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May 1, 1935.

Mr. S. C. Mead, Secretary,
The Merchants' Association of New York,
233 Broadway, Woolworth Building,
New York, New York.

Dear Mr. Mead:

This will acknowledge your letter of April 25th, conveying to me the views of the Merchants Association of New York on the Banking Bill of 1935, together with a statement of reasons for such views formulated by your Special Committee. You have doubtless communicated to Mr. Crowley your views concerning Title I of the Bill, so I shall confine my remarks to Title II. I propose to take up your specific objections to the pending bill in the order in which they are enumerated in the report of your committee.

1. Combination of the offices of governor and chairman of the board in each Federal Reserve bank, the incumbent of such office to be appointed by the boards of directors subject to the approval of the Federal Reserve Board.

You object that the passage of such a provision would effectively end independent expression of local opinion and give the administration practical dominance over the reserve banks. I would dissent very strongly from this view. In matters pertaining to credit administration the reserve banks have always played the dominant role and we propose to increase their autonomy in this respect. At present the Federal Reserve Board appoints three directors, one of whom is the chairman of the board, of the individual reserve banks. The governors of the reserve banks are not directors. It is proposed that the Federal Reserve Board surrender the power of appointing the chairman, that the governor be both a director and chairman, and that in return for this surrender of the power of appointment the Board should reserve only the power of approval of appointments of governors once every three years. The governors will be appointed by the local board of directors and hence will be acceptable to them. The Federal Reserve Board will have no power to

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force any person on a reserve bank as governor who is not acceptable to the local board of directors. The number of members of such boards directly appointed by the Federal Reserve Board will be reduced to two, and possibly one (in cases where the vice-governor is also a Class C director). We feel therefore that in matters of regional concern the reserve banks will be even more independent of the Board than they have been in the past. So far from attempting to centralize all matters pertaining to banking in Washington, we are asking that the Federal Reserve Board be empowered to delegate various matters to its representatives, mainly for the purpose of enabling the board to delegate to the reserve banks certain duties of a regional and local character now imposed on the board.

2. Your committee believes that it would be desirable to remove the Secretary of the Treasury and the Comptroller of the Currency from the Federal Reserve Board. I do not feel that it is appropriate for me to discuss this matter.

3. Your committee objects to the proposal to confer upon the Board power to change reserve requirements of member banks, on the grounds that "it would grant unquestionable power of inflation to a politically dominated board". It is true that the power to change reserve requirements is an instrument of control and, like the other instruments of control, it can be used for desirable or undesirable purposes. I shall, in a moment, describe to you the steps we are taking to insure that it will be used in the public interest.

4. Your committee objects to the real estate provision on various grounds. In the first place it is stated that "a most important factor in many of these bank failures was bad real estate loans". Actually the extent to which real estate loans contributed to our banking difficulties has been grossly exaggerated. A study just completed has disclosed that for all national banks that were suspended in the years 1930-32, inclusive, loans on real estate comprised only 10.3 per cent of total loans and investments immediately prior to suspension. Hence, even if all of their real estate loans were bad these banks need not have suspended if their other loans were all sound. It would appear to be a fair inference that in the case of national bank failures, which by assets comprised about one-third of all failures, factors other than bad real estate loans were dominant. Your committee also objects to the real estate provision on the ground that real estate loans, taken in conjunction with other sections of the bill, could be used for rediscount at the reserve banks. The proposal is not to make real estate loans with long maturities eligible for rediscount at the reserve banks until maturity but to make them eligible as collateral for member bank notes, which will of course have short maturities. The decision as to whether the assets offered as collateral are sound and as to whether the advance to the member bank shall be made at all, will rest with the individual reserve banks.

I note that your committee recognizes that the present reluctance of banks to continue existing loans or to make new ones is a factor militating against recovery. We are attempting to remove this reluctance by assuring the banks that if they make sound loans they will be able to receive assistance from their local reserve banks in case of need. 1c

5. The Open Market Committee. Since your committee objected to the proposal in the bill as introduced it would probably object even more to my supplementary suggestion that the Federal Reserve Board be charged with full responsibility for the initiation of open-market policy after having consulted with a committee of reserve bank governors. In order to understand the reasons for this proposal it is necessary to understand the present administrative set-up with regard to open-market operations. Your committee stated that the present open-market committee is advisory only. As the law now stands the Open-Market Committee is charged with the responsibility of initiating recommendations and the Federal Reserve Board has only the power to approve or disapprove these recommendations, and then in turn the reserve banks individually have the power to participate or not in operations recommended by the committee and approved by the Board. At the present time therefore authority and responsibility for open-market operations are shared by 14 bodies comprising 128 men. Some are appointed by the President, some are elected by the banks, some are appointed by the Federal Reserve Board, and some are appointed by the Boards of Directors of the reserve banks. With such an organization it is almost impossible to place definite responsibility anywhere. I am sure that the members of your committee would recognize that such a system, as applied to their individual businesses, would encourage friction and delay. If they would go so far as to agree with me on this I think they would also agree that from an administrative point of view the fixation of authority and responsibility in one small body is desirable.

The issue then becomes whether this body should be a public body appointed in the regular manner which we have developed under our form of government, or a private body. When the issue is thus stated I think it admits of only one answer. A body whose decisions may affect the economic well-being of every person in the community must be in some manner subject to public control.

While recognizing the fact that the body which has authority and responsibility for the determination of national monetary policies must be a public body, we have sought to insure that decisions of this body will not be activated by partisan considerations. To this end we have sought to add to the prestige of the Board by concentrating in it both authority and responsibility. The enhanced prestige and the new qualifications we are proposing will, it is hoped, enable the Board to secure

and retain the best talent available. We have sought to increase the independence of members of the Federal Reserve Board by granting them pensions and higher salaries, and I am pleased to note that your committee commends the bill in this particular. Accordingly, the inclusion in the law of a definite objective which I have suggested, looking toward stability of business and employment, will in itself greatly assist the Federal Reserve Board in resisting political pressure to use its powers for purposes inconsistent with the maintenance of business stability. Personally I feel confident that if in the past, with less prestige, lower salaries, no pensions, and the absence of a specific legislative objective, there has been no evidence that the Federal Reserve Board has ever been activated by partisan aims, there is little danger that such aims will enter into policy in the future.

6. Your committee finally suggests the appointment of a commission to study carefully the necessity of changes in the Federal Reserve System. I can myself see no objection to the appointment of such a commission after the present bill, which deals with the more immediately urgent matters, has been enacted. A great many banking proposals have been embodied in various bills now pending in Congress, and in reports and resolutions adopted by various prominent and influential groups-- such proposals for example as the One Hundred Percent Reserve plan, the Social Credit plan, the segregation of savings banking from deposit-currency banking, the establishment of regional or trade-area branch banking, and the taking over by the Federal Government of all banking functions now privately exercised. Some advantage might be derived from a leisurely study of these and other proposals to prepare the ground for legislation looking to the eventual unification of the banking system of the country with the various changes and refinements, the necessity for which would be indicated by the study as well as by current developments during the period of study. What I object to is that the proposal for such a study be used to prevent action from being taken on important measures that are essential to encourage recovery and to guard against an inflationary boom.

Having recently spent nearly three weeks testifying on the Banking Bill before the House Banking and Currency Committee, I shall not attempt to recount here the reasons I have urged for enactment of the bill at this time in the interest of present recovery and future stability of business and employment. I am sending you instead a copy of a summary of my testimony.

I am convinced that those sections of the bill that have aroused the most controversy relate to matters that cannot be resolved by further study. Our differences arise on questions of principle and cannot be

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cleared up by the accumulation of more factual information than we have at present. The issues are as simple and as clear-cut today as they would be after years of close study. I cannot therefore regard the suggestion of the desirability of appointing a commission as other than a device to delay the enactment of reforms which are urgently needed at the present time.

Sincerely yours,

M. S. Eccles
Governor

3-5-d