

Informal Memorandum of Mr. Eccles' Views Relating to the
Staff Report on the Federal Reserve Board Prepared for
the Committee on Independent Regulatory Commissions by
George L. Bach under date of August 1, 1948.

This memorandum, for the sake of convenience, is a running commentary upon the recommendations as summarized in part IV, chapter XVIII, pages 39-41 inclusive, without attempting to cover questions of a factual nature encountered in reading other portions of the report.

I. Coordination of Federal Economic Policy.

The adoption of such a recommendation would provide a definite forum for promoting better understanding and greater coherence among the various governmental agencies whose operations affect and are affected by fiscal, monetary and credit policies.

The operations of the Government in the economic field are so extensive that in any effort to achieve coordination it is necessary to include diverse activities under different authorities which may affect the execution of these policies. It is difficult and often ineffective to deal individually with the numerous agencies concerned and consequently the place to make a start is that suggested by the report, at the top.

The Coordinator, who would be the Chairman of the Economic Policy Council, should be appointed by the President and confirmed by the Senate with salary equal to that of a cabinet officer. The Council should be required to meet at least monthly. Its membership should be confined to the head of each agency represented, or to the top officer who has authority to act in his absence. This would be for the purpose of preventing the meetings of the Council from degenerating into a group of alternates consisting of relatively minor representatives of the agencies concerned.

The responsibility should be clearly placed upon the President not only to put the Council into operation through the prompt selection of a Coordinator with the necessary qualifications, but to see that the respective governmental agencies understand that they are expected to develop and carry out harmonious policies. To this end there should be set forth in the legislation a specific statement of the purpose which should guide the Council in its deliberations. Such a mandate should be in accordance with the general declaration of the Employment Act of 1946.

In order to put some teeth into its deliberations without giving it authority over the decisions of any of the agencies represented, the Coordinator should be required to submit to the President of the United States at least quarterly a report of the proceedings of the Council, publication of which should also be required. The report should include the reasons given in the case of any agency which does not follow the recommendations of the Council. The present Council of Economic Advisers, with an appropriate change

in title, should serve the Economic Policy Council through the Coordinator.

Certain suggestions as to the composition of the Economic Policy Council are offered. Since the Farm Credit Administration is a part of the Department of Agriculture, it would seem logical to confine the representation of that department to a single member, as would be the case with respect to any other department.

Policies with respect to wages, hours and other conditions of employment are administered outside the Department of Labor. It would therefore seem more effective to substitute the Chairman of the National Labor Relations Board for the Secretary of Labor, who does not have these responsibilities.

The list of proposed membership does not provide for any representation of the important activities of Government relating to public works, which involve large expenditure programs, such as reclamation projects, highways, power projects and the like, now embraced in the Bureau of Reclamation of the Department of the Interior, the Public Roads Administration of the Federal Works Agency, and the Tennessee Valley Authority. Consideration might well be given to a regrouping of public works activities of these types, under one administrative head who would be included in the membership of the Economic Policy Council.

The Chairman of the Securities and Exchange Commission might also be included in the membership of the Council.

- II. Status of the Federal Reserve Board.
- III. Relation of the Board of Governors and Reserve Banks.
- IV. Composition of the Board of Governors.

With respect to the membership of the Board, the number should be reduced, as proposed in the report, to five, but all of them should be appointed by the President and confirmed by the Senate as full time members. The term of office should be ten years, so arranged that one term would expire every two years, but without restriction upon reappointment except that of compulsory retirement at 70, regardless of the term for which appointed.

It would be preferable to retain the existing regional requirement with respect to membership on the Board of Governors, and it would be more consistent with the nationwide, public responsibility of the Board than the suggestion to abolish this requirement, which would subject the System to the criticism that possibly all or a majority of its members would be appointed from a single district, say the New York district. The Federal Reserve System embraces 12 districts, and with only five members there would seem to be no compelling reason for believing that fully qualified and entirely competent members could not be obtained without appointing more than one from a single district.

Ex Officio Memberships.

The System has had the experience of ex officio memberships and they have not worked satisfactorily. As pointed out in the staff report, this was demonstrated in the previous experience which resulted in the reorganization by the Banking Act of 1935 which removed the Secretary of the Treasury and the Comptroller of the Currency from ex officio memberships.

It would, therefore, not be desirable to divide the membership by the inclusion of such an official as the proposed Under-secretary of the Treasury for Banking. The suggestion is confusing because he would have no duties in that department, and it is complicated by the possibility that the Secretary of the Treasury might serve in his place. The reasons given in the report for the suggestion show its undesirability from the standpoint of good organization and administration. The broader purpose sought to be accomplished would be much more properly accomplished through the Economic Policy Council, whose membership would include the Secretary of the Treasury as well as the Chairman of the Board of Governors. As the recommendation indicates that the Under-secretary of the Treasury for Banking is not intended to have any operating functions in the Treasury Department, it is difficult to see how he could serve adequately the purpose of a spokesman for the Treasury or a liaison between the Treasury and the Federal Reserve. It would no doubt introduce confusion and uncertainty into these relations when the Chairman of the Board might be a different person.

With a Chairman and Vice Chairman serving as such at the pleasure of the President and the Under-secretary of the Treasury for Banking serving at the pleasure of either the President or the Secretary of the Treasury (with the further possibility of the Secretary of the Treasury serving in the place of the Under-secretary), doubt would be greatly increased as to the continuity and dependability of policy of the Board and the question of its freedom from political or Treasury influence would be injected into the situation. The Treasury naturally desires to finance the public debt as cheaply as possible and at times in the past followed policies having that end in view without full regard for long range economic and monetary considerations. It is preferable in such circumstances to maintain the official separation of the Board so that its advice to the Treasury in fiscal matters may in its inception be free from Treasury influence.

Since it is believed, as suggested elsewhere in the report, that the functions of the Comptroller of the Currency should be transferred to and administered by the Board of Governors, there would be no more occasion or justification for placing them under the proposed Under-secretary of Banking than any other important function which might be vested in the Board.

In this connection it is not believed that it would be helpful or desirable to add to or make a part of the membership of the Board of Governors, as suggested in one of the recommendations, a president of a Reserve Bank for a year at a time. It would include as a voting member of the governmental

agency charged with the responsibility for the supervision and regulation of the Federal Reserve Banks and member banks the top executive officer of one of the twelve Reserve Banks, who is appointed for a term of five years by the directors of that bank. Six out of nine of these directors are elected by member banks. Such a proposal would conflict with the principle laid down by President Wilson with respect to membership on the Board at the time of the formulation of the Federal Reserve Act, as recorded by Senator Glass in his book "An Adventure in Constructive Finance". That principle is equally sound today.

The fact that the Board of Governors passes upon the President's appointment and salary would also militate against the value of the suggestion. Matters involving differences of opinion might not be considered with the same impersonal and objective attitude that could be expected of equals in appointive status.

Federal Open Market Committee Powers.

For reasons stated in the report, the present powers of the Open Market Committee should be transferred to the Board of Governors. This recommendation is supported by experience as well as by the principles of organization involved. While the Board of Governors has the responsibility and the authority for determining within statutory limitations the amount of reserves that shall be carried by member banks at the Federal Reserve Banks, for the discount rates charged by the Federal Reserve Banks for advances to member banks, and for the general regulation and supervision of the lending operations of the Reserve Banks, the responsibility and authority under existing law for policy with respect to the Government security market, known as open market operations, is vested in the Open Market Committee. These operations have become an increasingly vital part of Federal Reserve policy. In practice they are the means through which the debt management policies of the Government are effectuated and the supply of reserves available to member banks is expanded or contracted. They are the means through which an orderly and stable market for Government securities is maintained. While the members of the Board of Governors constitute a majority of the members of the Committee, i.e., seven out of twelve, the other five are Presidents of Reserve Banks. It would seem on the face of it that the Board of Governors is the dominant factor in the Committee but it is also equally apparent that, if there were differences of opinion among the membership of the Committee, policy could be determined by seven members who might be at variance with the policies determined by a majority of the Board of Governors in the field of its responsibilities. While up to this time this may not have produced any serious consequences, its potentialities are quite apparent. The arguments against the division of powers are well stated in the report.

The contention may be made that all major policy functions of the Board should be transferred to the Federal Open Market Committee. What this might leave to the Board of Governors as such is not clear but would certainly be inadequate to justify its continued existence. It is clear, however, that there would be no justification for continuing and expanding governmental powers in a body of men in part appointed by the President of the United States

and confirmed by the Senate and in part by the directors of the Reserve Banks, two-thirds of whom are in turn elected by one-half of the commercial banks of the country. The entire banking system and the public are entitled to the assurance that Federal authority exercised over them is vested in a completely and unquestionably governmental body whose personnel is selected in the same manner as all others exercising governmental functions.

Membership in the governing body should not be open to the charge or suspicion that it might be the means by which directors of Federal Reserve Banks could gain information before it is available to the public which might influence their personal judgment or that of the institutions they represent, especially in a period of changing Treasury financing policies and extensive Federal Reserve operations in the Government security market. In order to accomplish the desired purposes, these operations must be kept strictly confidential.

Appointment of Reserve Bank Presidents.

It is difficult to understand what desirable purpose would be served by the proposal that, instead of the present method of appointment of the presidents of the Federal Reserve Banks as outlined above, i.e., appointment by the boards of directors and approval by the Board of Governors, the appointment should be made by the Board of Governors subject to the approval of the board of directors. This would place the directors of a Reserve Bank in possession of a veto over the Federal Reserve Board. Clearly, the final authority should be in the government agency. Perhaps the underlying question involved in the proposal is really whether there should be some change in the composition of the boards of directors who select the presidents.

Stock of Reserve Banks.

With respect to the suggestion that the Federal Reserve System should buy up the outstanding stock, it is felt that this is not a matter of very much importance. The existing system of stock ownership of the Reserve Banks provides for what is in effect merely a non-transferable membership certificate, the investment in which bears a statutory rate of return. Any equity would belong to the Government in case of liquidation. It would be very undesirable, however, to transfer the ownership of this stock to the Treasury as suggested elsewhere in the report. This would introduce a political consideration wholly different from any involved in the retirement outright of the stock of the Federal Reserve Banks. The latter step could easily be taken without any impairment whatsoever of the ability of the Reserve System to perform its functions and without in any way affecting the existing procedure of election of directors of the Reserve Banks.

Delegation of Administrative Functions.

It would be desirable, following a suggestion in the report, to provide specifically for authority in the Board of Governors to delegate administrative responsibilities other than those of determination of policy, the adoption of regulations, and the like. Such a proposal was embraced in

the Banking Act of 1935 as passed by the House of Representatives but was dropped from the bill as finally enacted. That provision read as follows:

"The Board may assign to designated members of the Board or officers or representatives of the Board, under rules and regulations prescribed by the Board, the performance of any of its duties, functions, or services; but any such assignment shall not include the determination of any national or system policy or any power to make rules and regulations or any power which under the terms of this Act is required to be exercised by a specified number of members of the Board."

The concentration of broad responsibility in the Board for all directly related Federal activities in the field of credit and monetary functions would strengthen the prestige of the Board and thereby add to the attractiveness of its membership for able men.

V. Bank Supervision.

As recommended in the report, the responsibilities for bank regulation and supervision now distributed among various Federal agencies should be lodged in one place to bring to an end the confusion, division and conflicts of authority, jurisdiction and responsibility which exist in the banking field. The reasons for this are set forth in the Annual Report of the Board of Governors for 1938. They are, if anything, understated in that report, which could be amplified in the light of subsequent experience.

The whole field of examination of banks subject to Federal jurisdiction, whether through membership as national or State banks in the Federal Reserve System or through insurance of deposits by the Federal Deposit Insurance Corporation, should be lodged in the Federal agency which has responsibility for national credit and monetary policies. Examination procedure is a tool of bank supervision and regulation which should be integrated with and responsive to such policies. When directed as if it were not concerned with those policies, its effectiveness is greatly weakened. Too often in the past bank examination policy became tighter when conditions grew worse, thus intensifying deflation, and, conversely, examination policy accentuated inflationary forces when caution should have been observed.

It does not make sense for Federal policy in the field of examination of national banks and certain regulations of national banks to be lodged in one place, for examination of State member banks and certain regulations to be lodged in still another place, and for examination of insured nonmember State banks and certain regulations to be lodged in a different place.

Only one of the three agencies, the Federal Reserve System, is charged by Congress with responsibility over the supply and cost of credit, which is directly affected by reserve requirements, discount rate policy and open market operations. The Reserve System views the economic scene principally from the standpoint of national credit conditions as affected by monetary, fiscal and other governmental policy. The Comptroller of the Currency, whose present day function consists mainly of chartering and examining national banks, does not have these broad responsibilities. The Federal Deposit Insurance Corporation is chiefly concerned with accumulating and

Safeguarding an insurance fund and is likewise without responsibility for determining credit policies. These inherent differences of interest inevitably lead to conflicts in policy conceptions and make it difficult and often impossible to reach agreements.

A recent example of where this diffusion might lead is found in the existing responsibility of the Federal Reserve Board with respect to bank holding companies which have as subsidiaries not only national banks but State member banks, and in addition, insured nonmember banks. The Board of Governors passes upon branches, consolidations and mergers of State member banks, the Comptroller of the Currency upon similar actions with respect to national banks, and the Federal Deposit Insurance Corporation has corresponding authority as to nonmember banks. Moreover, the Board has the responsibility, referred to in the report, of proceeding under the Clayton Act against monopolization of banking facilities. Yet in the face of an agreement among the three Federal agencies in 1942, that further expansion of a certain holding company's banking operations should not be permitted, the Comptroller of the Currency, under instructions from the Secretary of the Treasury, has in recent years granted approval of the establishment of a considerable number of branches for the principal subsidiary national bank in the group. The Board believes that continuance of this practice is incompatible with the proceeding instituted by it under the Clayton Act and the matter is in the process of discussion. It may be added that notwithstanding considerable effort it has not been possible to obtain agreement among the three agencies on the content of needed legislation relating to bank holding companies.

Federal Reserve Interest in all Phases of Bank Supervision.

Functions in the nature of examination, regulation, supervision and execution of credit policy in the banking field are interrelated. While national and State member banks number only half the commercial banks of the country they hold 85 per cent of the deposits. They are all subject to the Federal Reserve Act and the regulations of the Board of Governors, they are all members of the Federal Reserve System, and they all enjoy the same privileges and facilities at the Reserve Banks. Government securities constitute the bulk of their total loans and investments. By far the most important factor in the Government's relations with the banks of the country is the public debt and the part which open market operations and credit policies of the Reserve System play in that field. It has other important regulatory and supervisory powers, including the admission of State banks to membership in the Reserve System; reports of condition and examination of State member banks; trust powers of national banks; State member bank branches and branches of national banks in foreign countries; the removal of officers and directors of member banks, State as well as national; interlocking bank directorate relationships; loans by member banks to executive officers; voting permits for holding company affiliates of member banks; termination of membership of State member banks and under certain conditions the forfeiture of franchises of national banks. The Board regulates consumer credit extended by all banking institutions (Regulation W). It also regulates terms under which loans are extended with respect to listed securities (Regulation U) by all banks. The System is specifically charged by law with the duty of keeping informed of the general character and amount of the loans and investments of its member banks, State as well as

national, with the view of ascertaining whether undue use is being made of bank credit for any purpose inconsistent with the maintenance of sound credit conditions.

It follows as a matter of course that the System must have currently accurate information procured through examination, bank condition reports, special investigations, constant correspondence, and contacts with the banks. For this purpose the System must have examiners and other personnel responsible to it specially trained and directed for the purpose of procuring such information. The Reserve System is in the best position to determine the policies to be pursued by examiners; to coordinate them with credit policies; and at the same time to decentralize the actual administration by utilizing the facilities of the twelve Reserve Banks and their twenty-four branches. They have been for many years examining State member banks, are in close touch with all member banks, and are familiar with their conditions and personnel. Through their daily activities of furnishing currency, collecting checks, seeing that member banks maintain their reserves, and extending credit to them, the Reserve Banks obtain current information about banks which is invaluable for purposes of bank supervision. Since examinations supply information essential to the right conduct of the business of the Reserve System, and since the Reserve authorities must have access to all reports of examination, of State member as well as national banks, it is entirely illogical to argue that they should not have charge of examinations. On the other hand, it is equally illogical to argue that examinations should be divorced from all other functions.

Federal Deposit Insurance Corporation.

The corporate identity of the Federal Deposit Insurance Corporation should not be disturbed, but it should be confined to its basic purpose of insuring deposits in the banking system and liquidating insolvent banks. The Board of Governors would be substituted for the existing board of directors, but, if this latter suggestion should for any good reason seem impracticable of execution, there might be substituted for the existing directorate a full time Chairman of the board of directors who would be its active executive officer, together with the Chairman and Vice Chairman of the Board of Governors or other Board members selected as their alternates by the Board. In that case it should be specifically required that the Federal Deposit Insurance Corporation and the Board of Governors coordinate their policies and functions in the interest of uniformity and economy. The existing relations with State supervisory authorities could be continued through the same channels without any apparent alteration, but all conflicts and diffusions of authority could be avoided.

Possible Attitude of Reserve Banks and Others.

No doubt there will be opposition on the part of the Federal Reserve banks either to the grant of greater powers to the Board or to the consolidation of existing agencies of the Government in any manner which eliminated representation on the part of the Reserve Bank presidents. Nevertheless, divided authority and responsibility is incompatible with the best conception of proper administration of governmental functions relating to the banking system.

It should be emphasized that the Presidents of the Federal Reserve Banks are the chief executive officers, appointed by the boards of directors with the approval of the Board of Governors for five year terms. They are not directors of the banks, and they are not vested with policy-making authority, except in so far as they serve upon the Federal Open Market Committee.

If, however, it is felt that the functions of the Presidents should be expanded to include the general policy functions of the Board of Governors, including the right which some have claimed to make direct representations to the Congress, the logic of the situation thus presented would suggest that both the Board of Governors and the Federal Open Market Committee be abolished and that the twelve Presidents of the Federal Reserve Banks, as such, be constituted the Board of Governors of the Federal Reserve System. It would follow in such circumstances that, instead of being elected by their directors and their salaries being fixed by the directors with the approval of the Board of Governors in Washington, they should be appointed by the President of the United States and confirmed by the Senate, with their terms and salaries fixed by the Congress, as in the case of any other governmental agency. Then they would be responsible directly to Congress for the policies of the System in accordance with the Federal Reserve Act and related legislation.

This would no doubt involve setting up an administrator or general manager or executive secretary or some comparable official whom they would select as the chief executive officer of the Board with the necessary staff in Washington; they would make all rules and regulations and other policy determinations; they would set up committees among their membership to carry out such functions as they might delegate; and it would be necessary that they meet at least once a month in Washington.

VI. Margin Requirements.

While there is no objection to the suggestion that the Federal Reserve Board be required to consult with the Securities and Exchange Commission before fixing margin requirements, the reason in practical experience for this suggestion is not apparent. There is mention in the report of criticism by Securities and Exchange Commission officials, but the Board is not advised of the grounds for such complaint. It does suggest, however, that the Chairman of the Securities and Exchange Commission might well be a member of the Economic Policy Council.

VII. Lending Functions of the Federal Reserve.

The role of the Reserve System in relation to Government lending to business should be clarified as recommended in the report. This is particularly important as to the functions exercised in that field by the Reconstruction Finance Corporation and with respect to the authority of the Reserve Banks to extend credit to industrial enterprises under section 13b of the Federal Reserve Act. The latter should be modified as proposed in Bill S. 408 as submitted by the Board to the Senate Banking and Currency Committee during the last Congress.

The functions in the lending and credit field of the Reconstruction Finance Corporation properly belong in the Federal Reserve System because they may have an important bearing upon the execution of national credit and monetary policies. In other countries such as Canada and England, these functions are exercised by the central bank. The Reconstruction Finance Corporation could, however, continue to be a separate corporate entity, as would be the case with the Federal Deposit Insurance Corporation.

As a matter of general policy, it would be desirable for the credit functions of the Reconstruction Finance Corporation to follow the pattern of the Regulation V procedure of guaranties which prevailed during the war, with the exception that large loans might be made or participated in by the Reconstruction Finance Corporation in unusual and special circumstances such, for example, as those involved in bridge undertakings, railroad organizations and similar situations which could not be met adequately through existing banking and financial channels.

Federal Advisory Council.

A suggestion not embodied in the report is offered that the Federal Advisory Council, instead of being composed as at present of bankers selected by the boards of directors of the Federal Reserve Banks, be composed of the Presidents of the Reserve Banks. As stated in the staff report, continuous Board consultation with Reserve Bank officials is on a regular basis and the Presidents Conference serves as a convenient vehicle for consultation and analysis of common problems. The decentralized Reserve Bank structure provides established channels of contact between the monetary authorities and banks, businesses and the public for effectuating credit and supervisory policies. As an aid to policy making, the Reserve Banks provide an invaluable means for obtaining information and ascertaining attitudes throughout the Nation. On the other hand, in practice the Advisory Council has tended to represent the larger metropolitan banks of each district, primarily those doing a correspondent banking business. Members have been selected almost exclusively from such banks. In some districts it has been the practice to select the same representative over a long period of years. This is particularly undesirable if the Council member reflects the interest of his own type of institution rather than a broader public interest.

Since the Presidents of the Reserve Banks are constantly in touch with the banks of their districts, small as well as medium and large, and since it is one of the responsibilities of the Presidents to keep informed as to credit conditions throughout their districts as well as to contribute in the Presidents Conference to the working out of the operating problems of the Reserve System as a whole, it is believed that the Reserve Bank Presidents as a group could serve more effectively the purpose originally conceived for the Advisory Council in the enactment of the Federal Reserve Act. In this way statutory recognition could be given to the thought expressed in the body of the report that there should be consultation between the Board and the Presidents on important policy determinations.

Dual Banking System.

It will be said, no doubt, that the proposed consolidation of Federal functions in one Federal agency will destroy "the dual banking system". That argument is likely to come not only from State Commissioners of Banking, who fear the effects upon their political and administrative prestige, but also from those bankers who consider it advantageous, either in seeking privileges or retaining existing prerogatives, to deal with divided authority. The dual banking system is, of course, composed of State banks operating under State charters and national banks operating under Federal charters. Nothing in these proposals would in any way strike down or impair these two systems. With few exceptions the State banking system is already covered by deposit insurance administered by the Federal Deposit Insurance Corporation, a Federal agency. All State banks that are members of the Federal Reserve System are subject to the terms of the Federal Reserve Act. All national banks are chartered by the Comptroller of the Currency, a Federal officer. The Federal Deposit Insurance Corporation works in cooperation with the State authorities and the Federal Reserve works in cooperation with the same State authorities. The real question is not continuance of the "dual system" but maintenance of divided Federal authority. A consolidated Federal agency would continue to cooperate with the State authorities, just as the divided authorities do now. The charge that there is anything in these proposals inimical to the dual system of banking has no substance, since we are dealing here only with questions of administrative organization of Federal functions and not with questions of substantive powers of the Federal Government over banking.

It would be a relatively simple matter for the examination, research, legal and other functions of the three Federal agencies to be integrated both as to personnel and facilities. The best would be retained and the result would be simplification of administrative performance and elimination of time-wasting, expensive and uneconomical overlapping and duplication. Substantial savings in overhead and field organizations could be effected.

Objectives of Federal Reserve Policy.

As recommended in the staff report, the objectives of Federal Reserve policy should be clarified. A mandate for this purpose was embodied in the Banking Act of 1935 in the form in which it passed the House of Representatives, although it was dropped in the final enactment of the legislation. That mandate read as follows:

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

The foregoing observations represent the accumulated results of study of the problems involved in the course of long experience in the public

service with the background of a private business and banking point of view. They are not offered because of any desire to expand the authority and power of the Board of Governors but wholly in the interest of economy and the definite placement of responsibility where it cannot be avoided and where failure to meet it cannot be excused.