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REPRESENTATIVES OF THE FEDERAL RESERVE BANKS
UPON THE FEDERAL OPEN MARKET COMMITTEE

The Board of Governors of the Federal Reserve System has been asked by certain officers and directors of Federal Reserve banks for an informal expression of its views as to whether under section 12A of the Federal Reserve Act (providing that the Federal Open Market Committee "shall consist of the members of the Board of Governors of the Federal Reserve System and five representatives of the Federal Reserve banks, to be selected as hereinafter provided") representatives of the Federal Reserve banks may be selected outside of the executive personnel of the Federal Reserve banks to serve on the Open Market Committee.

A comprehensive review of the historical development of the Committee and of all available sources reflecting the legislative intent when the section was enacted and the purposes sought to be achieved clearly demonstrates that selection of representatives by the Federal Reserve banks from the ranks of banking, industry or commerce would constitute a flagrant violation of what Congress intended.

Realization of the importance and effect of open-market operations upon the national credit structure resulted in a gradual development of methods of control or coordination of activities culminating in the "Open Market Committee" created by section 12A of the Federal Reserve Act as revised effective March 1, 1936. This development is best reflected by a chronological listing of the various committees and bodies created for such purpose as follows:

1. "Committee of Governors on Centralized Execution of Purchases and Sales of Government Securities" - This committee was composed of five governors of Federal Reserve banks and functioned from May 1922 to April 7, 1923.

2. "Open Market Investment Committee" - This committee was created on April 7, 1923 as a result of resolution passed by the Federal Reserve Board on March 22, 1923 from which time open-market operations were not engaged in by the Federal Reserve banks except with the approval of the Federal Reserve Board. It was composed of five governors of Federal Reserve banks and functioned until March 31, 1930.

3. "Open Market Policy Conference" - This committee was created as the result of conferences by

representatives of the 12 Federal Reserve banks with the Board for the purpose of recommending policies and plans regarding open-market operations. It was composed of the twelve governors of the Federal Reserve banks and functioned until the passage of the Banking Act of 1933.

4. "Federal Open Market Committee" - This committee was created on June 16, 1933, by the Banking Act of 1933 and was composed of the twelve governors of the Federal Reserve banks.

5. "Federal Open Market Committee" - As provided in section 12A of the Federal Reserve Act as now in force, creating a committee consisting of "The Board of Governors of the Federal Reserve System and five representatives of the Federal Reserve banks".

At no time throughout the history of the Federal Reserve System have open-market operations been conducted by other than executive officials of the Federal Reserve banks, their actions being subject to approval of the Federal Reserve Board, all such executives as well as Board members being full-time officials who were required by established practice or by law to discontinue all active participation in outside business.

The issue as to whether representatives of private enterprise should serve upon a public body created for the purpose of discharging such responsibilities in the public interest seems to have been met and settled in the original enactment of the Federal Reserve Act when banker representation was forcefully argued and as forcefully denied both by Congress and by the President.

Senator Glass, in his authoritative book on the Federal Reserve System, entitled "An Adventure in Constructive Finance", described how a committee of bankers visited President Wilson and sought to persuade him to agree to banker representation on the Federal Reserve Board. Senator Glass wrote:

"When they had ended their arguments Mr. Wilson, turning more particularly to Forgan and Wade, said quietly: 'Will one of you gentlemen tell me in what civilized country of the earth there are important government boards of control

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"on which private interests are represented?' There was 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?' There could be no convincing reply to either question, so the discussion turned to other points of the currency bill; and, notwithstanding a desperate effort was made in the Senate to give the banks minority representation on the reserve board, the proposition did not prevail."

At the time of revision of Section 12A by the Banking Act of 1935, the issue was whether the primary initiative and responsibility for open-market operations should be fixed exclusively in the Board of Governors of the Federal Reserve System as then being set up, or left in a committee consisting exclusively of the then Governors of the Federal Reserve Banks, or committed to a combination of both, and at no stage in the development of the legislation was it contemplated by any of those actively interested therein, irrespective of differing viewpoints, that the responsibility should be shifted to or shared with those outside of the official executives of the banks and members of the Board.

The bill, as introduced and passed in the House (H.R. 7617), definitely fixed such responsibility in the Federal Reserve Board. In Congressman Steagall's report upon the bill the following was stated:

"Under the present law, open-market policies are formulated by the Federal Open Market Committee, which consists of the governors of the 12 Federal Reserve banks."

After explaining that the proposed bill would place the primary responsibility in the Board, his report continued:

"The participation of Federal Reserve banks governors in the deliberations leading to the adoption of open-market policies will be preserved. Open market operations may be initiated either by the committee of the governors or by the Board, but the ultimate responsibility for making a final decision and the power for adopting and carrying out national policies will be concentrated in a national body, as they properly should be in the public interest."

The bill was amended in the Senate to provide for the creation of a "Federal Open Market Committee" consisting of the members of the Board of Governors of the Federal Reserve System and five representatives of the Federal Reserve banks to be selected annually, but throughout the discussion it is evident that although the word "representatives" was used in place of "Presidents", to which the titles of "Governors" were changed by the Senate Committee, there was no intention of altering the original meaning and purpose to confine representation to members of the Board and executives of the banks.

During the consideration of the Banking Act of 1935 by the Banking and Currency Committees in both the House and the Senate, many distinguished bankers appeared before one or both of the Committees and expressed a unanimity of opinion that Governors of the Federal Reserve banks should be members of the Open Market Committee. The very fact that they so testified is indicative of the fact that the issue at stake in the pending legislation was whether or not responsibility for this important function should be vested in the Governors of the Federal Reserve banks or in the Federal Reserve Board. It appears that these witnesses never had in mind a selection of representatives of Federal Reserve banks from other than Governors or other executive officers of the Federal Reserve banks.

The recommendation of the special committee of the American Bankers Association was "that the Open Market Committee shall consist of the entire Federal Reserve Board, (reduced to five members), and four Governors of the Federal Reserve banks, selected by the Governors of the twelve Federal Reserve banks annually."

The recommendation of the Federal Advisory Council was that "The Federal Open Market Committee shall consist of the five members of the Federal Reserve Board (reduced in membership) and four Governors of the Federal Reserve banks."

The Commission on Banking Law and Practice of the Association of Reserve City Bankers in its "Summary of Arguments on Title II of the Banking Act of 1935" clearly recognized that the only point of difference was in whether the power to determine the open market policy of the Federal Reserve System was to be in the Federal Reserve Board or in a committee, as then constituted, of Governors of the Federal Reserve banks.

The Committee on Banking Legislation of the Chamber of Commerce of the United States, in an analysis and report filed with the sub-committee of the Senate Committee on Banking and Currency, recommended "that open market policies should continue, as at present, to be formulated by a committee representing the twelve Federal

Reserve banks." The Committee as then constituted was composed of the twelve Governors of the Federal Reserve banks.

The legislative policy with respect to outside domination or influence in the administration of the Federal Reserve Act is illustrated by section 10 of the Act, wherein it is provided that the members of the Board shall devote their entire time to its business and that "No member of the Board of Governors of the Federal Reserve System shall be an officer or director of any bank, banking institution, trust company, or Federal Reserve bank or hold stock in any bank, banking institution, or trust company." It is hardly conceivable that Congress, in setting up an administrative body to control and supervise credit, should zealously strive to insure that body's immunity from outside banking influence and then assign an important power over credit to a committee, five of whose 12 members could retain their private connections with outside business or banking.

It is self-evident that in order to render efficient service on the Open Market Committee a member must be in constant touch with the operations of the Reserve banks and have a continuing knowledge of the condition of the member banks, of the trends in loans and deposits, of the fluctuations in interest rates and of the money market and credit situation generally. Regardless of his ability, an outsider, engrossed as he would be most of the time in his own affairs, could not establish and maintain that interest and knowledge necessary to discharge properly his duties as a member of the Committee. Inevitably his attitude would not in the very nature of the case be truly representative of the Federal Reserve banks. It is only human nature that a person engaged in an enterprise for profit would be primarily concerned with the administration of that enterprise. Frequently, it might become the duty of such member to move in the direction opposite from that which would be advantageous to his private interests. Whether or not members finding themselves in that position could subordinate their private interests to the general public interest which the Open Market Committee is intended to subserve, it would be unfair to place any member of that Committee in the embarrassing position of being required to make such choices. Such a relation to the System would tend seriously to impair the efficiency and prestige of the directors and officers of the Reserve banks and produce at times confusion and embarrassment.

Members of the Committee are in a sense the trustees of the credit policy of the nation and, like trustees, they should not be in the attitude of purchasing from or selling to themselves. Such trustees must be scrupulous to place themselves beyond reproach and above suspicion. The prestige, and indeed the preservation of the Federal Reserve System, depend upon it.