CONTROL OVER CREDIT AND MONETARY POLICIES

In proposing the Banking Bill of 1935 the most important general purpose was to establish unified responsibility in a public body for national credit and monetary policies. The existing diffusion of responsibility between the Federal Reserve Board, the Federal Open Market Committee, and the 108 directors of the twelve Reserve banks was the most serious defect in the structure of the Federal Reserve System which the Banking Bill was intended to correct.

Under the bill as reported by the Senate Banking and Currency Committee, open-market operations of the Federal Reserve System would be subject to control by an Open Market Committee consisting of the seven members of the Board of Governors of the Federal Reserve System and five representatives of the Federal Reserve banks elected with a view to representation of the different regions of the country.

Recognition in the Senate bill of the importance of giving a national body full responsibility for open-market operations is an important step in the right direction. In view, however, of the great importance of this matter to the welfare of the nation, a close study of the proposal is necessary with a view to determining whether it falls short in any important respect of accomplishing the desired purpose.

In the first place, let us consider the question whether representation of the Federal Reserve banks on the Open Market Committee is in the best interests of the country. Two-thirds of the directors of the Reserve banks, who would elect the Reserve banks' representatives on the Open Market Committee, are in turn elected by the member banks. These members of the committee, therefore, would be definitely representative of banking interests. The question, therefore, arises whether there is any reason why all but equal power over open-market operations should be given to representatives of the banks.

This is no new question. It was prominent at the time that the Federal Reserve Act was proposed. At that time there had been serious agitation in favor of selection by the banks of some of the members of the Federal Reserve Board. This proposal, however, which was sponsored by the chairman of the Banking and Currency Committee of the House of Representatives, was not approved by President Wilson, who asked the pertinent question whether anyone would advocate that the railroads should select members of the Interstate Commerce Commission. By raising this point President Wilson made it clear that it would not be good policy to have the institutions that are to be supervised and controlled represented on a board charged with the duty of controlling them. In his address to the Joint Session of Congress on June 23, 1913, President Wilson said: "The control of the system of banking and of issue must be vested in the Government itself, so that the banks may be the instruments--not the masters--of business and of individual enterprise and initiative."

That this view expressed by President Wilson was accepted by Congress is indicated by the following passage from the Statement of Views accompanying the Senate report on the original Federal Reserve Act: "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 precedent of all civilized governments is against such a contention."

Recognition of the necessity of public control of monetary policy was, therefore, in the minds of Congress as early as 1913. The need for public control has become even more apparent during the twenty-odd years that the Federal Reserve System has been in operation.

The world has gone through a period of war, of inflation, and of deflation, of radical readjustments accompanied by the disappearance of the more automatic controls over monetary conditions, which to some extent had protected the countries of the world against excesses of inflation or deflation. Such controls were reasonably effective when world trade was sufficiently balanced to make it possible for an international gold standard to function freely. Such a condition does not prevail at the present time and no one can tell when if ever it will return again. One thing is clear, that it is not safe at this time to provide for a monetary system that depends in an important degree on automatic controls. If, however, controls are not to be automatic, then there has to be discretion and management, and if there is to be management, it must be in the interests of the nation as a whole and not in the interests of any particular group of people, be they bankers or politicians.

In these circumstances it is more imperative than ever that the control of monetary and credit policies be entrusted to a body that has complete and unescapable responsibility for the adoption of these policies. This body must be free from the influence of bankers or other special interests and must devote itself exclusively to the public service. Representatives of the Federal Reserve banks, however, do have banking constitutents and might be swayed by considerations that are more in the interests of these constituents than of the nation as a whole.

When the bill was originally proposed, there was more reason for giving consideration to participation by the Federal Reserve banks in the determination of open-market policy. This was because the Federal Reserve Board contained two ex-officio members, because there was no requirement that two members must be persons of tested banking experience, and that no more than 4 shall belong to one political party. The Senate bill has eliminated the ex-officio members from the Federal Reserve Board which wo ld consequently be more independent of the administration. The bill also provides that two members of the Board shall be men of tested banking experience. This would insure a proper understanding of banking technique by the Board and also provide for representation of the banking point of view. The bankers on the Board, however, would have severed their connection with the banks, and while they would understand the bankers, they would owe allegiance to no one but the country as a whole. They would have no special constituents. The Senate bill also provides that not more than four of the Board members shall belong to one political party. It is a Board, therefore, that is not likely to be swayed by partisan considerations and a Board that will have adequate representation of banking knowledge and of the banking point of view. Whatever reason there may have been for direct bank representation on the policy making body with the old Reserve Board, there would be no such reason with the Board as it would be reconstituted by the Senate bill.

It is clear, therefore, that the power over open-market operations should be vested in the Board of Governors, and that the Reserve banks should not be represented except by an advisory committee with which the Board should consult before taking action on credit or monetary policies.

It should also be pointed out that to give authority over open-market operations to any body other than the Board would perpetuate the diffusion of authority that now prevails. The Board has now and would continue to have under the bill, authority over the two other instruments of monetary policy--changes in discount rates and in reserve requirements.

It would be possible, therefore, under the Senate proposal, to have the different instruments of monetary policy used in opposite directions. The Open Market Committee, for example, might decide by a vote of five bank members and two Board members against the other five Board members to ease credit conditions through the purchase of Government securities, while the Board might decide by a vote of five to two to tighten conditions through raising discount rates or reserve requirements. There ought not to be the possibility of such a conflict in the administration of the nation's monetary policy. All the three instruments of monetary policy should be lodged in one public body with single unescapable responsibility. No other procedure would insure the prompt and courageous action that is necessary to protect the country from inflation and deflation, and to assure it that the influence of the monetary system will be exerted toward sustaining continuous employment of labor and of the productive capacity of the nation.