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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

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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. 76, 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.[168]

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.

[168] 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 qualitative controls need to be supplemented by quantitative controls, in "The Stabilization Doctrines of Carl Snyder," *Quarterly Journal of Economics*, Aug. 1935, pp. 618–620); 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,

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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."[111]

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.

[111] *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 succession of government agencies, ending with the Federal Farm Board, before coming to the Reserve Board in 1930. Meyer was appointed just after Harrison had failed in his at-

[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).

tempt 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.[117] 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.[118]

[117] 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.

[118] 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, 180; 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.[119] 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 appoinment; 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).

[119] 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.