

F E D E R A L R E S E R V E B O A R D

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The Banking Bill of 1935

Radio Speech

of

Marriner S. Eccles

Governor of the Federal Reserve Board

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I am grateful to the Washington Star for the invitation to speak in this Forum.

I should like to talk to you as plainly as I can about the Banking Bill which is pending before Congress. In the brief time at my disposal I shall have to confine myself to the most controversial features of the bill and omit discussion of many other provisions of the bill which would, in my judgment, contribute towards recovery, as well as towards the better coordinated and more efficient administration of the Federal Reserve System.

I shall assume that you believe that in order to have our money system controlled for the benefit of the nation as a whole and not for the benefit of special interests this control must be in the hands of a responsible body. If after all that this nation has gone through during the past five years you still believe that we can leave our monetary system to chance or to fate, then it would be futile for me to try to persuade you that our present system can and should be improved.

With the banking cataclysm so fresh in our memories, we would be justified in saying that the Government had failed in its duty if it neglected to correct at least some of those apparent defects in our banking system which contributed to bringing untold distress to millions of our people and threatened to plunge our entire economy into the abyss. We are told that there is no emergency at this time which demands prompt action to correct these defects, but surely we should not wait for another crisis before taking the steps necessary to remedy obvious defects which painful experience has exposed. We should profit by the lessons we have learned from the emergency.

The real problem is the control over the volume and cost of money. The defects which I have mentioned are not due to the absence of powers of control, but to the fact that the present responsibility for the exercise of these powers is so diffused and divided as to hamper seriously, if not to frustrate, their effective use.

We need also to state the objective towards which these powers should be directed. At present there is no objective for monetary policy stated in the law. The Banking Bill as passed by the House of Representatives proposes a definite objective which is, in a word, that monetary policy shall be directed towards the maintenance of stable conditions of production, employment, and prices so far as this can be accomplished within the scope of monetary action.

I do not wish to be understood as believing that by monetary action alone we can eliminate all booms and depressions and achieve a permanent and unvarying stability. I do believe firmly, however, that by monetary means exercised promptly and courageously we can greatly mitigate the worst evils of inflation and deflation.

What are these powers of control to which I refer? There are three principal means of control which now exist. The first is the power to raise and lower the discount rate, that is, to determine the cost at which banks can borrow from the Federal Reserve banks and consequently to influence the cost at which the public can borrow from the banks. The importance of this power is apparent. By lowering or increasing interest rates it is possible to lower or increase the cost of doing business and, therefore, to have an influence over the contraction or expansion of business. This power is now vested in the Federal Reserve Board at Washington.

The second means of control to which I have referred is the power to raise or lower reserve requirements of the banks which are members of the Federal Reserve System. This power more directly influences the

volume of money because under our law the amount of deposits that banks can create is limited in proportion to the amount of reserves they possess. Therefore, an increase or a decrease in the volume of reserves tends to increase or decrease the volume of deposits which are our principal means of payment, or money. Since 1933 this power has been vested in the Federal Reserve Board, but it can only be exercised when the President declares that an emergency exists and gives his approval. The responsibility for declaring an emergency should not be placed upon the President. Even if an emergency did not exist, the declaring of it would almost certainly create one. The bill proposes to give the Federal Reserve Board the use of this most important instrument of control without requiring the President to declare an emergency, which might involve insurmountable political obstacles. The Federal Reserve Board should be in a position to exercise this power in the normal course of events for the very purpose of preventing an emergency.

The third means of control is what is known, perhaps somewhat mysteriously, as open-market operations. Without going into the details of this technical matter, open-market operations mean that the Federal Reserve banks when they wish to increase the volume of money can do so by buying Government securities in the open market. The money they pay for these purchases is added to the reserves of the member banks. Conversely when the Reserve banks wish to diminish the volume of member bank reserves they can sell securities and in effect lock up the money paid by the banks for the securities. In this way they can directly influence the available volume of money. At the present time the control over this power is distributed between a committee of twelve governors of

the twelve Federal Reserve banks, who now have the responsibility for recommending purchases or sales, the Federal Reserve Board, which has authority to approve or disapprove the recommendations of the governors, and 108 directors of the twelve Reserve banks, who in turn have the right to determine whether or not they will buy or sell in accordance with the policy that has been recommended by the governors and approved by the Board. A more effective means of diffusing responsibility and encouraging delay could not very well be devised.

On this point I have recommended that the power over open market operations be entrusted to the Federal Reserve Board, which consists of eight members, six of whom are appointed by the President and confirmed by the Senate, and two ex-officio members, the Secretary of the Treasury and the Comptroller of the Currency. The Board would be required, however, before taking action on open market operations as well as on discount rates and reserve requirements, to consult with a committee of five governors selected by the Federal Reserve banks. In this way the responsibility for action will be unescapably fixed.

To my mind, the all-important thing is to place responsibility for the exercise of these three means of control in a clearly defined body and to state the objective towards the attainment of which that body shall exercise these powers. I do not wish to be dogmatic about how this body shall be constituted. I have recommended placing responsibility for the exercise of these powers in the Federal Reserve Board, which was established by law to serve the best interests of the nation in banking and monetary matters. However, there are powerful groups which are irreconcilably opposed to this plan and

wish to perpetuate the present unsatisfactory situation in which these powers cannot be effectively exercised.

This attitude is by no means characteristic of all of the bankers of the country. In all fairness, I wish to emphasize that in discussing this issue most of the leaders of the American Bankers Association have adopted a constructive and cooperative attitude. This is in sharp contrast with the attitude of a few bankers and business leaders, particularly in New York. Many of the bankers have frankly recognized the need and importance of the major changes proposed in the Banking Bill and have accepted them in principle.

With these bankers the issue over the banking bill narrows down largely to a question of the composition of the controlling body. Thus, the American Bankers Association proposes that the exercise of monetary powers shall be entrusted to a committee consisting of the Federal Reserve Board, which shall be reduced to five members, and a committee of four governors selected by the governors of the twelve Federal Reserve banks. This plan would give the governors of the Federal Reserve banks, who are selected by directors two-thirds of whom are appointed by private bankers, four votes as against five votes for members of the Federal Reserve Board.

There has been considerable support for another proposal which would entrust the powers of determining monetary policy to a committee consisting of the Federal Reserve Board of eight members, as now constituted, together with five governors of the Federal Reserve banks.

These governors would be selected with reference to a fair representation of the different regions of the country, one member to represent the Eastern Federal Reserve districts; one, the Middle West; one, the South; one, the far West; and one to be selected at large.

It is not for me to determine in whom these powers shall be vested. My recommendation was that they be vested in the Federal Reserve Board, with a committee of five governors acting in an advisory capacity. I have just mentioned two other proposals. It is for the representatives of the people of the United States in Congress to determine whether they want to give these powers to an independent public body, to private interests, or to a combination of the two. The one principle on which I feel there can be no reasonable ground for disagreement is that the powers must be vested in a clearly defined body which will have adequate authority and full and unescapable responsibility for the use of these important powers.

As I have said, the purpose of the bill is not to create new powers but to place existing powers in a responsible body where they may be effectively exercised. Against this proposal the cry of political control has been raised. This is not a new cry. It was raised against the original Federal Reserve Act more than twenty years ago. It was raised by about the same interests which are now resisting the passage of this bill -- the same interests that have repeatedly been against all progressive social and economic legislation, such as the income tax, even when it was proposed to make it as low as 2 percent; against child labor legislation; against the Federal Trade Commission and the Federal Power Commission; the Securities Exchange Commission; against pensions of all kinds, both

State and national; in short, ~~against~~ all that enlightened legislation which has long since been accepted and now forms the basis of such economic and social advance as we have achieved.

If it is fair to charge that the Federal Reserve Board is political, then the same accusation must be made against the Interstate Commerce Commission, against the Federal Trade Commission, and against other governmental bodies the members of which are nominated by the President and confirmed by the Senate. Experience has demonstrated that these bodies have consistently acted not for political advantage but in the public interest.

Some of the opponents of the bill are raising all the familiar bugaboos that they have so often trotted out in the past whenever any attempt has been made in the interests of the country as a whole to limit their influence in national affairs. I think that Mr. Walter Lippmann well stated the tone and temper of these irreconcilable opponents when, in a recent article, he referred to their hysterical methods. He pointed out that they tell us in one breath that we are threatened with a grave emergency because of the dangers of uncontrollable inflation while in the next breath they tell us that no emergency exists which requires the enactment of this legislation, designed as it is to enable us to deal effectively with just such an emergency. As Mr. Lippmann says with reference to the inconsistency of these opponents, "It does not make sense. If we are faced with these hideous dangers, are we not criminally negligent if we fail to fix clearly the responsibility for averting them?"

As I say, this cry of "wolf" is not new. I have had occasion to delve into the history of banking legislation and I note with some degree of consolation that the Federal Reserve Act was denounced in language so nearly identical with that being used today by much the same organized opposition, that unless you knew the dates you could not distinguish between what they said more than twenty years ago and what they are saying today.

Then, as now, the same interests were crying inflation and political control. Then, as now, they demanded full control. Indeed, they undertook to persuade President Wilson that they should have banker representation on the Federal Reserve Board. Senator Glass of Virginia in his authoritative and illuminating book on the Reserve System entitled "An Adventure in Constructive Finance", tells of how these bankers made their arguments to Mr. Wilson, and according to Senator Glass, when they had finished, President Wilson 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," wrote Senator Glass, "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?"

And Senator Glass adds in his book,

"There could be no convincing reply to either question * * *."

Let me quote another pertinent paragraph from this illuminating book:

"While the Federal Reserve bill was pending," wrote Senator Glass, "it was mercilessly condemned in detail by certain interests. Where there was any praise in these quarters, it was faint enough to damn. This hostile criticism reflected not alone the attitude of bankers, as the class which imagined that it was chiefly affected by the proposed readjustment; but it voiced the disapprobation of those business groups which are most readily impressed by banking thought. This was not surprising, since the phenomenon was and is of frequent recurrence."

Unfortunately this is all too true. You are witnessing the same phenomenon again today. You are hearing the same cry that the banking bill means reckless inflation -- that the purpose of the bill is to obtain control of the banks so that the administration may be able to finance an endless series of government deficits. The complete answer to this bugaboo is that if the administration had such a purpose it would not need this bill, for this or any other administration will always find means to raise the funds which the representatives of the people in Congress have appropriated.

As a matter of fact, the administration has at its command, in the Stabilization Fund and under the so-called Thomas Amendment, more than 5 billions of unexpended dollars. Demand for the purchase of government bonds is so great that the average interest rate has dropped by more than 25 percent since the administration took office. In the face of these facts, do you believe the opponents of this bill when they

tell you that the administration wants the banking bill enacted in order to enable it to finance governmental deficits?

The organized opposition to the banking bill wants to delay its passage, to leave matters as they are. Our opponents profess to believe that the issue should be submitted to a commission for further study. But manifestly this is not an issue which will be settled by further study. It is not an issue as to facts which need to be gathered together and pored over by another commission. Unless your memories are shorter than I believe them to be, you know the essential facts. The issue is plain. It is an issue of fundamental belief. It is whether such powers as we possess over monetary policy, which affects the welfare of all of us, shall be definitely placed in a body which shall have not only the necessary means of control but the fixed responsibility for its exercise, or whether these powers should be left as at present where they can neither be effectively used nor the responsibility for their exercise definitely fixed. It calls for a decision by the people of the United States through their representatives in Congress. It is my sincere conviction that this bill is in the interest of the banking system as a whole because it will enable it better to serve the public interest.

I thank you.