The stalemate within the System continued, with only minor variations, throughout the next year. Harrison was pressed on the one side by his officers and directors—though less consistently by the directors than in the preceding year—to work for greater easing and larger purchases. On the other side, he felt strongly his responsibilities, as chairman of the Open Market Policy Conference, to carry out loyally the policy adopted by the Conference. The one major difference in the situation was the replacement of Roy Young by Eugene Meyer as governor of the Federal Reserve Board. Young became governor of the Boston Bank in September 1930 and, as such, was a member of the executive committee of the Conference, where he joined McDougal in consistently opposing purchases and favoring sales.[104] Meyer was generally favorable toward purchases and, not having gone through Harrison's frustrating experience of 1930, inclined to press strongly for them.

The January 1931 meeting of the Open Market Policy Conference brought out clearly the changes in the situation. From October to mid-December 1930, there had been virtually no change in the System's holdings of government securities. The banking difficulties in New York following the failure of the Bank of United States in the second week of December necessitated purchase of $45 million of government securities by the New York Reserve Bank for its own account. They were bought from two banks undergoing heavy withdrawals of currency in order to enable them to avoid borrowing. In addition, $80 million of government securities were purchased for System account, as Harrison explained, "in order to avoid too great tightening of credit due to an unusual amount of 'window dressing'." The purchases were made in accordance with the authorization by the Conference meeting on September 25, 1930, as a compromise between the advocates of "anticipation" and "correction," of purchases up to $100 million for seasonal ease.[105] At its January 1931

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the deliberations of the period, e.g., Harrison, Miscellaneous, Vol. I, letter, dated Mar. 17, 1930, J. H. Case (chairman of the New York Bank) to Governor Young; Notes, Vol. I, Apr. 24, 1930; Miscellaneous, Vol. I, letter, dated Apr. 29, Harrison to Platt; *ibid.*, letter, dated July 10, 1930, J. B. McDougal to Harrison.

[104] According to Hamlin, Young was eased out of his position on the Board because of the administration's disappointment with his leadership. If so, the result could hardly have been the one intended. As governor of the Boston Bank and a member of the executive committee of the Conference, he may well have been in a position to exercise a stronger influence on open market operations, the key area in which policy had been and continued to be unsatisfactory, than he could have exercised as governor of the Federal Reserve Board (see Hamlin, Diary, Vol. 18, Sept. 4, 6, 24; Oct. 3, 10; Nov. 24, 1930, pp. 67, 70, 84, 89, 91–93, 118–119).

[105] See Harrison, Open Market, Vol. I, minutes of meeting, Jan. 21, 1931, in which Harrison reviewed changes in the money market since the Sept. 25, 1930, meeting. See also a memorandum, prepared for Harrison by W. R. Burgess, dated Dec. 19, 1930, referring to the absence of change in the System account between Sept. 25, 1930, and the date of the memorandum. The purchases by New York up

meeting, the Open Market Policy Conference recommended that "it would be desirable to dispose of some of the System holdings of government securities as and when opportunity affords itself to do this without disturbance or any tightening of the money position."[106] When the members of the Reserve Board met subsequently with the governors, both Adolph Miller and Eugene Meyer objected. Harrison, in his capacity as chairman of the Conference, defended the recommendation on the ground that it "represented a compromise since some of those present were in favor of considerable sales of securities, while others were only in favor of such moderate sales as might be necessary to take up the slack." Meyer, sensitive to political repercussions, stated that

> a reduction of bills and discounts of the System did not involve the launching of any major policy, whereas the sale of governments is commonly interpreted as a major move in Federal reserve policy. The Reserve System has been accused in a number of quarters of pursuing a deflationary policy in the past year, and a sale of government securities at this time is likely to draw fire. In this situation it would appear most desirable to avoid a move which appears to present a major change in policy when there is no necessity for doing it.

Despite Meyer's reservations, the Board approved the Conference's recommendation and, by February 1931, security holdings had fallen by $130 million, although there was concern about the associated tightening of the bond market.[107]

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to that date were only $40 million from one large bank. The purchases for System account after Dec. 20 were made by New York at its own discretion, the executive committee at a meeting on that day in Washington with Governor Meyer and several Board members having agreed "to leave it to the judgment of the Federal Reserve Bank of New York whether some additional amount of government securities should be purchased within the $100,000,000 authority with the understanding that the New York bank would keep in close communication with the members of the committee" (*ibid.*, minutes of executive committee meeting, Dec. 20, 1930).

[106] The original resolution as passed had the word "undue" (later deleted) before "tightening."

[107] Harrison, Open Market, Vol. II, minutes of meeting, Jan. 21, 1931, and letter, dated Jan. 29, 1931, McClelland (for Board) to Harrison, approving the recommendation; Notes, Vol. I, Jan. 15, 19, 22, 1931.

A memorandum on the Open Market Policy Conference meeting of Jan. 21, 1931, written by E. A. Goldenweiser, the Federal Reserve System's director of research, stated:

> Meyer strongly opposes sales of securities beyond the amount bought in December for seasonal and special purposes . . . . The rest of the governors did not change their minds, but were impressed by Meyer's sincerity and force. It appears to have been his first bout with the intrenched hard-money crowd of the Federal reserve system.

The memorandum is part of the Goldenweiser Papers in the Manuscript Division of the Library of Congress (Container 1, folder of Confidential Memoranda,

In April 1931, Harrison, as chairman of the Open Market Policy Conference, presented a report to the Governors Conference. He expressed great concern about the gold inflow and the dangers to the world of continued gold sterilization by the United States.[108] As to the domestic situation, he noted:

> While it is commonly stated that money conditions have been exceedingly easy in recent months, and while indeed money rates have been at very low levels there has not been over a period of months any consistent surplus of Federal reserve funds pressing for use upon the market . . . . Furthermore, apart from the relatively easy position of the banks in the larger cities, credit cannot be said to be very cheap or very plentiful generally throughout the country.[109]

Harrison's report was discussed at the Open Market Policy Conference, which approved, at his urging, a three-part program to make gold imports more effective and credit more active: maintenance of the bill portfolio, if possible; reduction of buying rates on bills and, less definitely, of discount rates; and—as a last resort, if bills purchased did not enable earning assets to be maintained—authority for the executive committee to purchase up to $100 million of government securities. The resolution including the final part of this mild program—the only part within the Conference's exclusive jurisdiction—was adopted with four reluctant supporters, three of the four, members of the executive committee.[110]

No purchases were made under that recommendation until after a June 22 meeting of the executive committee, at which Harrison urged purchases of $50 million. Meyer, who was present at the meeting, strongly supported Harrison, saying that "the Federal Reserve Board would . . . have some preference for a larger program of purchases . . . ." The authorization was granted with only one negative vote (Young of Boston), because Norris of Philadelphia abstained and McDougal of Chicago voted against his convictions out of deference to President Hoover's proposal, announced two days earlier, of a moratorium on intergovernmental debts ("purchases of governments would be received by the public as supporting the President's announcement"). On July 9, the executive

1922–33). Of the seven cardboard letter files (described as containers in the Division's records), only six are open to readers; the seventh may be opened before 1965 only upon written permission from Mrs. Goldenweiser. Only a small fraction of the open collection contains current analyses of Federal Reserve policy in 1919–45, the period of Goldenweiser's service with the Board. The Goldenweiser Papers are meager in coverage compared to the Harrison Papers and provide a far less comprehensive view from within the Federal Reserve System than the Hamlin Diary does. Consequently, we have made only minor use of them.

[108] See quotation from his report in sect. 4, above.

[109] Open Market, Vol. II, Apr. 27, 1931.

[110] Norris of Philadelphia, Young of Boston, and McDougal of Chicago. The fourth was Calkins of San Francisco (*ibid.*, minutes of meeting, Apr. 29, 1931).

committee agreed to a further purchase of $50 million to complete the $100 million authorized in April, but buying was stopped on July 16 at only $30 million because of Harrison's concern over foreign developments and despite the remonstrances of Meyer.[111]

By early August, Harrison and Meyer again pressed for purchases. In discussing the situation with the executive committee of directors of the New York Bank, Meyer presented figures showing that between November 1, 1930, and August 5, 1931, there had been "a total increase of $421,000,000 in the gold stock of the United States; that currency circulation had increased $350,000,000 instead of showing a normal seasonal decline of at least $100,000,000; and that the Bank of France had withdrawn about $125,000,000 from the market" (presumably the acceptance market). He then pointed out that "while there had been no intentional contraction of the base on which credit could be extended, the sterilization of an amount larger than the gain of gold had been passively permitted." He said that, "if we had been asked last November whether we would favor, or even permit, the sterilization of $400,000,000 of gold, undoubtedly we would have answered in the negative."[112]

When a majority of the executive committee of the Open Market Policy Conference proved to be unwilling to support further purchases, a meeting of the full Conference was called for August 11. Harrison proposed a program, to be put into effect when desirable, authorizing the executive committee to buy up to $300 million of government securities. Other governors, except Black of Atlanta who joined Harrison in favor of it, were entirely negative in their reaction, and the Conference voted instead an authorization for the executive committee to buy or sell $120 million.[113]

So far as we can discover, that was the first Conference meeting at which there was explicit reference to a problem later to be cited as a major reason for the Reserve System's failure to make any extensive security purchases—the problem of free gold. However, the free gold problem, to be discussed in the next section, played no role in the outcome.

When the Conference met the same day with members of the Board, Harrison was again in the position of having to present and defend a recommendation he did not favor. He explained that the Conference opposed immediate purchases of large amounts of government securities, because banks would not employ excess reserves. The banks' reason:

[111] Harrison, Open Market, Vol. II, minutes of executive meeting, June 22, 1931; Miscellaneous, Vol. I, letter, dated July 9, 1931, Harrison to Seay; Notes, Vol. I, July 16, 23, 1931.

[112] Notes, Vol. II, Aug. 10, 1931.

[113] Open Market, Vol. II, minutes of executive committee meeting, Aug. 4, 1931; minutes of meeting, Aug. 11, 1931. The $120 million included the usual $100 million plus the $20 million authorized in April but not used.

"most prime investments are selling on a very low yield basis, while secondary bonds consist largely of railroad issues, of which a considerable proportion may in a short time become ineligible for investment by savings banks, insurance companies, and trust funds, due to the provisions of various state laws. In addition the bond market has been uncertain because of pressure on the market, due to forced liquidation of bond portfolios of closed banks." Governor Meyer and other members of the Board expressed disappointment at the action taken by the Conference, "in that it limited possible purchases to an ineffective amount." However, the only consequence of their disappointment was a change in the timing of the Board's session with the Conference. Thereafter, the two bodies discussed policy actions before rather than after the Conference adopted its recommendation. Later, when the Board formally considered the recommendation, it did not approve it outright but delegated to Governor Meyer the authority to approve purchases but not sales.[114] In the event, not even the $120 million authorization was carried out.

BRITAIN'S DEPARTURE FROM GOLD, SEPTEMBER 1931

Britain's departure from gold and the resulting gold outflow from the United States changed the focus of policy-making from the Open Market Policy Conference back to the New York Bank. New York had always had, and continued to have, primary responsibility for international monetary relations. The Bank of England, the Bank of France, and other central banks had always treated the New York Bank as their counterpart and had conducted negotiations and consultations with it. The Board had been kept informed, consulted in the process, and its approval obtained

[114] Harrison, Open Market, Vol. II, minutes of meetings, Aug. 11, Nov. 30, 1931; and letter, dated Aug. 18, 1931, Meyer to Harrison.

Though Harrison was in agreement with Meyer on the substance of the policy issue, he was disturbed by the Board's response to the Conference recommendation, and complained to Meyer that it was contrary to the rules adopted when the Conference was established. To his own board of directors, Harrison stated:

> . . . the whole situation emphasized the inherent difficulties of existing open market procedure. Direction of system policies by a conference of twelve men who must also consult the Federal Reserve Board means . . . . that . . . we run a real risk of having no policy at all. Some of the Federal reserve bank governors . . . attended the Conference with preconceived ideas which would not admit of argument, and others in spite of, or perhaps because of, the fact that their banks would not be able to participate in further purchases of government securities, looked at the whole question from the narrow standpoint of their individual position (Notes, Vol. II, Aug. 20, 1931).

Commenting on the results of that meeting of the Conference, Governor Meyer said, according to Hamlin, that "Governor Harrison could present a matter very gracefully, but could not sell it; that if the Board had taken part in the conference, he believed the Governors would have followed the Board and the New York bank" (Hamlin, Diary, Vol. 19, Aug. 11, 1931, p. 129). He may have been right on this occasion, but later experience suggests that he was unduly sanguine.

before final action, but it had never had a major voice in forming policy. The other Reserve Banks had for the most part simply been kept informed. That had been the practice while Strong was alive and had remained the practice. The most recent instance during the contraction had been the negotiations in the summer of 1931 in connection with loans to foreign banks.

New York had little doubt about what action to take. At its October 8 meeting, the board of directors voted to raise the discount rate from 1½ to 2½ per cent. The arguments given at the meeting were, first, the gold outflow itself, and second, "advices from France, where foreign fears concerning the dollar appear to have concentrated, which indicated that an increase in the rate would be interpreted there more favorably than otherwise." Some fear was expressed that the rise in rates might have adverse domestic effects, particularly by interfering with Hoover's efforts to organize a National Credit Corporation, but that fear was belittled. Harrison noted that any unfavorable effect on the bond market could be offset by security purchases, since the executive committee of the Open Market Policy Conference still had authority, under the recommendation of the August 11 meeting, to buy up to $120 million of government securities.[115] The only discordant note was a cablegram from Burgess, who was in Europe on a mission for the Bank, recommending no action that would bring about higher money rates in the United States.[116] The cablegram was read at the meeting, then disregarded. The Reserve Board promptly approved the rise in discount rates, several of its members having been strongly in favor of a rise ever since the beginning of the gold drain.[117]

A week later, Eugene Meyer attended the directors' meeting at the New York Bank. Harrison proposed a further increase in the discount rate to 3½ per cent, giving as the technical reason the continued gold outflow. One director, Charles E. Mitchell, expressed serious doubts about the domestic effects. Meyer replied that "an advance in the rate was called

[115] However, three days earlier, at a meeting of the executive committee of the board of directors, Harrison said that "he considered the gold position of the System paramount at this time and on that account would not be inclined to purchase Government securities" (Harrison, Notes, Vol. II, Oct. 5, 1931).

[116] Burgess had arrived in Europe on Oct. 9 to attend a regular monthly meeting at Basle of the Bank for International Settlements. It was the first time a Federal Reserve official had formally participated in discussions of European central bankers at the world bank. The New York Bank was not a member, because it had been forbidden by the State Department to subscribe to shares of the BIS when the latter was formed in 1930. However, there were unofficial ties between the two institutions, strengthened by the fact that Gates W. McGarrah, president of the BIS, had formerly been chairman of the New York Bank.

[117] Hamlin and Miller, at least, strongly favored an increase in discount rates and considered a possible effect on the bond market as no valid reason for delay (Hamlin, Diary, Vol. 19, Oct. 1, 1931, p. 148).

for by every known rule, and that . . . foreigners would regard it as a lack of courage if the rate were not advanced." He expressed the opinion that "the bond market was already adjusted to a higher level of interest rates, and therefore it would be but little affected."[118] A month later, Owen D. Young pressed the desirability of purchasing government securities to offset unfavorable domestic effects. Harrison was exceedingly hesitant to accede.[119]

The sharp rises in discount rates were widely supported not only within the System but also outside.[120] The maintenance of the gold standard was accepted as an objective in support of which men of a broad range of views were ready to rally. The drain of gold was a dramatic event for which there were many precedents.[121] Thus both the problem and its solution seemed clear and straightforward. Indeed, one gets the impression that after grappling with unfamiliar, elusive, and subtle problems, the System greeted with almost a sense of relief the emergence of a problem that could be put in black-and-white terms.

Less than two weeks after the second rise in discount rates, the executive committee of the Open Market Policy Conference met. The preliminary memorandum for the meeting outlined the drastic change that had occurred in currency in circulation, pointed out that internal developments had been more important than the gold outflows in their effects on domestic business, and noted that the decline in deposits "constitutes by far the most rapid shrinkage in member bank deposits during the life of the System." Nevertheless, McDougal continued to recommend that the System should reduce its security holdings, although—in addition to the unprecedented pressure on commercial banks at the time—it was the beginning of the season when the System typically expanded its security holdings. The final outcome was a vote against sales but in favor of requesting the Federal Reserve Board to give the committee the same leeway for sales that the Board had given it for purchases under the Conference recommendation of August 11.[122]

[118] Harrison, Notes, Vol. II, Oct. 15, 1931.
[119] *Ibid.*, Nov. 25, 1931.
[120] "We think the really constructive event of the week has been . . . the action of the New York Federal Reserve Bank in raising its rediscount rate . . . . This step should have been taken long ago, and, indeed, it was a sad error of judgment to put such a fantastically low rate as that at New York in force. . ." (*Commercial and Financial Chronicle*, Oct. 10, 1931, p. 2305). ". . . [T]he Federal Reserve Bank of New York has been driven into making another advance of a full 1% in its rediscount rate . . . , a decidedly wise move. . . " (*ibid.*, Oct. 17, 1931, p. 3460). The New York *Times* reported that the rise was "welcomed by almost all bankers" (Oct. 11, 1931); that the rise was "hailed with enthusiasm in banking circles" (Oct. 16, 1931).
[121] See, however, further discussion in sect. 6, below.
[122] Harrison, Open Market, Vol. II, memorandum and minutes of executive committee meeting, Oct. 26, 1931. In the course of the meeting, Harrison noted that "the free gold position . . . was not a consideration at this time. . . ."

The preliminary memorandum for a meeting of the full Conference at the end of November noted with satisfaction that the "foreign and domestic drains upon bank reserves were met in the classic way by increases in discount rates combined with a policy of free lending." It recorded that "one result" of the rise in discount rates and the associated rise in other market rates "was certainly to make bankers and others more timid and reluctant in contemplating new uses of funds or new enterprises." It stressed the sharp decline in bond prices and the resulting worsening of the position of the banks. It discussed the year-end seasonal problem, suggesting that purchases "similar to those made last year" should be provided for, and proposed deferring the longer-term policy decisions until after the first of the year. The Conference adopted a resolution giving the executive committee authority to purchase up to $200 million of governments for seasonal needs.[123] Only part of that authority was in fact exercised. Government security holdings were raised by $75 million to the end of December 1931 and then lowered by $50 million in January 1932.

During those months, it is not clear that Harrison was as unhappy with the policy followed as he had been before and was to be again. His concern about gold inhibited his desire to expand Federal Reserve credit. New York still had control over the buying rate on bills, subject only to the approval of the Board. As we have seen, New York had repeatedly tried to use bill purchases to enable it to accomplish on its own what it could not accomplish through the System open market account. Yet the bill buying rate, which had been raised from 1¼ per cent to 3⅛ per cent in October along with the discount rate, was reduced only slowly and moderately, to 3 per cent on November 20, and to 2¾ per cent on January 12, 1932. Both reductions left the rate above the market rate and therefore did not lead to an increase in bill holdings.

Early in January 1932, partly under pressure from his staff and directors, Harrison resumed his advocacy of a program of further substantial purchases as part of a broader national program which he outlined to the meeting of the Open Market Policy Conference that month. The main features of the program were: passage of an act establishing the Reconstruction Finance Corporation, then under consideration by Congress; organized support of the bond market, predicated on an agreement between the railroads and the unions to cut wage rates; cooperation of Federal Reserve Banks and member banks with the Treasury in its financing program; purchase of bills by the Reserve System when possible; reductions in discount rates; and, as a final step, "buying of Governments, if necessary, facilitated by an alleviation of the free gold position," the

[123] Governor McDougal asked assurance at the meeting that no purchases would be made immediately. Governors Norris and Fancher said "they were not disposed to approve of the purchase of government securities solely for the purpose of enabling the New York and Chicago banks to keep out of debt at the end of the year" (*ibid.*, memorandum and minutes of meeting, Nov. 30, 1931).

final phrase being a reference to proposals then under consideration which were finally embodied in the Glass-Steagall Act. The Conference authorized the executive committee to purchase up to $200 million, "if necessary," over three negative votes.[124] That authorization was not exercised at all. Between the January 11 and February 24, 1932, meetings of the Conference, government security holdings declined by $11 million, bill holdings by $80 million, while discounts rose $20 million. Federal Reserve credit outstanding fell by $100 million over the six-week period.

The February meeting of the Open Market Policy Conference was largely a repetition of the January meeting, although the pending passage of the Glass-Steagall Act removed the problem of free gold. At the joint meeting with the Board preceding the formal business session, Meyer, who continued as governor of the Board though he had by then been named chairman of the RFC as well, asserted that "it seemed unnecessary for the banking position to be subjected to severe strain because of the funds withdrawn for hoarding." Miller stated that "he believed there was never a safer time to operate boldly than at present." He indicated that "he would approve purchases on an even larger scale than the amounts being discussed." McDougal continued to argue that "on general principles he preferred to see the banks borrowing to secure funds." The upshot was a mild expansion in the authority of the executive committee. It was authorized to buy up to $250 million at the approximate rate of $25 million a week, McDougal and Young voting in the negative. Immediately after the general meeting, the executive committee voted 3 to 2 to start the program.[125]

OPEN MARKET PURCHASE PROGRAM OF 1932

That modest program would very likely never have been expanded into a major one, or perhaps even carried out, if it had not been for direct and indirect pressure from Congress. Harrison told the executive committee of his directors on April 4 that apparently "the only way to forestall some sort of radical financial legislation by Congress, is to go further and faster with our own program." When Harrison reported to a full meeting of his directors on April 7 that the executive committee of the Open Market Policy Conference was deeply divided about the wisdom of accelerating the purchase program, and had voted to continue the existing program, one of the directors asked "if a more vigorous program

[124] Harrison, Open Market, Vol. II, minutes of meeting, Jan. 11, 1932. McDougal of Chicago, Seay of Richmond, and Deputy Governor Day, representing Governor Calkins of San Francisco, were the three who voted in the negative. Neither Governor Young nor any other representative of the Boston Bank attended the meeting. The Kansas City Bank was represented by a director who was not present at the session when the resolution was adopted.

[125] *Ibid.*, minutes of meeting, Feb. 24, 1932.

on the part of the Federal Reserve System would not be helpful in defeating the Thomas bonus bill and other similar legislation. Governor Harrison said that Senator Thomas had indicated to him that he might be satisfied not to press for Congressional action if the System would proceed more vigorously." The Bank directors accordingly voted to have the Bank, subject to the approval of the Board, buy for its own account up to $50 million of government securities, outside the System account and before the meeting of the Conference, which was set for April 12.[126]

In opening the joint meeting of the Conference and the Reserve Board, preceding the business meeting of the Conference, Governor Meyer "called attention, merely as a matter of information, to the fact that a resolution had been offered in the Senate asking the Federal Reserve Board to state its program . . . . Consideration of this resolution had been postponed. He stated that the Reserve System could now undertake to do more toward aiding in the recovery than it had yet done, and that he believed the time had come when the System might be expected to use its powers more fully in an effort to stop the credit decline." Other members of the Board supported Meyer. Ogden L. Mills, since February 13, 1932, Secretary of the Treasury, who had all along been in favor of more extensive action, stated: "For a great central banking system to stand by with a 70% gold reserve without taking active steps in such a situation was almost inconceivable and almost unforgivable. The resources of the System should be put to work on a scale commensurate with the existing emergency."

After the Board left, the Conference voted 10 to 1 to approve a resolution offered by Harrison authorizing the executive committee to purchase up to $500 million of government securities in addition to the unexpired authority granted at the February 24 meeting. The purchases were to be made as rapidly as practicable and, if possible, to be no less than $100 million in the current statement week ending next day, April 13.[127] The

[126] Notes, Vol. II, Apr. 4, 7, 1932.

[127] The lone dissenter was Governor Young of the Boston Bank, who had said at the joint session with the Board that he

> questioned whether purchases of governments which piled up reserves in the centers would result in the distribution of these funds to other parts of the country. He was skeptical of getting the cooperation of the banks without which success appeared difficult, and was apprehensive that a program of this sort would develop the animosity of many bankers, and was apprehensive also that an extensive program of purchases of government securities would impair the confidence of the public in the Reserve banks. He cited the experience of 1931 as an indication of the futility of government purchases.

Governor McDougal of Chicago asked whether the Reserve System "could retain the confidence of the public after inaugurating a policy of this sort, which was in some measure inflationary, particularly since it involved the use of government securities as collateral for Federal reserve notes" (Harrison, Open Market, Vol. II, minutes of meeting, Apr. 12, 1932).

final proviso was inserted after Harrison had informed the Conference he was scheduled to testify the next day before a subcommittee of the House on a bill that in effect would have directed the Reserve System to purchase in the open market until wholesale prices had risen to their 1926 level. He said that "it would probably be necessary for him to make some reference to the program at that time."[128]

After the initial program was voted on April 12, the System bought $100 million of government securities per week for five weeks. At the May 17 meeting, the Conference again voted another $500 million open market purchase, McDougal joining Young in dissenting. At the suggestion of Meyer, the weekly rate of purchases after that meeting was reduced. Harrison deplored the reduction: "The temper of Congress is not improving, and the danger of unsound credit proposals is still great. It might, therefore, be unwise to give unnecessary substance to the argument now being used, that the Federal Reserve System intends soon to abandon its open market program." Yet in June, partly no doubt in the hope of conciliating McDougal and Young, he suggested to the executive committee of the Conference that the purchases each week be geared to the maintenance of member bank excess reserves at a figure somewhere between $250 and $300 million, the purchases to be as small as possible to preserve the desired level, but with some increase from week to week in the System's holdings, "to avoid the creation of a feeling that the policy of the system had been changed."[129]

By the end of June, as Burgess summarized the results of the program for the New York directors, total purchases of $1 billion had offset a loss of $500 million in gold and a reduction of $400 million in discounts and bills bought, leaving a net increase of $100 million in Federal Reserve credit outstanding. To Owen D. Young, this meant that "most of our efforts had, in reality, served to check a contraction of credit rather than to stimulate an expansion of credit. We have been clearing the way for action, rather than taking action. . . ." A week later, in discussing the pressure from Chicago and Boston to stop the program, he said,

> As it is, we are asked to stop when we are just half way through our program, when we are just at the point where further purchases of Government securities

[128] The hearings, which threatened to develop into a full-scale investigation of the System, were held by the House Subcommittee on Banking and Currency on H.R. 10517 (a bill to stabilize commodity prices, introduced by Rep. T. Alan Goldsborough). Governor Harrison testified that the Federal Reserve "began to really utilize the" Glass-Steagall Act only two days before he appeared before the committee (*Congressional Record,* House, June 8, 1932, p. 12354, remarks of Mr. Goldsborough). See also *Stabilization of Commodity Prices,* Hearings before the House Subcommittee on Banking and Currency, 72d Cong., 1st sess., part 2, pp. 477–478, 500–501.

[129] Harrison, Open Market, Vol. II, minutes of meetings, May 17 and June 16, 1932; Notes, Vol. II, May 26, 1932.

> will bring actual and affirmative pressure to bear upon the member banks . . . . To stop just when you have reached the place where you are able to put on the pressure the program was designed to produce, would be a ridiculous thing to do. We shall have no policy left if we do this.[130]

Chicago and Boston took those same facts as evidence in favor of their opposition to the program, as evidence that it had only substituted an undesirable form of credit for a desirable form. McDougal, reported Harrison, "does not see what the purchases have done anyway, and is in favor of stopping." Governor Young felt "that there are going to be a lot more banks closed, that there will be a large increase in borrowing at the Federal reserve banks and that, therefore, we are wasting our resources buying Government securities."[131]

Some officers of the New York Bank, notably Burgess, and some directors favored continuing the program, with the approval of the Board, even if that meant New York would have to proceed without Chicago and Boston. Since the Reserve Board was in favor of continuing the program, it doubtless would have approved. But Harrison was unwilling to follow that course. The gold reserve ratio of the New York Bank was only 50 per cent, of the System 58 per cent, of Chicago 75 per cent. Yet Chicago was reluctant to participate. His own feeling, Harrison said, "is that we should continue with our open market program, and perhaps step it up a bit, but on one condition—that the program be made a real System program and that the Federal Reserve Banks of Boston and Chicago, in particular, give it their affirmative support." When the comment was made that the Board had the legal power to require other Banks to rediscount for New York, if its ratio fell below 50 per cent, Harrison replied "that it would be most undesirable for us to go ahead in defiance of the wishes of the other Federal reserve banks and then to have those banks bale us out under compulsion. System policy and the system Open Market Policy Conference might just as well be thrown out the window under such circumstances."[132]

At that juncture, Harrison made a final effort to secure the cooperation of Boston and Chicago. He pleaded the case not only with the governors and directors of the two Banks but also with commercial bankers and businessmen in the two cities. Owen D. Young made a trip to Chicago to

[130] Notes, Vol. II, June 30, July 5, 1932.

[131] Office, Vol. III, July 5, 1932; Notes, Vol. II, June 30, 1932.

[132] Notes, Vol. II, June 30, July 5, 1932. Harrison was at first attracted by the proposal that the Reserve Board bring pressure on the other Banks to participate in the purchase program. The Board's authority to compel one Reserve Bank to rediscount paper for another Reserve Bank, it was suggested, would apply also to purchases of government securities, when the reserve position of several Banks was involved (*ibid.*, June 30, 1932). On reconsideration, he decided that the Board had no power to bring such pressure, and that, "furthermore, this bank would be the first to object to such action by the Board, in other circumstances" (*ibid.*, July 5, 1932; see also July 11, 1932).

attempt to persuade the directors of the Chicago Bank. But all to no avail.[133]

In an attempt to decide the issue, the full Open Market Policy Conference met on July 14. At the joint meeting with the Board, Governor Meyer suggested that "in determining future policy it was important to consider that the public effect of any discontinuance of the policy which had been pursued would be unfortunate, and also that in future policy every effort should be made to secure an effective united system policy." He pointed out that "there existed a trend in Congress toward giving the System more centralization, and that the open market program offered a test of the capacity of the System to function effectively in its present form."[134] The Conference voted that excess reserves should be maintained

[133] Notes, Vol. II, July 7, 14, 1932; Office, Vol. III, letter, dated July 8, 1932, Harrison to Owen D. Young.

[134] Harrison, Open Market, Vol. II. Meyer was referring to the series of bills introduced by Senator Glass (see footnote 29, above), the most recent on Mar. 17, 1932, predecessors of the Banking Act of 1933. The latest bill was the occasion for a bitter exchange of letters between Glass and Harrison. With the approval of the New York Bank's directors, Harrison wrote to Senator Peter Norbeck, chairman of the Senate Banking and Currency Committee, enclosing a letter he had sent Glass, Feb. 6, about an earlier draft of the bill, which read in part as follows:

> Many provisions of this bill are designed further to limit the autonomy of the individual Federal reserve banks and to concentrate more and more power in the Federal Reserve Board . . . . [T]he provisions of your bill relating to the open market committee which is given jurisdiction over operations in bills as well as government securities are so cumbersome as to be inimical to the best interest of Federal reserve operation . . . . The bill requires approval not only of the Federal Reserve Board but of a committee of 12 representatives of the several Federal reserve banks . . . . Under the proposed bill no operations in securities or bankers bills, even the day to day transactions, can be effected, even in cases of emergency, without approval of the committee . . . .
> To the extent that your bill further shifts power and authority from the Federal reserve banks to the Federal Reserve Board, to that extent, I believe it aims towards centralized operation and control through a politically constituted body in Washington.

On Apr. 9, Glass answered Harrison's letter to Norbeck, writing:

> In my considered view it constitutes a challenge to statutory authority and an unyielding antagonism to any restraining influence whatsoever.
> . . . you and your board have thus stated in unequivocal terms the misconception of the Federal Reserve banking act which so long has been reflected in the extraordinary policies pursued by the New York bank with respect to both domestic and foreign transactions.

The "extraordinary policies" referred to by Glass, who was an undeviating follower of the real bills doctrine, included the use of open market operations in government securities and the failure to restrict loans to real bills only. In his eyes, the failure was responsible for both the boom and the bust.

Harrison's reply of Apr. 13 concluded the exchange:

> The officers and directors of this bank have been just as desirous to do their part in checking the use of bank credit for excessive speculation as you or anyone

at approximately $200 million by purchases limited in total to the amount previously authorized by the Conference but not executed—$207 million. For the guidance of the executive committee, the Conference recommended purchases not to exceed $15 million a week—except in unusual or unforeseen circumstances—but not less than $5 million a week for the next four weeks. McDougal, Young, and Seay of Richmond voted against even this resolution.[135]

Freed from Congressional pressure—Congress adjourned on July 16—the Conference lapsed into its earlier pattern.[136] The program adopted was a minimum face-saving program, and was carried out at nearly the minimum level consistent with the letter of the recommendation. McDougal and Young refused to participate in further purchases. Harrison was unwilling to proceed on his own. As a consequence, in the four weeks after the Conference met, total purchases amounted to $30 million ($15 million the first week, then $5 million a week). From August 10 until the close of the year, the System's holdings remained almost precisely constant.

THE BANKING PANIC OF 1933

The preliminary memorandum for the January 4, 1933, meeting of the Open Market Policy Conference said of the existing situation, "that a good start was made toward recovery, that this movement has been interrupted, and is now hesitant and uncertain." At the meeting, both Governor Meyer and Secretary of the Treasury Mills stressed that any slackening in Federal Reserve open market policy might provide an excuse for the adoption of inflationary measures by Congress. Governor Harrison listed the Congressional situation as one of three reasons for holding the System portfolio of government securities intact; the second was that a reduction "might operate as a check to the bond market thus retarding business recovery and further injuring bond portfolios of banks;" the third

> else. From their practical experience in operating a bank in this money center, they feel that in the long run there is only one really effective method of bringing about this result, and that is the traditional method of the vigorous use of discount rate and open market operations . . . . The tragedy of the experience of 1928 and 1929 lay, in our opinion, in the failure of the Reserve System promptly and vigorously to use the instruments for credit control which decades of experience have proved to be powerful and effective (Miscellaneous, Vol. II).

[135] Open Market, Vol. II, minutes of meeting, July 14, 1932.

[136] To the executive committee of the New York Bank's board of directors Harrison reported on July 11, 1932, a discussion he had had with Meyer in which "Governor Meyer agreed as to desirability of going ahead with the System open market program saying that, if for no other reason, it is politically impossible for us to stop at this particular time. The program was begun at about the time the Goldsborough Bill was introduced in Congress and if it were terminated just as Congress adjourned we would be crucified next winter" (Notes, Vol. II, July 11, 1932).

was that larger excess reserves might lead to the elimination of interest on deposits in principal centers, thus distributing "the pressure for putting money to work more widely." Against those three reasons, Harrison listed three others in favor of some reduction of the portfolio: first, the "System open market policy had not been one to accumulate any definite amount of securities but rather to check deflation through the reduction of bank debt and the creation of substantial excess reserves, which had been accomplished;" second, any further substantial increase in excess reserves might not increase pressure on the banks to lend and invest but would serve only to minimize control when necessary; third, the open market purchases had enabled the Treasury to borrow cheaply and "so in some measure has encouraged the continuance of an unbalanced budget."

The sentiment of most governors was clearly in favor of reducing the portfolio, and the final motion reflected that sentiment. It gave the executive committee authority to reduce the System's holdings of Treasury bills, the reduction in January not to exceed $125 million and not to bring excess reserves below $500 million. The committee was authorized to purchase securities if necessary to prevent excess reserves from falling below the existing level, but not if such purchases would do more than make up for declines in holdings. Before any increase in security holdings above the existing level was made, a new meeting of the Conference was to be convened.[137]

The policy recommendation was followed, and security holdings reduced by $90 million in January, despite the concern of Burgess and Treasury officials about the weakness of the bond market, and despite renewed banking difficulties. By February 1, 1933, excess reserves had fallen below $500 million, and the purchases made were not enough to restore that level. From the last week in January to February 15, the System increased its security holdings by $45 million, and permitted total Reserve credit to rise by $70 million. Yet, in those three weeks alone, member bank reserve balances at Federal Reserve Banks declined by $280 million.

The state to which open market operations—the most potent monetary tool of the System—had fallen was graphically revealed when, as the banking difficulties mounted in February, Harrison ruled out a meeting of the Conference on grounds that it would be "difficult, if not impossible, to hold a meeting of the system Open Market Policy Conference at this time." Instead, New York turned to bills as an alternative. On February 16, New York requested, and the Board approved, a reduction in its minimum buying rates on bills to ½ of 1 per cent. It acquired $350 million in

[137] Harrison, Open Market, Vol. II, preliminary memorandum, dated Dec. 31, 1932, and minutes of meeting, Jan. 4–5, 1933.

bills the following two weeks, though at the end of the second the Bank raised the bill rate twice, to 1 per cent on February 27, and to 1½ per cent on March 1, in consonance with rises in the discount rate. It also acquired $25 million of government securities in the first of the two weeks and $2 million in the second, primarily to enable banks to liquidate by selling government securities instead of borrowing on them.[138]

In the final two months prior to the banking holiday, there was nothing that could be called a System policy. The System was demoralized. Each Bank was operating on its own. All participated in the general atmosphere of panic that was spreading in the financial community and the community at large. The leadership which an independent central banking system was supposed to give the market and the ability to withstand the pressures of politics and of profit alike and to act counter to the market as a whole, these—the justification for establishing a quasi-governmental institution with broad powers—were conspicuous by their absence.

6. *Alternative Policies*

It is clear that the monetary policies followed from 1929 to 1933 were not the inevitable result of external pressure. At all times, alternative policies were available and were being seriously proposed for adoption by leading figures in the System. At all times, the System was technically in a position to adopt the alternative policies.

To give a clearer idea of the consequences of the policies actually followed, we consider explicitly the alternatives available at three critical periods and what their effects might have been. The periods are: (1) the first ten months of 1930; (2) the first eight months of 1931; (3) the four months following Britain's departure from gold in September 1931. This is followed by an evaluation of the chief justification that has been offered by writers on Federal Reserve history for the policy actually pursued in late 1931 and early 1932, namely, that a shortage of "free gold" greatly inhibited use of the policy alternatives available to the System until the passage of the Glass-Steagall Act at the end of February 1932.

The successive banking crises which followed the first period and occurred during the other two were, as we saw in section 2, each more severe than the preceding. Measures that might have been adequate to cope with the earlier ones would have been inadequate for the later ones. On the other hand, as we shall see, the bond purchases actually made in the spring and summer of 1932, which did halt the decline in the stock of money but were inadequate to prevent a subsequent relapse some months after, would have been more than adequate to cope with the earlier crises. As so often in human affairs, a stitch in time saves nine.

[138] Notes, Vol. III, Jan. 16; Feb. 2, 6, 16, 27, 1933; Conversations, Vol. II, Jan. 18, 1933. Quotation from Notes, Vol. III, Feb. 16, 1933.

JANUARY 1930 TO END OF OCTOBER 1930

None of the arguments later advanced in support of the view that expansionary monetary measures by the Federal Reserve System might have been ineffective or undesirable applies to this period, as noted above. There was no sign of lack of confidence in banks by the public, or of unusual concern by banks about their own safety. Banks were using reserves to the full. Any increase in reserves probably would have been put to use in expanding the assets of banks. Expansionary measures offered no threat to the gold standard. On the contrary, the gold reserve was high and gold inflows persisted. Throughout the twenties, the System had been concerned that it held too large a fraction of the world's gold stock; the only problem about gold that evoked discussion in 1930 within the System was how to repel the flow. Finally, no serious monetary difficulties had yet arisen abroad.

To evaluate the possible quantitative effect of an alternative policy, let us consider what the effect would have been if the purchase program actually carried out in 1932 had been carried out in 1930 instead; that is, if the System had embarked on a program to raise its security holdings by $1 billion during the first ten months of 1930. From December 1929 to October 1930, if we adjust for seasonal effects, government security holdings actually rose by $150 million. If some $850 million additional government securities had been purchased, high-powered money, instead of declining by $160 million, would have risen by $690 million, all of which would have increased reserves, since during the first ten months of 1930 the public reduced its currency holdings. However, changes in other forms of Reserve Bank credit might have reduced the impact of the hypothetical additional purchase. From December 1929 to October 1930, bills bought fell by $110 million—from $240 million to $130 million—and bills discounted fell by $390 million—from $590 million to $200 million. The purchase of $850 million additional government securities would doubtless have produced an even larger decline in bills discounted and less certainly in bills bought, since banks would have used some of the funds to repay borrowings and there might have been a larger demand for bankers' acceptances. To make rather extreme allowance for such an effect, let us suppose that discounts and bills bought had each been reduced to $50 million. Even then, the effect of the purchases would have been a rise in Federal Reserve credit outstanding by $130 million instead of the actual decline of $490 million, and a rise in high-powered money by $460 million.

If the deposit ratios had behaved as in fact they did, the change from a decline in high-powered money of 2½ per cent to a rise of 6½ per cent would have converted the actual 2 per cent decline in the stock

of money into a rise of 7 per cent. Under those circumstances, the deposit ratios might have altered in a direction to offset some of the hypothetical rise in high-powered money. But even very large allowances on this score would hardly change the general conclusion: a rise in the System's security holdings by $1 billion instead of $150 million in the first ten months of 1930 would have changed the monetary situation drastically, so drastically that such an operation was almost surely decidedly larger than was required to convert the decline in the stock of money into an appreciable rise.

The change in the monetary situation might have affected the gold movement, reducing the gold inflow or even converting it into a gold outflow. But it would have done that only by its effects on the trend of economic activity and on the state of the capital markets. Only if the change in the monetary climate had lessened the severity of the economic contraction and made the capital markets easier, would it have affected gold flows. But it is precisely the achievement of such results that would have been the aim of the alternative policies. Hence, a reduction in the gold inflow would have been a sign of the success of the alternative policy, not an offset to it.

The hypothetical purchase of government securities would have reduced in two ways the likelihood of a banking crisis like the one in the fall of 1930: indirectly, through its effect on the severity of the contraction; and directly, through its effect on the balance sheets of banks. The indirect effect would have improved the ability of borrowers to repay loans; the direct effect would have meant that bank reserves were rising sharply instead of staying roughly stable. It is impossible to say with any assurance that these effects would have prevented a banking crisis from occurring—though they might have—but it is certain they would have reduced the magnitude of any crisis that did occur and hence the magnitude of its aftereffects.

The effects on the capital markets and the reduction in the drain of gold from the rest of the world would have had desirable effects abroad. Again, these might not have prevented the later financial difficulties entirely, but they certainly would have eased them.

JANUARY 1931 TO END OF AUGUST 1931

The early months of 1931 were the next crucial time for monetary policy. The banking crisis had died down, there were signs of returning confidence in banks and of improving conditions in business. We have already suggested (section 2) that a vigorous monetary push at that time might have converted the faint signs of recovery into sustained revival.

Let us suppose that actual policy to the end of 1930, including the first banking crisis, had been what it was, but that in the first eight

false assumption

assur

months of 1931 the System had raised its security holdings by $1 billion instead of $80 million, after allowing for seasonal changes. During those eight months, currency held by the public rose by $370 million as a result of the internal drain on the banking system; bank reserves fell by $120 million. The difference between the rise in currency and the decline in bank reserves, or $250 million, is the amount by which high-powered money rose. The purchase of $920 million additional government securities, with no change in bills discounted or bills bought, would have raised high-powered money by $1,170 million instead, enough to meet the drain of currency that actually occurred and at the same time to increase bank reserves by $800 million. With such a sizable increase in their reserves, instead of a decrease of $120 million, banks would have been freed from the necessity of liquidating securities, and could have reduced their borrowing from the Reserve System, instead of increasing it by $40 million. The bond market would accordingly have been far stronger, bank failures would have been notably fewer, and hence the runs on banks milder if at all appreciable. In consequence, the drain of currency into circulation would have been smaller than it was and the increase in bank reserves would have been even larger than these figures suggest.

To put the matter as before, in terms of the effect on Federal Reserve credit—again assuming that bills discounted and bills bought would each have been reduced to $50 million—had the System bought an additional $920 million of government securities during the first eight months of 1931, Federal Reserve credit outstanding would have risen by $470 million instead of $40 million. High-powered money, under these circumstances, would have risen by $680 million or by 10 per cent instead of by 3½ per cent. Even if both the deposit ratios had fallen by as much as they did, the result would have been no change in the stock of money, instead of a decrease of 5½ per cent.

On this occasion, however, effects of the change in the monetary climate on the deposit ratios would clearly have enhanced rather than offset the expansionary effect of the hypothetical open market purchases. Depositors would have been far less eager to convert deposits into currency and banks, to strengthen still further their reserve position. Both deposit ratios would therefore have fallen less than they did. The second banking crisis might indeed never have occurred at all in such a changed monetary environment. Once again a $1 billion purchase program would have been much greater than needed to change drastically the monetary situation. But even if the second banking crisis had occurred, and even if it had been as severe as it was, the hypothetical open market operation would have completely eliminated its effect on the stock of money.

Again, the change would have produced a reduction in the inflow of gold and might have converted it into an outflow with a resulting easing

of the financial difficulties in Europe. And again, this must be counted an achievement of the hypothetical purchase program and not an offset.

SEPTEMBER 1931 TO END OF JANUARY 1932

We cited earlier the statement in a System memorandum written in November 1931 that the "foreign and domestic drain upon bank reserves [after Britain's departure from gold] were met in the classic way by increases in discount rates combined with a policy of free lending." The memorandum included a quotation from the *locus classicus* of central bank policy, Bagehot's *Lombard Street*. In fact, however, the System followed Bagehot's policy only with respect to the external drain, not the internal drain. To meet an external drain, Bagehot prescribed a high Bank rate, the part of his prescription the System followed. To meet an internal drain, he prescribed lending freely. "A panic," he wrote, "in a word, is a species of neuralgia, and according to the rules of science you must not starve it. The holders of the cash reserve must be ready not only to keep it for their own liabilities, but to advance it most freely for the liabilities of others."[139] Despite the assertion to the contrary in the memorandum, the System gave little more than lip service to this part of Bagehot's prescription, either before the external drain or after it ended. True, during the height of the internal and external drain in October, it permitted its discounts and its bills bought to rise sharply. But this was at the initiative of the member banks, in spite of sharp rises in the rates on both, and was a result of the desperate situation of member banks because of the double drain. As we have seen, even after the height of the crisis, the New York Bank reduced bill buying rates only gradually and kept them above market rates, so bills bought declined rapidly. The System took no active measures to ease the internal drain, as it could have done through open market purchases. Contrast its behavior with that reported approvingly by Bagehot:

> The way in which the panic of 1825 was stopped by advancing money has been described in so broad and graphic a way that the passage has become classical. "We lent it," said Mr. Harman on behalf of the Bank of England, "by every possible means and in modes we have never adopted before; we took in stock on security, we purchased Exchequer bills, we made advances on Exchequer bills, we not only discounted outright, but we made advances on the deposit of bills of exchange to an immense amount, in short, by every possible means consistent with the safety of the Bank, and we were not on some occasions over-nice."[140]

Though the response of the System to the external drain was "classic," it was sharply at variance with the alternative policy the System had de-

[139] Walter Bagehot, *Lombard Street*, London, Henry S. King, 1873, p. 51.
[140] *Lombard Street*, pp. 51–52.

veloped during the 1920's, the gold sterilization policy. That policy called not for tightness but for ease to counter the gold drain and, even more clearly, for ease in the period before and after the gold drain to counter the internal drain.[141]

The System had sterilized inflows and outflows of gold during the twenties. It had more than sterilized inflows from August 1929 to August 1931. Consistent policy called for sterilizing the outflow after September 1931 as well. And the System was in an extraordinarily strong technical position to follow such a policy. Just before Britain's departure from the gold standard, the U.S. gold stock was at its highest level in history, over $4.7 billion, and amounted to about 40 per cent of the world's monetary gold stock. The System's reserve percentage—the ratio of its gold holdings to its note and deposit liabilities—exceeded 80 per cent in July, averaged 74.7 in September, and never fell below 56.6 in October. At the lowest point, toward the end of October, its gold reserves exceeded legal requirements for cover by more than $1 billion.[142] And this sum could have been expanded under pressure by $80 million to $200 million by simple bookkeeping adjustments.[143] Further, the Reserve Board had the legal power to suspend gold reserve requirements with negligible sanctions, a power it did in fact invoke in early 1933.

The major short-term balances subject to withdrawal were held by France. French short-term balances, which had been declining since 1929, amounted to $780 million in January 1931 (out of a total of $1.8

[141] For example, see the memorandum by Benjamin Strong, listing the reasons for the Federal Reserve easy-money policy of 1924, one of which was, "To check the pressure on the banking situation in the West and Northwest and the resulting failures and disasters. . ." (*Stabilization,* Hearings before the House Banking and Currency Committee, 69th Cong., 1st sess., Mar.-June 1926; Feb. 1927, pp. 335–336). One of the tests of Federal Reserve policy, 1922–26, that Strong proposed was the number of bank failures (p. 476). See also Adolph Miller of the Federal Reserve Board on the role of the System in lending to "banks that are in distressed communities" and supplying emergency currency needs (pp. 861, 898–899); and W. R. Burgess, then assistant Federal Reserve agent of the New York Bank, on the powers of the System for stabilization, including "desperate remedies for a desperate emergency" (p. 1019).

[142] In contrast, the System's gold reserve ratio was only 53 per cent at its maximum in 1919 when it permitted inflation to proceed unchecked, and it did not take contractionary action in 1920 until the ratio had fallen to less than 43 per cent.

[143] Federal Reserve notes in vaults of issuing Federal Reserve Banks were subject to the same collateral and reserve requirements as notes in circulation. On Oct. 31, 1931, there were about $320 million of such notes in vaults of issuing Banks. According to an internal System memorandum, about $120 million in vault would have been adequate (Harrison, Miscellaneous, Vol. I, enclosure, dated Aug. 20, 1931, in letter, dated Aug. 21, Harrison to McDougal). A reduction of $200 million would have released $80 million in required gold reserves held against the notes. If, instead of 60 per cent eligible paper, gold were held as collateral against the notes, an additional $120 million in gold would have been released from legal requirements.

billion held by European countries) and by September were around $700 million.[144] France was strongly committed to staying on gold, and the French financial community, the Bank of France included, expressed the greatest concern about the United States' ability and intention to stay on the gold standard. That accounted for the special volatility of the French balances. As it happened, though the French balances were not withdrawn in October 1931,[145] they were almost entirely withdrawn in the

[144] *Banking and Monetary Statistics,* p. 574. These are estimates of short-term balances held by France and all of Europe in reporting New York banks on Jan. 31, 1931. The peak figures a year earlier were $890 million and $2.0 billion, respectively.

[145] Harrison informed the Bank of France in Oct. that, if it did not want to invest its funds in the U.S. money market, he preferred not to hold French deposits in excess of $200 million. He suggested that it buy gold which would be either earmarked for the Bank of France or exported to France. The French representatives expressed surprise at Harrison's willingness to part with gold, but were not eager to withdraw it at the time because of their fears of possible inflationary effects of gold imports on the French economy and because of the loss of earnings to the Bank of France. It was agreed, however, that the Bank of France would effect a gradual repatriation of a substantial fraction of its balances in New York (Harrison, Notes, Vol. II, Oct. 15 and 26, 1931).

Rumors about Harrison's conversations with the French misrepresented their substance: he was said to have requested them not to take more gold from this country and they had not agreed; and he was said to have committed himself to maintain a firm money policy. He denied these rumors in a letter to Governor Meyer:

> I have reviewed these matters in some detail only because of the continued and repeated reports of an agreement in the nature of a "bargain" whereby the Federal Reserve Bank of New York surrendered its freedom of action regarding credit or discount rate policies in exchange for a promise from the Bank of France that it would not withdraw its funds from the market. There was not any such agreement, nor any such bargain. The Bank of France is perfectly free at any time it chooses to withdraw its dollar funds. The Federal Reserve Bank of New York is equally free in its credit and discount policies. In fact, there has never been a time in any of my conversations with any central bank when there was any request or even any suggestion that they or we should in any way make a commitment as to any future policy that would in any way destroy or limit our complete freedom of action in our own self-interest.

These statements by Harrison are not necessarily inconsistent with the assertion by E. A. Goldenweiser, who was director of the Board's Division of Research and Statistics at the time: "The Bank of France at that time had large deposits in the United States and it was understood by the authorities that, if bill rates in this country did not advance, these deposits would be withdrawn in gold."

Without France's asking for a commitment and without Harrison's entering into one, the French representatives could still have made it clear that they would regard failure of the United States to raise discount rates as a sign that the United States was not serious about its announced intention to take whatever measures were necessary to stay on the gold standard (Harrison, Miscellaneous, Vol. I, letter, dated Dec. 18, 1931, Harrison to Meyer; *ibid.,* letter, dated Dec. 22, 1931, Harrison to Calkins, who evidently had accepted the rumors as truth; E. A. Goldenweiser, *American Monetary Policy,* New York, McGraw-Hill, 1951, pp. 158–159).

spring of 1932.[146] Their withdrawal in October would have made no ultimate difference in the gold position. It would, however, have reduced the System's reserve percentage to about 49 per cent and hence might have had psychological effects somewhat different from those experienced when the balances were actually withdrawn, since the System's reserve percentage did not then fall below 58 per cent. The lowest the reserve percentage ever reached during the 1932 open market operation was 56 per cent (monthly averages of daily figures). Consequently, it seems highly likely that, if a gold sterilization policy had been adopted, gold outflows would have ceased long before the legal reserve ratio was reached, let alone before the gold stock was drastically depleted.[147]

Suppose the System had raised discount rates when it did, adopting the "classic" remedy for an external drain, but had accompanied the measure by purchase of government securities as called for by the "classic" remedy for an internal drain and by its earlier sterilization policy. Again, to be concrete, let $1 billion be the amount of the hypothetical increase in its security holdings. What would have been the consequence?

Between August 1931 and January 1932, currency held by the public rose by $720 million and bank reserves fell by $390 million, which means that, as a result of the increase in discounts and other minor changes, high-powered money had risen by $330 million despite the gold drain. Other items being the same, Reserve purchases of $1 billion of government securities would have meant an increase of $1,330 million in high-

[146] French short-term balances with reporting New York banks were, on selected dates, in millions: Sept. 16, 1931, $685; Dec. 30, 1931, $549; May 11, 1932, $304; June 15, 1932, $102; June 29, 1932, $49 (*Banking and Monetary Statistics*, pp. 574–575). The statistics include all deposits and short-term securities held by the French at reporting domestic banks and bankers, but they may not include other American short-term liabilities to French citizens, such as bills and short-term securities held for them by agents other than the reporting banks. Hence these figures may underestimate French withdrawals.

Governor Harrison denied that the ultimate withdrawal of French short-term balances reflected French dissatisfaction with the change in Federal Reserve policy in the spring of 1932, though that was widely reported. He said, "[S]ome people might argue that our policy had been responsible for the recent heavy outflow of gold, but we know that it was largely the repatriation of central bank balances which would have been withdrawn in any case" (Notes, Vol. II, June 30, 1932).

[147] Goldenweiser asserts the contrary, writing that "a full-fledged easing policy [by which he clearly means, from the context, low discount rates, rather than open market operations] . . . would have involved a suspension of reserve requirements against Federal Reserve deposits" (*American Monetary Policy*, p. 159). However, Goldenweiser gives no evidence to support his assertion. It may have been the opinion of the authorities at the time, though we have been able to find no internal document in the Goldenweiser Papers or in the Harrison Papers and no reference in the Hamlin Diary indicating that such a policy was ever seriously contemplated or its consequences for the reserve ratio explicitly considered. These documents make the rise in discount rates appear to be more nearly a conditioned reflex than a policy decision reached after full consideration of a range of feasible alternatives.

powered money. That sum would have provided the whole $720 million in currency withdrawn by the public and at the same time have enabled bank reserves to increase by $610 million instead of decreasing by $390 million, or one-eighth of their initial level. The increase in bank reserves would have permitted a multiple expansion in deposits instead of the multiple contraction that actually took place.

Of course, under these circumstances, banks would have been under far less heavy pressure than they were and would have borrowed less from the Reserve System, thereby offsetting some of the hypothetical increase in high-powered money. However, this offset would have reflected fewer bank failures and a reduction in the public's desire to convert deposits into currency. Hence, the currency held by the public would have risen less than it did. The net effect of these offsetting factors on bank reserves might have been either expansionary or contractionary.

Again, to suggest orders of magnitude, suppose that from August 1931 to January 1932, discounts and bills bought had both remained unchanged instead of the first rising from $280 million to $840 million, and the second falling from $310 million to $100 million. Even under these assumptions, a purchase of $1 billion of government securities would have meant a rise in high-powered money by $650 million more than the actual rise. Even if we couple these assumptions with the further extreme assumption that, under such greatly improved monetary conditions, the deposit ratios would have fallen as much as they did—and for the deposit-currency ratio, the fall in so short a time was the largest on record—the result would have been to cut the decline in the stock of money to less than half the actual decline from August 1931 to January 1932. Only a moderate improvement in the deposit-currency ratio—a decline from 8.95 to 7.10 instead of to 6.47—would, under these hypothetical circumstances, have enabled the stock of money to be stable instead of falling by 12 per cent.

The crises were becoming successively more severe, so this time the $1 billion we have been using as our standard is not, as in the earlier periods, clearly a multiple of the amount required to turn the monetary tide. But these calculations suggest that an open market purchase of that size would have been adequate. And with so great a change in the monetary tide, the economic situation could hardly have deteriorated so rapidly and sharply as it did.

THE PROBLEM OF FREE GOLD

In the book he published after retiring from the System, from which we quoted above, Goldenweiser analyzed briefly the System's reaction to Britain's departure from gold. After discussing the rise in discount rates in reaction to the external drain, which he terms a "brief return to

orthodoxy"[148] which "had only passing and temporary effects on the banking system or on the course of the depression," he went on to say, with respect to the internal drain:

More serious was the fact that the System did not extend sufficient aid to member banks through discounting their paper and that it failed to pursue a vigorous policy of purchases in the open market. For this failure of the System to give more help in an emergency the major blame is on the law which prescribed rigid rules for the eligibility of paper for discount and also barred government securities from collateral acceptable for Federal Reserve notes.[149]

The problem to which Goldenweiser referred is the so-called free-gold problem. The internal drain had increased the volume of Federal Reserve notes outstanding. The law specified that the System hold against notes a reserve of 40 per cent in gold and additional collateral of 60 per cent in either gold or eligible paper (which consisted of commercial, agricultural, or industrial loans, or loans secured by U.S. government securities rediscounted by member banks; loans to member banks secured by paper eligible for rediscount or by government securities; and bankers' acceptances, i.e., "bills bought" in the terminology of Federal Reserve accounts). Because the System did not have enough eligible paper to furnish 60 per cent of the collateral for Federal Reserve notes, part of the gold in excess of minimum requirements had to be pledged for this purpose. The amount of free gold not needed to meet either minimum gold requirements or collateral requirements was therefore less than the amount of excess gold reserves. The Federal Reserve System, in its *Annual Report* for 1932, and Goldenweiser, in the passage quoted above and elsewhere in his book, assert that the shortage of free gold was an important factor preventing the System from engaging in larger open market purchases, such as the hypothetical purchases discussed in the preceding subsection. Such purchases, they assert, would have reduced eligible paper holdings still further by reducing rediscounts and therefore could have been conducted only to a very limited extent without eliminating free gold entirely. The Glass-Steagall Act of February 27, 1932, disposed of that problem by permitting government bonds in the Reserve Banks' portfolios as well as eligible paper to serve as collateral against Federal Reserve notes in addition to the 40 per cent minimum gold reserve.[150]

Our own examination of the evidence leads us to a different conclusion. Despite the attention it has since received, we do not believe a shortage of free gold exerted any major influence on Federal Reserve policy, for five reasons.

[148] However, while discount rates were raised at all Reserve Banks in Oct. or Nov. 1931, they were reduced a few months later only in Dallas and Richmond and New York. The reduction in New York was made more than four months after the second rise in Oct. 1931, and brought the discount rate only one-quarter of the way back to the level before the gold drain. Four months later, a second reduction was made in New York to 2½ per cent—only halfway back to the level before the gold drain—where the rate remained until raised again in March 1933.

[149] *American Monetary Policy*, pp. 159–160.

[150] See footnote 26, above, for other provisions of the Glass-Steagall Act.

(1) The earliest published full-dress discussion of free gold during the 1929–33 contraction we have found is an article by Benjamin Anderson in the *Chase Economic Bulletin* of September 29, 1930. Anderson, a firm believer in the real bills doctrine and an equally firm opponent of open market operations, warned, "There is not enough free gold to justify artificially cheap money."[151] We have found no evidence that the article exerted any influence within the Reserve System. In any event, by the time it appeared, New York had already lost its battle for expansionary open market purchases, and the general lines which were to dominate policy until the spring of 1932 had already been set.

(2) The earliest unpublished System document on free gold we have found is a memorandum by Goldenweiser, written on January 3, 1930. He refers to a Board discussion of a statement by Anderson "that free gold was down to $600,000,000 . . ." (in an address to the American Economic Association and American Statistical Association on December 30, 1929); Anderson concluded, "The Federal Reserve System is nearing the time when it must look to its own reserve . . . ." The memorandum makes clear that the Reserve System regularly kept track of free gold, and that its level was not at the time a source of concern to the Board.

The limited attention paid to free gold by the System is suggested by the fact that the earliest mention of free gold we have found in the Hamlin Diary is an entry of July 30, 1931, and in the Harrison Papers, a preliminary memorandum, August 3, 1931, for the meeting of the Open Market Policy Conference on August 11. Both noted that free gold on July 29 totaled $748 million and that internal bookkeeping adjustments, involving reduction of Federal Reserve notes in the tills of most Reserve Banks to a "reasonable minimum," would have raised the free gold on that date to $1,086 million.[152] A later memorandum of August 21, 1931, prepared at the New York Bank considered the likely effect on free gold of a variety of alternative hypothetical developments including large-scale open market purchases, internal drain of notes and gold, and an external drain and concluded that, even under rather extreme assumptions, free

[151] Anderson had referred to the significance of free gold in a Mar. 14, 1930, article (p. 13), indicating his intention to discuss the subject fully later, as he did in the Sept. 1930 *Bulletin* article, "The Free Gold of the Federal Reserve System and the Cheap Money Policy" (p. 8). W. R. Burgess told the Board that a subsequent article by Anderson on gold (*Chase Economic Bulletin*, Mar. 16, 1931) did much damage abroad to the Federal Reserve System (Hamlin, Diary, Vol. 19, Oct. 30, 1931, p. 173).

[152] See Goldenweiser Papers, Container 1, folder of Confidential Memoranda, 1922–33; New York *Times*, Dec. 31, 1929, which refers to Anderson's address; Hamlin, Diary, Vol. 19, p. 132; Harrison, Open Market, Vol. II.

gold did not constitute an important limitation on the alternatives available to the System.[153] The preliminary memorandum for the October 26 meeting of the Open Market Policy Conference noted there had been little change in free gold as a result of the gold outflow. Excess gold reserves had declined from $1.9 billion on September 16, 1931, to $1.1 billion on October 21, but free gold reserves had been roughly constant at over $0.8 billion because of a rise in eligible paper holdings. The preliminary memorandum for the November 30, 1931, meeting did not even refer to free gold, though it did note, "there is still plenty of gold left." After the first of the year, free gold may have fallen as low as $400 million during January and February 1932, which could have been raised to perhaps $525 million by bookkeeping adjustments.[154] Hence the actual amount of free gold throughout the whole period was sufficient to have permitted extensive open market operations.

(3) While free gold was alluded to from time to time at meetings of the Conference or of its executive committee or of the Federal Reserve Board or of the New York Bank directors, it was almost always mentioned as a problem by persons who had opposed open market operations all along on other grounds; it was never given as the principal argument against purchases, and the objections raised on this score almost always were immediately countered by figures showing that a shortage of free gold offered no serious limitation to policy.[155] It is impossible to read

[153] In his letter transmitting the memorandum to all governors, Harrison concluded, "apart from the position of individual Reserve banks the system as a whole has ample funds to deal with any situation within reason which may arise, and that in matters of policy we are probably in a position to do whatever seems wise for the country's economy."

The memorandum stated the immediate effect of the purchase of $300 million of government bonds would be a reduction of about $137 million in free gold, leaving the System about $600 million, which could be increased to more than $900 million by reducing Federal Reserve notes in vaults of the Reserve Banks. A large increase in the demand for Federal Reserve notes or for gold, according to the statement, would not affect the free gold position because that increase would be accompanied by an increase in Federal Reserve discounts and bill holdings, which would supply eligible paper collateral for Federal Reserve notes and release gold used for that purpose. Gold then in use as collateral, exclusive of free gold, was sufficient to provide a 40 per cent reserve for more than $3 billion of additional note circulation, or to provide $1¾ billion of gold for export (Miscellaneous, Vol. I).

[154] Open Market, Vol. II. No continuous figures on free gold during the critical period, Sept. 1931–Feb. 1932, were shown either in the *Annual Report* or *Federal Reserve Bulletin* for 1931 and 1932, and we have been able to find none in any System publication since. Our estimates for Jan. and Feb. 1932 are based on a chart in Federal Reserve Board, *Annual Report* for 1932, p. 17, plus amounts of their own notes held by issuing Banks, p. 91.

[155] At the Aug. 11, 1931, meeting of the Open Market Policy Conference, Governors Calkins and Seay said, in response to Harrison's recommendation of substantial purchases of government securities, their Banks did not hold enough free gold to permit them to participate in further purchases. Governor Harrison

in full the record of proceedings of the Open Market Policy Conference and of meetings of the New York Bank directors during the period from September 1931 through February 1932 and assign great significance to free gold as a factor determining policy. The closest approach to serious concern was expressed in January and February 1932, when the Glass-Steagall Act was in process of enactment and the problem was on its way to solution.[156] Concern over the gold problem during the period centered

cited the figures on free gold in the memorandum of Aug. 3, 1931, referred to above, and pointed out that "the question to decide was not whether individual banks could, or could not, participate, but to try to agree on a System policy which would be helpful." When the Conference met with the Board later that day, Governor Meyer asked if "there was any danger to the System" in authorizing the executive committee to purchase $200 million or $300 million of government bonds. "Mr. Goldenweiser stated that there was no danger in that direction as we have $750,000,000 free gold which can be increased to $1,000,000,000 by withdrawals from the agents" (Harrison, Open Market, Vol. II).

At a meeting of the executive committee of the directors of the New York Bank on Oct. 5, Owen D. Young asked how the purchase of government securities by the Reserve Banks "would fit into the proposed plan" for a corporation, eventually designated the National Credit Corporation. Harrison answered, "that he considered the gold position of the System paramount at this time, and on that account would not be inclined to purchase Government securities." Three days later, however, at a board meeting of the New York Bank, Harrison said "that the amount of free gold held by the System had not been materially affected by the recent loss of gold, so that there was still considerable leeway for purchases of Government securities" (Notes, Vol. II, Oct. 5, 8, 1931).

At the Oct. 26, 1931, meeting of the Conference, Harrison said that "the free gold position of the System was not a consideration at this time" (Open Market, Vol. II). On Oct. 27, Goldenweiser reported to the Board that free gold had been maintained despite the gold exports of the preceding five weeks (Hamlin, Diary, Vol. 19, pp. 169–170). No reference was made to free gold at the Nov. 30, 1931, meeting of the Conference, which authorized the executive committee to buy up to $200 million of government securities before the end of the year (Open Market, Vol. II).

The earliest mention of the free gold problem we have found in publications of the Federal Reserve Board is in the *Bulletin*, Sept. 1931, pp. 495–496. The term is defined and a chart is presented showing free gold and excess reserves of the Reserve Banks from 1925 on. It is referred to again in the *Bulletin*, Nov. 1931, p. 604. No mention of free gold is made in the *Annual Report* for 1931. In neither that report nor any earlier one is there a suggestion of legislation to meet such a problem, though it was standard procedure for the Reserve System to list legislative recommendations in its reports. The *Annual Report* for 1932, in commenting on the passage of the Glass-Steagall Act, contains the first discussion of free gold in the annual reports.

[156] On Jan. 4, 1932, Harrison told the executive committee of the New York Bank that "his only hesitancy in recommending" substantial purchases of government bonds was on account of the relatively small amount of free gold "we now have at our disposal," and for that reason the Reserve Banks should have authority to pledge all their assets as collateral for Federal Reserve notes (Notes, Vol. II, Jan. 4, 1932).

His hesitancy did not prevent his urging open market purchases at the Jan. 11, 1932, meeting of the Conference (see sect. 5, above). At the Feb. 24 meeting just before the enactment of the Glass-Steagall bill, the System's failure to pursue

not in the Federal Reserve System but in the White House and Treasury. At a conference with Congressional leaders on October 6, 1931, President Hoover presented the proposals eventually embodied in the Glass-Steagall Act.[157]

(4) If free gold had been a serious handicap to a desired policy, feasible measures fully consistent with past policies of the System were available, even during the height of the gold drain, to relieve the free gold problem. (a) The bookkeeping adjustments referred to above were apparently exploited to some extent, but by no means fully. (b) Bills could have been purchased instead of government securities, since they were eligible as collateral for Federal Reserve notes. After rising sharply during the height of the crisis (September–October, 1931), holdings declined continuously from October 1931 to February 1932, because buying rates were kept above market rates.[158] (c) Member banks could have been encouraged

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actively bill purchases, discount rate reduction, and "buying of Government securities, if necessary, facilitated by alleviation of free gold position," recommended on Jan. 11, was explained as follows:

> Continued uncertainties in the domestic situation, as well as a large drain of gold to Europe and particularly to France, stimulated by fear of inflation in this country, have been important factors in making it seem undesirable to carry through an aggressive program of reduction in discount rates and purchases of Government securities. The relatively small amount of free gold held by the reserve system was a further major factor in limiting the possibilities of purchases of Government securities (Open Market, Vol. II, minutes of meetings, Jan. 11, and Feb. 24, 1932).

[157] Hoover, *Memoirs,* pp. 115–118; see also Benjamin Anderson, "Our Gold Standard Has Not Been in Danger for Thirty-Six Years," *Chase Economic Bulletin,* Nov. 10, 1932, p. 10.

[158] On behalf of the System it could be claimed that the decline was not its own choice, that its buying rate on acceptances was below the rediscount rate, but New York City banks, which alone had bills, were substantially out of debt to the Federal Reserve Bank of New York by Nov. 1931 and hence had no incentive to sell (H. H. Villard, "The Federal Reserve System's Monetary Policy in 1931 and 1932," *Journal of Political Economy,* Dec. 1937, p. 727). The crucial point, however, is the relation of the buying rate, not to the rediscount rate, but to the market rate. As Villard has pointed out, from Aug. 1931 through Oct. 1931, while the System's bill holdings were expanding, its buying rate was at or below the market rate; thereafter its buying rate was ⅛ to ¼ percentage point above the market rate (*ibid.,* pp. 728–732). If the Reserve Bank had lowered the buying rate, the New York banks would have sold their acceptances to it. The New York Bank was fully aware that the relevant consideration was the relation of the buying rate to the market rate and not to the rediscount rate, as its actions in Aug. 1929 show. On Jan. 21, 1932, Harrison told his board of directors, "[W]e should probably have lowered our bill rates because they [are] well above the effective market rates and our portfolio of bills [is] rapidly diminishing" (Harrison, Notes, Vol. II).

Benjamin Anderson, who argued that the availability of free gold was a constraint on Federal Reserve expansionary policies (which, as we have noted, he opposed), nevertheless denied that the Glass-Steagall Act was essential to

to increase their discounts. At all times there was ample eligible paper in the portfolios of member banks.[159] Goldenweiser and others recognize this but say that the only way to increase the amount in the hands of the Federal Reserve Banks would have been to sell bonds and thereby force member banks to discount.[160] They add, quite correctly, that such a step would have been deflationary. However, that was not the only way. Failure of banks to discount was partly a consequence of the long-standing Federal Reserve pressure against continuous borrowing. In 1929, the System went beyond that and resorted to "direct pressure" to dissuade member banks from discounting for particular purposes. It would have been easier to use direct pressure to persuade member banks in 1931 or

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relieve the constraint. He listed alternatives available for increasing the supply of free gold similar to those listed in our item 4. Concerning 4 (b) he wrote:

> Moreover, it would have been very easy to increase the volume of open-market acceptances available for purchase by the Federal Reserve Banks, by concerted policy involving the coöperation of banks and great business corporations—a proposal of this sort was actually made by important industrial leaders ("Our Gold Standard Has Not Been in Danger," p. 9).

[159] See the figures on country and reserve city member banks' holdings of eligible assets, including eligible paper and U.S. government securities not pledged against national bank note circulation, on June 30 or at call dates, June 1926 through Dec. 1932, Federal Reserve Board, *Annual Report* for 1932, p. 126.

Holdings of eligible paper, including paper under rediscount, were four times as large as member bank borrowings, when this ratio was at a low point in Dec. 1931. Of course, member bank borrowings were secured by U.S. government securities as well as by eligible paper, so the possibility of increased borrowing on the basis of eligible paper holdings in Dec. 1931 is understated.

On Mar. 24, 1932, in Hearings before the Senate Committee on Banking and Currency on S. 4115 (*National and Federal Reserve Banking System,* 72d Cong., 1st sess., p. 109), Senator Glass remarked, "Let me say that in an interview I had with him as late as last Saturday evening, the chief of banking operations in the Federal reserve system stated to me that the banks had ample eligible paper."

Holdings of eligible paper were also widely distributed, according to figures Glass presented during the Senate debate on the Glass-Steagall bill. He said he supported the section of the bill that permitted banks without eligible paper to rediscount other security satisfactory to the Reserve Banks, not because banks no longer held adequate amounts of eligible paper, but because of the psychological effect of the measure in freeing the fear-ridden banks from their inhibition to rediscount the eligible paper they owned (*Congressional Record,* Senate, Feb. 17, 1932, p. 4137; see also H. P. Willis and J. M. Chapman, *The Banking Situation,* New York, Columbia University Press, 1934, pp. 678–679).

[160] Goldenweiser, *American Monetary Policy,* p. 160; and Federal Reserve Board, *Annual Report* for 1932, p. 18. Benjamin Anderson believed force would not have been necessary:

> They [the Federal Reserve Banks] could have done this [sold government securities] without force, by arrangement with the great banks of the country in such a way as to tighten money markets little, if at all, if it were done in concert and as a matter of general policy ("Our Gold Standard Has Not Been in Danger," p. 9).

1932 to increase their discounts, since that could have been made profitable for member banks.[161]

(5) Finally, enactment of the Glass-Steagall Act on February 27, 1932, entirely removed the problem of free gold. Yet, as we have seen, its enactment did not lead to a change in Federal Reserve policy. The large-scale open market operation of 1932 was begun six weeks later primarily because of Congressional pressure and was allowed to lapse not long after Congress adjourned.

The conclusion seems inescapable that a shortage of free gold did not in fact seriously limit the alternatives open to the System. The amount was at all times ample to support large open market purchases. A shortage was an additional reason, at most, for measures adopted primarily on other grounds. The removal of the problem did not of itself lead to change of policy. The problem of free gold was largely an ex post justification for policies followed, not an ex ante reason for them.

[161] The System need only have offered to discount member bank paper backed by government securities (which constituted acceptable collateral for Federal Reserve notes) at a rate below the market yield on government securities. Under Secretary of the Treasury Mills apparently made that recommendation to the Open Market Policy Conference meeting on Jan. 11 and 12, 1932. The Treasury, which had to raise $1½ billion by June 30, wanted to encourage bank subscriptions in the face of a severe depreciation in government securities since Sept. 1931. "The inclination of banks to subscribe would be increased by reduction of Federal reserve discount rates to give some differential between those rates and the yields on government securities. If banks can be induced to borrow and buy the net effect must be an expansion of credit" (Harrison, Open Market, Vol. II). No action was taken on the recommendation.

Suggestion of a "variation of the 'direct pressure' method, tried unsuccessfully in 1929," namely, "borrowing . . . would not be frowned upon by the Federal Reserve Banks," was made in 1930 by a New York Bank director, but it was not considered to be a practical solution of the problem (Notes, Vol. I, May 26, 1930). Individual Reserve Banks must have differed at any given time in the encouragement to discount they gave their member banks. See, for example, Charles E. Mitchell's comments on the San Francisco Bank, which suggest that it was not liberal in its interpretation of eligibility requirements (Notes, Vol. II, Oct. 15, 1931). Even Harrison, who in Oct. 1931 recommended that New York City banks borrow freely from the System "what was necessary to meet the needs of the situation," hesitated to call bankers in to see him in this connection, because "we must be prepared to have our action construed as an invitation to come in and borrow from this bank and to do something with the funds thus obtained. This procedure would, therefore, have its responsibilities." Owen D. Young said he wanted "to stop, look, and listen," before proceeding "by calling group meetings of bankers and by issuing what will be, in effect, an invitation to the member banks to come in and borrow at this bank" (Notes, Vol. II, Oct. 26, 1931; Mar. 24, 1932).

Clark Warburton maintains that, far from encouraging discounting as a means of getting more eligible paper, "as bank failures became frequent, the Federal Reserve banks developed an extremely hard-boiled attitude toward member banks which needed to borrow to meet deposit withdrawals" ("Has Bank Supervision Been in Conflict with Monetary Policy?", *Review of Economics and Statistics*, Feb. 1952, pp. 70–71).

7. *Why Was Monetary Policy So Inept?*

We trust that, in light of the preceding sections of this chapter, the adjective used in the heading of this one to characterize monetary policy during the critical period from 1929 to 1933 strikes our readers, as it does us, as a plain description of fact. The monetary system collapsed, but it clearly need not have done so.

The actions required to prevent monetary collapse did not call for a level of knowledge of the operation of the banking system or of the workings of monetary forces or of economic fluctuations which was developed only later and was not available to the Reserve System. On the contrary, as we have pointed out earlier, pursuit of the policies outlined by the System itself in the 1920's, or for that matter by Bagehot in 1873, would have prevented the catastrophe. The men who established the Federal Reserve System had many misconceptions about monetary theory and banking operations. It may well be that a policy in accordance with their understanding of monetary matters would not have prevented the decline in the stock of money from 1929 to the end of 1930.[162] But they under-

[162] For example, H. Parker Willis, who played a major role in the evolution of the Federal Reserve Act, was regularly reported in the columns of the *Commercial and Financial Chronicle* in 1931 and 1932—he had resigned from the editorship of the *Journal of Commerce* in May 1931—as inveighing against open market operations and arguing that the only task of the Reserve System was to discount eligible paper. A cabled article by Willis in a French publication (*Agence Économique et Financière*) in Jan. 1932, announcing that the Federal Reserve System had adopted inflationary policies, created a sensation in European financial circles. Governor Moret of the Bank of France cabled the article to Harrison for comment. It read in part:

> Inflation is the order of the day . . . . The discount rate will probably be lowered at the next meeting of the Board of Directors of the Federal Reserve Bank of New York. [The rate was not lowered until Feb. 26, possibly because of Willis' article.] The reduction of the buying rate for acceptances in the open market which took place on Tuesday [Jan. 12] is a preparatory measure to which the Federal Reserve Bank always has recourse in such cases. Financial circles consider it an indication of a change in monetary policy and expect heavy purchases of government securities, acceptances, and perhaps of other bills . . . . There is reason to expect that all attempts to curb inflation and hamper credit expansion based on long term paper will meet with general opposition. Inflationary ideas have seriously taken hold of many minds in financial circles . . . . Wall Street . . . hails inflation as assuring an upward movement of securities . . . . The greatest danger inheres in the risks to which the Federal Reserve Banks are exposed in connection with the various proposals for the broadening of their discount and loan operations . . . . In view of these developments certain observers remark that the gold export which ceased some time ago may easily begin again, the markets which permit the free export of gold having everywhere become very narrow (Harrison, Miscellaneous, Vol. II, Willis article, dated Jan. 13, 1932, quoted in full in cable, dated Jan. 15, 1932, Bank of France to Harrison).

Telephone calls and cable messages were exchanged by the New York Bank and the Bank of France before the excitement over Willis' article subsided (Conver-

stood very well the problem raised by a panic attempt to convert deposits into currency, and they provided ample powers in the act to deal with such a panic. There is little doubt that a policy based solely on a thorough perusal of the hearings preceding the enactment of the Federal Reserve Act and a moderately informed understanding of them would have cut short the liquidity crisis before it had gone very far, perhaps before the end of 1930.[163]

Contemporary economic comment was hardly distinguished by the correctness or profundity of understanding of the economic forces at work in the contraction, though of course there were notable exceptions. Many

sations, Vol. II, Jan. 14, 1932, dictated Jan. 20; Miscellaneous, Vol. II, cable, dated Jan. 15, 1932). New York City banks also received cables from their Paris agencies inquiring about the article. On Jan. 16, Harrison asked Senator Glass to use his influence to stop "Willis' rather steady flow of disturbing and alarming articles about the American position" (Miscellaneous, Vol. II).

Willis followed his former teacher J. Laurence Laughlin in his espousal of the "real-bills" doctrine (see Chap. 5, footnote 7). He applied those criteria to the operations of Federal Reserve Banks when he helped draft the Federal Reserve Act while serving in 1912-13 as an expert on the House Banking and Currency Subcommittee of which Carter Glass was chairman. After Glass became a Senator, Willis continued to be closely associated with him.

[163] See *Banking and Currency Reform,* Hearings before a subcommittee (Carter Glass, Chairman) of the House Banking and Currency Committee, 62d Cong., 3d sess., Jan. 7–Feb. 28, 1913; and *A Bill to Provide for the Establishment of Federal Reserve Banks,* Hearings before the Senate Banking and Currency Committee (R. L. Owen, Chairman), 63d Cong., 1st sess., Sept. 2–Oct. 27, 1913, 3 vols. In the House hearings especially, many witnesses showed clear understanding of the remedy for a liquidity crisis: cf. the testimony of Leslie M. Shaw, former Secretary of the Treasury, pp. 99-101; F. J. Wade, St. Louis banker, pp. 219-221; W. A. Nash, former chairman of the New York City Clearing House Association, pp. 338-339; A. J. Frame, Wisconsin banker, pp. 415-421. Frame did not favor establishing a reserve system; he urged extension of the Aldrich-Vreeland Act to state banks so they could "obtain extra cash in time of trouble." If that were done, "we would never have a suspension of cash payments in the United States again" (p. 421). In the Senate hearings, cf. the testimony of G. M. Reynolds, Chicago banker, Vol. I, p. 228; and Nathaniel French, Iowa businessman, who testified, "We can prevent a panic such as occurred in 1907 . . . by provisions for an elastic note issue, the mobilization of reserves, and their use in time of need" (Vol. III, p. 2075).

Note also Clark Warburton's comment:

> It is apparent that the Federal Reserve System could operate as intended—i.e., to provide an elastic currency without contracting member bank reserves—if and only if the Federal Reserve Banks acquired additional assets . . . to the full extent of increased currency issues in the form of Federal Reserve notes . . . . The necessity of keeping this principle in mind in the operations of the Federal Reserve System is so obvious—in view of its discussion in the literature preceding establishment of the Federal Reserve System and the provisions of the Federal Reserve Act—that the failure of Federal Reserve officials to handle the System in conformity with it in the 1930's warrants a charge of lack of adherence to the intent of the law ("Monetary Difficulties and the Structure of the Monetary System," *Journal of Finance,* Dec. 1952, p. 535).

professional economists as well as others viewed the depression as a desirable and necessary economic development required to eliminate inefficiency and weakness, took for granted that the appropriate cure was belt tightening by both private individuals and the government, and interpreted monetary changes as an incidental result rather than a contributing cause.[164]

The banking and liquidity crisis must, however, be distinguished from the contraction in general. It was a much more specific phenomenon, with far more clearly etched predecessors which had been studied and classified at length. One might therefore have expected a much better understanding of the banking and liquidity crisis and of the measures required to resolve it satisfactorily than of the contraction in general. To some extent, this expectation was fulfilled. For example, Congressman A. J. Sabath of Illinois wrote to Eugene Meyer in January 1931, after Meyer had turned down his suggestion that the proper response to the increase in bank failures was relaxation of eligibility requirements in order to encourage rediscounting: "Does the board maintain there is no emergency existing at this time? To my mind if ever there was an emergency, it is now, and this, I feel, no one can successfully deny. For while 439 banks closed their doors in 1929, during the year 1930, 934 banks were forced to suspend business." On the floor of the House, Sabath said, "I insist it is within the power of the Federal Reserve Board to relieve the financial and commercial distress."[165] Some academic people,

[164] See, for example, Alvin H. Hansen, *Economic Stabilization in an Unbalanced World,* New York, Harcourt, Brace, 1932, pp. 377-378. The repeated attempts to curb federal expenditures and the sharp tax rise in 1932 testify to the effectiveness of these views. Writing in 1932, A. B. Adams (*Trends of Business, 1922-1932,* New York, Harper, 1932, p. 68) stated:

> It would be quite undesirable to have an additional inflation of bank credit in this country at the present time. There is too much of the old inflation to be gotten rid of before business can be put on a sound basis. Temporary inflation would result only in a postponement of the inevitable deflation and readjustment and thereby result only in prolonging the present depression.

[165] *Reconstruction Finance Corporation,* Hearings before the House Banking and Currency Committee, 72d Cong., 1st sess., Jan. 6, 1932, pp. 78, 102-104. See also the testimony in March 1932 of former Senator R. L. Owen of Oklahoma, a banker and lawyer before his election to the Senate in 1907, and chairman of the Senate Banking and Currency Committee when the Federal Reserve Act was passed:

> The powers of the Federal Reserve Board and of the Federal reserve banks were abundantly great to have checked the collapse of values if they had had the vision to employ the authority given by law.
>
> Instead of expanding their credit when credit was being contracted and correcting the dangerous evil they contracted their own credits from December, 1929, to June, 1930, about $700,000,000 and only expanded it by Federal reserve notes when the depositors in banks were driven by fear to wholesale hoarding in August, 1930. Since January, 1932, they are again contracting credit.
>
> Clearly what the authorities of the Federal Reserve System should have done was to buy United States bonds and bills in the open market and emit Federal

such as Harold Reed, Irving Fisher, J. W. Angell, and Karl Bopp expressed similar views.[164]

Despite these important exceptions, the literature, and particularly the academic literature, on the banking and liquidity crisis is almost as depressing as that on the contraction in general. Most surprisingly, some of those whose work had done most to lay the groundwork for the Federal

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reserve notes to the extent necessary to stop the depression as far as it was due to the contraction of credit and currency. They were so advised by the experts of the Royal Bank of Canada and by others. They should have needed no advice for a remedy so self-evident (*Stabilization of Commodity Prices,* Hearings before the House Subcommittee on Banking and Currency, 72d Cong., 1st sess., part 1, p. 136).

See also testimony of D. H. Fisher, a director of the largest national farm loan association in the U.S., and of an Indiana county bankers' association (*ibid.,* pp. 289–293).

The monthly letter of the Royal Bank of Canada noted in July 1932:

> . . . [I]t is obvious that the attitude of the Reserve System during 1930 and 1931 to credit contraction was passive . . . When hoarding set in [dated October 1930 by the letter], this further contraction of credit was only partly offset by the purchase of securities . . . [I]t is necessary for large surplus reserves to accumulate in order that the banks should feel that it is safe for them to pursue a more liberal policy with their clients. It is noteworthy that in relation to the violence of the great depression, there has been much less of an accumulation of surplus reserves than in previous periods.

[164] See footnote 51 above; also H. L. Reed, "Reserve Bank Policy and Economic Planning," *American Economic Review,* Mar. 1933 Supplement, pp. 114, 117 (he subsequently qualified his argument, on the ground that quantitative controls need to be supplemented by qualitative controls, in "The Stabilization Doctrines of Carl Snyder," *Quarterly Journal of Economics,* Aug. 1935, pp. 618–520); Irving Fisher, *Booms and Depressions,* New York, Adelphi, 1932, pp. 96, 106, 126–134, 148–152; and J. H. Rogers, who wrote, "For the failure to create . . . a basis for much-needed credit and price expansion, the Federal Reserve System is by many capable students of its policy being held directly responsible. It is contended with much force that in periods like the present one, these central institutions must either use their great 'open-market' powers to arrest damaging price declines, or else must face highly deserved criticism" (*America Weighs Her Gold,* Yale University Press, 1931, pp. 206–209); W. I. King, who wrote, "Suppose . . . that in 1930, when prices began to plunge downward precipitously, the proper Federal authorities had begun vigorously to pump new money into circulation. Would not this process have started prices upward, restored confidence, or optimism, and brought business back to normal by the middle of 1931? The most probable answer . . . seems to be 'Yes!' " ("The Immediate Cause of the Business Cycle," *Journal of the American Statistical Association,* Mar. 1932 Supplement, p. 229); J. W. Angell, "Monetary Prerequisites for Employment Stabilization," in *Stabilization of Employment,* C. F. Roos, ed., Bloomington, Principia, 1933, pp. 207–214, 222–226; Karl Bopp, who wrote, ". . . Mr. A. C. Miller, who seems to be the dominant figure in the Board, has stated that he is opposed to open-market operations—the only effective method of stimulating revival from a severe depression—except as a 'surgical operation.' Even through 1932 he was not of the opinion that such a 'surgical operation' was necessary" ("Two Notes on the Federal Reserve System," *Journal of Political Economy,* June 1932, p. 390).

Reserve Act or who had been most intimately associated with its formulation—for example, O. M. W. Sprague, E. W. Kemmerer, and H. Parker Willis—were least perceptive, perhaps because they had so strong an intellectual commitment to the view that the Federal Reserve System had once and for all solved problems of liquidity. One can read through the annual *Proceedings* of the American Economic Association or of the Academy of Political Science and find only an occasional sign that the academic world even knew about the unprecedented banking collapse in process, let alone that it understood the cause and the remedy.

That climate of intellectual opinion helps to explain why the behavior of the Federal Reserve System from 1929 to 1933 was not checked or reversed by vigorous and informed outside criticism. But neither the climate of opinion nor external financial pressures nor lack of power explains why the Federal Reserve System acted as it did. None of them can explain why an active, vigorous, self-confident policy in the 1920's was followed by a passive, defensive, hesitant policy from 1929 to 1933, least of all why the System failed to meet an internal drain in the way intended by its founders. Economic contraction from 1929 to the fall of 1930, before the onset of the liquidity crisis, was more severe than it was from 1923 to 1924 or from 1926 to 1927. Yet, in reaction to those earlier recessions, the Reserve System raised its holdings of government securities by over $500 million from December 1923 to September 1924 and by over $400 million from November 1926 to November 1927 (all figures as of the last Wednesday of the month). By contrast, its security holdings in September 1930 were less than $500 million above the lowest level at any time in 1929 and more than four-fifths of the increase had occurred before the end of 1929 in response to the stock market crash. In the financially turbulent years, 1930 and 1931, the System's holdings of government securities varied over a narrower range than in all but two of the relatively tranquil years from 1922 through 1928—1925 and 1926.

The explanation for the contrast between Federal Reserve policy before 1929 and after, and hence for the inept policy after 1929, that emerges from the account in the earlier sections of this chapter is the shift of power within the System and the lack of understanding and experience of the individuals to whom the power shifted. Until 1928, the New York Bank was the prime mover in Federal Reserve policy both at home and abroad, and Benjamin Strong, its governor from its inception, was the dominant figure in the Federal Reserve System. Strong represented the System in its dealings with central banks abroad in a period when each of the great central banks seemed to be personified by a single outstanding individual—the Bank of England by Montagu Norman, the Bank of France by Émile Moreau, the German Reichsbank by Hjalmar Schacht. In the early years of the System, Strong was chairman and the

dominant figure of the Governors Conference, a group composed of the chief executive officers of the twelve Reserve Banks. Later, in 1922, when the Conference established a Governors Committee on open market operations, out of which developed the Open Market Investment Committee, he was named permanent chairman.[167]

Strong began his career as a commercial banker. He had been deeply involved in the 1907 banking crisis, as secretary of the Bankers Trust Company, something of a "bankers' bank," and as head of a committee set up by the New York financial leaders "to determine which institutions could be saved and to appraise the collateral offered for loans."[168] That experience had greatly impressed him, as it did the banking community in general, and had given him a strong interest in the reform of banking and currency. It had much to do with his becoming the first governor of the New York Bank.

Strong, more than any other individual, had the confidence and backing of other financial leaders inside and outside the System, the personal force to make his own views prevail, and also the courage to act upon them. In one of his last letters on System policy, to Walter Stewart on August 3, 1928, he spoke of the necessity of an easy money policy to anticipate the approach of the "breaking point" Stewart feared, and commented:

> Here is where I fear the consequences of hesitation or differences of opinion within the System . . . . If the System is unwilling to do it, then I presume the New York Bank must do it alone, despite the tradition which we have helped to create and maintain, that no extensive open-market operations should be conducted by individual banks. An emergency presents the possible need for emergency measures.[169]

One of the directors of the New York Bank recalled in April 1932, when the System finally began large-scale open market purchases, that he had once asked Strong, "why the authority for Federal reserve banks to purchase Government securities had been inserted in the Federal Reserve Act and that Governor Strong had replied that it was in there to use. Governor Strong had said further that if this power were used in a big way, it would stop any panic which might confront us."[170] If Strong had still been alive and head of the New York Bank in the fall of 1930, he

[167] See Chandler, *Benjamin Strong*, pp. 41–53, 69–70, 214–215, and Chaps. VII–XI.

[168] Chandler, *Benjamin Strong*, pp. 27–28.

[169] Chandler, *Benjamin Strong*, p. 460.

[170] Harrison, Notes, Vol. II, Apr. 4, 1932. The director, Clarence A. Woolley, then asked why the open market purchases "could not have been done sooner." He said, "the national nervous system has now been subject to strain for 29 months whereas, in former periods of business depression, 5 or 6 months have sufficed to clear up the worst of the wreckage. Is the Federal Reserve System responsible for cutting off the dog's tail by inches?" Burgess pointed out that "the presence

would very likely have recognized the oncoming liquidity crisis for what it was, would have been prepared by experience and conviction to take strenuous and appropriate measures to head it off, and would have had the standing to carry the System with him. Strong, knowing that monetary measures could not be expected to produce immediate effects, would not have been put off the expansionary course by a temporary persistence of the decline in business activity.[171]

Strong became inactive in August 1928 and died in October of that year. Once he was removed from the scene, neither the Board nor the other Reserve Banks, as we have seen, were prepared to accept the leadership of the New York Bank.[172] Chandler says in his biography,

of the Federal Reserve System tended to extend both the period of stimulation and of depression of business activity" (*ibid.*).

[171] See the copy of a letter, dated at Colorado Springs, Aug. 26, 1923, from Strong to Adolph Miller, in the Goldenweiser Papers (Container 3, folder of Open Market Committee, 1923–52). Strong wrote in part:

> The phenomena of credit somewhat resemble some of the phenomena of tuberculosis, concerning which I can speak with some certainty. Any imprudence or excess by a T. B. sufferer will not show ill results often for weeks or months. Some unusual mental or physical effort starts a slight inflammation which gradually develops, causes a lesion, then later comes the temperature, pulse, cough, etc. In our operations, suppose the imprudence consists in selling 50 or 100 millions of our Section 14 investments in the New York market . . . [W]e can if we are ignorant or careless pull down the credit structure at a rapid and dangerous rate, by a sale of investments, which shortly causes pressure to liquidate a much greater volume of bank loans. That process is at maximum—(with rapid pulse and high temperature)—at some indefinite period following our sale, and we may fail to detect the cause on account of the lag I mention.

Irving Fisher said, "Governor Strong died in 1928. I thoroughly believe that if he had lived and his policies had been continued, we might have had the stock market crash in a milder form, but after the crash there would not have been the great industrial depression" (*Annals of the American Academy of Political and Social Science*, Philadelphia, 1934, p. 151). See also Carl Snyder, *Capitalism the Creator*, New York, Macmillan, 1940, p. 203.

[172] An episode in the struggle between the Board and the Banks, still earlier than the dispute about how to deal with the stock market boom, occurred in the fall of 1927, when the Chicago Reserve Bank was unwilling to reduce its discount rate in line with the easy-money policy originated by Strong and adopted by the Board. The Board finally ordered the Chicago Bank (by a 4 to 3 vote) to reduce its rate—an unprecedented action. The "action aroused bitter controversy both within and without the System . . . . Most of the critics questioned the legality of the action; all denied the wisdom of this assertion of power in the absence of an emergency." Though Strong himself wanted a reduction in the Chicago rate, he "was quite unhappy about the Board's action and sought to prevent, or at least to delay it" (Chandler, *Benjamin Strong*, pp. 447–448). Presumably, he saw the preservation of the Banks' independence and indeed dominance in the System as more important than the specific substantive action of the moment.

Governor Crissinger's resignation may have been related to that incident. The Board met on Sept. 9 to impose the rate without being informed by Crissinger that Strong had telephoned him earlier in the day asking him to delay the meeting until Secretary of the Treasury Mellon, who had conferred with Strong in New

Strong's death left the System with no center of enterprising and acceptable leadership. The Federal Reserve Board was determined that the New York Bank should no longer play that role. But the Board itself could not play the role in an enterprising way. It was still weak and divided despite the substitution of Young for Crissinger in 1927. Moreover, most of the other Reserve Banks, as well as that in New York, were reluctant to follow the leadership of the Board, partly because of the Board's personnel, partly because they still thought of it as primarily a supervisory and review body. Thus it was easy for the System to slide into indecision and deadlock.[173]

The Banks outside New York, seeking a larger share in the determination of open market policy, obtained the diffusion of power through the broadening of the membership of the Open Market Investment Committee in March 1930 to include the governors of all the Banks. Open market operations now depended upon a majority of twelve rather than of five governors and the twelve "came instructed by their directors" rather than ready to follow the leadership of New York as the five had been when Strong was governor.

The shift in the locus of power, which almost surely would not have occurred when it did if Strong had lived, had important and far-reaching consequences. Harrison, Strong's successor at New York, was a lawyer who had acted as counsel to the Federal Reserve Board from 1914 to 1920 before coming to the New York Bank as one of Strong's deputies. In 1929 and 1930, he operated in the aura of Strong's legacy and sought to exercise comparable leadership. As time went on, however, he reverted to his natural character, that of an extremely competent lawyer and excellent administrator, who wanted to see all sides of an issue and placed great value on conciliating opposing points of view and achieving harmony. He was persuasive yet too reasonable to be truly single minded and dominant. Nevertheless, if the composition of the Open Market Committee had not been changed, his policies might have prevailed in June 1930—though that change probably was partly a reaction to New York's independent actions to meet the stock market crash. As it was, he had neither the standing in the System nor the prestige outside the System nor the personal force to get his policy views accepted in the face of active opposition or even plain inertia. His proposals were repeatedly voted down by the other Bank governors. When they finally agreed to a large open market operation in the spring of 1932, they were halfhearted and only

York, upon his return from a trip abroad, would arrive in Washington the next day. Presumably Mellon would have tried to dissuade the Board from taking action, and in any case would have tied the vote (Hamlin, Diary, Vol. 14, Sept. 15, 1927, p. 38). Crissinger resigned Sept. 15.

[173] *Benjamin Strong*, p. 465. Hamlin, who resented the dominance of the New York Bank (see his Diary, Vol. 19, Aug. 10, 1931, p. 126), nevertheless wrote of Strong, "He was a genius—a Hamilton among bankers. His place will be almost impossible to fill" (Diary, Vol. 16, Oct. 18, 1928, p. 60).

too eager to discontinue it. On January 20, 1933, Harrison told Hamlin that a majority of the governors really favored a complete reversal of open market policy by letting government securities run off.[174]

We commented earlier on the difference in the level of understanding and sophistication about monetary matters displayed by New York and the other Reserve Banks. The difference is understandable in view of the circumstances in which the several Banks operated and of their responsibilities. New York was the active financial center of the country. The securities market in general and the government securities market in particular were concentrated there. So also were international financial transactions. New York was the only U.S. money market that was also a world market. Despite the attempt of the Federal Reserve Act to reduce the dominance of New York in the banking structure, the demands of banks in the rest of the country for funds continued to be channeled through the other Reserve Bank cities into New York, and banks in the rest of the country continued to maintain correspondent relations with New York banks, especially after the stock market boom got under way. The New York Federal Reserve Bank was therefore acutely sensitive to the state of the financial markets and to the liquidity pressure not only on banks there but also on their correspondent banks throughout the country. Among Reserve Banks, the New York Bank alone was effectively national in scope and accustomed to regard itself as shaping, not merely reacting to, conditions in the credit market. The other Banks were much more parochial in both situation and outlook, more in the position of reacting to financial currents originating elsewhere, more concerned with their immediate regional problems, and hence more likely to believe that the Reserve System must adjust to other forces than that it could and should take the lead. They had no background of leadership and of national responsibility. Moreover, they tended to be jealous of New York and predisposed to question what New York proposed.

The form which the shift of power took—from New York as dominant head of a five-man committee to New York as the head of an executive committee administering policies adopted by the twelve governors—also had an important effect. A committee of twelve men, each regarding himself as an equal of all the others and each the chief administrator of an institution established to strengthen regional independence, could much more easily agree on a policy of drift and inaction than on a coordinated policy involving the public assumption of responsibility for decisive and large-scale action.[175] There is more than a little element of truth in the jocular description of a committee as a group of people, no one of whom knows what should be done, who jointly decide that

[174] Diary, Vol. 22, p. 61.

[175] Compare statements by Harrison in footnotes 89 and 114 above.

nothing can be done. And this is especially likely to be true of a group like the Open Market Policy Conference, consisting of independent persons from widely separated cities, who share none of that common outlook on detailed problems or responsibilities which evolves in the course of long-time daily collaboration. Such a committee is likely to be able to take decisive action only if it happens to include a man who is deferred to by all the rest and is accustomed to dominate. Strong might have played such a role. Harrison could not.

The shift of power from New York to the other Banks might not have been decisive, if there had been sufficiently vigorous and informed intellectual leadership in the Board to have joined with Harrison in overcoming the resistance of some of the other Banks. However, no tradition of leadership existed within the Board. It had not played a key role in determining the policy of the System throughout the twenties. Instead, it had been primarily a supervisory and review body.[176] It had its way in early 1929 about the use of "direct pressure" instead of quantitative measures in dealing with speculation, because it had a veto power over discount rate changes, not because it was able to win the Banks to its views.

There was no individual Board member with Strong's stature in the financial community or in the Reserve System, or with comparable experience, personal force, or demonstrated courage. Roy Young, governor of the Reserve Board until September 1, 1930, was apparently an able administrator, and Strong supported his appointment. However, he took a leading role in the conflict between the Bank and the Board and strongly opposed open market operations in government securities. He left the Board to become governor of the Reserve Bank of Boston, a position which enabled him to continue to exert his influence against the policy favored by New York—and perhaps not less effectively than before. Young was succeeded by Eugene Meyer, who had left his Wall Street brokerage firm in 1917 to serve with a war agency, became head of the War Finance Corporation, and then served with a number of government agencies, including the Federal Farm Loan Board, before coming to the Reserve Board in 1930. Meyer was appointed just after Harrison had failed in his

[176] The salary structure in the System at that time is some indication of the relative position of the Banks and the Board and of their ability to attract able people. Board members received $12,000 a year until 1935. Though equal to the salary of cabinet members, those salaries were drastically lower than those of Bank governors (later presidents). Strong at New York received $50,000 a year from 1919 until his death, and Harrison the same. The salaries of other Bank governors ranged from a low of $20,000 (six southern and western Banks) to $35,000 (Chicago) during the twenties. The relative differentials were only slightly narrower in 1960: Board members, $20,000 (the chairman $500 more); the highest paid Bank president, $60,000 (New York); the lowest, $35,000 (all other Banks except Chicago and San Francisco).

attempt to persuade the other governors to engage in open market purchases and just before the onset of the first liquidity crisis—on both grounds a difficult time to get the System to change course sharply. Perhaps, if he had had more time to develop his leadership of the System, he might have been able to lead the System along a different route.[177] In the initial months at his post, he was in favor of expansionary measures and, through most of 1931, he tried unsuccessfully to persuade the Conference to approve larger open market purchases. During his six months as chairman of the RFC, February–July 1932, members of the Board felt he slighted his duties as governor. None of the other full-time members of the Board or staff had the personal qualities and the standing within the System to exercise the required leadership.[178]

[177] During Meyer's term of office, two committees of the Reserve System (including officials of several Reserve Banks), appointed to study problems of branch, chain, and group banking, and of reserves, submitted reports but no action was taken on their recommendations (see Report of the Federal Reserve Committee on Branch, Group, and Chain Banking, mimeographed, 1932; and "Member Bank Reserves—Report of the Committee on Bank Reserves of the Federal Reserve System," Federal Reserve Board, *Annual Report* for 1932, pp. 260–285). Meyer recommended to the Senate Committee on Banking and Currency a unified commercial banking system for the United States to be implemented by limiting banking privileges to institutions with national charters. He obtained the opinion of the Board's general counsel in support of the constitutionality of such legislation (*ibid.*, pp. 229–259), but no further steps were taken.

[178] Harrison opposed Meyer's acceptance of the chairmanship of the RFC (Notes, Vol. II, Jan. 21, 1932).

The remaining members of the Board from 1929 to 1933 consisted of Edmund Platt (who served as vice-governor until he left the Board on Sept. 15, 1930), Adolph Miller, Charles S. Hamlin, George R. James, Edward Cunningham (until Nov. 28, 1930), and Wayland W. Magee (after May 5, 1931). Platt had studied law, had been a newspaper editor, then a member of Congress (where he served on the Banking and Currency Committee) before he was appointed to the Board in 1920. Miller and Hamlin were members of the original Board appointed in 1914. Miller, an economist of considerable scholarly ability, had written some good articles on monetary matters. But he, and Hamlin as well, had already demonstrated just after World War I an incapacity to exert leadership and to take an independent course. In Chandler's words, Miller, "undoubtedly the most able of the appointed members of the Board, was the eternal consultant and critic, never the imaginative and bold enterpriser" (*Benjamin Strong*, p. 257, and also pp. 44–45). If any credence can be put in Hamlin's repeated comments on Miller, this is a generous evaluation. Hamlin's Diary makes Miller out to be a self-centered person, with little hesitancy in using his public position for personal advantage, and capable of shifting position on important issues for trivial reasons (see Vol. 4, Aug. 6, 1918, pp. 180–181; Vol. 6, May 6, 1921, p. 90; Vol. 14, Jan. 6, June 9, 1928, pp. 105, 106, 130; Vol. 16, Oct. 30, 1929, p. 194).

Hamlin was a lawyer, described by Chandler as "intelligent, . . . but . . . as one of his associates put it, 'an amanuensis sort of fellow unlikely to undertake anything on his own'" (*Benjamin Strong*, pp. 256–257). His Diary confirms this view. He was shrewd, particularly about political issues and details of administration, public spirited in a self-righteous way, dependable and honest, if inclined to be partisan, and, fortunately for our purposes, an inveterate and, so far as we can judge, an accurate gossip. But the Diary shows exceedingly limited under-

The detailed story of every banking crisis in our history shows how much depends on the presence of one or more outstanding individuals willing to assume responsibility and leadership.[179] It was a defect of the financial system that it was susceptible to crises resolvable only with such leadership. The existence of such a financial system is, of course, the ultimate explanation for the financial collapse, rather than the shift of power from New York to the other Federal Reserve Banks and the weakness of the Reserve Board, since it permitted those circumstances to have such far-reaching consequences. Nonetheless, given the financial system that existed, the shift of power and the weakness of the Board greatly reduced the likelihood that the immediate decisive action would be taken, which was required to nip the liquidity crisis in the bud.

In the absence of vigorous intellectual leadership by the Board or of a consensus on the correct policy in the community at large or of Reserve Bank governors willing and able to assume responsibility for an independent course, the tendencies of drift and indecision had full scope. Moreover, as time went on, their force cumulated. Each failure to act made another such failure more likely. Men are far readier to plead—to themselves as to others—lack of power than lack of judgment as an explanation for failure. We have already seen this tendency expressed in the

standing of the broader issues of monetary policy and no sign of venturesomeness in thought or action. James was a small merchant and manufacturer from Tennessee and, for a few years, had been president of a commercial bank; Cunningham, a farmer; Magee, also a farmer and rancher, who had been a member of the board of the Omaha branch of the Reserve Bank of Kansas City and then a director of the Bank of Kansas City (see Chandler's comments, *Benjamin Strong*, pp. 256–257).

Of the staff, E. A. Goldenweiser, director of research and statistics from 1926 to 1945, was perhaps the most influential, but he was primarily a technician. His predecessor, Walter W. Stewart, had been close to Strong, had influenced him greatly, and continued their relationship after leaving the Board in 1926. Goldenweiser was a gentle person who could not match Stewart's influence on policy.

The ex officio members of the Reserve Board were the Comptroller of the Currency, and the Secretary of the Treasury, who served as chairman—from 1921 to February 1932, Andrew W. Mellon, a well-known financier and industrialist at the time of his appointment; thereafter, until March 1933, Ogden L. Mills. Mills, a lawyer, tax expert, and Congressman, before becoming Under Secretary of the Treasury in 1927, was an able and forceful man. As mentioned above, he gave active support to the Glass-Steagall bill because he saw lack of free gold limiting Federal Reserve action. Mills apparently contributed the chief ideas embodied in the Emergency Banking Act of Mar. 9, 1933 (see Chapter 8).

J. W. Pole, formerly chief U.S. national bank examiner, and Comptroller of the Currency from 1928 to September 1932, advocated as a bank reform measure branch banking limited to "trade areas" or regions around important cities. But he had no influence of record on bank legislation or Federal Reserve policy during that period (see Comptroller of the Currency, *Annual Report*, 1929, p. 5; 1930, p. 5; 1931, p. 1). Hamlin referred to him as "on the whole, a good but not very strong man" (Diary, Vol. 21, Sept. 1, 1932, pp. 105–106).

[179] See Sprague, *History of Crises, passim.*

Federal Reserve System's reaction to the criticism of its policies during 1919–21. It was expressed again in 1930–33 as the Board explained economic decline and then banking failures as occurring despite its own actions and as the product of forces over which it had no control. And no doubt the Board persuaded itself as well as others that its reasoning was true. Hence, as events proceeded, it was increasingly inclined to look elsewhere for the solution, at first to hope that matters would right themselves, then increasingly to accept the view that crisis and doom were the inescapable product of forces in the private business community that were developing beyond the System's control. Having failed to act vigorously to stem the first liquidity crisis in the fall of 1930, the System was even less likely to act the next time. It was only great pressure from Congressional critics that induced the System to reverse itself temporarily in early 1932 by undertaking the large-scale securities purchases it should have made much earlier. When the operation failed to bring immediate dramatic improvement, the System promptly relapsed into its earlier passivity.

The foregoing explanation of the financial collapse as resulting so largely from the shift of power from New York to the other Federal Reserve Banks and from personal backgrounds and characteristics of the men nominally in power may seem farfetched. It is a sound general principle that great events have great origins, and hence that something more than the characteristics of the specific persons or official agencies that happened to be in power is required to explain such a major event as the financial catastrophe in the United States from 1929 to 1933.

Yet it is also true that small events at times have large consequences, that there are such things as chain reactions and cumulative forces. It happens that a liquidity crisis in a unit fractional reserve banking system is precisely the kind of event that can trigger—and often has triggered—a chain reaction. And economic collapse often has the character of a cumulative process. Let it go beyond a certain point, and it will tend for a time to gain strength from its own development as its effects spread and return to intensify the process of collapse. Because no great strength would be required to hold back the rock that starts a landslide, it does not follow that the landslide will not be of major proportions.