

Office Correspondence

FEDERAL RESERVE BOARD

111-2-40

Date April 23, 1935

To Governor Eccles

Subject:

From Mr. Goldenweiser

REC'D IN FILES SECTION
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I am sending you a statement about Mr. Willis' position on the Banking Act of 1935, and, beginning with page 7, some quotations of his earlier statements in connection with Federal Reserve legislation. His general position is perfectly clear. He believes in the Federal Reserve System being limited in its operations to emergency functions based entirely on self-liquidating paper. General monetary control or regulation is a concept which does not enter into his thinking. He considers the problem purely from the point of view of extending credit required by industry, trade and agriculture. Supervision by the Federal Reserve Board is in his view merely a matter of coordination and prevention of abuses.

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COMMENTS OF H. PARKER WILLIS ON THE BANKING BILL

It is important in understanding Mr. Willis' views on the banking legislation to note that he is against any banking legislation at the present time and furthermore, that it is his belief that all banking legislation under the present Administration has been/ and incompetent." "radical

His criticism of Title II of the banking bill of 1935 is consistently adverse. To him the bill is a deliberate plot of the Administration to bring the Federal Reserve System under complete political control, through the changes proposed in the Federal Reserve Board and in the boards of directors of the Federal Reserve banks. The proposed changes in the functioning of the System, that is in eligibility requirements, open-market operations, reserve requirements, and collateral for note issues, are all looked at in the same light. The Administration is merely providing the means for politicians to use the System for political purposes.

In view of the fact that Mr. Willis' criticisms of the bill hinge so completely on its presumed political effects, and he is using the term political in the most undesirable sense, the best way to comment on his criticism is to quote him.

Mr. Willis repeatedly and forcefully points out that the bill aims at complete political control of the System through the provisions relating to the appointment of the Governor of the Federal Reserve Board and to Board approval of the governors of the Federal Reserve banks.

"However, it is not true that, even of recent years, our Reserve System has been run upon the low political level which is now proposed under the new legislation."

Commercial and Financial Chronicle
February 9, 1935

"We now have a measure which professes nothing of the kind. ^{1/}It is a bare-faced usurpation of the control over the entire banking assets of the nation. It provides for opening the door to political favoritism and control of the worst kind."

New York Herald-Tribune
February 10, 1935

"The present proposal is the fusing of all central banking powers in the hands of the Federal Reserve Board at Washington, and of making the Board itself the direct executor of the will of the President of the United States."

Commercial and Financial Chronicle
February 9, 1935

"As the President already has two political appointees on the Board, he would thus be able at all times to make sure of a third; and, as the history of the Board has shown, would invariably be able thus to carry any policy he might desire should the Board, as in rare cases it has been, be somewhat recalcitrant. So far as the Board is concerned, provision for early reorganizing it is made through a new policy, which permits present members to retire on full pay upon reaching the age of 70. As there are three members who have reached or will shortly attain that age, it may be expected that within less than two years the complete reorganization of the Board will be effected."

Commercial and Financial Chronicle
February 9, 1935

"This measure would convert our Federal Reserve Board into a direct personal agency of the President. It would convert the boards of directors of our Federal Reserve banks into direct agencies of the Federal Reserve Board."

The American Banker
March 19, 1935

^{1/} Refers to comment that earlier changes have been made under the guise of improving the System. See quotations on page 6.

"Under the new act it is now intended to have the governors of Reserve banks replace the chairman — thus combining the making of policy with the actual execution of it and placing the operation of the banks under the immediate influence of the Reserve Board at Washington. . . The proposed act, however, would have the Reserve Board practically originate the appointments of the governors, while the board itself is to be more than ever under Executive control."

New York Herald-Tribune
February 10, 1935

"There is no concealment and no doubt about what is being sought. It is an effort to take over our banking system although without paying for it, and to run it as an agency of the Government, primarily in behalf of its own financing and secondarily, in behalf of those industries upon which the Government looks with favor."

The American Banker
March 19, 1935

"It is a bare-faced act of usurpation — an act which could result in meetings at Tammany Hall to fix the future Federal Reserve Bank discount rates."

Baltimore Sun
February 22, 1935

The power of the Board to approve the governors of the Federal Reserve banks is seen by Mr. Willis as a means of depriving the Federal Reserve banks of their entire autonomy in local credit matters. In his opinion, Government control of banking will be changed to Government operation of banking.

"It is a government-operated central bank. Although the measure does not call for the acquisition of the stock in Federal Reserve banks, it might quite as well do so; however, the present method is far cheaper than the plan originally contemplated would have been."

Commercial and Financial Chronicle
February 9, 1935

"The power, however, of banking direction and of the distribution of credit is located in the White House, by a system especially devised for that purpose. This brings out into the open the long-festering controversy between centralization and local self-government in finance."

Commercial and Financial Chronicle
February 9, 1935

"Put in a nutshell, this simply means that the idea of a local self-governing board is to be superseded by that of an advisory local board, operating the detailed administrative machinery of a bank which is actually controlled and directed by a person appointed from Washington and removable on orders from that place. The Reserve bank must and will, in such circumstances, become wholly subservient to the wishes of those who name its Governor. It will be a local financial despotism, since the Governor will in no wise be responsible for his appointment, duties, powers, or make his reports to the bank itself."

Commercial and Financial Chronicle
February 9, 1935

"We now have definitely before the country the question, whether one who happens to be President of the United States shall at any given time be able to change, direct, supervise, and control, the volume and character of the credit of the country, the rates of interest that are charged by financial institutions and, above all else, the degree of safety which may be allowed to the savings and the property of the people."

Commercial and Financial Chronicle
February 9, 1935

(The proposal is for) ---

"a reserve banking mechanism which is fully authorized to appoint clerks, pay rent, buy stationery, etc., but which in all other activities shall be controlled by the political authorities at Washington." 16

New York Herald-Tribune
February 10, 1935

In view of the part which Mr. Willis played in the preparation of the original Federal Reserve banking act, it is important that he interprets this legislation merely as one more of a number of steps that have been taken since 1913 to bring the System under political control.

"...in the original draft of the Federal Reserve bill it was proposed to give the Reserve banks themselves a controlling place on the Federal Reserve Board, so that the whole system would have been a self-governing banking agency."

Commercial and Financial Chronicle
February 9, 1935

"Political considerations led President Woodrow Wilson to change this composition of the Board, making it an all-government group of politicians."

"Under this fundamental error there has grown up from time to time, and of late years more or less continuously, a political menace to the safety of our deposits and to the structure of our credit..."

"There was a change after the war but it did not last long, and the practice of directing and controlling the discount rate and the general policies of the System as the sale of Treasury notes required became settled."

Commercial and Financial Chronicle
February 9, 1935

"With the Federal Reserve Board constantly subordinated to the Treasury Department, and with its membership steadily chosen for political reasons, it has never been able fully to carry out the purposes of the Federal Reserve Act itself."

Commercial and Financial Chronicle
February 9, 1935

"The tone of the proposal and its interpretation in the light of actual experience is far more important than its actual provisions. It is an old saying that, even the worst of laws, through good administration, can be made tolerable and workable.

"The Federal Reserve act as originally drafted had many flaws. Some of them were due to inexperience in central banking; others to political compromises which were made necessary in order to secure the adoption of the measure at all. The passage of time has resulted in aggravating these errors, and the multitudinous amendments that have been made to the Federal Reserve act, in the score and a half of modifying laws that have been passed by Congress, has defaced the original measure in essential particulars, and has greatly lessened the safeguards against maladministration which were originally set up.

"It is fair, however, to add that the twenty years which have passed since the adoption of the Federal Reserve act have not resulted in a material change in the admitted purport and underlying thought of the legislation. Even those who have found its restrictions irksome and likely to prevent the attainment of their desires, and even the ignorant and ill-advised administrators whose lack of knowledge of central banking has made them restive under the restraints, which in other countries would have gone as a matter of course as a result of long-established custom, have always made their onslaughts upon the system under the guise of an effort to improve it and to make its provisions more adaptable to the actual needs of the community.

"We now have a measure which professes nothing of the kind. It is a bare-faced usurpation of the control over the entire banking assets of the nation. It provides for opening the door to political favoritism and control of the worst kind. . .

"The theory of the act had continued unchanged up to the act of January 30, 1934, when the Secretary of the Treasury was vested with the power to use a stabilization fund of \$2,000,000,000 in buying and selling government bonds, foreign exchanges, and practically any kind of marketable paper that he saw fit. . .

"The new bill, taken in conjunction with the act of January 30, 1934, must thus be regarded as a complete repudiation of the entire conception not only of the Federal Reserve act but of central banking as it is practiced today in central banking countries. It substitutes politics for knowledge, government guaranties for salability of assets and irredeemable gold certificates for coin."

New York Herald Tribune
February 10, 1935

In analyzing the provisions of the bill other than those affecting organization of the System, Mr. Willis is primarily concerned in pointing out the usefulness of the changes for political purposes. The quotations below are selected to show his emphasis on the adverse political features of the provisions. The comments which are descriptive of the nature of the provisions are not included.

"...we now propose to substitute a politically controlled, 'frozen' and inflationary banking machine for the Federal Reserve system as we have known it in the past."

New York Herald-Tribune
February 10, 1935

"In short, therefore, the new bill is essentially a measure for freezing the assets of member banks, admitting them freely to discount at Reserve banks, and shifting reserve requirements to meet the resulting situation--whatever it may be."

Commercial and Financial Chronicle
February 9, 1935

"There is thus no reason why we should not have an issue of reserve notes limited only by the volume of assets owned by the banks and safeguarded by a reserve which may be lowered or raised in amount at the will of the President and his financial vassals on the Federal Reserve Board; and which, in any case, has behind it only irredeemable gold certificates representing gold stored in the Treasury and paid for at any price the Secretary of the Treasury may from time to time choose to name."

New York Herald-Tribune
February 10, 1935

"Member banks are enabled to go broadly and with little restraint into two businesses, namely, operating and speculating in government securities and real estate finance."

New York Herald-Tribune
February 23, 1935

"Governor Eccles of the Reserve Board has himself given the reason for these proposed changes. He says that they are intended

to permit the more comfortable financing of the Government by placing the bonds of the Treasury in the banks when and as desired and that they are also intended to permit the existence of a planned money and banking control designed to stabilize the price level and to bring about thereby a better distribution of credit." 10

The American Banker
March 19, 1935

"Put in plain language, this (proposed open-market committee) means that an appointee of the President of the United States, selected as he may see fit, and supported by two satellites, is to have control of the open market operations of the system and to prescribe such operations as he may choose on the part of every one of the Reserve banks.

"...The meaning of this provision (eligibility requirements) evidently is that the governor of the Reserve Board (appointed and removed at the pleasure of the President of the United States), shall have power to operate Reserve banks on a rediscount plan which shall admit any assets, bonds, stocks, commercial paper, mortgages on real estate, that may be owned by a member bank, provided that the 'board,' constituted as heretofore indicated, has designated them as 'sound.'

"...The language of this provision (reserve requirements) is obscure, but apparently would imply that it may release member banks in a favored Federal Reserve district from all or any part of existing reserve requirements, at the same time that it maintained and increased them in others, perhaps that any individual bank may be most favored."

New York Herald-Tribune
February 10, 1935

The proposed elimination of collateral requirements comes in for special criticism. His final pronouncement on the subject is that under the bill, "we shall have neither a sound and elastic, nor redeemable, currency."

"Then, (in 1913) as a matter of expediency, democratic politicians were permitted to make the notes a liability of the Treasury Department which guaranteed them, and in order to protect the government against this guarantee it was agreed to place assets in trust behind the notes. Such assets were made

to consist of short-term commercial paper, it being the belief of the originators of the Act that bank currency should expand and contract according as business expanded and contracted. This phase of the Federal Reserve Act was never given a trial, for almost immediately the outbreak of the World War led to modifications which permitted the placing of bond-secured paper and, eventually, government bonds behind the notes, so that in effect they have been almost as truly bond-secured notes as were the national bank notes themselves....

"Now, it is proposed to sweep away all of the protection behind the notes and to make them straight unsecured obligations of the Reserve banks. This they in effect really are and should be, since they are in theory no different from the deposit credits on the books of the banks. Unfortunately they remain also government legal tender notes with Reserve banks the holders of two and a half billion dollars of government bonds, their chief current business consisting of government bonds, and now making industrial loans and authorized to discount 'any sound asset' of a member bank, the whole conception of liquid currency disappears, and the reserve notes become confessedly, as they have in fact been--low-denomination obligations of the government without interest."

Commercial and Financial Chronicle
February 9, 1935

(of political control)

"This philosophy/is definitely worked out in the present measure. The law as thus amended no longer seeks to maintain liquidity, safety, protection of the depositor, convertibility of assets and the like, but it undertakes to convert frozen property of doubtful salability direct into legal tender currency, without any protection to the holder of the latter, except the irredeemable gold certificates which were created under the act of January 30, 1934."

New York Herald-Tribune
February 10, 1935

Of course, Mr. Willis follows along with the other economists in suggesting that legislation be postponed until experts in the field have an opportunity to study the matter exhaustively.