THE ECONOMIC CLUB OF NEW YORK

EIGHTY-EIGHTH MEETING,

MONDAY EVENING, MARCH 18th, 1929.

HOTEL ASTOR.

SUBJECT FOR DISCUSSION:

"THE FEDERAL RESERVE SYSTEM AND THE CONTROL OF CREDIT."

MR. LOUIS MARSHALL, Presiding.

MR. ELY: This is one of the most largely attended dinners in the history of the Economic Club. But even those who are farthest from this rostrum show by their faces in what a kindly mood they are. May I say that the amplifier arrangement is such that those who are rather remote will nevertheless be able to hear as well as those who are nearby.

Governor Miller, to his and our great regret, is prevented from coming tonight by professional duties from which he could not escape. But in his absence we are fortunate in having a member of our committee as our

Chairman, Mr. Louis Marshall, whom it is my pleasure to present to you (applause).

MR. LOUIS MARSHALL: Members of the Economic Club, honored guests, ladies and gentlemen: The honor has been conferred upon me to serve as the moderator of this symposium not because of any special familiarity that I may have with the subject to be discussed, but because of the absence of those members of the Club who would naturally have been expected to function on this occasion.

The subject which we are to consider is one which has become of vital importance, the discussion of which is most timely, and the underlying problems are of such a character as to give rise to a great variety of opinion. It is the Federal Reserve System and the control of credit. Before this System became crystallized into law this Club, on a memorable meeting, through the addresses delivered on that occasion, made a valuable contribution to the elucidation of the subject. That was more than 15 years ago, for it was on December 23rd, 1913 that the Federal Reserve Act was approved and became an essential part of our banking system.

Its title was an accurate index of its purpose. It reads, "An act to provide for the establishment of the

Federal Reserve Banks to provide an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States and for other purposes."

The creation of 12 Reserve Districts was authorized, under the general supervision of the Federal Reserve Board. That Board, among other powers, was authorized to examine the accounts, books and affairs of each Federal Reserve Bank and of each member bank, and to require such statements and reports as it might deem necessary, and was required to publish once weekly a statement showing the condition of each Federal Reserve Bank, and a consolidated statement for all Federal Reserve Banks to show in detail the assets and liabilities of these banks, singly and combined, and to furnish full information regarding the character of the money held as reserve, and the amount owned, and maturities of the paper and other investments owned and held by the Federal Reserve Banks.

It was empowered to permit, or on a formal vote of at least five members of the Reserve Board to require, Federal Reserve Banks to rediscount the discount paper of other Federal Reserve Banks at rates

of interest to be fixed by the Federal Reserve Board. Other important powers, which it is not necessary to enumerate, were likewise conferred. They will doubtless be explained and analyzed and defined by one of those whom you shall presently hear. The 12 Reserve Banks authorized have gone into operation, and although there have been differences of opinion as to whether or not the present system has proven as satisfactory as a centralized bank would have been, speaking generally the system has been regarded as successful. In the serious test of the World War it contributed a steadying influence. During the past year, however, there have been differences of opinion as to whether or not the underlying purpose of the System has been in all respects maintained, but it has been pointed out that the ~~actual~~ gold reserves have decreased during the last two years to the extent of $450,000,000; that bankers' loans have largely increased in volume; that a considerable part of the available credits have found their way into speculative channels; that the cost of money marketed in industry and commerce has increased, and that the credit available in these activities has been measurably diminished, the cost of loans having been

enhanced not only to the brokers but also to those engaged in productive business.

There are those who believe that there is no occasion for alarm or for a change of policy on the part of the Federal Reserve Board, and as it has been expressed, that the best solution of existing conditions is that nothing be done and that nature should be permitted to take its course. There are those who have expressed the view that the extravagant use of funds for speculative purposes is apt to absorb so much of the nation's credit as to cripple the regular business. There are those who express the fear that the increase in rediscount rates of the Federal Reserve Bank is negligible, while still others claim there should be no delay in bringing rediscount rates into a proper relation to actual needs, and that a failure to do so might have serious results.

My function tonight is merely to state some of the varying opinions, but to maintain the strict impartiality of a Presiding Officer. It is, however, proper to add that a problem of the utmost delicacy is presented, not only to the bankers, merchants, manufacturers and producers of all kinds, but also to the entire community, because in these days of banking

interdependence, a sound policy as to credits is of primary importance. It is axiomatic that such a policy is the mainspring of permanent national prosperity.

The aggregate wealth of our country has grown to a marvelous extent. There seems to be no limit to enterprise. The volume of business seems almost fabulous, and yet one cannot regard with indifference the question as to whether or not there is danger of maladjustment in the delicate and, to most of us, mysterious machinery of modern finance. Recognizing this to be the fact the subject which is about to be debated has been deliberately selected for elucidation.

You will have the opportunity of listening to experts of national renown, one of them connected almost from the beginning with the Federal Reserve Board; others prominent in banking; all of them economists of high rank; and each of them having the confidence and esteem of the men in every walk of life. It will be their purpose to instruct us in the science of which they are masters, and to shed light upon the problems which, to the average man, partake of the mystic qualities of relativity, and of the latest of Einstein's mathematical demonstrations (laughter).

I am sure they will speak to us in words of one syllable so that we may be able to form our own judgment as to whether or not the Federal Reserve Act calls for revision and amendment; whether or not the administration of it requires a change in policy, or whether the Board itself should have regard for the duty which it owes to help maintain a proper balance in the workings of the system upon which financial safety is largely dependent. Whatever action is taken it should be inspired with a courage of genuine conservatism, and not with the hot head of impatient radicalism.

All that remains for me to do is to present the gentlemen now occupying the anxious seat who will make confession of the faith that is in them (laughter). The first of the speakers is the Hon. William P. G. Harding, for six years one of the Governors of the Federal Reserve Board; now Governor of the Federal Reserve Bank of Boston; formerly president of the First National Bank of Birmingham, Alabama; former president of the Alabama State Bankers' Association and of the Birmingham Chamber of Commerce. It is a great pleasure which is conferred upon us to have him

here to define a subject with which perhaps there is nobody in this country who is equally familiar (applause).

HON. W. P. G. HARDING: Mr. Chairman, Gentlemen of the Economic Club, Ladies and Gentlemen: I appreciate very much the honor of participating in this discussion, but I must ask that you regard what I shall say as being merely an expression of my own personal views and not in any sense as an authoritative expression of the opinions of the Federal Reserve Board or of any Federal Reserve Bank. Even with this reservation I am sure that you will agree with me that this, in the present circumstance, is rather a ticklish subject for the Governor of a Federal Reserve Bank to discuss in public. So, therefore, I shall adhere very closely to some notes which I have prepared. I will promise you, however, that I will not burden you with any statistics.

The problems connected with the control of credit by the Federal Reserve System while not as simple as they may appear to some, are not so difficult as to render them incapable of solution. In considering this question, let us first understand what the Federal Reserve System is, and where lies the responsibility for its policies. It is composed of the Federal Reserve

Board at Washington and the twelve Federal reserve banks. The members of the Board are government officials, appointed by the President and confirmed by the Senate. Two-thirds of the directors of the Federal Reserve Banks are chosen by the member banks and one-third are appointed by the Federal Reserve Board, although the capital stock of the Federal Reserve Banks is owned entirely by the member banks. The operations of the System are conducted by the Federal Reserve Banks for the Board at Washington is not an operating body. The Federal Reserve Board has, however, plenary powers as far as system policies are concerned. In the matter of discount rates, no question has ever been raised as to the necessity of the Board's concurrence before any rate established by the Board of Directors of a Federal Reserve Bank can become effective; nor has the Board itself, since the Chicago episode of eighteen months ago, ever disavowed the right which it claimed at that time to change the rate of any Federal Reserve Bank under its power of review and determination, without the cooperation of the directors of the bank concerned.

The directors of a Federal reserve bank are

required by law to administer the affairs of the bank fairly and impartially and without discrimination in favor of or against any member bank or banks and shall, subject to the provisions of law and the orders of the Federal Reserve Board, extend to each member bank such discounts, advancements and accommodations as may be safely and reasonably made with due regard for the claims and demands of other member banks. The directors of Federal reserve banks are, naturally enough, inclined to be jealous of their prerogatives and have not been prone to emphasize the phrase "the orders of the Federal Reserve Board" in connection with their dealings through their appointed officers or agents with member banks, while the Federal Reserve Board, appreciating the desirability of being tactful in its dealings with Federal reserve banks, has never in specific terms called attention to this phrase. It is recognized by all that the Federal Reserve Board has the right to determine or define the character of paper eligible for discount within the meaning of the Act, but the Federal Reserve Board has conceded to the directors through their appointed officers or agents, the right to pass upon the desirability and soundness of the paper

offered for discount, and has never undertaken to compel a bank to take paper which its officers regarded as undesirable even though technically eligible. The law describes the security which must be offered for Federal reserve notes and gives the Board the right at any time to call upon a Federal reserve bank for additional security to protect Federal reserve notes issued to it and also gives the Federal Reserve Board the right to grant in whole or in part, or to reject entirely, the application of any Federal reserve bank for Federal reserve notes.

One of the three directors appointed by the Federal Reserve Board must, under the law, be designated by the Board as Chairman of the Board of Directors of the Federal reserve bank to which he is accredited as Federal Reserve Agent, and in addition to his duties as Chairman of the Board of Directors of the Federal reserve bank, he is required to maintain, under regulations to be issued by the Federal Reserve Board, a local office of the Board on the premises of the Federal reserve bank. The law requires that another of the directors of Class C shall be appointed by the Federal Reserve Board as Deputy Chairman to exercise

the powers of the Chairman of the Board when necessary, and prescribes that in case of the absence of the Chairman and Deputy Chairman, the third Class C director shall preside at meetings of the Board.

The law permits Federal reserve banks to establish accounts with each other for exchange purposes and provides that with the consent, or upon the order and direction of the Federal Reserve Board, and under regulations to be prescribed by said Board, they may open and maintain accounts in foreign countries.

State banks and trust companies desiring to become members of the Federal Reserve System are required to make application to the Federal Reserve Board, which body, under such conditions as it may prescribe, may permit the applying bank to become a stockholder in the Federal reserve bank of its district.

The Chairman, in his introductory remarks has already mentioned the power of the Federal Reserve Board to permit or require Federal reserve banks to rediscount for each other and to fix rates, and also has told you of the power of the Board to examine into the affairs of any Federal reserve bank, and of any

member bank at its pleasure.

The Board has power to suspend or remove any officer or director of any Federal Reserve Bank, but the cause of such removal shall be forthwith communicated by the Federal Reserve Board to the removed officer or director and to the Federal Reserve Bank concerned.

The Board is authorized also to suspend for the violation of any of the provisions of the Federal Reserve Act, the operations of any Federal Reserve Bank, to take possession thereof, administer the same during the period of suspension and when deemed advisable, to liquidate or reorganize such bank.

Any compensation which may be provided by the Board of Directors of Federal reserve banks for directors, officers or employees, shall be subject to the approval of the Federal Reserve Board, which body is authorized and empowered also to exercise general supervision over the Federal reserve banks.

It appears, therefore, that the Board's authority over the twelve Federal reserve banks is far greater than that of the Comptroller of the Currency over the National Banks, or of the State Superintendent of Banks over state banks and trust companies. These broad

powers, some of which have never been exercised and probably never will be, which are given to the Federal Reserve Board necessarily impose upon the Board a great responsibility which, from the very beginning, the Board has appreciated and of which it has been constantly reminded by critics. It is this sense of responsibility which has doubtless impelled the Board, from time to time, to issue statements which contain a note of warning intended not only for the banks but for the general public. Occasionally these warnings were effective, but more generally they have been merely a prelude to more substantial action. One of the earliest warnings issued by the Board for the benefit of the general public was in October, 1916, following an announcement by a prominent international banking house that it proposed to sell indeterminate amounts of British treasury bills over its counter. This particular statement was very carefully considered, and because of its bearing upon the international situation, was not issued until it had received the approval of the President of the United States. It proved effective, for the proposed offering was immediately withdrawn.

During the period when the United States was involved in the World War, admonitions or warnings by the Board were as a rule heeded without much adverse criticism because of the general patriotic impulses which prevailed. After the armistice, however, admonitory statements which the Board on several occasions deemed it advisable to make were not so well received, and a number of Federal reserve banks reported that it would be necessary in order to regain an effective control in their respective districts, to resort to means which up to this time have always proved effective, namely, to establish higher rates of discount which would conform more closely to current market rates. The Board, for what seemed to be at the time valid reasons, was reluctant for some time to permit the establishment of higher rates and the Federal reserve banks were advised to try the policy of what was known as direct action which involved closer scrutiny in accepting paper for rediscount, and an appeal to member banks to use more discrimination in giving accommodation to their customers. Several months of valuable time were lost in this way, and it seems probable that had higher rates been established in the late summer of 1919

instead of in January 1920, some of the economic tragedies of the so-called deflation period might have been averted. The depression which began in the summer of 1920 and extended during the year 1921 was, however, of much shorter duration than that which had followed any other serious financial crisis in the country's history, and was followed by a period of unparalleled activity in many lines and by a prolonged season of low interest rates.

The rediscount rate of the Federal Reserve Bank of New York which in the autumn of 1920 had been 7 per cent, stood, after successive reductions, at 3 per cent in the late summer and fall of 1924. Late in February 1925, the rate was advanced to 3-1/2 per cent and in January 1926, to 4 per cent, where it remained until August 5, 1927 when it was reduced to 3-1/2 per cent. At the time this last reduction was made, it was the policy of the Federal Reserve System to use its influence in favor of easier money conditions. This policy was initiated by the Federal Reserve Bank of New York and was approved, as was necessary to enable it to be carried out, by the Federal Reserve Board. The

principal reasons as pointed out by the Under-Secretary of the Treasury, Mr. Mills, in a magazine article not long ago, were (1) European exchanges were weak and it was believed that unless rates were kept easy here, there might be a movement of funds to this country and a consequent necessity of raising rates abroad, to the disadvantage of world trade and prices, and particularly to the disadvantage of American agriculture. (2) Business in the United States at the moment showed a tendency to decline and some industrial unemployment was foreseen which in fact developed during the winter. It was believed that easier money might ameliorate those conditions. The policy was effective in just those particulars which the Federal Reserve System had in mind when it was adopted. At the same time, it is undeniable that it served as an encouragement to speculation and no one foresaw the extent to which the speculative movement would reach. The movement of gold abroad had begun in May 1927 and the reduction in the discount rate accelerated this movement. In order to offset the effects of these gold exports on the money market, purchases of government securities were made for a long time by the Open Market Investment Committee for

the Federal reserve banks, but as soon as it became evident that the object of the policy adopted had been accomplished and that speculation was growing, this policy was reversed. After the middle of November the reserve banks discontinued offsetting gold exports by the purchase of securities and allowed such exports to work their usual effects on the credit situation. In January 1928, in order to offset the return flow of currency to the financial centers from the interior something over one hundred million dollars of government securities were sold by the Federal reserve banks and during January and February the discount rates of all Federal reserve banks were raised from 3-1/2 to 4 per cent. Loss of gold and the sale of securities forced the banks to increase their borrowings from the Federal reserve banks. The action taken was not effective, however, and when it became clear that repeated increases in credit were taking place for speculative purposes, the Federal Reserve System resumed its sale of securities and during the Spring, all of the Federal reserve banks advanced their discount rate to 4-1/2 per cent and by July and August, eight of them had advanced the rate to 5 per cent. The periodic purchase and sale of government

securities by Federal reserve banks had been going on for several years and was for a time thought to be an effective means of stabilizing credit without resorting to substantial changes in the discount rate. The experience of the early months of the year 1928, however, proved that this method of stabilization cannot always be depended upon to be effective. The securities sold by the System last year involved a considerable loss and many of them found their way back into the portfolios of the reserve banks as security for member banks' fifteen day collateral notes. It appears also that it was a mistake to advance the discount rate by only one-half of one per cent and that it would have been better to have adopted the time honored policy of the Bank of England and advance the rate a full one per cent. Whenever it becomes necessary to administer to a speculative market the medicine of a rate advance, homeopathic doses should be avoided.

The Federal Reserve System is handicapped at the present time in its efforts to exercise an effective credit control because there are so many lenders both domestic and foreign not connected with the System, who have been attracted by the abnormally high

rates which have been paid for many months past for funds to be used in stock market operations. During the easy money period, many corporations took advantage of conditions then existing to anticipate their future cash requirements by selling additional stock or new securities. Ordinarily the money resulting from such operations would have been permitted to remain in banks at reasonable rates of interest, but the high rates obtainable on stock exchange loans attracted large amounts which reduced in corresponding degree the deposits of the banks. At the present time it appears that at least one half of the amount of brokers' loans as shown in the weekly statements are represented by funds belonging to individuals, firms and corporations whose primary business is not that of money lending, who feel no responsibility whatever as to market stability, and who have no hesitation in calling their loans whenever their individual necessity or convenience may impel them to do so. During the latter part of last December, such loans were called to so great an extent, that in order to prevent a serious reaction banks in New York City felt called upon to increase their lendings to brokers by about four hundred million dollars. This

necessitated their borrowing perhaps one half of this amount from the Federal reserve bank.

I have seen some references in the newspapers to an alleged contest that is going on between the Federal Reserve System and the Stock Exchange. I do not believe that there is any hostility between Federal reserve authorities and the members of the Stock Exchange. Certainly the exchanges are necessary in carrying on the business of the country. We have a vivid recollection of the chaos which followed the closing of the exchanges at the outbreak of the World War in 1914 and we recall how quickly conditions improved after the exchanges were reopened. Neither do I see any occasion to find fault with the methods of the brokers generally, both on the Curb and on the Big Board. They have not hesitated to increase their margin requirements from time to time and the occasional reactions which have occurred have brought about no failures, yet as Mr. Warburg recently pointed out in his notable address to the stockholders of his bank, dangerous tendencies are developing. These tendencies ought to be corrected and the sooner the better. A review lately issued by one of the large banks points out that during

the past twelve months there has been an expansion of credit of about 8 per cent, while at the same time there has been an expansion of production and distribution of only three or four per cent. This difference represents inflation. The best time to check inflation is during the period of its incipiency. The longer the postponement the more serious the inevitable result will be when inflation is checked, as was clearly demonstrated in 1920. In the February issue of the Federal Reserve Bulletin, the Federal Reserve Board stated its views very frankly and released the statement to the press in advance of its publication in the Bulletin. The immediate effect of this release was a break in the stock market and the Board has been greatly censured in some quarters for making the statement. The Board stated, "The Federal Reserve Act does not, in the opinion of the Federal Reserve Board, contemplate the use of the resources of the Federal reserve banks for the creation or extension of speculative credit. A member bank is not within its reasonable claims for rediscount facilities at its Federal reserve bank when it borrows either for the purpose of making speculative loans or for the purpose

of maintaining speculative loans. The Board has no disposition to assume authority to interfere with the loan practices of member banks so long as they do not involve the Federal reserve banks. It has, however, a grave responsibility whenever there is evidence that member banks are maintaining speculative security loans with the aid of Federal reserve credit. When such is the case the Federal reserve bank becomes either a contributing or a sustaining factor in the current volume of speculative security credit. This is not in harmony with the intent of the Federal Reserve Act nor is it conducive to the wholesome operation of the banking and credit system of the country."

In a recent magazine article, Senator Glass stated, "The fact remains too, and it ought to be emphasized in red letters, that whether dangerous for the moment or not, this sucking in of the country's resources for use in gambling in stocks and bonds, without regard to the need for money in legitimate industry, is precisely the sort of thing the Federal Reserve Act was designed to prevent, or at least to minimize." He then quotes from Section 13 of the Federal Reserve Act, the paragraph which defines what kind of paper Federal

reserve banks may discount and in which the Federal Reserve Board is given the "right to determine or define the character of the paper thus eligible for discount within the meaning of this Act..... but such definition shall not include notes, drafts or bills covering merely ~~in~~ investments or issued or drawn for the purpose of carrying or trading in stocks, bonds or other investment securities except bonds, and notes of the Government of the United States." He points out that "Thus even the legitimate and necessary trading in stocks and bonds for purposes doubtless sound and productive was barred as a basis for rediscounting..... Could there have been a more emphatic pronouncement of the intent of Congress to hold our capital resources down closely to the vital processes of producing and distributing actual commodities?"

The Federal Advisory Council as you know is composed of twelve practical bankers, one from each Federal reserve district. If I remember correctly, the members of the Council from the New York District have been Mr. J. P. Morgan, A. Barton Hepburn, Paul M. Warburg, James S. Alexander, and now Mr. William C. Potter, all of them bankers of the very highest dispute.

The Council is a statutory body (Section 12 of the Federal Reserve Act) and has power to "confer directly with the Federal Reserve Board on general business conditions; to make oral or written representations concerning matters within the jurisdiction of said board; to call for information and to make recommendations in regard to discount rates, rediscount business, note issues, reserve conditions in the various district, the purchase and sale of gold or securities by reserve banks, open market operations by said banks, and the general affairs of the reserve banking system." Its members are elected by the directors of the Federal reserve banks and the Counsil is, therefore, entirely independent of the Federal Reserve Board.

At the last meeting of the Council held on February 15, it went on record as approving the action of the Federal Reserve Board instructing the Federal reserve banks "to prevent as far as possible the diversion of Federal reserve funds for the purpose of carrying loans based on securities. The Federal Advisory Council suggests that all the member banks in each district be asked directly by the Federal reserve bank of the district to cooperate in order to attain the

end desired. The Council believes beneficial results can be attained in this manner." The Federal Reserve Bank of Boston immediately sent a letter to all of its member banks asking for their cooperation. The letter was well received and the results have been satisfactory, although it was pointed out by some of the banks that it was difficult to decline to make loans secured by good collateral to regular customers even where it seemed probable that the proceeds would be used for speculative or investment purposes, because in many cases loss of deposits and good-will would follow a refusal.

The paragraph in Section 14 of the Federal Reserve Act which gives the Federal reserve banks "Power to establish from time to time, subject to review and determination of the Federal Reserve Board, rates of discount to be charged by the Federal reserve bank for each class of paper which shall be fixed with a view of accommodating commerce and business" contains a definite mandate - "the rate shall be fixed with a view of accommodating commerce and business." Generally speaking, low rates give such accommodation and high rates do not. I have always noticed a more marked

disposition on the part of the Federal Reserve Board to agree to a reduction in rate than to an increase in rate. Doubtless this is because of the view that high rates do not conduce to the accommodation of commerce and business. Sometimes, however, it is necessary to look beyond the immediate effect, to take a longer view into the future. The highest rate now prevailing at any Federal reserve bank is 5 percent and yet I doubt if there is any firm or corporation in the United States today which is able to borrow from its own bank at that rate. Until recently offerings of U.S. Treasury certificates bearing interest of from 3-1/2 to 4-1/2 percent have been heavily oversubscribed, sometimes at a ration of more than 2 to 1, but the offering of $475,000,000 last week at 4-3/4 percent was oversubscribed by less than $50,000,000. The Federal reserve bank rate is no longer the dominant rate. It is generally recognized both at home and abroad that the master rate in this country is the call money rate in New York, which fluctuates at frequent intervals from 6 to 12 percent. Perhaps the Federal Reserve Board at the present time may feel the same reluctance to agreeing to an advance in rates that some members of the Board

felt in the summer of 1919; but yet if there is to be an advance, and I may say that I have no information whatever as to the likelihood of this, the rate established would only follow and not lead the market, for market rates have already been established.

In matters of credit control, it is of course important that there should be a thorough understanding between the Federal Reserve Board and the various Federal reserve banks; they should work in harmony and not at cross purposes. The Federal reserve banks should do everything in their power to carry out the views of the Board in matters of policy and if the Board believes that appeals to member banks should be made, or statements to the public should be issued, such appeals or statement should be made; and if it should develop as was the case in the fall of 1919, that conversation is not effective, resort should be had to those sterner methods which have never failed to be effective. Continued high rates of interest will eventually bring about a slowing down in business and industry. Such a slowing down would inevitably affect adversely security values. While the Federal Reserve System is not engaged in any kind of economic warfare,

and has no desire to destroy values, it is my belief that under the terms of the Federal Reserve Act its first duty is to the industrial, commercial and agricultural interests of the country. That this duty cannot be performed effectively if the resources of the System are permitted to be diverted through indirect methods into channels expressly prohibited directly by the law, appears to me so clear as to be beyond dispute (applause).

MR. MARSHALL: More than half a century ago I lived in what now might be considered a rural community, but which has now grown to be an urban center, where bank consolidations are announced weekly (laughter). In those days a bank president was entirely a different individual from the banker of today. He was graduated from the farm; he knew all about thrift and economy, and nothing of economics. He knew nothing of statistics except his balance sheet and the statistics of his money box. But he was strong in horse sense. Today no bank can get along without statisticians and economists, and it is well that it should be so. This evening we have the opportunity of listening to one who is a great economist. He has been professor in

a college of Missouri; at Columbia University; at Harvard University, and today he is the economist of the Chase National Bank. I have the pleasure of introducing to you Dr. Benjamin M. Anderson, Jr. as the next speaker (applause).

DR. BENJAMIN M. ANDERSON, JR: Mr. Chairman, ladies and gentlemen; I have listened with great interest to the wise words of Governor Harding. The banking community of the United States honors him and will always honor him for many things, but very especially for the distinguished courage and steadfastness he exhibited as Governor of the Federal Reserve Board during the trying crisis period of the last half of 1920 and early 1921, and for the even greater courage that he exhibited in opposing the unreasonable optimism of the first half of 1920.

In the time that I have I want to cover certain definite things. First, an analysis of the situation and the causes that brought it about, which will have to be in bold outline and briefly presented. Second, the right of the Federal Reserve System to control, which has been challenged. Third, the power of the Federal Reserve System to control, which has been challenged;

and, fourth, the proper tactics of control.

Let me paint on a very large canvas the events of the past six or seven years leading up to the present situation. In 1922 the world had gone through four years of war, and four years of disorganization after the war, during which, on the whole, production had not been as great as consumption; during which there had been a dissipation of capital, and the normal expectation of any economist or banker on the basis of that set of facts would be that interest rates would be high and that capital available for current purposes would be scarce. The expectation would be that as a result of high interest rates there would be new capital created, and an incentive to saving, and as a result of high interest rates there would be economy in the use of capital so that capital would be used only for the most economically necessary purposes and the world would gradually rebuild what it had destroyed. But the fact is that in 1922, and in the period since, and until very recently, interest rates have been low and capital has been seemingly abundant, and no matter mf how much of it you used, no matter how actively you fed the securities market with new issues

there was more and more capital eagerly awaiting opportunity for investment.

Where did it come from? Have we discovered something new, some "widow's cruise" of oil, inexhaustible? I don't think so. I think I can explain rather readily where that capital came from. It came from bank expansion; it came from an increase in the assets and liabilities of banks. It came from an increase in credit transactions, not from savings primarily.

Bank expansion is a necessary recourse at times, even on a great scale, when things have to be done in a hurry. During the war, when our Government had to finance, had to borrow $20,000,000,000 or $25,000,000,000, had to raise a great army, had to send that army to France, had to convert the industry of the country from a peace basis to a war basis in a great hurry; when we had to do business on a very high price level and a rising price level; when we had to finance shipments of goods from all over the world to our allies in Europe; an immense bank expansion was called for and took place. We watched it with fear and trembling, knowing that it was necessary, but afraid of

it, the effort being made at all points to hold it down to what was imperative. That expansion during the period of our participation in the war from April, 1917 to the end of 1918, amounted to $5,800,000,000 in deposits and to $7,000,000,000 in loans, discounts and investments. I shall give you just as few figures as I can, but some are necessary. Bear this in mind for the purposes of comparison; $5,800,000,000 in deposits, $7,000,000,000 of loans and investments.

Since 1922, between 1922 and early 1928, without any need for it, there took place a vastly greater expansion; as against the wartime expansion in deposits of $5,800,000,000, there was an expansion of deposits of $13,000,000,000; and as against an increase or expansion of $7,000,000,000 of loans and investments, there was an expansion of loans and investments of $14,500,000,000; unneeded by commerce; commerce could have done with even less credit than we had. We should have had under ordinary conditions a contraction of that wartime expansion. It did not take place. Commerce did not need it and would not use it. Where did it come from? The answer is clear and the record simple. A vast deal of it went into bank holdings on real estate mortgages which now stand, for

member banks of the Federal Reserve System, well over $3,000,000,000, as against $700,000,000 then.

There has been a great growth in instalment finance paper in banks, a growth which would not have taken place if bank credit had not been super-abundant. There would have been instalment credit, but the magnitude would not have been anything like so great had there not been this super-abundance of credit. There has been a terrific growth in the buying of bonds by banks and bankers; and finally there has been a terrific growth of stock and bond collateral loans by banks.

These have been the main employments of bank credits during this period, with an actual decline in the portfolios of the banks of commercial paper, and I will come back to that later. Let me point out incidentally here, that where you can go to the Federal Reserve Banks with commercial paper for rediscount and where you can go to the Federal Reserve Banks with Government securities and borrow on them, instalment finance paper, stock and bond collateral loans, bond investments other than government bonds, and real estate mortgage loans, cannot go to the Federal Reserve

Banks, and that there has been consequently a sharp decline in the percentage of bank assets that may be taken to the Federal Reserve Banks. I will give those figures later. I should like to take a minute to explain that process of bank expansion. It is to many minds a mysterious thing, and there have been many erroneous statements about it. There are text books, for example, which will tell you that when a bank gets $100 in cash it can forthwith lend $400 or $500. One very able banker from New Jersey, a veteran, said to me some years ago that he had been trying for many years to make one dollar do the work of four or five, but that in the warfare of checks at the clearing house the other banks would not let him do it, and he is right on the basis of ordinary banking situation. When there is no excess of reserve money, no excess of reserves in the banks, -- one bank with perhaps a little surplus, and another bank with a deficit, but on the whole just about the right amount of reserves,-- the banks can only lend what they have. The bank with an excess can lend it, but just it, and if it lends more, the other banks should dig into its reserves in a day or two at the Clearing House. The expectation is that, and it is a justifiable expectation. The

lending process, as every business man knows, is not to give your note to the banker and have the bank give you cash which you carry out in your pockets. The lending process is to give your note to the banker, and for him to give you a deposit credit against which you may check, with the result that the making of the loan expands both the assets and liabilities of the bank. Now, then, if the next day the borrower draws against his deposit credit a check which he puts into some other bank, or which he puts on deposit at some other bank, the bank which has made the loan will lose cash at the Clearing House. But suppose on the same day the Chase, the City Bank, the Guarantee, the Commerce, the other banks in the city, all have excess reserves, what then? We lend our excess reserves. The other banks lend theirs. Our deposits and loans go up. Their deposits and loans go up. Next day at the Clearing House checks are drawn and presented against the loans we made the day before, deposited with the other banks. Checks are drawn against them also which are deposited with us, and the result is a wash at the Clearing House. None of us loses any cash. We have that cash still on hand, that excess cash. It may be

a little bit less. If we have $10,000,000 excess which we try to lend out on loans of $10,000,000, and build up $10,000,000 of deposits, we must keep a reserve against new deposits. We must segregate $1,300,000 against new deposits, but that still leaves us $8,700,000 to lend and which we go on lending and drawing against the next day, until finally there has been built up a super-structure of credit, loans on deposits based on that excess reserve such that the excess reserve is just 13 percent of the larger super-structure. That is the multiple expansion which takes place when reserves generally are excessive, and I have given you the 13 percent ratio for New York. In most other cities it is either 10 percent or 7 percent, and against time deposits it is 3 percent. Expansion really has taken place much more rapidly than that 13 percent ratio would indicate. There is the source of this superabundant capital. What is the source of the excess reserves on which we base it? How do we happen to have excess reserves? First, there was too much gold in the country in 1922, and gold kept coming in because the rest of the world was off the gold standard, and this was one place where we could use gold for monetary

purposes and, secondly, the influence of the gold was intensified by the easy money policy of the Federal reserve banks holding their rediscount rates below the market, and then when the banks even at the low discount rates did not borrow, or did not borrow adequately, but kept pushing out additional money in the money market through buying Government securities or acceptances. The two things, excess gold, easy money policies of the Federal Reserve Banks, kept the banks' excess intact year after year, with one exception of the year 1923, during which this great expansion went off. The thing was intensified by a final cheap money market in the Fall of 1927, to which I shall refer in a moment. But many things took place outside of the field of banking as a consequence of this great expansion. I haven't time to go into it all. But we have had a vast speculative move in real estate; but most of all, most dramatic of all, and of greatest current interest, the rise in securities.

The low price of the New York Times average of 50 stocks, 25 rails and 25 industrials, in 1921 was $58 per share.. At the end of 1924 this had risen to $107 per share. At the end of 1926 to about $138 per

share. Early in February of this year, before the break, $251 per share, and very nearly that on the recent rally, and it is rather interesting to observe that while a very great deal of this was being put on, business receded in 1927, picked up in 1928, to levels perhaps like they were in 1926 or a little better, while securities moved rapidly and dramatically up.

Prior to the Autumn of 1927 the speculative market had been rather readily responsive to changes in the money situation. Its immediate response in the Autumn of 1927 to cheap money, the very cheap money that came about then, was languid, and then suddenly the forces of intense speculative activity broke loose in a way that has amazed virtually every observer. The methods that were employed in the early part of 1928 by the Federal Reserve System in the effort to restrain it, when they reversed their policy of the past might have been expected to be more or less adequate. But they were inadequate, as we all know.

Now, then, as to the right of the Federal Reserve System to intervene. Disclaiming a desire to act as arbiters of speculation, or of the values of securities, the Federal Reserve authorities have

declared that they are concerned when speculative demands for credit force a rise in rates of interest for commercial borrowers. I believe that they may properly go much further than this. They have responsibility for the banking position of the country, and this banking position tends to be impaired when bank credit is used in great and growing quantity for speculative purposes. The risks of bank loans against securities are greater when security values are too high than they are when security values are reasonable, and the Federal Reserve authorities may, therefore, properly consider the level of security prices in framing their money market policy, just as they may properly consider with concern a speculation in commodities which sharply and suddenly raises commodity prices.

The individual banks, of course, endeavor to deal with this by the margins they require in connection with security loans and by the loan values they assign to securities, and I believe that our policy in this city with respect to these points has been very vigorous, and that our loans are well margined. But it is also surely a legitimate matter of concern for the Federal Reserve authorities.

The Federal Reserve authorities may properly consider the decline in the percentage of bank assets eligible for rediscount at the Federal Reserve Banks, which has taken place as this speculative move has gone on, as security values have mounted, and as commercial loans have actually declined in the portfolios of banks.

Let me give you the figures there briefly as I can.

The percentage of loans in national banks eligible for rediscount at Federal Reserve Banks under date of June 30th, 1923 for the United States as a whole was 30.2 percent; for New York City 25.5 percent; Chicago, 38.5 percent, and Boston 32.5 percent. On June 30th, 1928, the figures were for the United States, 21.6; New York City, 16.6; Chicago, 18.1, and Boston 15.3.

The Federal Reserve Authorities may properly take cognizance of figures like those, and there have been similar declines in the percentage of Government bonds to total securities owned for the national banks fr from 53 to 40 percent, though I take occasion to call your attention to the fact that the great city

banks since the end of 1926 have been building up their portfolios of Government securities, sacrificing profits in the process, but doing it in the interests of liquidity and sound banking.

Now, I don't think that the Federal Reserve System needs to wait until the situation becomes unmanageable before taking cognizance of this situation. I think the situation is still manageable, and I think they should probably take cognizance of it now.

Second, regarding the power of the Federal Reserve System. The control of the money market is in the member bank reserves. We have $44,000,000,000 on deposit in commercial banks of the country, a vast figure. The control is in a much smaller figure, about $2,400,000,000 of member bank reserves. The control is in a smaller figure still, because those member banks reserves are mostly all required reserves. But the control is in the margin. $120,000,000 to $100,000,000, plus or minus, to the required reserves, makes the money market, governs interest rates. Can the Federal Reserve Banks control that?

Of that member banks reserves, nearly $1,500,-000,000 is borrowed from the Federal Reserve Banks

directly or indirectly. Nearly a billion borrowed on rediscounts, and the rest of it obtained through the sale of bank liabilities in the form of acceptances through the Federal Reserve System, and another borrowed on Government securities purchased by the Federal Reserve System. The power of the Federal Reserve System is unquestioned. They can restrict credit, and they can restrict credit to the stock market, without any question. Outside money in brokers' loans are a substantial figure, $3,800,000,000, when you take the figures for the Federal Reserve Banks and combine them with the additional figures reported by the Stock Exchange. But that is only a small part of the loans made to carry securities in this country. For the country as a whole it is not possible to give figures for the total of security loans, but some 600 great city banks alone on March 6th of this year had loans against securities of $7,573,000,000, and in addition had holdings of $ securities of $5,961,000,000, making a total of bank credit employed in the securities market for these 600 odd banks alone of $13,534,000,000. For the banks in the country the figure is very much

greater. The brokers' loans for account of others looks small in comparison with this. The Federal Reserve Authorities can control bank credit, and controlling bank credit can control credit to the stock market.

Now, how shall they control it? Control by rate or control by admonition? They have got to cut the total of reserve credit down to make their policy effective. They have got to cut into the total of member bank reserves to make their policy effective. They are selling Government securities and letting acceptances run off, which curtails Federal Reserve Bank credit, and cuts into member bank reserves.

But the member banks are replenishing that by going to them and discounting at 5 percent, sometimes 4-1/2. The traditional and normal way to handle that matter is by the rate. Rediscounting is done if it is inexpensive and profitable, and if it is costly it is not done so readily. The banks, when they have to borrow at a cost, using rediscounting in emergencies only. The traditional practice with reference to rediscount rates before the war, well established, was that the rediscount rate should be above the market. The Federal Reserve System at the beginning had its rediscount rate

above the market, down to 1917. But during the war, in order to assist the Government in its financing, they put the rate below the market and held them there, and with the exception of a brief period of about a month and a half at the beginning of 1919, the Federal Reserve rediscount rates have never been above the market since.

What is the market? I will abbreviate what I meant to say on that point, defining it this way: For the United States the market rate above which the Federal Reserve Bank rediscount rate should be kept is the rate to prime borrowing customers of great city banks who have relationships with several banks, and often in several cities. That rate is not published but it is known in the banking community and is known to the Federal Reserve authorities. In order to be above the market rate today the rediscount rate of the Federal Reserve System needs to be 6 percent.

There has grown up, and especially in recent years, a timorous fear regarding upward changes in the rediscount rates of the Federal Reserve System. It should not be. It is a banking matter. It should be understood as a banking matter. It should be adjusted from time to time to the banking position, just as the

price of copper rises or falls based on supply and demand. Ar artificially low rate masks the facts of the situation and stores up worse troubles for later times. We should have rates that reflect the facts.

In connection with the fear of rate change there is one fallacy that I want to dispel, in conclusion. It is that credit can be restricted by admonition without affecting the rates to commercial borrowers, whereas, if the rate is raised the rates to commercial borrowers will automatically go up. I maintain that whether the policy of admonition or of rate be used, either, if it is successful, must do the same thing, namely, restrict rediscounting, restrict the total of Federal Reserve credit; consequently, restrict and curtail member bank reserves; consequently force banks to economize their credit; consequently, in a competitive money market, force up rates to all kinds of borrowers. The banks will continue, as they are now doing, to give preference to commercial borrowers. But with a danger of shorter credit all class of borrowers will have to pay more. I thank you (applause).

MR. MARSHALL: We have heard from the Governor of a Federal Reserve District. We shall now hear from a

former Governor of a neighboring State, ex-Governor Edward C. Stokes, of New Jersey. He is also a banker. Indeed he was the first President of the New Jersey Bankers Association and is now chairman of the Board of Trustees of the Mechanics National Bank of Trenton, New Jersey. Governor Stokes (applause).

HON. EDWARD C. STOKES: Mr. Toastmaster, Ladies and Gentlemen of the Galleries and Pit (laughter): I rise on this occasion with a sincere appreciation of the compliment paid me by this club, but with all the natural timidity of a Jersey man. The modest sons of our State always stand with awe in this metropolitan community, now the proud financial center of the world. We countrymen look with reverential awe upon the ability of your bankers to reap a return of from 8 to 12 percent on your loans while we starve along with a beggarly 5 or 6 (laughter). And we look with childish delight on that Napoleonic strategy by which, when your credit situation becomes strained, you call your loans at one window and immediately reloan them at another to the same person at a higher rate of return (applause and laughter).

And so the other day when we received, as we

did, from the Federal Reserve Bank of our district that little nursery tract containing the gospel of the Federal Reserve Board, telling us to be good boys and keep away from brokers (laughter), we wondered if we were being admonished because you were getting rich (laughter).

Now, after listening to the preceding speakers, one of whom I love, Governor Harding, because we differ so much (laughter) I feel like a genuine heretic, which I shall prove to you before I close.

A distinguished feature of America's financial system is its independent individual banks, locally owned and locally controlled and locally managed, in marked contrast to the European System of centralized banking. America has over twenty-six thousand of subh banks each a local institution, while Great Britain has only twenty-three banks with hundreds of branches and France only nineteen banks with numerous branches. Under this American system of individual finance our country has reached the highest degree of prosperity the world has ever known and its people have comforts and luxury beyond the dreams of other lands. So well conducted have

been the American banks that since the inauguration of the National Banking System the loss to depositors has averaged less than 1/4 percent per year. Banks who can show such a record of business ability and such safety in handling other people's money have proven their capacity to allocate credit and their right to handle their own business and they are entitled to the respect and cooperation of the government authorities instead of public admonition and public criticism, as though they were guilty of some unethical practice.

I have the most profound respect for the members of the Federal Reserve Board (laughter). I have profound confidence in their sincerity, integrity, good faith, ability and courtesy, but they are human beings and they can err (laughter).

The powers of the President and Congress are limited and circumscribed. The powers of the Federal Reserve Board are without veto and with little check and they may assume powers at times beyond their province. Our forefathers who devised a government of checks and balances would be shocked by the powers placed in this body. Its responsibility, therefore, is measured by its possible capacity to do harm. If a member bank makes

a mistake, it may injure a few individuals or perhaps part of a community. When the Federal Reserve Board makes a mistake, it injures the whole country and creates chaos, doubt and lack of confidence in our industrial and business circles.

An illustration is the drastic deflation policy of 1920, a policy which Cassels, the greatest financier of the world, according to Lloyd George, twice adviser to the League of Nations on financial matters, declared was artificial, a policy which drew forth the protest of the then Comptroller of the Currency, a policy which caused a drop in prices in six months as great as they fell in six years after the Civil War, a policy which caused shrinkage in inventory values, failure of manufacturers and merchants and loss to banks, and brought distress to the American farmer until there was created the farm problem not yet solved by American statesmen, a policy that by raising discount rates to five percent caused the decline in Liberty Bonds to 82 and a loss to thousands of patriotic investors. The policy of no one bank could have had this widespread effect. The attitude of the Federal Reserve Board, therefore, is freighted with such serious consequences

that a Coolidge-like caution is most necessary.

The progress of America is due to individual f freedom unfettered by governmental paternalism. Whenever the government interferes in business in any form of activity, business suffers. As President Hoover said in his inaugural, "Progress is born of cooperation in the community not of government restriction. The government should assist and encourage these movements of collective self help by itself cooperating with them." That is just as true in banking as in other fields. The paternalistic interference of the government authority in business, financial, industrial or public utility, is un-American and is based upon two assumptions, first, that the American people, though the most successful in the world, are incapable of self-direction or of managing their own affairs, and second, that when you pick a half-dozen or more of these same incapable people out of the masses and place them in official positions, they somehow become annointed with superior foresight or superior capacity to tell you how you can run your own affairs. Both of these assumptions are false. The American people can manage their own business better than any official authority can tell them.

One more suggestion as to the proper relations between the government and the sovereign people who own the government. The officers of the Federal Reserve System are the officials of the member banks and not their masters. The member banks own the stock and constitute almost the sole depositors of the Federal Reserve System. They therefore have some rights and are entitled to the cooperation of their public officials rather than public scolding and public criticism. I do not doubt the right of anyone, officialor otherwise to give advice, advice is always welcomed by the intelligent, but I doubt the right of anyone, official or otherwise to tell a member bank how to dispose of its credits, so long as that member bank is managed in accordance with the law. Private advice is always welcomed by any banker but public warnings to the whole banking system of the Republic is frought with danger and disturbs public confidence.

The Federal Reserve System was created to stabilize credit and make it easier and cheaper for the legitimate borrower. President Wilson said at its inception that it was panic proof, that high interest rates would no longer prevail and that no banker in the

future need tell a legitimate borrower that he had no money to loan because he could borrow of his Federal Reserve Bank and thus obtain the required credit. This prophecy has not been realized. Has the functioning of the System gone astray? Under at least the implied object of the charters of the Federal Reserve Banks their right to charge a discount rate beyond that which enables a member ~~mmk~~ bank to loan to its customers at the legal rate without loss is open to serious challenge. The cost of operation of the average member bank is 1.35 percent and if the rediscount rate is five percent, the money which it loans to its customer costs it 6.35 percent. The member bank thus is loaning at a loss and the chief object for which the Federal Reserve System was created, namely, to furnish credit for legitimate borrowers is made impracticable. I do not think that the Federal Reserve Banks are within their implied charter rights when they raise the discount rate above 4-1/2 percent in states where the legal rate is 6 percent. If the Federal Reserve System cannot keep interest rates low and credit cheap, it is of no use to the member banks or the country and it has confessed its failure to perform the function for which it was created. Its usefulness is over. The average

man of the country feels that the real object of the Federal Reserve System was to furnish credit at reasonable rates for business purposes and when the Federal Reserve System steps beyond this well-recognized function and attempts to use its power to regulate or control speculation, either for or against, either up or down, it is in the position of a minister who leaves the pulpit to referee a prize-fight. It means well but it is out of its sphere and is exercising ultra-vires powers in a field where it is bound to fail.

I don't exactly know what speculation is. I trust I am not immodest when I suggest that there are many in my class. A man who buys knowing the worth of what he is buying better than the rest of the world is not a speculator; he is an exponent of business-like foresight. The many who buys on a guess may be a speculator. I think Columbus was a speculator when he sailed an unknown ocean to find India. Washington was a speculator when under the historic elm on the Watertown Road to Cambridge he took command of the Armies of Liberty. I think Hoover was a speculator when he ran against Smith. I think the farmer is a speculator when he plants seeds in the spring and takes the hazard of the

rain and the storm and drought and insects. I think Franklin was a speculator when he toyed with the lightning. I think Edison was a speculator when he gave us the electric light. Captain Fried was a speculator when he saved the crew of the Antinoe. All life is speculation. When speculative activity ceases, progress stops and the world dies. Moreover, who are these speculators? They are not criminals. They are the sovereign American people, as sovereign and as responsible as you or me. Burke said you couldn't indict a whole nation. No more can you successfully indict this tendency of the dynamic American populace especially when they see C. & O. earning $24. B. & O. and American T. & T. earning over $12. per share per year and Dupont and General Motors, earning more, trade eight percent above normal, motor output fifty percent more than this time last year, employment constantly increasing and 900 representative industries earning 14 percent net more than the previous year. This country is marching on and all attempts to prevent the intelligent masses from keeping step to the music of its progress and buying a partnership in its prosperity, are beyond the province of government authority and bound to fail.

like old King Canute's attempt to brush back the rising tides of the sea. During the war the government taught us to save and invest. Now, when good prospects lie all about us, as Secretary Mellon says, we are told alike by those in and out of authority to stop, sit on the fence and watch the prosperity procession go by.

Human nature and the custom of years cannot be changed by a banking edict. Stocks will continue their upward swing so long as earnings warrant or until the strong ones see fit to shake out the weak, then stocks will recede until the strong ones buy them back when they will again advance. This merry-go-round will go on in the future as in the past. The centralized banking authorities may make easier the shake-out of the weak ones but they cannot set aside the law of events. I often wonder why these financial reformers are never on the bull side of the market(laughter). Apparently they never are. They seem to think it wrong to speculate upwards but all right to speculate downwards (laughter).

A recent statement of the Federal Reserve Board of February 7th contained the charge by innuendo

if not directly that the banks were diverting their credit resources from legitimate business to speculative purposes. I do not agree with this assertion in the slightest. I know of one bank that has never refused the legitimate needs of its borrowers, that regards loans for business needs as its paramount care and duty and never refuses any borrower his business requirements in order to make call loans on Wall Street. I believe that ninety-nine per cent of the bankers of this country pursue the same patriotic course. I know of one bank that if it had the money out on Wall Street on call and if any farmer, or business man or manufacturer, asked for a loan within the limits of safety and warrant of his credit, that bank would withdraw that much money from call in New York at high rates and loan it to its community patrons at not exceeding six percent and I am sure that 99 percent of the banks of this country pursue the same course. Any insinuation to the contrary from any source whatsoever is an unjust charge against the American banker who will do his duty to his fellowmen and his country without being scolded for something he does not do. The banker after taking care of all the legitimate demands has a right to loan his

surplus on call. Indeed, that is a duty he owes his bank in order to maintain a liquid reserve, a policy the Comptroller of the Currency has always advised.

It is certainly true that only a small number of people out of the hundred millions of citizens engage in speculation. It is certainly true that only a few banks, if any, divert their credit resources from legitimate purposes to speculative fields. Why then scold the whole American public and the whole American banking system because of a guilty few?

According to this policy, if the government banking authorities were school teachers and two boys were unruly they would spank the whole school (laughter).

No one has yet proved that the credit resources of this country are perverted to any appreciable extent from their true object for the purpose of creating a gambler's paradise. This demurrer cannot be made too emphatic. Last year before the Banking Insurance Committee of Congress, Professor Sprague of the Banking Department of Harvard University said, "I do not believe that any part of the country is suffering from a dearth of banking credit because of brokers' loans."

The policy of raising the rediscount rate in order to stop speculation is a wrongful and ineffective remedy and is based upon the theory that the millions of innocents should be punished for the sins of the few. If a young inexperienced patron of my bank is branching out too much in the speculative field, I quietly call him to my desk and kindly tell him that he has reached his limit, but I don't raise the rate of interest on every other borrower of our institution. Raising the rediscount rates to stop speculation invites money into Wall Street. It does more. It impairs the value of the securities of every innocent investor in the country, reduces the value of government bonds, impairs the surplus of every holding bank and individual and makes government financing more expensive for the taxpayer, makes credit dearer for every farmer, manufacturer, merchant builder or contractor who never speculated in their lives, checks business activity and penalized the whole country - all this for the sole purpose of stopping speculation and it doesn't stop it at all. That goes merrily on.

The raising of the rediscount rates works an unfair hardship on the member banks. It is one of the

responsible factors for the high interest rates with the result that depositors withdraw their deposits in order to loan at usurious rates on Wall Street, to the extent of $1,300,000. in one bank alone that I know of. Many of the banks of the country can testify to the same sad experience, and then these banks are compelled to force immediate payment on the part of their legitimate borrowers to the latter's discomfort and loss or borrow themselves to fill up the avoid at high rates. The consequence is, the member banks are losing deposits at one end and compelled to borrow at high rates at the other end and we are supposed to smile. In the meantime individuals and corporations have taken control of the money market and have become the real bankers until this class of call loans according to the best figures I have, now exceeds in amount those of the banks. Such a policy has defeated its own ends. It is a reductio ad absurdum. It is creating irresponsibility if not anarchy in our financial system.

Another aspect of the present situation hedges around the amount of brokers' loans. So much inaccurate propaganda has been spread about this phase of commercial activity that it has become the bogey man

in American finance. Congressman McFadden said, "I do not know, nor do I believe, there is anyone in these United States who can correctly state whether or not brokers' loans are too high or too low. An intelligent answer to this question requires full knowledge as to what use the proceeds of brokers' loans are ultimately put." A whole sermon lies in that phrase "the use to which the brokers' loans are put", and yet, members of Congress, newspapers and government officials are condemning brokers' loans without a knowledge of their merits or a knowledge of their function. It is like condemning an insectiverous bird because he is too big although he may save the lawn and the trees.

A decrease or an increase in brokers' loans is not necessarily evidence of an increase or decrease in speculation. The brokers' loans may contain a large amount of industrial securities for industrial credit, as they do. They may contain a large amount of securities for refunding purposes, as they do. They may contain a large amount of foreign securities purchased by banking houses for distribution in the American market, the aggregate of which has been tremendous in

in this country. They may contain securities for the account of individuals for investment purposes to be paid upon the instalment plan, as they do. They may contain new issues of stock by business corporations, a method of borrowing from the stockholders instead of banks, as witness the recent proposed issue of new stock by the United States Steel.

All of these items are a part of the brokers' investment loans and none of them are speculative in character.

In the City of Trenton, a well-established industrial enterprise issued a million dollars worth of bonds to modernize its plants. That went into brokers' loans. Another one issued $2,500,000. for credit uses in its business. That went into brokers' loans, but it was just as much a legitimate credit as though they had borrowed directly of the bank and it was not for speculation. Until the brokers' loans are honestly analyzed and all such items deducted from the aggregate, no man has a right to say that there is over-speculation or criticize the American public and when he does, he is indulging in the art of the Irish woman who when asked what she was talking about said: "And shure I'm just

making conversation"(laughter).

It is perfectly amazing to hear this loose talk about brokers' loans without any accurate knowledge of the character or purpose of those loans on which to form an intelligent judgment. No banker would ever decide a credit risk on any such inadequate information and yet this ephemeral term has become so much a reality in American finance that it is used as the basis of threatened legislation of a banking policy and of general criticism although it would not for one moment be admitted as competent testimony in any court of evidence.

"Ubi gentium sumus", as Virgil said, "Where in the world are we?" (laughter). Every day one picks up the newspaper to read of an offering of new securities for industrial or transportation or other development. New listings on the exchange have doubled in four years. New issues are largely responsible for the increase in brokers' loans. Such increases simply spell progress, but some financiers mistake it for a pain. Brokers' loans created through new issues are onward pioneers. They are building a new railroad here, a new electric plant there, a new factory in another place, a

waterpower is another place, a new kind of farm equipment in another place, adding to the happiness and comfort of our people but the very minute these laudable activities are called brokers' loans, Washington shivers as though it was being pursued by Banquo's ghost.

A friend of mine defines a pessimist as a man who if you held up a doughnut sees only the hole and fails to see the cake (laughter). Today these pessimists see nothing but the aggregate of brokers' and investment loans. They fail to see the ninety billions income of this country, greater than the total wealth of Austria-Hungary and Germany combined, greater than the total wealth of France or Great Britain. They fail to realize the immense wealth of this country $400,000,000,000. They fail to realize that compared to this the increase in brokers' loans is microscopic. They look only at the sun spots but they never see the flood of the sunshine. Why, there aren't enough brokers' loans in this country in comparison with its wealth and income and demand for investment to affect its available commercial credit to any appreciable degree. Remember what Professor Sprague said.

The Jeremiahs have failed to realize that most of the activity of the day, religious, charitable, commercial, agricultural, industrial, transportation and power development is done in the form of corporate stocks. They fail to understand that in 1922 the business corporations financed 9.2 percent of their credit needs through corporate issues and in 1927 over 26 percent of their credit transactions were consummated in that form and that practice is growing more and more. The bankers of the country must learn that business is changing and that instead of loaning directly to business enterprises today they loan to the stockholders who furnish these corporations with credit.

If a banker loans $100,000 to United States Steel directly, he receives applause, but if he loans $100,000 on the stock of the United States Steel that has been issued to pay the debts or furnish credit to that company, he gets the stop signal.

The natural result of such a discriminating policy will be this, and I am now a prophet - just as investment trusts have grown up, there will be formed in this city one or more of what might be termed collateral loan corporations free from the supervision

of the National Banking authorities who will make a practice of loaning on call to brokers at attractive rates and divert deposits from banks and become serious competitors to the banking institutions. Unless a policy of lower call loan rates is adopted, the Federal Reserve System will build up a competitor that will seriously impair its usefulness, make futile its policy and injure the member banks.

The remedy? Very simple. Let the Federal Reserve System keep its hands off of the speculative field, keep within its real province of furnishing credit to member banks, reduce its discount rates to at least 4-1/2 percent in states where the legal rate is 6 percent. Interest rates will fall and money will naturally flow back as available deposits in the banking institutions of the country.

No man can afford to be other than fair. Brokers' loans are not the main users of our credit resources. The loans of the banks of the country together with their investments amount to $59,000,000,-000. The increase in brokers' loans of $2,000,000,000. is small compared with this. It is manifest that one of the factors leading to dear credit is the tremendous

amount of loans we have made abroad, probably $15,000,000,000 by this time, which does not include loans to governments and municipalities abroad. How insignificant the brokers' loans compared to this! Why lay all the blame upon the shoulders of the American broker and not upon the loans in foreign fields? President Coolidge said in his Armistice Day speech, "There is little reason for sending capital abroad while rates for money in London and Paris are four and five percent while ours are higher. The needs of our own people require that any further advances by us must have most careful consideration." Why doesn't the Federal Reserve Board say something about this? Several years ago, President Hoover, then Secretary of Commerce called attention to the fact that our liberal loans to foreign lands not only established competing industries with America but enabled other countries to hold, maintain and raise prices on raw materials that were needed by American manufacturers for production here. Why not apply the Stop, Look and Listen policy to foreign loans as Hoover suggests? Why make an attack solely on brokers' loans? Why make the brokers the scape-goat for dearth of credit when the real cause is the

tremendous loans abroad? When interest rates are higher in the creditor nation of the world than elsewhere, somebody is artificially rigging the money market and somebody in this country is trying to stop the flow of gold that is naturally ours according to the laws of trade.

We are loaning abroad today for the benefit of foreign agriculture, water power, public utility, industry, public improvements, enormous sums of money which make insignificant the little increase in brokers' loans. Our loans of this character take credit from our own people but the Federal Reserve Board utters no protest.

But when we loan money here for agriculture, or industry, like United States Steel, for water power, public utilities, for the development of a State like Alabama and its natural resources and these activities take the form of corporations, as they do, and get into brokers' loans then the country is taught to be horribly shocked as though speculation were supplanting commercial credit.

It is apparently all right to loan our credit abroad but apparently wrong to use it for exactly the

same purpose in America.

Let us not deceive ourselves. The student of civilization fully understands the significance of this so-called credit controversy. It is not a present-day evil. It is a symptom of a struggle between two contending forces of long centuries. As Abraham Lincoln put it, "There have always been two forces contending since the beginning - one is the right of the individual to carve out his own destiny and the other the attempt of his government to control it." It is the outcropping of that old struggle of centralized power to manage local affairs. I am not a critic. I am a philosopher. Give a man power and he will exercise it. If you and I were members of the Federal Reserve Board, we would probably do as they are doing and in good faith, but we would unwittingly be the agents of those forces, which despite the tumult of debate, move on in their majesty and their might - the forces of centralized authority attempting to control individual freedom and local autonomy. I thought we had decided this issue when the government gave up the management of the railroads after the war but the battle never ends.

The Federal Reserve System was adopted after

long discussion and debate. Its object was made perfectly clear to the lowliest. It was to co-ordinate the activities of 26,000 banks, mobilize their credit resources and marshall them constructively for the nation's business. But it was never intended that it should become the ring-master of the stock exchange. These two functions are incompatible. You cannot raise the interest rates upon the broker without raising them in every other field of activity. If the American banking system is to be made the regulator of the stock exchange and curtail its activities by high interest rates, for every merchant, for every manufacturer, for every business man, for every farmer, for every promoter, or pioneer throughout the length and breadth of the land, it will make dearer the necessary capital without which America cannot onward move.

You have these two alternative courses. "Choose ye this day whom ye will serve." (Prolonged applause).

MR. MARSHALL: We have now heard from the Governor of New Jersey, a practical banker, according to views expressed by the audience, and we shall now hear a voice from the Congress of the United States,

the Hon. Louis T. McFadden who, for 14 years, has been a member of the House Committee on Banking and Currency, and for 9 years its Chairman, who likewise is a practical banker and who has been president of the Pennsylvania Bankers Association. Mr. McFadden (applause).

HON. LOUIS T. McFADDEN: Mr. Chairman, Members of the Economic Club, honored ladies and guests. It is my duty to pronounce the benediction, I suppose, to take you back from the sublime to the serious. But I want to warn you in advance that I am not going to take up very much of your time, but I will get right to my subject.

Independent banking in the United States universally prevailed until 1913 when the Federal Reserve Act became the law of the land. This Act provided for the establishment of Federal reserve banks and its purpose was to provide an elastic currency to afford means of rediscounting commercial paper and to establish a more effective supervision of banking in the United States. The passage of this Act marked the beginning of a new epoch of centralization and control of credits.

It has been quite clearly defined and understood that the operation of this system gave control to the management over the volume of credit and the maintenance of the gold reserve. The establishment of the so-called decentralized system of banking for the United States resulted in the creation of twelve independent institutions situated geographically so as to serve best the interests of the whole country. Subsequent administrative action has centralized control of these institutions through the creation of the open markets committee and the exercise of the authority of the Board over discount rates.

During the fourteen years of the development of this system, banking in various forms has advanced to a remarkable degree, practically keeping space with a similar industrial development in the country, and resulting in the organization of many new kinds of banks and financial institutions almost wholly independent of the Federal Reserve System. While the Federal Reserve System was, of necessity, organized and put into operation with the national banking system as its foundation, many of the larger state

banking institutions have been permitted to join, thus placing their assets, so far as their credits are concerned, under the control of the management of the Federal Reserve System. At the present time, inasmuch as their business is largely transacted through the member banks as correspondents, all non-member State banking institutions are after all practically under the domination of the System.

Along with this development in banking and finances has come a keener sense of the realization on the part of industry and commerce of the strength that arises from the development of independent cash resources in industry. With the keen competition which has naturally developed, there have come new opportunities for obtaining investment capital. This has resulted in the more general practice of going directly to the public for money, which is materially aided by the efficient management of issuing houses, bringing forth classes of securities of more attractive types than the public has heretofore known. Such securities usually represent a larger participation in the benefits to be derived from industry. The development of these new classes of securities, coinciding with a broader

investment market, largely resulting from the Government's campaign to popularize and sell Government securities, has been an invitation to the entire public to participate more freely in the benefits of the securities market. The attractiveness of this new class of securities has relegated to the background the older classes of securities such as bonds and preferred stocks, and their marketability has been greatly facilitated by the speculative tendency which is imbedded so deeply in the American people.

In this whirli-gig of investment activity has been injected a new opportunity, largely as a result of our changing from a debtor to a creditor nation, namely, foreign investment securities. This development has been brought about by the changed conditions here through the offering of these modern types of securities to attract the public and amounts running into billions of dollars are being yearly absorbed by American investors.

Now we have arrived at a point in this country where conversions, consolidations, and reorganizations are the supreme order of the day, and we find practically all of our financial operations

becoming departmentalized. As a result of this the facilities of banks and investment houses throughout the country have been brought to the doorsteps of their customers - the people of the United States. The keen competition naturally following this intense development has necessarily demanded new and modern methods of salesmanship, alike in manufacturing, commerce, industry, banking, and in the distribution of investment securities. More modern methods of purchase and sale have been provided with which we are so familiar, until now one can buy his daily food, or a railroad, on the instalment plan. The necessary credit to do this is made available through modern financial developments such as instalment houses, investment trusts, and holding companies. This modern development has been so rapid and so important that we have hardly had time to catch our breath and appraise the meaning of it, until now we are brought face to face with a situation that demands our serious consideration. This unprecedented development of natural resources through the expansion of industry and commerce, which has made necessary a corresponding expansion in our financial system along the lines indicated, has brought squarely before us a

situation which compels a careful analysis.

In proceeding with an analysis of the situation, we must consider that there has been established in New York the most modern institution for the absorption of idle money and credit that was ever conceived, namely, the call loan market. Here, at all times, and at varying rates desirable and sound loans are obtainable. Borrowers and lenders are brought together on a basis of equality; where rates of interest and terms of security are discussed free from all the ordinary bargaining and bartering of old; where the terms and rates are handled by a committee of impartial managers who take into consideration the supply of money as regulated by the reserve position of banks, and the general supply of loanable funds throughout the country, and their natural desire to make full use of their lending power right up to the limit set by their reserve requirements. The only impediment to this class of loans is that under the law such loans are not eligible for rediscount with the Federal Reserve Banks. This market is always open to the money lenders and qualified borrowers of this country and the world, and the effect of these

operations is a material factor today in world affairs.

In addition to the call loan market development, there have developed refinements and organizations sufficient to cope with modern investment demands and opportunities together with distribution facilities such as never before have been available anywhere in the world. The easy operation of these substantial institutions is made possible through the greater assurance of attractive return on capital investment, and upon this more substantial basis these houses, through the use of modern underwriting methods, obtain large amounts of credit by loans negotiated through existing banks, investment and stock exchange distributing houses. These accommodations are used to promote gradual distribution of the securities to the general investing public.

When considering the modern development of the investment banking business, we should not overlook the fact that by the opportunities offered for a profit and by recent amendment to the banking laws more banks than ever before are now engaged in many of the functions being carried on by investment houses, thus strengthening the position of industry, commerce, and

the railroads in securing easy access to capital as well as commercial credit, all of which has tended to make for more independent business in the United States.

As an integral part of the development of commercial and investment banking and the now available call loan facilities, is the development and conduct of the New York Stock Exchange, and, to a lesser degree, the other important exchanges in the United States. It must be noted, that during this industrial and financial development, great refinements in stock exchange transactions have been made, and the opportunities presented by this great market-place have been extended and made available to practically every person in the United States, so that the daily transactions have increased ten-fold. This has been made possible not only because of the development of the wider operations, but because of the increasing value in dollars and the number of securities listed and traded in this market including foreign, government, state, municipal, and industrial securities and is a natural sequence of the centering of the world's financial power in New York. It is quite natural that the

ebb and flow of all such foreign and domestic securities would leave in the hands of the distributors and financial institutions located in close proximity to this central market a varying quantity of securities awaiting redistribution which, without a doubt, at times causes expansion in brokers' loans and increased borrowing at Federal reserve banks.

New York has become the reservoir into which flow the surplus securities, ultimately to be redistributed to the public. The money and credit to do this are obtained through brokerage and investment houses and banks, which at times make use of Federal reserve credit.

The importance of maintaining such an open market is readily apparent, and, whether or not we may agree as to the varying values and prices of these securities, we can all readily understand that this market, as now operating, is an integral part of our whole industrial and financial structure.

It is of particular importance that we recognize the changed type of the large member banks in New York and in the other reserve cities where financial operations are now centered. The organization

of credits, the management thereof and the use of credits and facilities by these large member banks, in the these important centers, have caused a readjustment of the entire operation of these institutions in order to meet the demands which are either directly or indirectly affected by these changed conditions. Therefore, in order to meet the demands for the maintenance of such a call loan market and in support of the great market provided through the stock exchanges, and because of the change in trend of financial operations during this development, these banks have resolved their assets into a type of security that is more readily self-liquidating, or a great portion of their assets are readily available to be used in obtaining credit from Federal reserve banks.

The management of reserve banks in market centers like New York relize the responsibility resting upon them in keeping their assets in a liquid condition because they understand that their institutions are semi-reserve in character and that it is their responsibility to meet any emergency withdrawal that might be made, particularly as regards immediate demands of the call loan market, or through

their regular customers, the investment and commercial houses. For instance, the banks of New York are aware of their responsibilities in case of a sudden withdrawal of any or all of the entire volume of brokers' loans. These loans are construed by the New York banks much in the same manner as are their demand deposits and practically the same calculations in the way of reserves have to be taken into consideration. Business has become so financially independent of late that it no longer relies on the rediscount privileges that were made available to it through the creation and operation of the Federal Reserve System.

The development of a bankers acceptance market in lieu of a real bill market is facilitating trade relations throughout the world, and it is interesting to note that this acceptance market is largely with the twelve Federal Reserve Banks. If it is to continue to serve these needs successfully, this acceptance business should be carried on by bankers directly, and recourse to the Federal reserve banks should be only in emergency, much in the same manner as the London bill market now operates.

The increasing use of investment securities in the Federal Reserve System is causing considerable concern. The Secretary of the Treasury in his Annual Reports has repeatedly called attention to this increasing tendency on the theory that the development seemed to be absorbing an undue amount of the liquid assets of the System. It would seem to me, however, that some of the danger in this situation is modified by the maintenance of an active and increasing market and the quick turnover of this class of securities. Marketability in this instance must be considered as a factor in the liquidity of assets.

In times of normal operations there is supposed to be sufficient capital and credit available without resort to the use of surplus reserve credit through the Federal Reserve System. It frequently occurs, however, as I have said, due to some unusual development such as foreign loans or internal operations that may absorb a greater amount of capital and credit than is available through regular banking channels, that relief must be sought through the Federal Reserve credit reservoir. It is under these circumstances that the Federal Reserve policy becomes important to our whole

financial situation. It is likewise true that the general public then become interested in the competent management of the central control of the credit system. All of the power that is necessary to manage this system properly has, I believe, been written into the law. It becomes, therefore, readily apparent that the success or failure of the System depends entirely upon the management. The only power that is vested by law in the administration that affects the general price level is the authority to fix the price for money or credit - the discount rate, the authority to deal in the open market and the additional power of publicity.

Great responsibility rests upon the administration of these three functions because they exercise an effect on the domestic and foreign price levels. Therefore, through the use of these powers the Federal Reserve Board substantially controls the destinies of the nation's business, industry and trade.

The maintenance of the gold reserve and supervision over the total volume of credit is a man's job, and the observation and discussion that is now taking place throughout the country, and throughout the world for that matter, is bringing home to the people

the importance of having the best minds that are available in charge of this mighty structure, which is undoubtedly the most potential influence operating in the world today.

The prominent position into which the world war forced this country economically and financially has developed an improved leadership. This financial leadership has resulted in a close working agreement with the central banks of the major countries of the world in the necessary management of the world's gold reserves, which has resulted in a deference to our banking authorities, principally because of the fact that our Federal Reserve System is now custodian of over 40 percent of the world's available gold reserves.

The change from a debtor to a creditor nation has necessarily broadened our vision concerning the management of our economic and financial affairs. This cooperation with the central banks of issue is undoubtedly developing, and in conjunction with conferences now taking place in connection with foreign debt and reparation settlements, the idea of an international bank has been suggested. Primarily

such a bank would be used in connection with the debt settlements and payments incidental thereto, and also to effect international adjustments incidental to government as well as trade and financial transactions. If established, such a bank should ultimately lead to a central mobilization or earmarking control of the world's entire reserves and possibly its management. The development of this idea has no doubt proceeded through the observance of the successful operation of the gold settlement fund of the Federal Reserve System. The intimation of such an international plan is of great magnitude and importance to the whole world. If properly safe-guarded, such an institution should be of inestimable value to this country and to the world. It should bring about economy in the use and transportation of gold. It should bring about a better equilibrium between countries. It should be a great facility in the settlement of international accounts and differences and should tend to lessen the consequences of errors in financial policies. It should be a great shock absorber and enable central bank managements to bring about greater price stabilization. Such an institution should,

however, have no voice in the determination of interest or discount rates, and the tendency to make such an institution a super-bank with centralized control should be avoided.

In conclusion, may I emphasize that it is not the function of the Federal Reserve System to become involved in the control of speculation, but that its principal function is to maintain a proper gold reserve and to adjust the volume of currency and credit to meet the actual needs of business, industry, trade and commerce (applause).

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