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History of Economic Ideas, V/1997/2

THE CHICAGO PLAN AND THE RESERVE REQUIREMENT INCREASE OF 1936-37*

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In 1936, the Board of Governors of the Federal Reserve System implemented a significant increase in reserve requirements for member banks and in 1937 there was an economic recession. Friedman and Schwartz (1963) and Timberlake (1993) attribute the recession in large part to a fundamental mistake in monetary policy attributable to faulty monetary theory. Currie (1980) argued that the reserve increase did not cause the recession. Currie's view is attributable to his view of monetary policy, the nature of the money supply, and his advocacy of the 100% reserve proposal. Evidence is presented that the reserve requirement increase was part of a longer run plan to implement 100% reserve banking in the U.S.

Introduction

On July 14, 1936, the Federal Reserve Board raised reserve requirements by 50 percent, to become effective on August 15, 1936. On January 30, 1937, the Board took action to increase reserve requirements by another 50 per cent, effective May 1, 1937. On the one hand, Milton Friedman and Anna Schwartz (1963) and Richard Timberlake (1993) argue that this increase in reserve requirements was a policy error and contributed significantly to the economic downturn in 1937-38. On the other hand, Lauchlin Currie, who was Marriner Eccles's top advisor at this time, argued that the reserve requirement increase would not affect bank lending and that the recession was not caused by monetary policy. I will not attempt to definitively determine who is correct, but rather discuss the role that Lauchlin Currie's view of monetary policy and his policy prescription for 100 percent reserve banking played in the reserve requirement increase. Essentially, I will integrate Frank Steindl's work on Currie with the facts surrounding the

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reserve requirement increase as presented by Friedman and Schwartz. This paper does not refute the Friedman/Schwartz/Timberlake hypothesis about the 1937-38 recession, but it does raise basic issues about money and credit. Currie advocated, and Friedman still supports, the separation of money and credit. What I will suggest is that the reserve requirement increase of 1937-38 was part of a longer range plan to implement 100 percent reserve banking[1]. My evidence for this comes from published and unpublished memorandum written by Currie, and the fact that he drafted the administration version of the Banking Act of 1935[2]. My analysis depends upon two crucial assumptions: that Currie was a major force in the increase in the reserve requirements, and that he was relying upon the analysis of the money supply that he had presented in his book *The Supply and Control of Money in the United States* (1934).

The Reserve Requirement Increase: Friedman, Schwartz, and Timberlake

From June 1933 to June 1936, the money stock (M_2), grew at annual rates of 9.5, 14, and 13 percent (Friedman and Schwartz 1963, p. 544). This rise was due to an inflow of gold resulting from the devaluation of the dollar and capital inflows into the US. Banks accumulated reserves far beyond their legal reserves, and by the end of 1935, excess reserves were greater than required reserves. In response, the Federal Reserve Board raised reserve requirements in two steps up to the legal maximum beginning May 1, 1937. The table below summarises member bank reserve requirements from 1917 to 1941.

As Friedman and Schwartz note, the reserve requirement increase was not imposed primarily to affect current conditions, but rather to enable control of future developments. This centred on the Board's interpretation of the significance of excess reserves (Friedman and Schwartz 1963, p. 517). Because of the prevalent view at the Board that excess reserves were idle funds, there was little effort to either offset seasonal or short term movements in reserves, or to vary the discount

1. A complete exposition of the 100% reserve plan will not be attempted here. See PHILLIPS (1995) and ALLEN (1993).

2. In 1978 Currie wrote: "Some of my most influential work left no record at all, as it took place in the preparation of speeches and statements by Eccles. ... Naturally none of this work left a written record under my name. This, I fear, is a price an advisor must pay if he wishes to be effective". (CURRIE 1978, p. 543)

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rate or engage in open market operations (Friedman and Schwartz 1963, p. 518). The Federal Reserve System's portfolio of government securities was kept constant after 1933, though the maturity distribution varied (Friedman and Schwartz 1963, p. 519).

Beginning in 1934, through memoranda and the *Annual Reports*, there was a debate on the merits of a reserve requirement increase (Friedman and Schwartz 1963, p. 521). There was a recognition that the increase in reserve requirements might have adverse consequences. Friedman and Schwartz point to internal memoranda of the Federal Reserve Bank of New York as the origins of the reserve requirement increase (Friedman and Schwartz 1963, p. 520). Indeed, Friedman and Schwartz and Timberlake (1993, p. 291) argue that the New York Fed had an incentive to advocate the maximum increase in reserve requirements for reasons of its power vis-à-vis the Board. Once reserve requirements were at their maximum by the Board, then the

Table: Member Bank Reserve Requirements (percent of deposits)

Classes of Deposits and Banks	June 21, 1917 to August 15, 1936	August 16, 1936 to February 28, 1937	March 1, 1937 to April 30, 1937	May 1, 1937 to April 15, 1938	April 16, 1938 to November 1, 1941
On net demand deposits:					
Central Reserve Cities	13	19.5	22.75	26	22.75
Reserve City Banks	10	15	17.5	20	17.5
Country Banks	7	10.5	12.25	14	12
On time deposits:					
All member banks	3	4.5	5.25	6	5

Source: *Annual Report*, Board of Governors of the Federal Reserve System, 1938, Table No. 9, p. 60.

regional banks, and primarily New York, would again have some influence through the traditional tools of setting the discount rate and open market operations returned (Friedman and Schwartz 1963, pp. 521-22; Timberlake 1993, p. 291).

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The Board ultimately decided on the reserve requirement increase "to prevent an uncontrollable expansion of credit in the future" (Friedman and Schwartz 1963, p. 524). Friedman and Schwartz state that the desire to tighten in early 1937 was entirely understandable because of the (admittedly irregular) expansion over the past four years: wholesale prices had risen nearly 50 percent since March 1933 (Friedman and Schwartz 1963, p. 525). The mistake made by the Board, according to Friedman and Schwartz was:

> What rendered the action unfortunate in retrospect was, as we shall see, that the System failed to weigh the delayed effects of the rise in reserve requirements in August 1936, and employed too blunt an instrument too vigorously; this was followed by a failure to recognise promptly that the action had misfired and that a reversal of policy was called for. All those blunders were in considerable measure a consequence of the mistaken interpretation of excess reserves and their significance. (Friedman and Schwartz 1963, p. 526)

Friedman and Schwartz conclude that the reserve requirement increase did have important current effects, though they note that George Harrison, and others, denied at the time that there was a connection between the recession and the reserve requirement increase (Friedman and Schwartz 1963, p. 528). The error lay in the Board's interpretation of excess reserves, though Friedman and Schwartz believe that the underlying reasons on the failure was due to the passivity of individuals and institutions, the shifting locus of power from the regional banks to the Board, and to the view that was becoming prevalent that "money doesn't matter" (Friedman and Schwartz 1963, pp. 532-33).

As to the causes of the 1937-38 recession, Friedman and Schwartz stress the importance of monetary, as opposed to purely credit, impacts on economic activity. The reserve requirement increase, together with the Treasury gold-sterilisation program, sharply reduced the money stock during this time. From June 1936 to June 1937, the money stock grew at 4.2%, followed the next year by a 2.4% rate of growth. The peak in the money stock came in March 1937, the trough in May 1938, while the business cycle peak was in May 1937 and trough in June 1938. Friedman and Schwartz thus conclude:

> The sharp retardation in the rate of growth of the money stock must surely have been a factor curbing expansion, and the absolute decline, a factor intensifying contraction. Though the decline may not seem large in absolute amount, it was the third largest cyclical decline recorded in our figures, exceeded only by the 1920-21 and 1929-33 declines. (Friedman and Schwartz 1963, p. 545)

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Recovery came after the money stock started to rise, growth at rates of 7.8, 13.1, and 12.1 over the three years from June 1938 to June 1941. In summary, then, the policy was a mistake resulting from a misunderstanding of the nature of excess reserves and an inattention to the impact of money (real balance effect, not just liquidity effect) on economic activity.

Though the basic facts as presented by Friedman and Schwartz and Timberlake are not in dispute, two factors are missing. First, Lauchlin Currie was likely the author of the Board's memoranda and statements in the *Annual Reports*. His view of monetary theory was certainly one that did not neglect the role of money indeed, Frank Steindl argues that Currie's views were quite modern, and many believe anticipatory of the Friedman and Schwartz analysis of the Great Depression and monetarism (Steindl 1991, pp. 445-6)[3]. Second, Currie was also the author of the original version of the Banking Act of 1935, and the important section 209 on reserve requirement increases. In the *Annual Reports*, this section of the Banking Act is repeatedly referred to. This raises the questions then: did the Federal Reserve Board have a faulty view of monetary policy and its impact, as Friedman, Schwartz, and Timberlake maintain, and could the motivation for the increase be seen as first step toward raising reserve requirements to 100 percent on demand deposits? I will suggest some tentative answers to these questions by briefly reviewing Currie's monetary theory and his role in the Banking Act of 1935.

Lauchlin Currie's Monetary Theory

Currie was a Canadian by birth who became a naturalised U.S. citizen in 1934. He received his Ph.D. from Harvard University under the direction of Allyn Young, and was on the faculty there until he joined the Treasury department. He was considered an expert in monetary theory and had published several articles on the problems of monetary control. His book, *The Supply and Control of Money in the United States*, which included material from his articles, was published in 1934. In this book, 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 pri-

3. In fact, Currie's views were more in line with those of the "old" Chicago school of Friedman's teachers: Henry Simons, Frank Knight, Lloyd Mints, and others. On this see Patinkin 1981, Barker 1996, Phillips 1995, and Steindl 1995.

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mary means of control of the money supply was the level of required reserves (Steindl 1991, pp. 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 criticised the Fed's concern about speculation versus productive investments in the period prior to the Great Depression. Later, he wrote to Chairman Eccles, that the entire Research Division at the Board was unanimously of the opinion (excluding the Division director, E. A. Goldenweiser) that the Federal Reserve had *never* been too restrictive, but rather erred on the inflationary side (Steindl 1991, p. 449). Currie also criticised the Fed's policy of buying and selling banker's acceptances as a normal part of its policy of accommodating seasonal movements in reserve demands. This policy often conflicted with open market operations in government securities (Steindl 1991, p. 449).

Currie's monetary model is one of a simple deposit expansion mechanism with the quantity of bank reserves as the control mechanism (Steindl 1991, pp. 451-2). As Steindl explains, Currie adopts the Burgess-Riefler view of borrowing, that is, the idea that when indebtedness is increasing, the desire of member banks to reduce their indebtedness results in an increased reluctance to lend, and a consequent contraction of loans (Steindl 1991, pp. 452-3). Because the New York banks are the most sensitive to indebtedness, there are important implications for monetary control. The endogenous behaviour of member bank indebtedness loosens the effectiveness of monetary policy to actually change reserves. As a result, Currie advocated the abolition of the discount window (Steindl 1991, p. 453).

Though Currie is at times ambiguous about whether banks have a demand for excess reserves, Steindl concludes that Currie ultimately believed that excess reserves are redundant, thus banks at any particular time may have more or less reserves than desired (Steindl 1991, p. 455). Quoting Steindl:

> Currie *definitely* sees the large amount of excess reserves as surplus reserves, and increases in reserve requirements as basically absorbing those surplus reserves, thereby preventing a later undesired expansion of the money supply. He does not view those reserves as desired in which case banks would adjust to disequilibria created by reserve requirement increases by rebuilding their excess reserves. He does not regard the accumulation of excess reserves as rational behaviour in response to low interest rates and increased bank liquidity (Steindl 1991, p. 456).

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Steindl concludes that Currie's interpretation of the money mechanism is "quite significantly different from that of Friedman and Schwartz" and thus so is the interpretation of the reserve requirement increase of 1936-37 (Steindl 1991, p. 459). Friedman and Schwartz view the doubling of reserve requirements as inducing banks to rebuild their excess reserves to desired levels, while Currie argued that eliminating those "surplus" reserves would have no significant impact (Steindl 1991, p. 459).

Though their views of the monetary mechanism differ, interestingly, Currie's long run policy recommendation, 100 percent reserve banking, is also advocated by Friedman (1960)[4]. According to Currie, if it was desired to precisely control the money supply, this could be achieved by direct government issue of all money, both notes and deposits subject to check (Currie [1934] 1968, 151). A nation-wide system of government agencies would be established that would purchase government securities to expand deposits, and sell securities to contract them. This did not amount to a nationalising of the banking system, however. The underlying theme in Currie's book was that the confusion between money and credit had compounded monetary reform proposals. Thus, those who called for nationalisation were thinking of the control of credit by the government. Currie believed that his proposal was superior to nationalisation. This leads then to another possible reason for the reserve requirement increase of 1936-37: as a first step in implementing 100 percent reserves. We thus turn to Currie's role in the Banking Act of 1935.

Eccles, Currie and the Reform of the Federal Reserve

Marriner Eccles, a Mormon banker who had impressed Tugwell and Henry Morgenthau, had been brought to Washington in early 1934 to work in the Treasury Department. It was Morgenthau who suggested to Roosevelt that Eccles would 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. Following the Democratic gains in the elections of 1934, it was widely recognised by New Dealers that there was an opportunity to pass new legislation. Roosevelt was very interested in Eccles's

4. This policy prescription was also advocated by the "old" Chicago school. See Patinkin 1981 and Phillips 1995.

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thoughts on reform and requested that Eccles prepare a statement of his proposed reforms. On November 4, Eccles brought to his meeting with FDR a memorandum he and Lauchlin Currie had prepared with their desirable reforms in the Federal Reserve System (Eccles 1951, p. 166). Eccles welcomed Currie's refinements "on points of detail" (Hyman 1976, p. 155). The central concern of the memorandum was the Federal Reserve's ability to control monetary aggregates, precisely the problems Currie had addressed in his book. Eccles shared Currie's view that the real bills constraint on the Federal Reserve undermined any attempt to undertake an appropriate monetary policy.

The memorandum was titled "Desirable Changes in the Administration of the Federal Reserve System". The memorandum first outlined the history and fundamental problems with the Federal Reserve System as currently structured. It noted that the present structure gave power to each Federal Reserve Bank and its President, who was selected by local bankers. The Federal Advisory Committee, comprised of the regional bank officials, met with the Federal Reserve Board to advise on policy, but the Board did not have the power to implement policy. Open market operations and an Open Market Committee, which were not a part of the original 1913 Act, were authorised by the Banking Act of 1933. The flaw in the 1933 revisions was that each regional bank could refuse to participate in decisions by the Open Market Committee. The problem was that:

> The Federal Reserve Board, which was ultimately held responsible for policy, could not initiate open-market operations; it could only ratify or veto the policies initiated by the Open Market Committee. That committee could initiate policy but could not execute it. The board of directors of the individual Reserve banks, who took no part in forming policy, had the power to obstruct it. A more effective way to fragment responsibility, and to encourage inertia and indecision, could hardly have been devised (Hyman 1976, p. 157).

The memorandum was drafted by Currie and generally reflected his views on the problems of controlling the money supply. The major points in the memorandum were: money is important in business fluctuations; short term support for emergency financing is necessary, but the avoidance of subsequent inflation and depression is necessary; the Federal Reserve Board should take responsibility for monetary policy and the conduct of open market operations; and the reforms were necessary in order to create a true central bank (Hyman 1976, pp. 157-158).

Sandilands notes that one point was added by Eccles that he considered important, but Currie was less interested in. Eccles thought

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that an extension of bank assets available for rediscount by the Fed was vital. The Federal Reserve Act restricted discounting to short-term commercial loans and investments. 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, p. 173; Sandilands 1990, p. 63).

In summary, Eccles and Currie believed that two important changes necessary in the Federal Reserve System were: (1) Complete control over the timing, character and volume of open market purchases and sales of bills and securities by the Reserve Banks should be conferred upon the Federal Reserve Board; and (2) The Governors of the individual Federal Reserve Banks should be appointed annually by their Board of Directors subject to the approval of the Federal Reserve Board (Burns 1974, p. 145).

The Banking Act of 1935: the Roosevelt Administration Version

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 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, p. 64). The wording with respect to reserve requirements is important, especially in light of Currie's analysis of the monetary system. 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.

Though the House passed the administration version of the bill virtually unchanged, it was modified by Carter Glass in the Senate (Phillips 1995). Section 209 was amended so that the reserve requirement increase could not be more than double their present level.

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In late 1935, Eccles became concerned about rising bank excess reserves. Gold was continuing to flow in to the U.S. stimulated by the Treasury's gold purchases, the dollar shortage, and unstable political and economic conditions in Europe (Hyman 1976, p. 215). In a statement issued after the meeting of the Federal Open Market Committee on December 17-18, 1935, Eccles stated that the level of reserves was far beyond existing or prospective needs of business, though there was not currently evidence of overexpansion (Hyman 1976, p. 215). The Federal Reserve Board subsequently undertook studies, directed by Lauchlin Currie, of the excess reserve situation. In May 1936, Currie prepared a memorandum for Eccles titled "Some Monetary Aspects of the Excess Reserve Problem" (Sandilands 1990, p. 88). Currie argued that the large level of excess reserves frustrated the effectiveness of monetary control which, as Currie had argued previously, "depended crucially on the ability of the reserve banks to force member banks into debt" (Sandilands 1990, p. 88). Currie believed that there was a danger that given a business recovery, the money supply could increase too rapidly and generate inflation.

Eccles did not wish to increase reserves without Presidential approval, though the Board had been given the power to do so. Eccles did not want FDR to be held responsible for the Fed's actions. On July 9, 1936, Eccles went to the White House to explain to Roosevelt the reasons he believed a 50 percent increase in required reserves was necessary. He gave FDR a memorandum specifying that the reserve requirement increase might be interpreted as putting the brakes on the recovery. Eccles did not agree that it would do so and stated in the memorandum:

> The action contemplated (reserve requirement increase) will not satisfy those groups which have been clamouring for action in the hope that it would stiffen interest rates. If there was any serious danger of such a result, I should oppose action. I would not favour action under any circumstances unless assured of authority through the Open Market Executive Committee to counteract any recession of a point or more in the price of government securities (Hyman 1976, p. 216).

With Roosevelt's behind the scenes agreement, the Federal Reserve Board ordered a 50 percent increase in the reserve requirements of member banks effective August 15, 1936. The increase not only generated concerns by the public of a tightening of monetary policy, but also upset Secretary of the Treasury Morgenthau, who had not been given prior notice of the reserve requirement increase (Hyman 1976, pp. 216-217). This contributed to further bad feelings between Mor-

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genthau and Eccles, despite the fact that Eccles could reply that circumstances made it difficult to inform Morgenthau, and in any event, Roosevelt himself approved the increase. According to Hyman, the $1.79 billion in excess reserves merely siphoned off what was superfluous to the needs of business and therefore had no impact on credit availability (Hyman 1976, p. 217). This is in line with the arguments that Eccles and Currie had continually made. However as noted earlier, Friedman and Schwartz, while recognising the Federal Reserve Board actions were "entirely understandable," and that they were not intended to be contractionary since open market operations were to counter any dramatic disturbances in the credit markets, conclude that the increase did have important current effects (Friedman and Schwartz 1963, pp. 525-526). However, they note that only Governor Eccles among the Federal Reserve Board members, favoured large-scale purchases or rescinding of the final rise in reserve requirements which was announced in January 1937 to become effective in March (Friedman and Schwartz 1963, p. 527).

In the *Annual Report* for 1936, the reason given for the increase was derived from the legislation which required that the Federal Reserve look to the long, as well as the short run:

> The section of the law which authorises the Board to change reserve requirements for member banks state that this power may be exercised "in order to prevent injurious credit expansion or contraction". The significance of this language is that it places responsibility on the Board to use its power to change reserve requirements not only to restrict and minimise an injurious credit expansion or contraction after it has developed, but to anticipate and prevent such an expansion or contraction. (*Annual Report* 1936, p. 14)

In a memorandum to Eccles on January 25, 1937, Currie warned of the long-run restrictive effects of reserve requirements against *time* deposits. In a second memorandum on the same date, he argued further that the present volume of money at a "normal" velocity of circulation, was adequate to finance full economic recovery and that further expansion entailed inflationary risks (Sandilands 1990, p. 88). Thus, in 1935-37, monetary policy was undertaken entirely in line with the then Eccles and Currie analysis of monetary control: required reserve increases were a precautionary measure rather than a restrictive measure, and a way to enhance the effectiveness of monetary policy (Sandilands 1990, p. 89; Currie 1980).

At the same time that Currie was concerned with the excess reserve problem and the recession of 1937-38, he wrote another memorandum for Eccles on the 100% reserve plan. This is further evidence

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that while he was developing a "Keynesian" analysis of economic downturns, he remained convinced that monetary reform along the lines of the 100% reserve plan was essential to enable the government to use all available means to combat the recession (Sandilands 1990, p. 385). Though remaining a long run goal, in the *Annual Report* of 1937, it states that in making the finally reserve requirement increase that "The Board stated that it was not its intention to request from Congress additional authority to absorb excess reserves by means of further raising reserve requirements" (*Annual Report* 1937, p. 5). It is perhaps significant that the Board felt compelled to make such a statement, whether or not that was their true intention.

In his article on the causes of the 1937 recession, Currie evaluated the arguments that the reserve requirement increase was either responsible for or was a contributing factor in the recession. Currie argues that the period from 1933 to the end of 1936 was one of "rapid expansion," in accord with monetary ease. By the end of the summer of 1936, the volume of excess reserves had increased to over $3 billion (Currie 1980, p. 325). Currie then brings up that the Banking Act of 1935 placed upon the Board the responsibility of raising reserve requirements "in order to prevent injurious credit expansion". By the phrase "injurious credit expansion" it is meant that credit could expand on the basis of the reserves which could lead to asset inflation, and if deflation then occurred, you could be in a depression situation. Thus Currie believed that "it appeared to be a wise precautionary measure to reduce excess reserves by increasing legal reserve requirements" (Currie 1980, pp. 325-6). Currie wrote: "A body charged with the responsibility of preventing an injurious expansion of credit was in duty bound to weigh the dangerous potentialities in the situation" (Currie 1980, pp. 325-6).

Whether the reserve requirement increase "caused" the recession, or was a significant factor, the facts are that a recession occurred and the reserve requirement increase policy was later reversed, but not until 1941. There is thus another possible explanation for the reserve requirement increase; given Currie's monetary theory, and his long run goal of 100 percent reserves, he believed (and perhaps Eccles believed as well) that raising reserve requirements now on demand deposits to their maximum, would, if inflation became a problem, induce Congress to amend section 209 of the Banking Act of 1935 so that reserve requirements could be raised further, eventually, it is presumed, to 100 percent.

In the 1938 *Annual Report* in a section on "The Problem of Reserves", presumably written by Currie, it states:

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There is nothing in the present monetary or banking situation that would point to a proximate danger of injurious credit expansion. It is in such a period as this, however, when there is no call for quick action to meet emergency situations, that problems that may arise in the future should be analysed and the efficiency of the existing machinery appraised.

It is from this point of view that the System's existing powers to absorb excess reserves should be considered. ... The ability of the banks greatly to expand the volume of their credit without resort to the Federal Reserve banks would make it possible for a speculative situation to get under way that would be beyond the power of the System to check or control. The Reserve System would, therefore, be unable to discharge the responsibility placed upon it by Congress or to perform the service that the country rightly expects from it (*Annual Report* 1938, p. 22).

Did Currie and Eccles want to raise reserve requirements further? In the long run, I think the answer is definitely yes. However, the recession of 1937-38 removed that possibility, and in 1939 Currie became Roosevelt's economic advisor and left the Federal Reserve Board. With the onset of World War Two, and other concerns, the 100 percent reserve plan was left behind[5].

Conclusion

The goals of this paper have been modest. Certain facts are known: reserve requirements were raised in 1936-37, and there was a recession in 1937-38. There is a consensus that the policy was a mistake, though there is a difference on the magnitude of the impact on economic activity. Friedman and Schwartz and Timberlake say it was significant, while Currie says it was not. Who was right has not been finally determined, and may be impossible to finally decide. However, the reasons for the increase are given as either bad monetary theory or a result of the New York Bank versus the Board power struggle. To this a third can be added: the desire to implement, in the long run, 100% reserves. This paper has suggested that this could be historically an important, and neglected, reason, though it has not been possible in this short space to weigh the relative importance of alternative reasons. It is quite likely that the reasons lie in an amalgam of the three. It also leaves open the question of contemporary policy relevance, and whether indeed the 100 percent reserve proposal supported

5. Though this was not the end of the story on 100 percent reserves. See Phillips 1995.

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by Friedman and Currie remains a viable policy alternative to strengthen monetary control.

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