The 'Chicago Plan' and New Deal Banking Reform

by

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The history of the legislative changes in the financial system which occurred during the 28 months from Franklin D. Roosevelt's inauguration in March 1933 until the passage of the Banking Act of 1935 has been well documented [Burns 1974; Kennedy 197'31. This period saw the enactment of the Emergency Banking Act, the Banking Acts of 1933 and 1935, as well as reforms of the stock market and agricultural credit. The existing histories have given us detailed examinations of the political maneuvering involved in the passage of the legislation, but they have neglected the role of the "Chicago plan" --the 1933 proposal put forward in a series of memoranda by economists at the University of Chicago to abolish the fractional reserve system and impose 100% reserves on demand deposits. The proposal was known to the Roosevelt administration prior to the passage of the Banking Act of 1933 and later led directly to legislation introduced by Senator Bronson Cutting of New Mexico, and other Progressives, as part of the debate over the Banking Act of 1935. The influence of the Chicago plan was felt even before Irving Fisher's more widely known, and largely unsuccessful, efforts to enlist Roosevelt's support for the 100% reserve plan [Allen 1977, 1991].

The Chicago plan was a proposal to radically change the structure of our financial system, and as such its best chance of passage was in the period of the early New Deal. The objective of this paper is to document the role of the Chicago plan in the debates over New Deal banking legislation, and provide an

assessment of why the Chicago plan ultimately lost out to the alternative measures embodied in the Banking Act of 1935. The failure of the Chicago plan in the 1930s is also of interest in the contemporary debates over banking reform. The Chicago plan, by restricting bank assets, would not have saddled the taxpayers with an enormous liability from federal deposit insurance. Recently, proposals have been put forward for "narrow" or "core" banks, which restrict bank assets, and embody many of the components of the Chicago plan [Tobin 1985, 1987; Bryan 1988, 1991].

The Banking Crisis and the March Memorandum

The stock market crash of October 1929 was followed one year later by a banking crisis lasting from October to December 1930. As deposits in failed banks rose, a contagion spread to convert demand and time deposits into currency and, to a lesser extent, postal savings deposits [Friedman and Schwartz 1963: 308]. In December, the failure of the Bank of United States, though a private commercial bank, furthered damaged confidence in the banking system [Friedman and Schwartz 1963: 3113. After a brief respite, this was followed by the second banking crisis in March 1931 which peaked in June with $200 million in deposits of suspended banks [Friedman and Schwartz 1963: 314].

In January 1932, President Hoover asked Congress for legislation to reform the banking system. Hoover asked for a strengthening of the Federal Land Bank System, the creation of the

Reconstruction Finance Corporation, the creation of Home Loan Discount Banks, an enlargement of the discount privileges of the Federal Reserve Banks, and a plan to safeguard depositors and a swifter means of paying off those who held deposits in closed banks [Krooss 1969: 2670-2671]. During the same month, the Reconstruction Finance Corporation (RFC) was created and authorized to loan to banks and railroads [Friedman and Schwartz 1963: 321]. The Glass-Steagall Act, passed on February 27, 1932, allowed the Federal Reserve to hold government securities against Federal Reserve notes and widened the circumstances under which member banks could borrow from the Fed [Friedman and Schwartz 1963: 321]. In July 1932, the Federal Home Loan Bank Act, which attempted to respond to the problems of home mortgage financing institutions by allowing advances to be made to those institutions on the basis of first mortgages, was passed [Friedman and Schwartz 1963: 321-322]. The only piece of legislation which did not pass was a bill for temporary deposit insurance introduced in May by Congressman Henry Steagall, which was not reported out of committee [Friedman and Schwartz 1963: 321].

In January 1933, the RFC made public the list of financial institutions that it had loaned to (Hoover had insisted they not be public). One state (Nevada) had already declared a banking holiday in October 19'32, and was followed by Iowa in January, Louisiana and Michigan in February, and by March 3rd, there were bank holidays declared in about half the states. The pressure intensified on the New York banks and on March 4th, a banking holiday was declared in

New York state [Friedman and Schwartz 1963: 324-327].

When Roosevelt came into office, he faced a myriad of problems related to the economy. Farmers, workers, bankers, politicians, were all demanding action. On the financial front, there were three critical issues which had to be dealt with: (1) the safety of the medium of exchange; (2) the financing of the capital development of the economy; and (3) the control of money and credit by the Federal Reserve. In response to the widespread bank holidays which had already been declared by many states, Franklin Roosevelt's first act as President was to declare a national bank holiday for the period March 4-9, 1933. In his inaugural address, Roosevelt, referring to the financial collapse, stated that "The money changers have fled from their high seats in the temple of our civilization" [Schlesinger 1957: 7; Tugwell 1957: 289].

Despite the eloquent rhetoric against bankers, Helen Burns observed, Roosevelt never definitively set forth his own views own banking [Burns 1974: 183].[1] Roosevelt was against federal deposit insurance, at least when he took office. During his first press conference he was asked to comment on federal deposit insurance and.he did so, but asked that his remarks be kept off the record. Roosevelt said of federal deposit insurance:

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[1] During the period of the banking holiday, Roosevelt proposed to his advisors a plan for converting all government bonds ($21 billion at the time) directly into cash at par. His advisors thought it would be a disaster, but Roosevelt told them to come up with an alternative. Also discussed was the issuing of script or a direct printing of Federal Reserve Notes to provide the banks with enough cash to meet withdrawal demands. This plans were not needed because at the end of the bank holiday, widespread runs had ended [Burns 1974: 45].

> The general underlying thought behind the use of the word 'guarantee' with respect to bank deposits is that you guarantee bad banks as well as good banks. The minute the Government starts to do that the Government runs into a probable loss. ... We do not wish to make the United States Government liable for the mistakes and errors of individual banks, and put a premium on unsound banking in the future [Roosevelt 1939: 37].

Roosevelt's concern over the plight of debtors, especially farmers, was also evident. Writing a few months later to his Secretary of Treasury William Woodin, Roosevelt blasted the bankers and economists for their neglect of the problem:

> I wish our banking and economists friends would realize the seriousness of the situation from the point of view of the debtor classes, --i.e., 90 per cent of the human beings in this country-- and think less from the point of view of the 10 per cent who constitute the creditor classes [Roosevelt to Woodin, September 30, 1933]

The Emergency Banking Act, which was passed in less than an hour, did not provide any permanent solutions to the problem, it only gave the Congress and the President a breathing spell in which to formulate a plan. During his first fireside chat that Roosevelt explained his reasons for closing the banks and announced their

reopening. It is a tribute to Roosevelt's charisma that when the banks reopened on Monday, March 13th, the runs had virtually ended. Walter Lippmann remarked that "In one week, the nation, which had lost confidence in everything and everybody, has regained confidence in the government and in itself" [Schlesinger 1958: 13]. Raymond Moley, one of the original Brain Trusters wrote: "Capitalism was saved in eight days" [Moley 1939: 155].

In is within this historical context that economists at the University of Chicago presented their proposal for reform of the banking system.' The six page memorandum on banking reform which was given limited and confidential distribution to about 40 individuals on March 16, 1933 [Knight 19331. A copy of the memorandum was sent to Henry A. Wallace, then Secretary of Agriculture, with a cover letter signed by Frank Knight. The letter listed the following supporters of the plan: F. H. Knight, L. W. Mints, Henry Schultz, H. C. Simons, G. V. Cox, Aaron

[2] After the passage of the Glass-Steagall bill in February 1932, there were two other proposals on the. legislative agenda intended to stimulate the economy. The first was an amendment by Wright Patman to pay the remaining portion of the veterans's bonus in the form of a direct issue of $2.4 billion in fiat currency. The second was the Goldsborough Bill which would direct the Federal Reserve to take appropriate actions to raise the price level [Barber 1985: 155]. In mid-April, Congressman Samuel B. Pettengill solicited responses to the Patman proposal from leading economists. Twelve members of the economics faculty at the University of Chicago responded in a lengthy statement which advocated federal expenditures financed by deficit spending, unless the gold standard could be abandoned and a direct issue of currency could be utilized to increase purchasing power. The document included concerns about the role of credit and price inflexibility in the economy [Barber 1985: 156-157]. A group of eleven Chicago economists signed a memoranda in January 1933 which advocated deficit spending as a way out of the depression [Schlesinger 1960: 2371.

Director, Paul Douglas, and A. G. Hart.[1] The authors anticipated skepticism about their plan as evidenced by a typed postscript which stated: "We hope you are one of the forty odd who get this who will not think we are quite looney (sic), I think Viner really agrees but doesn't believe it good politics."

The proposal opens with the statement: "It is evident that drastic measures must soon be taken with' reference to banking, currency, and federal fiscal policy." The general recommendations were: (a) federal guarantee of deposits; (b) the guarantee only be taken as part of a drastic program of banking reform which will certainly and permanently prevent any possible recurrence of the present banking crisis; and (c) the Administration announce and pursue a policy of bringing about, and maintaining a moderate increase in the level of wholesale prices, not to exceed 15 percent [Knight 1933: 1].

The detailed suggestions advocated outright ownership of the Federal Reserve Banks; the guarantee of the deposits of member banks which were open for business March 3rd, 1933 but subject to full supervisory control over the management of these banks by the Fed. They advocated the issue of Federal Reserve Notes, which should be declared legal tender, in any amounts which may be necessary to meet demands for payment by depositors. Further, the Federal Reserve Banks should liquidate the assets of all member banks, pay off liabilities, and dissolve all existing banks and new institutions should be created which accepted only demand deposits subject to a 100% reserve requirement in lawful money and/or

deposits with the Reserve Banks. Saving deposits would be handled through the incorporation of investment trusts. Present banking institutions would continue deposit and lending functions under Federal Reserve supervision until the new institutions can be put into place. The government should then undertake to raise the price level by 15 percent by fiscal and currency means but further inflation (beyond 15 percent) be prevented. Finally, there should be suspension of free-coinage of gold, embargo upon gold import, prohibition of private export of gold, call in all gold coins in exchange for Federal Reserve notes, suspension of the gold-clause in all debt contracts, and substantial government sale and export of gold abroad [Knight 19331.

Henry Wallace, then Secretary of Agriculture, gave the Chicago plan to Roosevelt less than a week after it was distributed. Wallace hoped FDR would give the plan serious consideration, though the plan was a radical break with the past. Wallace wrote to Roosevelt:

> The memorandum from the Chicago economists which I gave you at [the] Cabinet meeting Tuesday, is really awfully good and I hope that you or Secretary Woodin will have the time and energy to study it. Of course the plan outlined is quite a complete break with our present banking history. It would be an even more decisive break than the founding of the Federal Reserve System [Wallace to Roosevelt, March 23,1933].

Though Roosevelt's views on the Chicago plan are unknown, the plan addressed his concerns of deposit safety, the separation of investment and commercial banking, and reflation. It also provided an alternative to those who advocated branch banking, which Roosevelt was very much against because he thought it would mean domination of the small banks by the larger banks. The recommendation for deposit insurance was that it only be a temporary measure as part of permanent reform.

During the first 100 days of the Roosevelt administration, numerous measures were passed to deal with the economic situation, and especially the crisis of the banking system and agricultural. On March 20, the Economy Act was passed; on March 31, the Civilian Conservation Corp was created; and on April 19, the U.S. went off the gold standard. These measures were followed by the sweeping reforms of the Agricultural Adjustment Act (AAA) in May which sought to raise agriculture prices through output restrictions. An amendment to the AAA gave the President the power to issue greenbacks and to monetize gold [Schlesinger 1958: 199-200]. Congress also passed the Emergency Farm Mortgage Act in May which provided for the refinancing of farm mortgages. The month of June saw the passage of the Home Owners's Loan Act, providing for the refinancing of home mortgages, the National Industrial Recovery Act (which included a public works program), the Farm Credit Act, the joint resolution by Congress to suspend the gold standard and abrogate the gold clause, and perhaps most importantly, the Banking Act of 1933, which separated investment and commercial banking,

established temporary federal deposit insurance, and made an official body the previously informal Federal Open Market Committee.

Thus by June, many of the proposals contained in the March memoranda had been enacted. Though there was a separation of commercial and investment banking, 100% reserve deposit banks had not been created. Federal Reserve notes had not been declared legal tender, and though liberalized, the Federal Reserve still did not have full use of its policy tools to affect monetary aggregates. The Fed had long had the discount rate, though it could vary regionally, and now as a result of the Thomas Amendment to the AAA, the suspension of the gold standard, and the Banking Act of 1933, it could issue Federal Reserve notes. However, the Fed was not yet totally free to set reserve requirements.

Though Roosevelt had opposed deposit insurance, there was strong support for it within Congress and the general public. As Carter Golembe has argued, federal deposit insurance was neither requested nor supported by the Roosevelt administration. Deposit insurance was purely a creation of Congress where for nearly fifty years there had been attempts to introduce it. Its adoption in 1933 was, according to Golembe, due to a uniting of two groups: those that wished to end the destruction of circulating medium due to bank failures and those who sought to preserve the existing bank structure [Golembe 1960: 182]. Deposits up to $2,500 were insured 100%, up to $5,000 insured 75%, and over $10,000, fifty percent.

There was also widespread support for the separation of

commercial and investment banking because it was believed that bankers had speculated with depositors funds in the stock market, and when the stock market speculation spree ended, many banks became insolvent. The separation of investment and commercial banking was supported by prominent bankers such as Winthrop Aldrich [Leuchtenburg 1963: 601.

The two proposals, for federal insurance and separation of commercial and investment banking, were linked in the Banking Act of 1933. The linking of these two reforms is vital in the understanding of the subsequent evolution of the debates and reforms. Though they became identified as administration measures, the crisis nature of 1933, and the support of a new administration, merely facilitated their passage. Deposit insurance made banks "safe" not by direct restrictions on their assets, but rather by the promise that the government would guarantee <u>all</u> banks, both good and bad. The separation of commercial and investment banking removed some abuses resulting from the use of depositors funds in stock market speculations, but it did not address directly the issue of financing for the capital development of the economy.

On passage of the Act, J. P. Morgan predicted that the separation would have dire effects on his firm's ability to supply capital "for the development of the country" [Schlesinger 1958: 443]. William O. Douglas observed that the Act was a nineteenth century piece of legislation which ignored the need the problem of capital structure and the need to manage investment [Schlesinger 1958: 445]. While it is true that the RFC had undertaken the role

of providing capital funds for industry, the banking legislation attempted to restore credit availability by restoring confidence in the medium of exchange, and therefore an increase in bank deposits. The Banking Act of 1933 attempted to kill two birds with one stone. Though it succeeded in stopping bank runs, the fractional reserve nature of the banking system, coupled with a lack of power on the part of the Federal Reserve Board, effectively undermined the ability of the financial system to supply adequate investment funds. In 1929, the ratio of loans to total assets for all commercial banks was 58%. By 1934, that ratio had fallen to 38%, as total bank assets began increasing after falling steadily from 1929 to 1933. This was also in spite of the fact that total bank failures went from 4,000 in 1933 to 61 in 1934. Clearly, though bank numbers were increasing and total assets were increasing, bank loans remained at about the same level from 1933 to 1936. The economy was in a credit crunch.

In late October 1933, Roosevelt began the gold purchase program, operating through the RFC, in an attempt to raise agricultural prices through the purchase of domestically held gold. According to Arthur Schlesinger, the gold-purchase program set the financial community in an uproar and the result was a national debate over monetary policy that had not been seen since the William Jennings Bryan campaign of 1896 [Schlesinger 1958: 244-2451. With the 73rd Congress meeting for a second session, it was clear that 1934 was to be the decisive year for debate on monetary reform. However, after the introduction of deposit insurance, bank

failures dropped from 4,000 in 1933 to 61 in 1934. Federal deposit insurance was a program which had worked to restore to confidence in the banking system and assured little opposition to the establishment of permanent deposit insurance.

Though much had been accomplished by November 1933, the central problem which remained was the Federal Reserve's ability to use all means available to it to affect monetary aggregates. In order to do this, changes would have to be made to the Federal Reserve Act which would restrict the power of individual Reserve Banks, especially New York, while strengthening the power of the Federal Reserve Board in Washington. This was the focus of the November Chicago memoranda, and it was to become the crucial issue in the Banking Act of 1935.

The November 1933 Memoranda

During the period March to November, the Chicago economists received comments from a number of individuals on their proposal and in November 1933 another memorandum was prepared.[3] The memorandum was expanded to 13 pages, there was a supplementary memorandum on "Long-time Objectives of Monetary Management" (7 pages) and an appendix titled "Banking and Business Cycles" (6 pages). Though signed by the same group of economists, this

[3] In April Simons circulated a revised version of the last three pages of the March proposal. This material was later expanded and used in the November version.

document was evidently written by Henry Simons.[4] The proposal began by noting that government had failed in its primary function of controlling currency by allowing banks to usurp this power. Such "free banking" in deposit creation "gives us an unreliable and inhomogeneous medium; and it gives us a regulation or manipulation of currency which is totally perverse." What was necessary was a *'complete reorientation of our thinking'* and a redefinition of the objectives of reform." [Simons 1933:1] The solution was the "outright abolition of deposit banking on the fractional-reserve principle." [Simons 1933: 2]

The proposal included many of the items in March reform: (i) Federal ownership of the Federal Reserve Banks; (ii) exclusive Congressional powers to grant charters for deposit banking; (iii) suspension of all powers of existing corporations to engage in deposit banking within two years; (iv) creation of a new type of deposit bank with 100% reserves in the form of notes and deposits at the Federal Reserve Banks; (v) abolition of reserve requirements for Federal Reserve Banks; (vi) replacement of private-bank credit with Federal Reserve bank credit over a two-year transition period; and restricting currency to only Federal

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[4] In a letter to Paul Douglas, Simons wrote:

> the memorandum, as I consider it now, has so many faults that there should be no quarrels over "proprietorship." Actually I did write the thing alone; but it would never have been written except for my conversations with other people, Mr. Director especially; and it never would have been circulated without favorable critical reports from yourself and the other members of the group. So, what is uniquely my own is merely the phrasing [Simons to Paul Douglas, October 2, 1934].

Reserve notes. However, they went on to add: (vii) enacting a simple rule of monetary policy; (viii) and achievement of a price-level specified by Congress. There is no mention of federal deposit insurance which had already gone into effect in June.

As before, the plan would displace existing commercial banks by two types of institutions: deposit banks and investment trusts. If private companies failed to provide new deposits, then government through the extension of a postal savings system could offer such deposits. [Simons 1933: 6] Investment trust banks would acquire funds exclusively by sale of their own securities, thereby limiting-their lending capacity to the funds so obtained. Investment trust banks would provide a service by bringing borrowers and lenders together, and could therefor charge for this service. [Simons 1933: 7] The memorandum also evaluated a return to the gold standard (which was rejected unless it was a 100% gold standard) and various rules to guide monetary policy, including price-level stabilization. [Simons 1933: 8-11] The proposal noted that a monetary rule which set money supply growth could be carried out by conversion of interest-bearing federal debt into non-interest bearing debt, open market operations by the Reserve banks, an increase in federal expenditures, or a reduction in federal taxes. [Simons 1933: 12]

In summary, the memoranda stated that the Federal Reserve Act had faulty objectives because commercial paper offered no real liquidity, and that the answer lay in the abolition of fractional reserve banking, so that a reconstituted Federal Reserve would have

precise power over the money supply. However, monetary management was not to be discretionary, but subject to definite rules laid down by Congress.

This version of the proposal which was given to Gardiner C. Means, who worked for Assistant Secretary of Agriculture, Rexford G. Tugwell. Means's responded to the Chicago plan in a three page, single spaced memo [Means, "Comment", c1933]. Given the Administration's concern over the relationship between farmers and bankers, it is no surprise that the Agriculture Department would be interested in monetary reform. Mean's praised the Chicago memorandum's primary objective of placing control of the monetary medium in the exclusive hands of government, and the method by which the transition would be effected [Means 1933: 1]. He thought the Chicago proposal provided a "relatively simple and direct method of dealing with the deposits aspect of our banking system," though it would likely be opposed by bankers [Means 1933: 21. Means's only disagreements with the plan was that he would allow the Federal Reserve banks to purchase high grade commercial paper in order to establish 100% reserves, and Means argued that monetary policy should be discretionary, and not subject to a rule [Means 1933: 3]. It is interesting that the Chicago proposal had found greatest favor with Rexford Tugwell (who advocated a similar scheme to expand the postal savings system) and Gardiner Means, both institutional economists and planners.

With the onset of severe erosion problems in a number of western states in 1934, Agriculture Department attention focused on

the immediate concerns of conservation. As output fell, prices of agricultural products rose, thus further easing financial pressures on farmers. Between 1932 and 1936, gross farm income increased 50 per cent, and cash receipts from marketing, including government payments, nearly doubled. The relative price of agricultural products rose as farm debt decreased dramatically. Thus at a time when the economy was still experiencing high unemployment, agriculture was beginning to recover [Schlesinger 1958: 71].

In January 1934, Roosevelt sent a message to Congress asking for legislation to organize a sound and adequate currency system. Roosevelt requested that Congress enact legislation to vest in the United States Government sole title to all American owned monetary gold and "other monetary matters [which] would add to the convenience of handling current problems in this field." FDR furthered indicated that the Secretary of the Treasury was prepared to submit information concerning changes to the appropriate committees of the Congress [Krooss 1969: 27911. It was soon after FDR's address to Congress that there was direct involvement by the Chicago group in the drafting of legislation to enact the Chicago plan for banking reform.

Legislating the Chicago Plan

Robert M. Hutchins, the President of the University of Chicago, mailed a copy of the November Chicago plan to Senator Bronson Cutting of New Mexico in December 1933. Cutting was a

progressive Republican in the mode of Robert LaFollette, Sr. He was highly critical of the role of private bankers in the economy and an advocate of greater government involvement in banking and credit and national planning. As Schlesinger has noted, this emphasis on planning and the role of government was very much in line with New Dealer's such as Tugwell, Means, Adolph Berle, and others [Schlesinger 1960: 389-391]. Cutting was one of the radicals in the Senate, mostly old Progressives, which included: George Norris, Robert La Follette, and Gerald P. Nye, all Republicans, and Democrats Burton K. Wheeler of Montana, Edward P. Costigan of Colorado and Homer Bone of Washington, all of whom started as Progressive Republicans [Schlesinger 1960: 134-5].

Cutting was quite interested in the Chicago proposal and largely in agreement. He replied to Hutchins:

> I may say at once that I agree decidedly with most of the views expressed by the members of your faculty. I wonder if any of them has considered the idea of drafting a bill embodying their views? I suspect that Bob La Follette would be as much interested in this matter as I am, and if we could get a draft in tangible shape, it would at least give us something to shoot at [Cutting to Hutchins, December 15, 1933].

Hutchins replied "we'll set to work drafting a bill" [Hutchins to Cutting, December 22, 1933], however, in March 1934, Cutting wired

Hutchins inquiring about the status of the proposed bill [Cutting to Hutchins, March 7, 1934]. As a result, Henry Simons traveled to Washington and met with Cutting on March 16 to discuss the essential features of a bill [Simons to Cutting, March 10, 1934; Cutting to Simons, March 14, 1934]. Simons did not feel that he was qualified to draft an entire bill since he would not be familiar with many of its technical features. His outline for a bill was given to Cutting and Senator Robert La Follette, Jr. The actual bill was written by Robert H. Hemphill, a writer for the Hearst newspapers.[5]

To kick off the campaign for his bill, Cutting published an article in the March 31, 1934 issue of Liberty magazine entitled "Is Private Banking Doomed?" Cutting's answer, of course, was that it was doomed by the New Deal because government should control money and credit, without the interference of private banks. Cutting remarked that unless the administration introduced such legislation to deprive private bankers of this power, that he would introduce such a measure [Cutting 1934: 10].

Banks could remain, in Cutting's view, if they held 100%

[5]"While in Washington, I prepared for Senators Cutting and LaFollette a rough outline of some features of a possible bill. I am enclosing a copy of this outline -- although it is too crude for critical examination." [Simons to Irving Fisher, March 29, 19341 In a later letter to Fisher, Simons wrote: "The Cutting Bill, for present purposes at least, is much better than I had anticipated. It was written by Robert Hemphill, of the Hearst staff and formerly with the Richmond (?) Reserve Bank." [Simons to Fisher, July 4, 19341. Simons reluctance to become more involved in the legislative battle apparently reflected his growing reservations about "crucial details of the scheme as I had outlined it" [Simons to Frank Taussig, November 12, 1934].

reserves against deposits, but they would not be allowed to create credit. Cutting expected a battle against the bankers would not be easy, and lamented FDR's failure to nationalize the banks in March 1933. Cutting wrote:

> The fight against the abolition of the credit power of private banks will be a savage one, for their power as a unit is without equal in the country. Knowing this is why I think back to the events of March 4, 1933, with a sick heart. For then, with even the bankers thinking the whole economic system had crashed to ruin, the nationalization of banks by President Roosevelt could have been accomplished without a word of protest. It was President Roosevelt's great mistake. Now the bankers will make a mighty struggle [Cutting 1934: 12].

On May 19, 1934, Senator Cutting gave a speech to the People's Lobby in which he announced his intention to introduce a bill to create a national bank which would have a monopoly of credit and that private bankers should not make profits from credit. Cutting was quoted as saying:

> The bankers are collecting tribute from the community on the community's credit. ...Commercial banking and issuing of credit should be exclusively a government function. Private financiers are not entitled to any

profit on credit [New York Times, May 20, 1934, 32:1].

Business Week, noting that radical ideas for banking reform were receiving wide support, wrote in reference to Cutting's remarks:

> The fact that the more radical opinions are so widespread as to be reflected in the House indicates that the banks have not resold themselves to the public. ... But unless the banks convince the people the present system is best or unless business picks up markedly by the start of 1935, Congress may go beyond the small changes of the deposits insurance bill and alter the whole banking setup -- despite the anguished wails of established banks. [Business Week, June 2, 1934, p. 27]

The bill, S. 3744, was introduced by Cutting and Congressman Wright Patman of Texas (H.R. 9855) on June 6, 1934 and had as its stated objective to "provide an adequate and stable monetary system; to prevent bank failures; to prevent uncontrolled inflation; to prevent depressions; to provide a system to control the price of commodities and the purchasing power of money; to restore normal prosperity and assure its continuance." [U.S. Congress 1934] To achieve these goals, the bill proposed to (1) segregate demand from savings deposits; (2) require the banks to keep 100% reserves against their demand deposits; (3) require them to keep 5% reserves against their savings deposits; (4) set up a

Federal Monetary Authority with full control over the supply of currency, the buying and selling of government securities, the gold price of the dollar; (5) have the FMA take over enough of the bonds of the banks to provide 100% reserve against their demand deposits; and (6) have the FMA raise the price level to its 1926 position and keep it there by buying and selling government bonds.[6] As a consequence of this bill, the only money that would exist would be either currency issued by the Federal Monetary Authority, or in demand deposits backed 100% by lawful money (gold) or government securities. The legislative bill would retain squarely within the federal government the power given to it in the Constitution to create money and maintain its value. This bill would also achieve the other long-run New Deal objectives of raising the price level and to strengthen government's influence on economic activity, in this case, through monetary policy.

Cutting, who shared Roosevelt's background as a graduate of Groton and Harvard, and should have been a natural political ally, had alienated Roosevelt over the issue of payment of the veteran's pensions. Cutting had worked hard against Roosevelt's attempt to reduce veteran's pensions [Schlesinger 1960: 140]. Whether warranted or not, Roosevelt personally disliked Cutting, who was the only Progressive that Roosevelt failed to endorse for reelection in 1934. There is little doubt that the animosity between Roosevelt and Cutting would mean little likelihood of

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[6]For favorable comments on the bill from Canada, see S.H. Abramson "A Proposal for Banking Reform," The Canadian Forum, October 1934.

administration support for Cutting's bill.

It is also clear that Cutting did not view the measure as one that would be politically acceptable at the time, but it would help set the agenda. He wrote:

> The bill which I introduced is merely tentative, and there is no intention of pressing it at the present session, when, you will understand, passage would be impossible. I introduced it largely as a target for criticisms and suggestions, such as yours [Cutting to E. W. Mason, June 16, 1934].

Robert Hemphill, who drafted the bill, was convinced that the 100% reserve plan was the only real solution. In an article in the November 1934, Magazine of Wall Street, he stated that he knew of no valid argument against the Cutting bill's reforms and in fact believed that they were inevitable [Hemphill 1934: p. 109]. Hemphill was optimistic that the bill he had drafted for Cutting would play an important role in the debates on banking reform and intended to garner wide support for the plan. He wrote of its importance to Cutting:

> I have a hunch this bill is going to inaugurate a prolonged battle which you will finally win, and I regard this legislation as the most important that has been offered in a century; . . . I am going to use every effort and every avenue, and believe we can assemble a very

> powerful and influential group behind this legislation. I am going to cable Mr. Hearst, and am sure he will get right in behind the movement, and am also going to keep closely in touch with the Treasury and the study they propose to make of this question this summer [Hemphill to Cutting, June 7, 1934]

Hemphill's reference to the forthcoming Treasury study undoubtedly reflected his view that the 100% reserve plan would be given serious consideration. The studies undertaken during the summer and fall of 1934 by the Treasury formed the backbone research for the Administration's version of the Banking Act of 1935. The studies were undertaken in a context that sweeping reform of the system, especially the Federal Reserve, was necessary and politically possible for the next Congressional session. The November election results were very favorable to the New Deal and FDR was in a strong position to complete the overhauling of the banking system.

Cutting's bill served to put the Roosevelt administration on notice that there were those in Congress prepared to take drastic and extreme measures if the administration's reforms did not go far enough toward complete government control of money and credit. The goal of the bill was to correct the shortcomings of the Banking Act of 1933. The Act had not addressed the problem of the availability of credit, nor had it dealt with the issue of the Federal Reserve's control over the money supply. The Cutting bill sought to make

both the money supply and credit availability subject to government control.

In 1934, the New York Fed, and therefore the New York banks, still held substantial power with respect to monetary policy [Schlesinger 1960: 293]. Though the price level was rising in 1933-34, it was still about 30-40% below the 1926 level. In October 1934 Roosevelt made a speech to the bankers convention imploring them to aid the recovery and begin making loans (FDR Public Papers, pp. 435-440, speech 10/24/34). There was clearly more to be done with respect to banking reform in 1935.

The Banking Act of 1935

According to Rexford G. Tugwell, an original member of FDR's Brain Trust, the objectives for banking reform as they developed within the New Deal were: (1) making deposits safe; (2) separating deposits from investments so that bankers could not speculate with the depositors's funds; (3) to raise and stabilize the price level; and (4) to strengthen central management so that governmental influence could be brought to bear on business activity [Tugwell 1957: 368]. As already discussed, the Banking Act of 1933 addressed the first two objectives: deposit safety and separation of deposit and investment banking. The remaining goals were interconnected: centralize control of the monetary policy in Washington, and undertake an expansionary policy to raise the price level. As the legislative battle unfolded, the administration

found itself between the radicals and the Progressives who wanted complete centralization and government control of money and credit, and Carter Glass, one of the architects of the Federal Reserve Act, who was against any changes in the Act.

The Administration strategy for the final phase of banking reform began with studies directed under Jacob Viner. William Woodin was Roosevelt's first Secretary of the Treasury, but when he resigned for health reasons in November 1933, Roosevelt nominated an old friend, Henry Morgenthau, to take his place. The appointment was confirmed in January 1934, and soon afterward Morgenthau suggested to Jacob Viner, who was a special assistant to the Secretary, that he assemble a group of the best minds he could find in monetary, banking, and public finance, to see what they could come up with.[1]

The group would include Viner, four senior staff, four junior research staff, and clerical and secretarial staff. On June 27, 1934, Secretary Morgenthau announced that the Treasury was undertaking a number of studies in preparation for next year's legislative program in the areas of currency and banking and taxation and revenue [Treasury Department Press Release, June 27th, 1934]. Those temporarily employed by the Treasury to work on the

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[1]Albert G. Hart in a letter to Henry Simons encouraging wide distribution in government of the Chicago proposal, noted: "Viner complained to us this summer that before he went there (Treasury) he was deluged with circulars on policy, but that there seemed to be a tabu among economists against writing on policy to people who might conceivably be in positions of some power"[Albert Hart to Henry Simons, December 9, 1934].

Monetary and Banking Survey studies were: Lauchlin Currie, Harry D. White, Albert G. Hart, Benjamin Caplan, Virginius F. Coe, and Edward C. Simmons.* It is important to note, that two of this group, Currie and Hart were already known advocates of the 100% reserve plan, while Viner appears to have been at least strongly sympathetic.

In his book, The Supply and Control of Money in the United States, Currie presented a model of the money supply mechanism in which the major source of variation in the money supply was the level of excess reserves, while the Federal Reserve's primary means of control of the money supply was the level of required reserves [Steindl 1992: 452-3]. At the time Currie wrote, the Federal Reserve did not have the power to change reserve requirements. The Federal Reserve actions were firmly grounded in the "real bills doctrine." The Fed was allowed to discount only real bills, and thus its monetary policy was pro-cyclical. Currie saw this as a major limiting factor in effective monetary control. Currie then went on to discuss the "ideal conditions" for monetary, control which he argued was a system with 100% reserve requirements on

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*The reports were: Edward C. Simmons, "The Currency System;" Benjamin Caplan, "Branch Banking;" A. G. Hart, "Federal Credit Institutions;" Lauchlin Currie, "Monetary Control in the United States," and "Deposit Insurance;" Alan R. Sweezy, "Objectives and Criteria of Monetary Policy;" H. D. White, "Selection of a Monetary Standard for the United States;" and H. W. Riley, "Bank Examinations and Bank Reports." [Mrs. Belsley to Mr. Viner, Inter Office Communication, Department of Treasury, December 20, 1934, FDR Library, Morgenthau Papers, Correspondence, Box 301, File Viner 1933-34].

demand deposits.[9] In a footnote in his book, Currie stated that Albert Hart had brought the Chicago proposal to his attention after the book had gone to press [Currie 1968: 156].

In September 1934, Lauchlin Currie submitted a comprehensive proposal for monetary reform to the Secretary of the Treasury Henry Morgenthau. The fundamental faulty working of the monetary system Currie attributed to the unsatisfactory nature of the compromise between private creation of money with governmental control [Currie 1968: 197].

Currie did not provide an elaborate theoretical rationale, as the Chicago economists had in their appendix on "Banking and Business Cycles," but rather noted that the monetary system had been acting as a "maladjustment-intensifying factor" due to the "unsatisfactory nature of the compromise of private creation of money with government control" [Currie 1968: 197].

Currie proposed that the reserve ratio for checkable deposits be 100%, for non-checkable deposits 0%, and an end to interbank deposits unless subject to 100% reserves. During the transition to the new system, Currie sought to insure that banks would not see a loss of income with the increase in the reserve requirements. When the new policy was announced, banks would initially meet the 100%

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[9] In his book The Supply and Control of Money in the United States, and stated in a footnote that he learned of the Chicago proposal after he had written his book [Currie 1934: 156]. Simons greatly admired Currie's book on the supply of money and reviewed it in the Journal of Political Economy. In a letter from Simons to Fisher, Simons says: "I'm interested in your mentioning the Currie book. It's the only book on banking, and almost the only decent book in American economics, which makes me genuinely envious of the author for having written it." [Simons to Fisher, November 9, 1934]

requirement with a non-interest bearing note from the Reserve banks. This note might be left outstanding indefinitely, or only retired upon suspension or merging of the bank. Alternatively, the debt might be retired over a period of time from 5 to 20 years by the member banks turning over to the reserve banks Government bonds. [Currie 1968: ZOO-2013 Any excess reserves held at the time of the imposition of 100% reserves may be loaned out, but there will be no multiplier effect because of the 100% reserve requirement. [Currie 1968: 202] Assuming the reserve ratio was initially 15%, once the 100% reserve policy goes into effect, a typical balance sheet might look as follows:

Assets:		Liabilities:	
Required Reserves	100	Checkable Deposits	100
Excess Reserves	0	Note payable to Fed	85
Loans	85		

There would be no impact on the current earning capacity of the bank, nor would there be a significant increase in expenses, since the note payable to the Fed would be non-interest bearing and with negligible transactions costs. However, if banks experienced an increase in deposits, say in the amount of 10, then under 100% reserves, they could not acquire any earning assets. Currie proposed that under these circumstances banks be paid interest on that portion of the addition to reserves that could have been loaned out under the fractional reserve system. Thus for example,

if deposits increased by 10, Currie would propose that interest be paid to the banks by the Reserve banks on 8.5 of the addition to reserves. The interest rate paid would be that on specified government bonds. [Currie 1968: 202] Of course, if deposits declined, then the process is reversed and banks would pay the Reserve banks a comparable amount.

If it is decided that banks must repay the Fed loans made at the time of the implementation of the 100% reserve system, the interest earned on those bonds would be paid to the commercial banks. Again, there would be no impact on the current income/expense situation of the bank. However, once those initial loans are repaid, banks could no longer acquire earning assets by selling checkable deposits. As a final policy recommendation, Currie proposed that banks be allowed to make service charges for their checkable accounts to avoid incurring a loss. [Currie 1968: 2041

In the event that the implementation of the 100% reserve plan created a shortage of loanable funds in a particular area, then the Reconstruction Finance Corporation (RFC) would be empowered to subscribe to the capital of local loaning agencies, to make secured loans, or to establish loaning agencies [Currie 1968: 219].

Currie's views are important, because he was soon to become intimately involved with drafting the administration version of the Banking Act of 1935. The key figure in the administration's strategy for banking reform in 1935 was Marriner Eccles, a Morman banker who had impressed Tugwell and Henry Morgenthau, and had been brought to Washington in early 1934 to work in the Treasury

Department. It was Morgenthau who suggested to Roosevelt that Eccles who be the perfect choice as the head of a restructured Federal Reserve System.

Eccles agreed to take the job if certain changes were made to enhance the power of the Federal Reserve Board and therefore reduce the power of the regional banks. Roosevelt agreed and Eccles, along with Lauchlin Currie, prepared a memorandum for Roosevelt with their desirable reforms in the Federal Reserve System [Eccles 1951: 166]. The central concern of the memorandum was the Federal Reserve's ability to monetary aggregates, precisely the problems Currie had addressed in his book. Eccles are shared the view that the real bills constraint on the Federal Reserve was absolutely the crucial constraint on any attempt to undertake an appropriate monetary policy. The memorandum was drafted by Currie and generally reflected his views'on the problems of controlling the money supply. Sandilands notes that one point was added by Eccles that he considered important, but Currie was less interested in. Eccles thought that an extension of bank assets available for rediscount by the Fed was vital. This point boiled down to the substitution of "sound assets" for the Federal Reserve Act's "eligible paper." The significance of this is that it would allow banks to continue making long term loans, but at the same time provide some incentive to assure the quality of those loans since such loans could potentially be available for rediscount in the event of a run on the bank [Eccles 1951: 173; Sandilands 1990: 63].

Though Eccles appointment was announced in late 1934, he was not confirmed until April 1935. Roosevelt, in selecting Eccles, had not conferred with Carter Glass, Chairman of the Senate banking committee. Glass was a powerful senator and a Jacksonian Democrat who feared increased centralization of government. Glass held up the confirmation of Eccles and in the end was not present when the Committee voted to confirm him and Glass was lone dissenting vote when the matter was voted on by the entire Senate. The sometimes strained and confrontational relationship between Eccles and Glass undoubtedly had an impact on the ability of the administration to get its bill passed. Eccles himself recognized this in his memoirs [Eccles 1951: 177-181; Schlesinger 1960: 291-301].

With the Eccles and Currie move to the Federal Reserve in late 1934, the impetus for banking reform shifted to the Federal Reserve. A Legislative Committee was formed composed of E. A. Goldenweiser, Chester Morrill, Walter Wyatt, and Lauchlin Currie. The plan of action was to have the Committee's report sent to the Federal Reserve Board, to the FDIC, the Comptroller of the Currency, to Morgenthau at Treasury, to Roosevelt, and finally presented in Congress [Eccles 1951: 193]. Eccles, though respected by bankers and businessman, had never been to college and found it difficult to formalize his ideas in writing. Currie, on the other hand, had written for both academic and nonacademic audiences [Sandilands 1990: 62]. The actual writing of the Banking Act of 1935 was left largely to Currie with substantial input from Eccles on the ideas to be incorporated in the bill

[Sandilands 1990: 64].

The important amendments to the Federal Reserve Act which were contained in the so-called Eccles bill on banking reform were with regard to the makeup of the Federal Reserve Board (section 4), expansion of assets which could be discounted by the Fed (section 13), legal tender status for Federal Reserve notes (section 6), and power to change reserve requirements (section 19). In amending section 19 of the Federal Reserve Act with regard to reserve requirements, Section 209 of Title II of the bill stated:

> Notwithstanding the other provisions of this section, the Federal Reserve Board, in order to prevent injurious credit expansion or contraction, may by regulation change the requirements as to reserves to be maintained against demand or time deposits or both by member banks in any or all Federal Reserve districts and/or any or all of the three classes of cities referred to above.

In line with his Treasury proposal for reform, according to Sandilands, Currie intended that the Board be given unlimited power to alter reserve requirements with the view of eventually raising them to 100% [Sandilands 1990: 66].

The Administration bill was introduced by Senator Duncan Fletcher in the Senate (S. 1715) and Congressman Steagall in the House (H.R. 5357) on February 5, 1935. Title I of the bill made Federal Deposit Insurance permanent, Title II contained amendments

to the Federal Reserve Act, and Title III included technical amendments. The debate over the bill centered on Title II which sought to give greater powers to a revised Federal Reserve Board whose members would be appointed by the President. Senator Carter Glass denounced the **Eccles's** bill as the most dangerous and unwarranted measure of the entire New Deal [Sandilands **1990: 641.**

On March 4, Senator Fletcher asked to have a statement by Frank Vanderlip on Senate bill 1715 read into the Congressional Record. Vanderlip pointed out that in a country with a highly developed banking system, the volume of purchasing medium included not only currency but the volume of bank credit turned into bank deposits. He noted: "This principle is recognized in the bill, and an effective means for the control of the volume of bank credit is set up in section **209** [Congressional Record, 1934: **28201.** Vanderlip believed that these powers were necessary in order to regulate the value of the currency, but that Congress should define its objective in exercising the power to regulate the value of currency. Further, he states, "Congress must itself designate the price level which it desires to establish and maintain." Finally, he said:

> The regulation of the value of currency is not properly a banking function. It has, in fact, far too long remained a banking prerogative. There should be clear differentiation between the business of granting bank credits and the fundamentally important policy of

regulating the value of currency [ibid].

Also on March 4, Senator Cutting reintroduced his bill to create a Federal Monetary Authority and require 100% reserve banking [S. 2204]. Just a few days before, the New York Herald Tribune ran an article entitled: "Many Withhold Opposition to Present Banking Bill Lest Legislators Put Forward Measure Requiring 100% Reserves for Demand Deposits"[New York Herald Tribune on February 25, 1935, p. 41] The article stated that many on Wall Street, though opposed to Title II of the bill, were reluctant to voice their opposition. The fear was that a "worse bill" would be put forward which "might be a bill embodying the theories of that group advocating 100 per cent reserves for demand deposits." The article went on to note that the plan had gained wide academic support. Though no one in the Administration had gone on record in support of the plan, the paper noted that "should there be a resurgence of New Dealism the 100 per cent reserve scheme might possibly get some attention in the high quarters." Though some might view the proposed bill as radical, according to the Tribune article, "Compared with the 100 per cent reserve plan, it will be seen, the banking act of 1935 is weak tea" [New York Herald Tribune on February 25, 1935, p. 411.

A revised version of-the Banking Act of 1935 was introduced on April 19, 1935 by Congressman Steagall (H.R. 7617). The version introduced by Steagall included section 209 unchanged from the earlier version. Fletcher, as Chairman of the Senate Banking

Committee, was deluged with letters opposing Title II of the proposed Banking Act of 1935 (H. R. 5357 and S. 1715). In a statement read into the Consressional Record, Fletcher asserted that the changes in the Federal Reserve System embodied in Title II did not "involve a radical change in the present powers and functions of the Federal Reserve Board and the Federal Reserve System as it is now constituted" [Congressional Record, April 22, 1935, pg. 61031. He explicitly stated that this applied unequivocally to section 209 granting the Board the power to change reserve requirements. Fletcher was clearly concerned that the banking system remained subject to wild fluctuations as a result of bankers influence on the creation and destruction of credit. He stated:

> It is common knowledge, however, that there now lies within the hands of bankers the potential makings for one of the most stupendous inflations this or any other Nation has ever experienced. And experience teaches us that banker control of monetary policy will probably give us an equally devastating financial whirlwind when that bubble is pricked [Congressional Record, April 22, 1935, p. 61041.

In May, Eccles testified that the most effective way to achieve the goals of centralization, without undue political influence or banker influence, would be to have outright ownership of the Federal Reserve banks [Schlesinger 1960: 299]. Though not

advocated by Currie, it was part of the Chicago plan for banking reform.

A significant blow to the Chicago plan came in May when Senator Bronson Cutting died in an airplane crash. Cutting's reelection in 1934 turned out to be a very dirty campaign, with the actively opposing him. After Cutting emerged as the apparent victor over Dennis Chavez by slightly over one thousand votes, the election results, with Roosevelt administration approval, were contested. In was during a trip back to New Mexico to get affidavits in connection with the contested election that Cutting's plane crashed in Missouri. Schlesinger reports that some of the Progressives blamed Roosevelt for Cutting's death [Schlesinger 1960: 140-1].

Currie was optimistic that a banking bill would be passed which would include what he viewed as the crucial reforms. Currie wrote to Viner:

> The prospects for the banking bill are looking better all the time. You may have noticed that I got my objective in the bill as reported by the House Committee. I admit that the word "unstabilizing" in it is not elegant, but I couldn't think of a good synonym. I know that you will derive an enormous amount of comfort out of the assurance that we will have perfect stability in the future [Currie to Viner, May 3, 1935].

The bill passed easily in the House in early May, where Alan

Goldsborough had assumed responsibility for Title II, and then went to the Senate where hearings were held [Burns 1974: 169]. In the House, the only significant amendments were Alan Goldsborough's proposals to create a Federal Monetary Authority along the lines presented by Cutting and to mandate an explicitly declared policy of the United States to restore the average purchasing power of the dollar to level of the period 1921-1929 [Leuchtenburg 1963: 159; Burns 1974: 130]]. After this restoration, the purchasing power of the dollar would be maintained substantially stable in relation to a suitable index of basic commodity prices [Congressional Record, May 8, 1935: 7163]. The amendment was defeated by a vote of 128 to 122 [Consressional Record, May 8, 1935: 71851.

The last attempt to explicitly introduce 100% reserves in the Senate as part of the overhaul of the Federal Reserve System came on July 25th when Senator Nye of North Dakota introduced a substitute for Title II of H.R. 7617 (the revised Banking Act of 1935). The amendment embodied most of the Cutting bill (S. 2204) introduced in March. In addition to the 100% reserves and the creation of a central monetary authority, price stabilization was also included, as it had been in the original Cutting bill outlined by Simons. The amendment was defeated on a vote of 10 yes, 59 no, and 27 not voting [Congressional Record, July 25-26, 1935, pp.11842-11906]. Roosevelt signed the Banking Act of 1935 into law on August 22, 1935, and established the basic framework of the financial system which continues today.

Glass set out to rewrite H.R. 7617 to remove those elements

which he thought increased unduly the government's role. As an example, the final version of the Banking Act of 1935 limited the Fed's ability to change reserve requirements by adding the following to section 209:

> but the amount of the reserves required to be maintained by any such member bank as a result of any such change shall not be less than the amount of the reserves required by law to be maintained by such bank on the bank of enactment of the Banking Act of 1935 nor more than twice such amount [Section 207 of H.R. 76171.

This effectively prohibited any move to raise reserve requirements to 100%.[10] Glass also had removed a statement which mandated the government to "promote conditions conducive to business stability" in so far as it was possible with the "scope of monetary action and credit administration" [Egbert 1967: 152].

As the debate on the bill came to a close, Senator Glass in remarks to remarks to the Senate stated:

> I may say that repeated references to the bill as an

[10] As an historical note, on August 16, 1948, in a Joint Resolution of Congress (S.J. Res. No. 157, 80th Cong., 2nd sess.), the Banking Act of 1935 was temporarily amended (1) in order to prevent injurious credit expansion; (2) raised the limit on time deposit reserves to a maximum of 7 1/2 per cent, and the maximum reserves against demand deposits in central reserve cities to 30 per cent [Krooss 1969: 2999-3000]. The increased reserve requirements of the resolution expired on June 30, 1949.

> administration bill have no justification whatsoever. It is not an administration bill. The President of the United States has never read a word of it, unless he has done so very recently. The Secretary of the Treasury is on record in the printed hearings of the Appropriations Committee as saying that he had not read it. Every member, except one, of the Federal Reserve Board testified before the committee that he had not seen the bill until it was introduced and printed. ... I speak of it simply as the Eccles bill, because nobody, with a single exception, who appeared before the Banking and Currency Committee of the House or of the Senate has advocated this bill [Consressional Record, July 25, 1935: 118241.

When asked if he was referring to Title II, Glass said "Yes; only to title II."

Despite Glass's later boast that "We did not leave enough of the Eccles bill with which to light a cigarette," the bill provided for a significant shift toward centralization of monetary policy and thus achieved what Currie believed to be a necessary reform if monetary policy was to be effective [Leuchtenburg 1963: 160]. The administration had achieved its goal of enhancing the Federal Reserve's ability to manage the money supply, and therefore, hopefully the economy [Schlesinger 1960: 301].

Conclusion

The Chicago plan for radical banking was well known at the highest levels of government during the period 1933-35 and, though the plan called for radical changes', the early New Deal probably offered the best chance for radical reforms to be undertaken. The question is thus why did the Chicago plan lose out?

The answer, on one level, should be of no surprise: it lost as a matter of pure political expediency. It is important to note that it did not lose because the principles of the plan were rejected. In fact, the banking legislation passed during the period moved in part toward the Chicago plan reforms. Tugwell though that radical reform seemed like such a remote possibility, that Roosevelt abandoned any such attempts and opted for "simple restoration of a system people understood under conditions which would assure them of future safety" [Tugwell 1957: 2641.

The Banking Act of 1933 was successful in restoring confidence in the banking system. It did so by institutionalizing Federal Deposit Insurance and by the separation of commercial and investment banking. By 1935, few politicians opposed doing away with deposit insurance. The economy did not recover fully in 1934, and the administration was convinced that it was due to a lack of centralized control over monetary policy. Given the determined resistance of Carter Glass, the administration got as much as it could in the Banking Act of 1935 in the way of enhanced Federal Reserve Board control. The Chicago plan played a role here by being viewed as an extreme position, and therefore bolstered the

administration bill.

The key player for the administration appears to be Lauchlin Currie, who though an advocate of 100% reserves, sought to achieve measures that would be politically acceptable. In doing so, he compromised on the 100% reserve goal, and in the end, his compromise prohibited any possibility that such reform could be achieved in the future.

There is evidence that Currie believed that Hemphill and Fisher were politically naive. In his unpublished memoirs, Currie, reflecting on the battle over the Banking Act of 1935, says: "An adviser in Washington is of limited usefulness unless he acquires some sense of what is feasible and how projects and policies should be presented to have the best chance of being adopted [Sandilands 1991: 65]. In a letter to Viner written in early 1935, Currie stated:

> You will be tickled by Hemphill's childlike naivete in suggesting that instead of his bill being introduced and then sent to the Board for comments it would save time if we drafted the bill together at the Board! I pointed out that such a procedure would make his bill in effect an administration measure, and he said very seriously he would not mind that! [Currie to Viner January 18, 1935]

The fact that the Chicago plan was supported by the early New Deal planners, and then by the Progressives, though it may have helped the administration, at the same time reduced the possibility that

the legislation would have been passed. However, there were attempts, especially after Cutting's death, to create both a Federal Monetary Authority, reflation, and price-level stabilization. This indicates that support for the ideas embodied in the plan went beyond the radical and Progressive members of Congress.

Roosevelt came into office with the intent of restoring the safety of the banks and increasing government control over monetary policy. The legislation passed during the period 1933-35 gave Roosevelt most of what he wanted: safety of the payments system, separation of commercial and investment banking, and enhanced control over monetary policy by a reconstituted Federal Reserve. Safety of the bank deposits came at the price of a system of contingent liabilities with inherent problems which all came to a head decades later. The separation of commercial and investment banking eliminated the problem of banks using depositors funds to speculate in the stock market, but it did not prevent banks from making risky loans.

Still, the legislation passed in the early New Deal must be viewed as a success as judged by the fact that little change was made in the system for nearly fifty years. Though passage of the Chicago plan might have advocated the large scale bailouts of financial institutions we are seeing today, there is no guarantee that it would have been equally successful.

The Chicago plan without an appropriate transition period could have worsened the credit crunch. The crucial action would

have been the supplanting of fractional reserve bank credit with the credit of new investment trusts, and if necessary, credit supplied by the RFC. One possible evolution could have been the complete socialization of investment as Bronson Cutting and others advocated.

Control of M-l could have accelerated the expansion of money substitutes and deposit banking could have been reborn, perhaps in a relatively short period of time. However, one response to this is that technology seems to have driven the developments of near monies in recent years and it is unlikely that 100% reserve banking could have affected the development of computers which, as we have seen in recent years, enable the creation of financial assets which would have been technologically impossible in the past.

The problems we face today are in large part a direct result of the programs that were implemented during the early New Deal. The first and most obvious is federal deposit insurance. The amount of money necessary to pay off all depositors is unknown. We have done nothing to fundamentally change the situation. Even modest reforms to limit the amount of federal deposit insurance have been difficult to implement.

The 100% reserve idea did not disappear after the passage of the Banking Act of 1935, in fact, Irving Fisher spent the remainder of his life lobbying Congress and the public on the need for 100% reserves [Allen 1991]. It is also not surprising that in recent years, we have seen the emergence of "narrow banking" or "core banking" proposals which are in the tradition of the 100% reserve

plan. If we are ever again faced with economic, and particularly financial, problems on the level of the Great Depression, the clamor for the separation of the depository and lending functions of banks may reappear.

It is also clear that the Federal Reserve can do little to cajole banks into lending when they do not wish to do so. What we are seeing is banks buying more government debt, which is available today on a scale far beyond the 1930s. The Federal Reserve can effectively restrain activity during a boom, but during a business downturn can do little to stimulate the economy beyond cutting interest rates to historically low levels. This is precisely the situation we face today.

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U.S. Congress. Senate. Statement by F. A. Vanderlip on S. 1715, 74th Congress, 1st session, March 4, 1935. _Consressional Record_.

U.S. Congress. House. Radio Address by Congressman Steagall regarding H.R. 5357, 74th Congress, 1st session, January 24, 1935. _Congressional Record_.

U.S. Congress. Senate. Text of Senate bill 1715, 74th Congress, 1st session, February 6, 1935. _Congressional Record_.

U.S. Congress. Senate. Text of Article by Senator Cutting "Is Private Banking Doomed?", 73rd Congress, 1st session, May 4?, 1935. _Congressional Record_.

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U.S. Congress. House. Amendment by Senator Goldsborough to H.R. 7617 (Banking Act of 1935), 74th Congress, 1st session, May 8, 1935. _Congressional Record_.

U.S. Congress. Senate. Statement by Senator Glass on H.R. 7617 (Banking Act of 1935), 74th Congress, 1st session, July 25, 1935. _Congressional Record_.

U.S. Congress. Senate. Amendment by Senator Nye to H.R. 7617 (Banking Act of 1935), 74th Congress, 1st session, July 25, 1935. _Congressional Record_.

Washington, D.C. National Archives, U.S. Treasury. Press Release, June 27th, 1934.

Washington, D.C., Library of Congress Manuscript Collection. Bronson Cutting Papers.

ENDNOTES

1. The text of the letter reads as follows:

> During the past week, we have tried to formulate and agree upon a specific program which would provide, both for emergency relief, and for permanent banking reform. The results of this effort are contained in the five-page statement which we enclose. This document is strictly for your private use; and we request that every precaution be taken against mention of it in the press.
>
> The program defined in the statement is one which we believe to be sound, even ideal, in principle. What its merits may be, in the light of political consideration, we frankly do not know. We are sensitive, moreover, of an obligation not to broadcast publicly any statement whichmight impair confidence in Administration measures, or impair their chances of successful operation.
>
> On the other hand, we feel that our statement may deserve thoughtful consideration, among people of interests like our own; also, that it may suggest measures which might usefully be incorporated- in other, and perhaps less impractical, schemes. Moreover, most of us suspect that measures at least as drastic and "dangerous" as those described in our statement can hardly be avoided, except temporarily, in any event.
>
> Please feel free to use the document in any manner consistent with complete avoidance of newspaper publicity. If you feel disposed to send us your comments, favorable and adverse, upon the proposals, we shall be grateful indeed for your cooperation. Communications may be addressed to any member of the group.