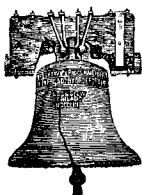


# Working Back to Normal



HON. W. P. G. HARDING, *Governor*  
FEDERAL RESERVE BOARD



PUBLISHED BY  
FEDERAL RESERVE BANK  
OF PHILADELPHIA

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HON. W. P. G. HARDING  
GOVERNOR OF THE FEDERAL RESERVE BOARD

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## Working Back to Normal

THE SUBJECT of my remarks tonight is "Working Back to Normal." It had been suggested that it be "Getting Back to Normal," but the substitution of the word "Working" was made deliberately in order to give proper stress to the means by which a return to normal conditions may be accomplished.

It should be clearly understood at the outset that we cannot get back to normal by a mere stroke of good fortune. While truth is stranger than fiction, we are not living in fairy-land and we cannot summon by rubbing Aladdin's Lamp some good genie and have him bring conditions back to what we think they ought to be. A return to normal, which under the most favorable circumstances will be a slow and gradual process, involves work—hard work of every description—and calls for the best efforts of those who manage the commercial and industrial enterprises of the country, the intelligent guidance of those who direct the use of capital and credit, the productive energies of those whose contribution is manual labor, and full coöperation all along the line. No satisfactory substitute for work has ever been devised.

While working back to normal, we may perhaps have time to consider just what normal conditions are. They are conditions which have existed in the past and which we hope will exist in the future, but which never exist in the present. The term is relative rather than absolute, and "normal times" can properly be defined as a period when conditions prevail which the general community has become accustomed to and which it accepts without any unusual degree of dissatisfaction. In such times the

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relations to each other of all the various elements which enter into everyday life are fixed more definitely than is the case in distinctly abnormal times, when these relationships become unstable and a proper sense of proportion is lacking. As an example, we may now regard the year 1913 as a period of normality or "normalcy," if you prefer, although many of us perhaps would not have admitted it at the time. Conversely we are all prepared to agree, I think, that times were not normal in the years 1919 and 1920, although there may be some who failed to recognize the fact while those years were passing.

In considering how we may work back to normal, or more properly how we can progress toward normal conditions, for we can not retrace our steps and follow the path which led us away from normalcy, it is well to review briefly the circumstances which brought about existing conditions.

The underlying cause was, of course, the World War, which had been raging for two years and a half when America entered. Early in the year 1915, all the belligerent countries began to look toward the United States, the greatest of the neutral powers, as the storehouse from which to draw foodstuffs, supplies and munitions. The demands were insistent, quick deliveries the main object, and prices were a secondary consideration. These great demands accompanied by constantly advancing prices naturally stimulated American industry and in part payment for goods purchased from us, we received during the years 1915 and 1916 \$1,200,000,000 of gold, the basic money of the world. This great influx of gold broadened our credit base and made possible the expansion which followed.

The United States entered the war on April 6, 1917, and shortly thereafter the Federal Reserve

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Act was amended by abrogating a requirement that a part of the member banks' lawful reserves be carried in gold or lawful money in their own vaults and providing instead that the entire lawful reserve of each member bank should be carried as a credit upon the books of the Federal Reserve Bank of its District. This legislation, together with the changes in the note issue provisions, made at the same time, vastly increased the lending power of the Federal Reserve Banks and made it possible for them to coöperate effectively with the Treasury in the flotation and distribution of the enormous loans which were required to meet the necessities of the Government.

During the war conditions became more and more abnormal but the changes were accepted cheerfully and as a matter of course. It was evident, however, that the public had begun to lose its sense of proportion and it was observed that many were speaking of billions as glibly as they had formerly spoken of millions or even thousands.

Following the armistice there came a lull and a period of uncertainty and hesitation. Many were of the opinion that reaction would set in at once, just as it did immediately after the close of the Civil War. But although the war was ended from a military standpoint, it was not closed in a financial sense until our troops had been brought back home and disbanded, and until the enormous floating liabilities of the Government were ascertained and provided for. Shortly after the flotation of the Victory Loan there ensued a period of boom times, which extended well into the year 1920. Prices and wages constantly advanced, bank loans and deposits increased by leaps and bounds, speculation became rampant, and the removal of all war-time restrictions gave free rein to the exercise of individual

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judgment, or sad to say, in many cases, lack of judgment. Warnings went unheeded and the spirit of optimism was so great that many who admitted that reaction and readjustment must come, deluded themselves into the belief that reaction would merely hold others in check without affecting themselves. The high cost of living became a burning issue until finally the long-suffering consumer rebelled.

The process of readjustment set in almost simultaneously in all countries of the world. It is evident now that the readjustments which have taken place were inevitable and unavoidable and in view of worldwide conditions could not have been long deferred in this country, no matter what expedients might have been resorted to. Great wars have invariably caused great expansion, and the recent war was no exception. Periods of great expansion have always been followed by periods of reaction and the reaction is usually most severe where expansion has been greatest. The readjustments which have taken place in this country since last spring have been painful, paper profits have been wiped out and in many cases those who have produced goods and commodities at a high cost find themselves unable to obtain cost of production for them, and are thus faced with loss of accumulated profits. These conditions have been widespread; they have affected every section of the country and it is not unnatural that during recent months the spirit of pessimism should have run amuck just as in the months preceding the spirit of optimism exceeded all reasonable bounds.

I have always been impressed by the philosophy of an old saying which, I believe, is one of the many bits of wisdom attributed to Confucius—"Things are never as good or as bad as they seem."

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While this philosophy is too often overlooked in boom times, it should always be taken to heart in the periods of reaction which follow. I am sure that we have all heard more pessimistic talk during the last six months than we usually hear in ten years, and if I may be permitted to use an overworked term, the "psychological effect" of public sentiment has much to do with molding actual conditions.

While disclaiming any authority to speak for the banking community generally, and reflecting only impressions gained from observation, I feel that whatever the shortcomings of the banks may have been in failing to check expansion during the times when a speculative spirit was rife, they have redeemed themselves by their attitude and conduct during the past six months. We have heard much complaint of constant and drastic deflation, which some allege has been the cause of the depression, but from the periodical reports of the national banks and the weekly reports of the Federal Reserve Banks, it is evident that the deflation which has taken place has not been a deflation of credit or currency. The banks of the country have, generally speaking, responded to the urgent needs of those dependent upon them for credit accommodation and while exercising care and discretion in making new loans, have not resorted to precipitate or drastic means of forcing collections. The member banks have received ample accommodations at the Federal Reserve Banks, which have in turn extended accommodations to each other. There has been no deflation for the sake of deflation, but expansion during the year just closed was checked. From September, 1919 to January, 1920, a period of scarcely more than four months, loans to member banks and total investments of all Federal Reserve Banks rose from \$2,350,000,000 to

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\$3,300,000,000, an increase of almost a billion dollars, or nearly fifty per cent. As shown graphically on a chart this represents an ascending angle of credit of about 45 degrees. Firm measures to restrain further expansion were adopted in January, 1920, and the ascending angle of credit from January 27th to November 5th, 1920, when loans of the Federal Reserve Banks reached their peak was reduced to about 2 degrees. Since November 5th the loans and note issues of the Federal Reserve Banks have been reduced in amounts which might be regarded as normal in ordinary circumstances, and the reserves of the twelve Banks combined are now 48 per cent as compared with 45 per cent a year ago.

Our present banking system has been put to the severest tests during the past four years and has met them all. It has shown its ability to extend credits in ever-increasing volume in order to meet the requirements of a great producing country in time of war, and during the past year has shown its ability to absorb the shock and prevent a money panic, such as heretofore has always occurred in times after periods of undue or extraordinary expansion. The readjustments which have taken place in this country, painful as they may have been, have been attended with less privation, less unemployment and have been less severe than in other countries where the expansion of bank credit and currency had been proportionately greater, and the prospect for revival is also far better here than elsewhere.

In working back to normal, an important step has been taken in the recovery of a normal state of mind in business, of a better sense of proportion and in the restoration of saner and sounder judgments. Many signs are in evidence that the country now appreciates the fact that in order to prosper it must produce,

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that in order to continue production it must sell, and in order to sell it must buy.

There are produced in this country every year goods and commodities in volume in excess of domestic requirements and in many cases quantity production is essential to economical production. In order to dispose of our surplus products we must sell them to foreign countries and in the present posture of world affairs, it is out of the question for foreign countries to pay for goods purchased here in the usual manner. We must buy their goods if we expect them to pay for ours, and pending restoration of the normal productive activities of the world and of Europe particularly, where those activities have been most curtailed, it is necessary that we should devise new means of financing our foreign trade. It is of vital importance to us that our trade with Europe be continued and it is of scarcely less importance that the trade relationships of other countries with Europe be maintained. Otherwise there will be a constant tendency toward the accumulation here of goods—principally raw materials—from those countries which have been in the habit of selling to Europe but which now, on account of Europe's inability to pay and their own inability to extend credit, are shipping to the United States in order to sell for cash.

I shall not presume to discuss before a body so much more familiar with the subject than I am, the movements of foreign exchanges during the past year. It is a matter of common knowledge that they have fluctuated violently, with the general tendency downward, and that transactions in foreign exchange, handled in the usual manner, have been attended with the greatest risks. In the present circumstances, it would be vain to expect to finance our exports to Europe by means of short-time bankers' credits.

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Several months after the armistice, exports to Europe were sustained partly by reason of the presence of large bodies of our troops, and after their return by use of the remainder of the credits which had been extended during the war to other countries associated with us in the war.

The War Finance Corporation has been revived and, subject to the restrictions imposed by the Act creating it, it is authorized to extend credits in export transactions, but it is evident that new agencies must be resorted to in order to furnish Europe with long-time credit, which is so essential for her rehabilitation and for her continuance as a potential buyer in the world's markets. Of course, the political stabilization of Europe is most desirable, but this result will be better assured as her economic and financial rehabilitation develops. The situation, therefore, is one which calls for both long term credits and investments in European securities as means of supplementing ordinary banking activities.

The law, commonly known as the "Edge Act," which authorizes the incorporation of foreign trade financing corporations, under Federal supervision, was designed to meet this end. One corporation with a comparatively small capital has been in operation for several months past and another with a capital of \$6,000,000 has recently been organized, with headquarters in New Orleans, and authorized to begin business. Another and larger corporation, nationwide in its scope, is in process of organization, and should these pioneers prove that the operations which they propose to engage in can be conducted successfully, other corporations will doubtless be organized as the occasion arises.

We should keep this thought clearly in mind, that our problems in working back to normal are not

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domestic problems merely, but they are problems connected with the working back to normal of a war-torn world. Europe cannot work back to normal without the help of America, and America cannot become normal unless and until the normalcy of Europe is in some measure restored, and until the restoration has proceeded far enough to justify the conclusion that it will eventually be completed. It is useless to attempt to discuss in detail in an after-dinner speech, which ought to be of moderate length, the problems which must be met and the difficulties which must be overcome in working back to normal, but present conditions, I think, justify some conclusions which ought to encourage and hearten us all. Our banking position is sound and stronger than it has been for many months, and the business community, which has been first over-exhilarated and then unduly depressed, has recovered its normal state of mind. Public sentiment today undoubtedly approves of working back to normal. Whatever danger of crisis there may have been, has been passed. The gloomy forebodings which many felt a year ago because of the knowledge that readjustments were impending, has given way, in the assurance that the most trying and critical stage of the readjustment period is safely over, to a feeling of conservative optimism, renewed courage and restored confidence. In such a spirit let us all work together to make the new year one of constructive achievement.