April 14, 1932.

C.S. Hamlin.

THE GLASS BILL.

Reply to the Memorandum of Governor Harrison, and letters of February 6, and April 7, 1932.

On April 7, 1932, Governor Harrison sent to the Banking and Currency Committee of the Senate, a memorandum commenting on each section of the original Glass bill, - Senate 4115 - and on the amendments suggested by the Federal Reserve Board.

He also enclosed a copy of a letter sent by him to Senator Glass dated February 6, 1932.

In the letter of February 6, Governor Harrison stated that he would withhold detailed comments on the bill pending the report thereon of Dr. Goldenweiser and Dr. Burgess.

He did, however, discuss the provisions as to open market operations and some others, and strongly attacked the increased power given to the Federal Reserve Board, referring to it as a politically appointed body.

He stressed the necessity for autonomy in the Federal reserve banks and made three suggestions as to the amendments to the Federal Reserve Act.

These suggestions were:

1. To reduce the number of directors of each bank so as to concentrate responsibility and to encourage supervision and management *through the experienced directors*. (Italics mine).

2. A grant of power for removal of incompetent bank officers.

3. Restriction upon borrowing by bank officers except with approval of a committee of directors.

The first suggestion will be taken up later.

As to the second suggestion, it will suffice now to state that in the memorandum, Governor Harrison states that this should not be done at the present time.

II.

In the letter of April 7, 1932, accompanying the memorandum, Governor Harrison admits "certain past defects, and the need for provision for possible future abuses," but in another part of the letter states that "there do not appear to be any parts of the Glass bill for which there is an imperative need for immediate passage."

The only exceptions made to this sweeping condemnation are the Federal Liquidating Corporation and the branch banking provision; the former, he states, might be helpful and the latter he states would be helpful.

He reaffirms the position taken by the Federal Reserve Bank in 1929 that only the discount rate and open market operations can effectively regulate the price and total volume of credit.

He severely criticises the attempt of the Federal Reserve Board to control through direct action the loan or investment policies of individual banks.

He admits, however, that direct action has its uses in dealing with individual banks using more than their share of Federal reserve credit, but he asserts that it is neither an effective nor suitable method for general control of credit or the uses to which credit may be put, involving as it does an assumption of responsibility for the management of individual banks which could not be effectively fulfilled.

I shall not undertake in this connection to go over the arguments for or against direct pressure. It will be sufficient to point out that the Federal Reserve Bank of New York, in 1929, wished to increase discount rates to prevent a runaway market which it believed was imminent; that the Board refused to increase the discount rate but kept in the 5% rate, exercising direct pressure upon the member banks to control their speculative loans, thus taking back part of the Federal reserve credit which had seeped into speculative markets; that the runaway market feared by the Federal Reserve Bank did not eventuate; that on the contrary, during the period of direct pressure, - from early in February to early in June, 1929, - the total bills and security holdings of the Federal Reserve Bank of New York steadily declined, while its reserve ratio steadily increased; that for the whole System, Federal reserve credit declined 193 millions during this period; that the large gold imports were kept by this direct pressure from swelling the member bank reserves and were used to take down acceptances, thus avoiding a tremendous further expansion of member bank credit; that member bank reserves in fact declined 68 millions during this period.

The fact is that direct pressure under the 5% rate was so successful that about the first of June, 1929, the Federal Reserve Bank informed the Federal Reserve Board that there was shortly to be expected a commercial need for expansion of Federal reserve credit; that the member banks were afraid to increase their borrowings, and that an easing policy would soon be essential.

Governor Harrison, in his letter, criticises Section 3 of the Glass bill, as amended by the Federal Reserve Board, perhaps more severely than any other Section of the bill. He absolutely opposes the grant of power in this Section to close the discount window to banks abusing the discount privileges and to suspend such banks from further use of Federal reserve facilities.

He also objects to the duty imposed by this Section on Federal reserve banks to keep themselves informed as to the loan and investment policies of the member banks, (the imposition of which duty it may be parenthetically stated was strongly recommended by the Federal Advisory Council in February, 1931.)

He states that the powers granted and the duties imposed by this Section would be ineffective, would involve responsibilities which neither the Federal reserve bank nor the Federal Reserve Board could fulfill, and that the assumption of such powers would be harmful to the member banks and to the Federal Reserve System as a whole.

In this connection, I would point out that both Governor Harrison and Mr. Owen D. Young, who signed the memorandum stating the above objections, took a very different view of the matter in their testimony before the Sub-committee of the Senate.

On January 20, 1931, Governor Harrison suggested to the Sub-committee that power should be given to the Federal reserve banks, or the Federal Reserve Board, to suspend a member bank from any or all of the privileges of membership, during a given period, in the event that the bank has not conducted itself in the safest way for the depositors. (Testimony, p. 46).

On February 4, 1931, Mr. Owen D. Young stated to the Sub-committee that the Federal reserve bank should have the power to limit or refuse rediscount even of eligible paper, and to suspend other privileges of membership, if the banking practices of any particular bank were, in its judgment, unsound, and therefore subjected its depositors to unreasonable risk, either as to liquidity or security, with a right of appeal on the part of the member bank in case the Federal Reserve Bank exercised its power unfairly, and that if the unsound practices were persisted in, the Federal Reserve Board, on complaint of any Federal reserve bank, might expel the bank from membership. (Testimony, p. 356).

Both Governor Harrison and Mr. Young were asked by the Chairman of the Sub-committee whether under existing law the Federal reserve banks had not the right to refuse to discount eligible paper.

Governor Harrison replied that that had always been his opinion, and that he had so advised the Federal Reserve Board when he was its Counsel, but that this right had been denied. (Testimony, pps. 47, 48.)

Mr. Young told the Sub-committee that the directors had never been able to agree that the power was clearly enough expressed to warrant such action by the Board of Directors; that he believed the power now existed but that such an extraordinary power and the obligation to execute it, should be made clear. (Testimony, p. 363).

The Glass bill, as amended, makes explicit these grants of powers, and yet the memorandum, signed by both Governor Harrison and by Mr. Young, positively objects to such power as harmful both to the member banks and to the Federal Reserve System!

It is possible that the Federal reserve bank may claim that it desired this power only over individual banks borrowing more than other banks of their class. This, however, would be tantamount to saying that if any one bank loses its head in the way of speculative loans, they want power to correct it, but if all banks are infected with the speculative mania, they desire no power except their existing powers over the discount rates on commercial paper.

The power vested in the Federal Reserve Board by Section 3 of the Glass bill, would, of course, be exercised only on individual banks, but it is a power which could not be defeated by proof that not one but all banks are possessed by the speculative mania.

III.

Analysis of Memorandum.

The memorandum comments on each section of the bill in detail.

It opposes every section of the original bill except Section 16, relating to a larger capital for future national banks, which it states it prefers to the draft submitted by the Federal Reserve Board.

It approves in general the Federal Reserve Board's recommendations as to 22 sections of the original bill, but states that of these 22, 13 are not now necessary, and should be postponed for future consideration. Among these latter were:

Most of the recommendations as to affiliates, and especially the divorce of affiliates.

The 90-day clause for member bank collateral notes secured by eligible paper.

Supervision of holding companies.

Removal of officers and directors of member banks.

The memorandum opposes the following recommendations of the Board:

The power to suspend member banks for abuse of Federal reserve facilities.

The Board's bill covering new reserve provisions.

The separation of bank and affiliate stock.

The divorce of affiliates, "the desirability of which at any time is doubtful".

IV.

The Glass bill, with the amendments of the Federal Reserve Board, is designed to give some assurance to depositors and the public that the speculative excesses culminating in the crash of 1929 will not be repeated.

The speculative craze which swept over the country will take its place in history along with the tulip mania and the South Sea bubble.

The crash of 1929 was probably one of the worst in the world's history.

It represented a successful raid of the speculating public upon the banks of the country.

The banks were unable to stem this raid. On the contrary, they permitted it to increase by undue and excessive loans to their customers.

The final crash brought ruin to thousands and thousands of our people and was felt over the whole world.

The Glass bill offers a remedy by giving the Federal Reserve Board the right and duty to protect the public interest against any such future mania of speculation.

The Federal Reserve Bank of New York admits past defects and the need for some provision for future possible abuses. It suggests, as stated before, that the directors of each bank be reduced in numbers "so as to concentrate the responsibility and to encourage supervision and management through the experienced directors".

"Through the experienced directors"! To what directors does this refer?

At first blush it would seem to refer to the Federal reserve bank directors. Such a change, however, would disrupt the Federal Reserve System by removing all directors representing the public interest, as distinct from the member banks.

I assume, however, that the reference is to the directors of the member banks.

Coupled with this recommendation is a recommendation limiting borrowings by bank officers, and also giving power of removal of incompetent bank officers.

The memorandum, however, states that the latter suggestion should not be considered at the present time and, presumably, the same suggestion would apply to the other recommendations.

V.

To sum up:-

The Federal reserve bank admits abuses in the past, and admits the necessity for provision against possible future abuses, but it opposes the present bill, and in effect takes the position that practically no legislation is imperatively demanded at the present time.

The correspondence contains the statement that the business in the United States is more dependent upon the securities market (called in the correspondence the "capital market") than upon the banks, and that business recovery is dependent upon the proper functioning of the capital market. There may be an element of truth in this statement as regards what is popularly known as "Big Business", but it is certainly not true as to that large volume of business which is absolutely dependent upon short term credit extended by banks under the auspices of the Federal Reserve System.

It should not be forgotten that it was the secession of "Big Business" from the banks, and the issue of their own securities on specially favorable terms beginning in 1927, and later their action in pouring the funds thus obtained into the maelstrom of speculation, that was a major cause in the final collapse of 1929. Yet the attempt of the Glass bill to prevent a recurrence of these practices, is condemned as being injurious to the capital market, upon the prosperity of which the revival of business activity is stated to depend.

The conclusion irresistibly to be drawn from the correspondence and memorandum is that the need for changes in the Federal Reserve System must yield and give precedence to the needs of the capital market, and that any changes in the Federal Reserve System which might affect the capital market would be most unfortunate.

The Glass bill as amended by the Board by placing restraint upon future mad speculation, will ultimately place the securities market upon a much sounder foundation than exists today, and the argument that legislation bringing about this ultimate result should be postponed, seems to be not sound. It is a customary objection to all remedial legislation that it should be postponed, and the time will never come when all will agree that the task should be then undertaken.

The Federal Reserve Bank, as before stated, denies that there is a necessity for legislation on any subject in the Glass bill, except possibly the Liquidating Corporation and branch banks. It takes the position squarely that when legislation is enacted, it should give the Federal reserve banks more complete autonomy, free from all but very general supervision by the Federal Reserve Board, but it makes clear that if given this autonomy, it will use it in meeting another speculative mania solely by the exercise of the discount rate and open market operations, and that too even though all of the member banks are feeding the fire of unbridled speculation by undue and excessive loans to their customers on stock exchange collateral.

I venture to express the view that the public demands something more than this, and that if such a wave of speculation should sweep over the country again, it will find the Federal Reserve Board charged with such power that its future warnings in the public interest will be received with respect and carried out with promptness.
