate, the Board in 1923 recognized the open-market committee which had been formed at the Governors' Conference in 1922 and announced that from that time on open-market operations should be engaged in only with the approval

of the Board. In 1930 the Board announced that as a result of a meeting attended by representatives of the twelve Federal Reserve banks, the number of members on the committee in charge of open-market operations was increased from 5 to 12 so as to include representatives of all the Reserve banks. By enacting the Banking Act of 1933, Congress, for the first time, gave the open-market committee an official legal status and affirmed the principle that the open-market policies of the System should be subject to the approval of the Federal Reserve Board by the following provision:

> "(b) No Federal reserve bank shall engage in open-market operations under section 14 of this Act except in accordance with regulations adopted by the Federal Reserve Board. The Board shall consider, adopt, and transmit to the committee and to the several Federal reserve banks regulations relating to the open-market transactions of such banks and the relations of the Federal Reserve System with foreign central or other foreign banks."

The provision of the above subsection that no Federal Reserve bank shall engage in open-market operations except in accordance with regulations adopted by the Board was rendered ineffective, however, by the enactment of subsection (d) of section 12A which reads as follows:

> "(d) If any Federal reserve bank shall decide not to participate in open-market operations recommended and approved as provided in paragraph (b) hereof, it shall file with the chairman of the committee within thirty days a notice of its decision, and transmit a copy thereof to the Federal Reserve Board."

Under the provisions of section 205 of the proposed bill, section 12A of the Federal Reserve Act would be clarified and revised

so that open-market policies proposed by a committee representing the Reserve banks, or initiated by the Board after consultation with the committee, would be binding on all Federal Reserve banks.

Representation Of Federal Reserve Banks on Board Controlling Open-Market Operations

The question has arisen as to whether the final authority over open-market operations of the System should be vested solely in the Federal Reserve Board as provided in the bill which passed the House or whether such authority should be vested in a group composed of members of the Board and representatives of the Federal Reserve banks as proposed in the original bill and as advocated by the American Bankers' Association. It must be realized that such a proposal is in effect the creation of another Board in which would be vested final authority over one of the most important instruments of credit control. This would, of course, result in a diffusion of responsibility and would create the undesirable possibility of a conflict between the group entrusted with control over open-market operations and the Federal Reserve Board which would retain power to determine the discount rate and to establish reserve requirements. Such a conflict might arise where a majority of the members of the Board thought that one course of action should be taken and a majority of the group vested with control of open-market operations thought a different course should be pursued. In such a case, two bodies with power to make final decisions on different phases of

the same problem would be working at cross purposes with each other.

That this proposal for representation of private interests upon the Board charged with responsibility for the formulation of national monetary policies is contrary to the underlying principles of the Federal Reserve Act and is a revival of an idea which was rejected by President Wilson and by Congress when the original Act was under consideration is shown by the following.

In his book "An Adventure in Constructive Finance" Senator Glass relates that the bankers made a desperate fight to have inserted in the original Federal Reserve Act a provision giving them the right to have representatives selected or at least nominated by them included in the membership of the Federal Reserve Board. In the following passage from pages 112 to 114 of his book Senator Glass tells how this question arose and also shows that at the outset he was definitely committed to giving the banks representation on the Board:

> "It was at this point that the President had us come to the White House for a conference concerning that feature of the bill that gave the banks minority representation on the Federal Reserve Board. I was very definitely committed to giving the banks some voice. Senator Owen, of the Senate committee, had sided with Mr. Bryan in opposition. At the White House conference McAdoo agreed at first with me; but later in the evening he proposed a compromise. The President decided against banking representation. This was one of the crucial questions the President had to determine. It was evident it might involve the failure of legislation by embittering the bankers should they be entirely excluded. If they should be included, Bryan and his following might revolt. I had urged the 'essential injustice and political inexpediency' of denying the banks minority representation. The President was not bothered about the political phase;

but he was willing to discuss the justice of the thing. So convinced was I that the President was wrong in his conclusion that I sent him this note; which is reproduced here to indicate that the President was not easily persuaded nor the chairman of the committee entirely complaisant:

"'At the risk of being regarded pertinacious I am going to ask if you will not consider the advisability of modifying somewhat your view of bank representation on the proposed Federal Reserve Board. The matter has given me much concern, and more than ever I am convinced that it will be a grave mistake to alter so radically the feature of the bill indicated. Last nite, when I came back to my hotel, I found Mr. Bulkley waiting, and he sat with me until past one o'clock this morning. Knowing that he was so earnestly for a government note issue and for government control, I imagined he would be delighted with the suggested alteration. I told him of the change without first indicating my own view; and, much to my astonishment and gratification, he instantly and vigorously protested, saying he had regarded the extent to which we had already put the government in control, together with the tremendous power of the Board, as the real weakness of the bill. He also said we could not escape the charge of exposing the banking business of the country to political control. As indicated to you last night, Mr. Bulkley is a strong man of the committee with whom we must reckon; hence his view of this proposed alteration fully confirms my belief that it would prove an almost irretrievable mistake to leave the banks without representation on the central board. You will note that the bill requires the three members selected by the banks to sever all bank connections before qualifying. Might it not be well at least to take Mr. McAdoo's suggestion and have the President select these men from a list proposed by the banks? With high esteem, etc.'."

Immediately following the quotation of his letter to President Wilson, Senator Glass goes on to state that he soon was won over to the President's view of the matter. The manner in which the proposal for banker representation on the Federal Reserve Board was defeated by President Wilson and the conclusive reasons for his position are

shown in the following passage from pages 115 and 116 of Senator Glass' book:

> "The President was adamant; and, if there was ever a lapse, I soon was to revive the conviction that Mr. Wilson knew more about these matters than I did. As anticipated, when the bill was introduced in Congress, bankers raised an uproar about this provision. With scarcely suppressed satisfaction, I headed a delegation of them to the White House to convince the President he was wrong. Forgan and Wade, Sol Wexler and Perrin, Howe and other members of the Currency Commission of the American Bankers Association constituted the party. The first two, peremptory and arbitrary, used to having their own way, did not mince matters. They evidently were not awed by 'titled consequence', for they spoke with force and even bitterness. Sol Wexler and Perrin were suave and conciliatory. The President was courteous and contained. These great bankers, arbiters for years of the country's credits, were grouped about the President's desk in the Executive office adjoining the Cabinet room. I sat outside the circle, having already voiced my own dissent from the President's attitude. President Wilson faced the group across the desk; and as those men drove home what seemed to me good reason after good reason for banker representation on the central board, I actually experienced a sense of regret that I had a part in subjecting Mr. Wilson to such an ordeal. When they had ended their arguments Mr. Wilson, turning more particularly to Forgan and Wade, said quietly: 'Will one of you gentlemen tell me in what civilized country of the earth there are important government boards of control on which private interests are represented?' There was painful silence for the longest single moment I ever spent; and before it was broken Mr. Wilson further inquired: 'Which of you gentlemen thinks the railroads should select members of the Interstate Commerce Commission?' There could be no convincing reply to either question, so the discussion turned to other points of the currency bill; and, notwithstanding a desperate effort was made in the Senate to give the banks minority representation on the reserve board, the proposition did not prevail."

President Wilson again confirmed this position in his message to the joint session of Congress on January 23, 1913, in the following language:

> "The control of the system of banking and of issue which our new laws are to set up must be public, not private; must be vested in the Government itself, so that the banks may be the instruments, not the matters, of business and of individual enterprise and initiative."

That the stand taken by President Wilson against representation of private interests on the Federal Reserve Board was adopted by Congress is shown by the following passage from page 20 of the Statement of Views, accompanying the Senate Report on the original Federal Reserve Act (Report 133, Part 2):

> "Many of the big banks quite urgently insisted that the bankers should have representation upon the Federal reserve board. This was denied for the obvious reason that the function of the Federal reserve board in supervising the banking system is a governmental function in which private persons or private interests have no right to representation except through the Government itself. The precedents of all civilized governments is against such a contention."

The present proposal to vest control over open-market operations in a joint board consisting of members of the Federal Reserve Board and representatives of the Federal Reserve banks selected by directors, two-thirds of whom are elected by the member banks, is merely an effort to revive the principle urged by Bankers Forgan, Wade, Wexler, Perrin, Howe, and others, which was vigorously and convincingly denied and defeated by President Wilson.

Guiding Principle to be Followed by Federal Reserve Board in Determining Open-Market Policies

The Banking Act of 1935 as originally introduced was criticized on the ground that the Federal Reserve Board was given an unlimited discretion as to the purposes of the open-market operations of the System.

However, this criticism was eliminated in the House of Representatives by inserting in section 204(b) of the bill the following statement of objective:

> "It shall be the duty of the Federal Reserve Board to exercise such powers as it possesses in such manner as to promote conditions conducive to business stability and to mitigate by its influence unstabilizing fluctuations in the general leval of production, trade, prices, and employment, so far as may be possible within the scope of monetary action and credit administration."

That such a mandate is in harmony of the purposes of the original Federal Reserve Act is shown by the following quotation from page 7 of the Statement of Views accompanying the report of the Senate Committee on Banking and Currency (Report 133, part 2):

> "The chief purposes of the banking and currency bill is to give stability to the commerce and industry of the United States, prevent financial panics or financial stringencies; make available effective commercial credit for individuals engaged in manufacturing, in commerce, in finance, and in business to the extent of their just deserts; put an end to the pyramiding of the bank reserves of the country and the use of such reserves for gambling purposes on the stock exchange."