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THE SECRETARY OF THE TREASURY
Washington

June 14, 1933

My dear Arthur:

Your letter of June 13th (lucky date) has just been received. Of course, you have not forgotten it was on March 13th we started to open the banks (another lucky date). Maybe it was like opening oysters, we opened some that we should not have opened, but perish even the thought.

I have been trying to write you a letter ever since you left here. I think I have written at least sixteen, but tore them up and consigned them to the wastepaper basket, because all dictionaries of the English language that I possess do not some way or other seem to have the proper words with which to express my thoughts. I have even gone so far as to wander into other linguistic lanes, Latinesque, if you please, but my dear boy, I just cannot find them. All I can say is, that the greatest rainbow of the whole affair here since March 4th was my learning to know, admire and conceive great affection for Arthur Ballantine. You are certainly a patriot if there ever was one, and I shall never forget how nobly you stood by the ship and very often prevented me from making some of those high dives to which I am afraid I am somewhat prone, which might have ended up in a lot of broken bones.

My goat is still tied to the desk, and no one has had it, not even for five minutes. Being of a musical turn of mind, I

confess that I occasionally go around humming a little tune from the Mikado: "I have got a little list", but I am in a way riding over the sharps and flats of the recent comedy.

The new Undersecretary is doing very well. He handles me with a firm but kindly hand, showing a great deal of tact, and one thing I particularly admire about him is that when he doesn't know a thing he says so instantly. I am a little that way myself, so often when we meet in conference we admit to each other that we don't know a thing about the thing we are discussing, and a loud SOS is sent out from the room which reverberates throughout the building.

I certainly do miss your dry humor and lots of other things about you which, as I said before, I cannot find expression for.

I trust that some time in the future our paths will be thrown together again, as there is no one in the world I would love more to work with than with you.

That success and happiness may walk side by side with you all the rest of your existence, is the fervent wish of

Yours most affectionately,

(Signed) Will Woodin

Hon. Arthur A. Ballantine,
31 Nassau Street,
New York, N.Y.

Ballantine

STATEMENT OF INTERVIEW WITH MR. HENRY FORD
In Detroit, February 13, 1933,
by Secretary Roy D. Chapin and
Under Secretary A. A. Ballantine

In accordance with the arrangement made by President Hoover by telephone Sunday evening, February 12th, the undersigned conferred with Mr. Henry Ford in his office at Dearborn at 10 o'clock on the morning of February 13th. There were present Mr. Henry Ford, Mr. Edsel Ford, Mr. E. G. Leibold, and the undersigned.

Mr. Ballantine stated that we had come in accordance with word from the President to discuss the acute situation existing with reference to the Union Guardian Trust Company of Detroit and a plan which had been worked out to enable the trust company to remain open. Mr. Ford stated at once that he knew about the plan, that he would not agree with us as to what he understood we proposed that he do, but that he would be glad to discuss the situation.

Mr. Ballantine then stated that the difficulty was that the trust company had deposit liabilities of some \$20,500,000 and that it already had a loan with the Reconstruction Finance Corporation to the amount of some \$15,000,000, secured by the pledge of assets, and that the remaining assets of the trust company were of the face value of some \$6,300,000 and of a loan value which did not exceed \$5,000,000; that a plan had been worked out under which the Guardian group would pay in to the trust company assets of a loan value of some \$3,600,000 so that a loan of \$8,600,000 could be made by the R.F.C.

for the purpose of furnishing funds to the trust company; that this loan for the trust company would represent the full value of the collateral available for the trust company as found by a group of the most competent examiners of the R.F.C., who had carefully examined all of the assets; and that this loan was to be part of a larger loan aggregating about \$23,000,000, the purpose of the additional amount being to provide further liquidity for the Guardian National Bank of Commerce and certain units of the Guardian group. We stated that the amount of this larger loan had been agreed upon with the representatives of the Guardian group as sufficient for the purpose of the needs of the other units.

Mr. Ballantine stated that the making of this loan would leave a gap of some \$13,000,000 in the assets of the trust company and that to make this up it was proposed to have subordinations of the deposit liabilities of the trust company to the amount of at least some \$9,000,000, this leaving a balance of some \$4,000,000 to be supplied by new cash. He stated that in addition to that cash some \$2,000,000 more would be necessary to furnish the capital for the mortgage company which it was proposed to organize, which would be the actual applicant for the new R.F.C. loan and the vehicle of the proposed financing transaction. He stated that on the loan being made the deposit liabilities of the trust company would be assumed by the Guardian National Bank of Commerce, which would receive from the trust company cash assets to make good the liabilities so assumed.

Mr. Ballantine pointed out that this plan had been formulated on the basis that the deposit liabilities of the trust company to the Ford Company to the amount of seven and a half million dollars would be subordinated and that in addition the General Motors Company and the Chrysler Company, which had been approached to supply part of the new cash required, took the position that part of the new cash required should be supplied by the Ford interests. Mr. Ballantine stated that it was the opinion of those who had been giving continuous thought to the situation that a plan so worked out would enable the trust company to continue as a trust company and the Guardian group to continue their banking activities.

Mr. Ford stated at once that he would not in any way subordinate the seven and a half million deposit liabilities held by the Ford Company. In the course of the discussion he said that if he had said some two or three weeks earlier that this might be done he had not fully understood it and that in any case his determination was that he had changed his mind and that he would not do this. Mr. Ballantine stated to Mr. Ford that this would make any plan for saving the trust company impossible.

Mr. Ballantine then stated that if the trust company could not be saved it was the opinion of the Chief Bank Examiner for the Seventh District, who had been carefully into the situation, that the Guardian banks would be forced to close.

He stated that the consequences of this would be to throw great pressure upon the First National Bank and group and upon all of the other banks in Michigan and that the consequences of that pressure would probably very soon extend outside of the State.

Mr. Ford asked Mr. Ballantine whether it was his opinion that the First National could continue to stand. Mr. Ballantine stated to Mr. Ford that it was hoped that it could, that it was his expectation that every assistance would be rendered to that bank, and that it might succeed in weathering the fight. Mr. Ford reiterated that he would not agree to make the subordination of the Ford deposits in the trust company and stated that if the trust company was not kept open he would immediately on Tuesday morning withdraw from the First National Bank the Ford deposit of \$25,000,000. Mr. Ballantine asked whether he had understood that correctly and Mr. Ford said that he had, and on Mr. Ford's saying he had Mr. Ballantine asked if he were free to immediately report that to the R.F.C. and those working on this situation as he felt that he must do this in order to enable them to perform their functions. Mr. Ford said that Mr. Ballantine was at entire liberty so to report what Mr. Ford had said.

Mr. Ballantine then said to Mr. Ford that he felt that he should lay before him very carefully the probable consequences, as he saw them, of the failure of the Union Guardian Trust Company plan under existing circumstances. Mr. Ballantine

stated that it seemed clear that the Guardian group could not survive; that with the withdrawal of the Ford account from the First it would be very much more difficult to preserve that bank; that if that bank could not survive it was difficult to see how any Michigan banks could be kept open. He said that the effect of closing Michigan banks would be vast distress in the State of Michigan as there were nearly a million bank depositors, probably representing the source of support of as many as three million people; that all of these people would be subjected to loss and suffering because of the situation; and that the business of the State would be vastly hampered, if not paralyzed. He further pointed out that the situation so resulting could not be confined to Michigan but would probably communicate itself to neighboring states and would be soon reflected in the pressure upon banks elsewhere. He said that the ultimate effect might be to subject banks in other states to the same sort of development feared for Michigan, with similar results throughout the Nation. He said that what the consequences of such a development would be, not only on business but on the lives of the people and on social developments, was very difficult to foresee.

Mr. Ford said: "You say that all of these terrible consequences may come and yet the Government proposes to let this situation come about by refusal to put up \$6,000,000." Mr. Ballantine told Mr. Ford that this was not the case, that the Government stood ready to put up every cent in the situation that it could lawfully furnish and that in view of what he said

Mr. Ford should understand that the plan was not failing because of any difficulty about the \$6,000,000 new cash, but was failing because of Mr. Ford's refusal to subordinate the seven and a half million deposit in the trust company held by the Ford interests, as unless that subordination were made there could be no plan. Mr. Ford stated, in effect: "All right, have it that way. I think that Senator Couzens was probably right in saying 'Let the crash come. '" Mr. Ballantine said at once: "Suppose that I could show that if Senator Couzens had said anything like that he is not now of that opinion, for I have some reason to believe that he would not take that view." Mr. Ford said: "This would not make any difference to me because I think that when Senator Couzens spoke as I understand he did, he was probably giving his real opinion."

Mr. Ford went on to say that he did not think that Mr. Chapin or Mr. Ballantine understood the situation at all. He said that this trouble and this effort to draw him into a plan came from sources which they did not know about. Mr. Ballantine asked him what these were and Mr. Ford said it was part of the operation of the same force that brought about the strike at the Briggs plant for the purpose of harming or destroying his business. Mr. Ballantine asked him whether he felt this was due to some of his competitors and he gave us to understand that he thought it was, or some of the people back of them. Mr. Ballantine told Mr. Ford that it was not conceivable that competitors or people back of them could be doing any such thing,

that this situation was one which had developed inevitably out of conditions which had unfortunately existed and that competitors or people back of them would be hurt by any such development or any failure of the plan as Mr. Ford would be hurt, and that it would be suicidal for them to have brought any such situation about. Mr. Ford repeated that neither Mr. Chapin nor Mr. Ballantine knew anything about this and that he was satisfied that he was right.

Mr. Ballantine then undertook to point out to Mr. Ford that as to his feeling that a crash had to come, nobody really knew whether it had to come or not, and that the consequences of anything like a general crash were so dreadful that anybody in a position to act ought to employ his last resource in striving to prevent it. Mr. Ballantine pointed out that it would seem a particularly bad thing for Mr. Ford and the Ford Company to have any such crash start in Detroit and in Michigan and that as a rescue effort was being made by all available interests it would seem inconceivable that Mr. Ford would not be a part of it. Mr. Ford said that Mr. Chapin and Mr. Ballantine did not understand what the general situation called for; that if he had three or four days to talk to them he might explain his views; that short of that he was convinced that the effort to bolster up the financial situation was unwise and ineffective; that the country had to have a general cleaning up process, and that he did not care how soon it came about. He said that he thought the R.F.C. had probably been a mistake.

Mr. Chapin then said that he wanted to talk to Mr. Ford as a fellow-manufacturer with whom he had been in friendly relations for thirty-two years. He said that he felt that he and Mr. Ford were a good deal in the same position as they had independent companies. Mr. Ford said that that was so except for the fact that Mr. Chapin's stock was listed on the stock exchange. Mr. Chapin said that as a manufacturer he felt that the consequences to the industry of the tying up of the banks of Michigan would be to add immensely to the already serious difficulties of the business. He said that if the condition which might develop in Michigan were to extend to other parts of the country he was afraid it would practically stop the business. He pointed out that while some years ago it had been thought that automobiles were in the class of consumers goods that during the period of the depression it had become clear that old cars could be retained longer than had been anticipated and that under present conditions the purchase of new automobiles was regarded almost as a capital expenditure. He said that such purchases, even for low priced cars, required the expenditure of a relatively large amount of the family budget and that if the people of the country were made still further short of funds they certainly would drastically curtail purchases. He said that it was very hard for him as a manufacturer to contemplate such a development and that he could not see how Mr. Ford could possibly want to face such a situation.

Mr. Ford said that the great adverse financial development might have a very bad effect upon the industry but that even if the effect were so bad that his company would be destroyed he would proceed to start a new one and believed that he could again build up a business as he still felt young. Mr. Chapin then spoke to Mr. Ford about the immediate effect upon the local situation. He said that Mr. Ford had been the greatest developed² of Detroit, that he himself hoped that he had also contributed something to that development, that he believed that Mr. Ford must feel a deep interest in the future of Detroit and its people, and that it would seem a very strange thing for Mr. Ford in effect to turn his back on the course which he had pursued and fail to help stave off the threatened adversity.

Mr. Ford said that the people here and all people might have to go through the experience of a crash; that the general effect would be that everybody would have to get to work a little sooner; that it might be a very good thing; and that in any event it had to come.

Each of us suggested various other considerations to Mr. Ford in the hope of finding some thought or argument that would appeal to him. Mr. Chapin said that he was very much concerned with the danger of social disorders resulting from anything like a general crash. Mr. Chapin and Mr. Ballantine both urged that as other people concerned with this situation were doing everything in their power to prevent adverse developments Mr. Ford ought to give them the chance to work out a plan, at

least by going in with the subordination. They stated that if this were done they knew that everybody else would do their utmost to raise the \$6,000,000. They pointed out that, so far as they could see, depositors in the trust company could not possibly realize more than 20 or 25¢ on the dollar. Mr. Ford said that he would not subordinate or in any way contribute a single dime as he felt that the principle was wrong. Mr. Ford stated that he had already done everything which he felt he ought to do to help the trust company.

Mr. Chapin and Mr. Ballantine endeavored to make the whole situation, as they saw it, entirely clear to Mr. Ford. At times Mr. Ford approached the point of irritation and suggested that they might be making threats. They told him that they were not trying to and were certainly not threatening or even arguing, but that they felt it was their absolute duty to point out to him with the utmost clearness what was believed to be involved in this situation and his decision. They told him that they could not help feeling that this occasion was like the conference before the outbreak of the European war when different decisions might have prevented or staved off the dreadful development. He stuck to the point that the crash had to come. Mr. Ballantine quoted to him the Scriptural text: "if needs must be offense come, but woe unto those by whom it cometh", and stated that it would be far better not to be among those who failed to do everything in their power to prevent the crash.

We pointed out that he certainly could not show any

more definitely that there had to be a general crash than we could show that there didn't have to be.

When we left Mr. Ford stated that the only terms on which he would subordinate his deposits in the trust company would be to receive for them endorsed notes which would be absolutely good. Mr. Chapin remarked that Mr. Ford always claimed the right to change his mind and that he hoped he would think over most carefully all we said and let us know if there was any change that day.

Mr. Ford remarked that the trust company was dead anyhow. Mr. Chapin said he ought to reflect on the point that the corpse might communicate disease over a very extensive area.

When we got back and reported this conversation to those working on the plan it was at once suggested by Melvin Traylor that this might mean that banks over wide areas, if not generally, might have to go on a clearing house certificate basis and asked whether Mr. Ford fully realized this. We said that we thought it was covered but would call up Mr. Leibold about it. Mr. Ballantine did that and told him that that was the thought of the bankers and that the certificate basis would certainly tie up the automobile business and also urged him to have it clear in Mr. Ford's mind the possible adverse reaction on Mr. Ford and the company through not coming in to the rescue effort. Mr. Ballantine also asked Mr. Leibold if he was absolutely right in his understanding of Mr. Ford's withdrawing at once his entire deposit from the First National Bank and

Mr. Leibold said that certainly was what he said. At about 4:30 in the afternoon we were called by Mr. Leibold, who said that there was no change in Mr. Ford's position in any respect. That message appeared to entirely end the hope of any support for the plan to save the trust company by Mr. Ford.

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Author(s): Arthur A. Ballantine

Title: A Few Poems

Date: July 1955

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Author(s): Arthur A. Ballantine

Article Title: When All the Banks Closed

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This was the original paper which was submitted to the President on March 7th by Secretary Woodin, George W. Davison, and myself, and on which the plan for opening the banks was approved by the President.

You can use statement that
my cleaning house doesn't want to
open. have excess cash - will
give currency for needs no
hard and fast rule

The purpose of this program is to give to the country as promptly as possible adequate banking facilities and an adequate and sound currency and to restore confidence.

It is, therefore, proposed:

(1) That under the Presidential Decree of March 6th wholly solvent banks of the country shall be opened for business Friday morning. There are many banks, members of the Federal Reserve System, well distributed throughout the country, that the Secretary of the Treasury would be able to pass immediately as sound banks. These banks could be authorized to open for business on Friday morning.

(2) Other banks not members of the Federal Reserve System and other members of the System not specifically named in paragraph (1) could, no doubt, promptly satisfy the Secretary of the Treasury on further investigation that they are solvent banks. Such banks could thereupon be permitted to open for business.

(3) Steps should be taken at once to reorganize all banks not now wholly solvent so that they might open at the earliest possible date as new banks of unquestioned solvency. In order to expedite this program of reorganization it might be practicable to consider dealing first with these institutions in cities of populations of 100,000 and over (of which there are 93), leaving institutions outside of these cities to run along under such local plans as have been devised and under the protection that is afforded by the general emergency control.

(4) To supplement this plan and to insure an adequate supply of currency, the Federal Reserve banks should be authorized to make loans direct to corporations, firms, or individuals on their notes secured

*as
submitted
to Pres*

*3
Steps
as first
submitted
possible
Cautions
very suitable*

by Government securities and to issue Federal Reserve bank notes secured by such Government securities, or by notes collateralized by such securities. This will enable any holder of Government securities to procure Federal Reserve bank note currency direct from Federal Reserve banks. There are approximately eleven billions of dollars of such securities outstanding in the hands of the public other than banking institutions.

(5) In order to enable any solvent bank to open for business under this program to procure currency sufficient to liquidate all of its deposits, if demanded, Federal Reserve banks should be authorized to lend to any bank regardless of its size on its sound assets. As any bank authorized to open is to be sound this would permit all loans in amounts sufficient to pay off all of the deposits of such a bank, if demanded.

(6) In order to provide adequate Federal Reserve bank currency to satisfy the possible demands of this program Federal Reserve banks should be authorized to issue Federal Reserve bank notes, not only against Government securities or notes secured by such securities, but also against any member bank note secured by sound assets.

(7) During the early stages of this program and until further notice, the embargo on gold payments, except under license, should be continued and appropriate steps should be taken to penalize the continued hoarding of gold or currency. The continuing to hold gold or currency in excess quantities should be considered hoarding.

BOARD OF GOVERNORS
of the
FEDERAL RESERVE SYSTEM
Washington

Office of the Chairman

February 7, 1939.

Mr. Arthur A. Ballantine
31 Nassau Street
New York City

My dear Mr. Ballantine:

Somewhat to my surprise, I noted recently in the press accounts of your luncheon address before the New York State Chamber of Commerce attributing to me ideas so foreign to what I actually believe that I can only conclude either that you have been misinformed or that the accounts ~~are~~ misleading. From my acquaintance with you, I am confident that you would not intentionally misrepresent me or wish to add to the merely political or emotional confusion of what, I am sure you will agree, is a subject of the utmost importance to the country.

For example, you are quoted as saying that I am an advocate of the theory that by going deeply into debt, this country can increase its general well-being, that I have "glorified" debt, and that we need not worry about paying the debt. Any such conception of my views is so far from the truth that I am venturing to enclose copies of my recent address in New York which was the subject of Senator Byrd's personal attack, my reply to him, and my recent radio discussion of the same general subject.

There is a fundamental difference of opinion involved in this entire discussion, and while I do not expect men in politics to approach the subject from an economic and dispassionate standpoint, I do expect that approach from men of your experience and standing in the community.

It is because I would like to make the conduct of national affairs less of a gamble that I am convinced we must learn sooner or later, and I trust that it will not be after more bitter experience, to time and direct the inescapably large volume of public expenditures so that it will tend to moderate rather than accentuate instability and, above all, so that it may contribute as much as possible to sustained private employment in private enterprise.

The difficulties, as I see them, are political, not economic. My own views represent a choice of alternatives and not a preference. I am loathe to believe that this whole matter cannot be discussed on a plane of intelligence and on its merits without partisanship, politics, emotion and distortion. I may be mistaken in this hope. Certainly, if men of your experience and training are to discuss it in terms of glorifying deficits and of perpetual unpaid debt, I can only view the future with pessimism.

Sincerely yours,
(Sgs) M.S. Eccles, Chairman

February 11, 1939.

Hon. Marriner S. Eccles, Chairman,
Federal Reserve Board,
Washington, D.C.

Dear Mr. Eccles:

I am in the office this morning for the first time in several days, as I have been continuously engaged in a trial out of the city and shall continue to be. I find that so many matters which had to be postponed are now calling for my attention here that I am unable for the moment to go into the subject in detail.

I thoroughly appreciate the friendly spirit of your letter. I wholly agree with you that it should be possible to discuss Government financial policies on a plane of intelligence and the merits, without partisanship, politics, emotions and distortions. I believe my views on this subject are not political. At the same time, as you recognize, when we deal with these subjects in a way to call forth any public interest we have to employ emphasis that may not be strictly academic!

I certainly hope that I have not in any way misrepresented your views, and I do not see that I have. I enclose a copy of the release of the talk to which you refer, which I made before the New York State Chamber of Commerce. I was discussing both what the President said about the budget and what you said, and some confusion may have arisen in the press as to what I attributed to you and what I attributed to the President.

You will see that the particular phrase to which you refer about "glorifying the deficit" was not used in reference to what you said, but with reference to what the President said.

I am of course in entire accord with what you so well express in your statements about the necessity of making the private enterprise system work. I am also in agreement with what you say about recognition of the Government function

in seeing to it that people do not suffer want or go without employment. Your general expressions on that subject I regard as wholly admirable. The difference is wholly as to how the Government finances are to be employed to facilitate that object.

On that score I think that I differ from you in feeling much more strongly the human value of adhering in general to the idea of balancing the federal budget. I fear deeply that as we get away from that fundamental idea, we run into great dangers to human values. I feel that once we get away from that conception it is most difficult to get back, and that anything like a permanent departure from the idea of balance involves destructive consequences. I think that you are in agreement as to the danger of such an ultimate development, but you are very much more hopeful than I as to the ability to continue departure from balance and then get back to shore.

My main point, as you will see, is that if deficit financing gets to be regarded as a positive and helpful force in upbuilding the income of the nation we can never get away from it. I do not believe that it is such a force and I think the idea is extremely dangerous. I have the feeling that those in the position of the greatest financial responsibility for the Government ought to deal more cautiously with the idea of piling up the debt through deficit financing than you and the President have done. This is said in all respect and sincerity.

I feel that in your proposition that no nation "need impoverish itself by borrowing from itself" there is also another dangerous idea about the debt, which I have expressed in that talk. I think a nation can completely upset its economy by borrowing from itself.

I think that there is a vast difference between the public debt and private debt, and that it is dangerous to confuse the two or treat them as on a par. While there are certain aspects of similarity, there are to my mind greater aspects of difference.

You refer to politics. One great difficulty is that the handling of public finances does become inevitably political. I do not mean this merely in the sense that it becomes the subject of partisan differences. I mean that public finances cannot be handled like private finances because there are not the same natural restraints. If we

Hon MSE - p3

could actually enlarge and then contract public expenditure in the manner you hope for, that would be one thing. My fear is that largely because of political pressure you can always enlarge public expenditure and it is exceedingly difficult to reverse, and almost fatal not to reverse.

I know that you recognize many of the difficulties which trouble me and regard the possible courses as perhaps largely in a sense a choice between evils. I feel the particular dangers which I have referred to so deeply that I have felt obliged to discuss them, believing that that is part of the healthy democratic process.

I would like much to sit down and talk over these problems with you. Your letter makes me feel that we can do so, and I hope before long to come in and see you.

Sincerely yours,

(Sgd) Arthur A. Ballantine

COPY

BOARD OF GOVERNORS
FEDERAL RESERVE BOARD
Washington

Office of the Chairman

February 14, 1939.

Mr. Arthur A. Ballantine,
31 Nassau Street,
New York City.

Dear Mr. Ballantine:

Your letter of February 11 raises a number of questions that cannot be dealt with satisfactorily by correspondence, even if you and I were not so preoccupied with other matters. I should very much like to have an opportunity to sit down and talk over some of these problems with you in the same spirit of fairness which characterizes your letter and I know is intended in public discussions. I would be particularly glad if when you are in Washington, you will let me know so that we might arrange at your convenience possibly to have luncheon together here at the Board.

I recognize the dangers in so-called deficit-financing, as you do, and while I may be too sanguine about political willingness to get back to shore, as you put it, it seems to me that the greater dangers arise from persistent large scale unemployment. I see no prospect that the Government, regardless of which party may be in power, will be able to bring about an end of deficits through reduction of government expenditures, although, of course, I would agree that money doubtless would be spent more prudently and with greater stimulation to private enterprise if there were a clear recognition of the purposes and principles involved, as I see them.

Since I am forced to conclude that we are in for high levels of government expenditure for a good many years to come, my main thought is that such expenditures shall be so timed and directed as to interfere the least with and to generate a maximum of private activity. Manifestly, this is far from being a cure-all, and I certainly would not wish to over-emphasize its importance or to distract attention from the many other factors, such, for example, as labor problems, wages, hours, prices and various other maladjustments, particularly affecting agriculture. I know of no sovereign remedy for all of these things and I, of course, am under no illusions as to the limitations of government monetary and fiscal policy. I am compelled, however, to conclude that monetary and fiscal policy can be made more of a stabilizing and less of an unstabilizing influence.

I would say that we all should deal more cautiously with the whole problem of debt, but possibly in attempting to look at the whole problem rather than the public debt part of it alone, one inevitably appears to be defending public debts and deficits. While I am not undertaking to make a virtue out of necessity, I should like to be able to face the issues which I have discussed in what seems to me to be a more realistic manner than is usually the case.

Many of my business and banking friends appear to feel that investment capital would flow freely into production and thus give employment if various government policies, including its expenditures, were moderated. Heaven knows, I would like to see some modifications that, in my judgment, would increase the incentive for private enterprise to go ahead, but my major concern is due to my inability to agree that under present day conditions with a relative scarcity of profitable investment outlets for the enormous volume of funds, augmented by foreign capital, now piled up, we can move to substantially higher levels for any sustained time at least merely by minor modifications of government policy. Under one guise or another, I think you and I are going to see a continued heavy expenditure by Government. I regret to say that I am far from optimistic about the ultimate outcome, and much of my pessimism is due to the apparent hopelessness of getting our economic problems in correct perspective and discussed on a reasonably high level of understanding and intelligence.

I have not attempted to discuss the many points raised in your address, a copy of which you were kind enough to send me, for it is evident that we are talking from widely divergent premises. However, we can reserve some of these matters for the ~~time~~ when I hope we may get together here, preferably in the near future.

Sincerely yours,

(Signed) M.S. Eccles

COPY

February 21, 1939

Hon. Marriner S. Eccles, Chairman,
Board of Governors,
Federal Reserve System
Washington D.C.

Dear Mr. Eccles:

As my return to Washington has been a bit delayed, I want to put on record acknowledgment of your very thoughtful letter of February 14th. I think that I fully grasp the point of view that you express and recognize the aspect of the great financial problem with which you are so deeply concerned.

It will be fine to sit down with you and have a talk on the subject. I look forward to accepting your very pleasant invitation for the next time I am in Washington, and if that happens to be convenient to you, as I hope.

Sincerely yours,

(Sgd) Arthur A. Ballantine

P. 8

For release February 2, 1939
1 p.m.

A NEW THEORY OF FEDERAL FINANCE

Remarks of Arthur A. Ballantine, former Under Secretary of the Treasury, at the Meeting of the Chamber of Commerce of the State of New York, at the Chamber of Commerce Building, 65 Liberty Street, New York City
February 2, 1939

The great debate now going on as to Government spending has significance for every one, old and young, employed or unemployed. The outcome is likely to determine the pattern of their lives.

Outstanding advocates of free spending, pressing the idea that it admits of no stopping, are the holder of the Presidency, an office which has usually stood firm for economy, and Hon. Marriner S. Eccles, head of the Federal Reserve Board, an institution identified with the protection of financial safety. Curiously enough, the staunch defender of limiting expenditures to revenues is in Congress, where spending usually flourishes - Senator Byrd. Congress now seems to show encouraging response.

The issue is whether continued federal deficits are to be treated as a blessing, making for larger national income, prosperity and security, or as essentially a danger threatening ultimately to undermine the economic structure, produce misery and defeat social progress.

The question is not one of humanity against inhumanity or sensitiveness to distress and deficiencies against apathy

and indifference. The problem is one of economics, of business and financial engineering calling not so much for emotionalism as for hard-thinking.

The old view as to the proper conduct of the financial affairs of the Government of the United States was that the Government should pay its bills as it went along out of current receipts, should borrow only for some extraordinary and presumably temporary purpose - in fact only for war purposes - and should proceed to reduce such debts with all convenient rapidity.

The theory was that in this way the Government, as a separate institution, kept strong and independent, able to choose its own course without constraint and meet emergencies. This course made for placing the least possible burdens on industry and agriculture which supply the living of the people and of the Government. Voting taxes was regarded as spending other people's money, something to be sparingly practiced. This was the financial plan under which the Government of the United States was conducted until the advent of the New Deal. In general the plan was successful.

The New Deal coming into office with ardent profession of loyalty to the established view of Government finance, soon gave up any adherence to that plan in fact, and has now adopted a formula which seems to discard altogether any idea of the need or virtue of balancing expenditures and receipts. It was discovered that Government bonds

and other obligations could be placed in banks and insurance companies in amounts never before imagined to be possible.

Up to the close of the 1937 fiscal year federal deficits under the New Deal aggregated \$18,600,000,000, averaging \$2,300,000,000 annually. Beginning with 1937 revenues increased so much, due in part to increased business activity and in large measure to new taxes, that the deficit for the fiscal year 1938 was less than a billion and a half. Beginning in the spring of 1937, however, business receded. The answer of the New Deal was not to look carefully at rectifying Government policies which might be regarded as unduly hampering commerce and industry, but to resort further to deficit spending. The result is an estimated deficit of almost four billions for the current fiscal year, with something over a three billion dollar shortage now in sight for the fiscal year 1940.

1940 will be the tenth year of continuous federal deficits. It is officially estimated that at the close of that year the deficits will aggregate over twenty-seven billions; that the national debt will then stand at nearly forty-five billions, or over twice where it stood in 1933, with well over five billion of guaranteed obligations in addition. Interest charges alone will run next year at over a billion. That is more than it cost to run the whole government back in 1916.

This situation has not led to any resolve on the part of the Administration to reduce spending or to increase taxes. Indeed expenditures, although at the record rate of nine billions a year - or nearly \$18,000 a minute - appear to be on the increase. Expenditures for national defense are mounting. The National Health Program, very recently recommended by the President, would involve ultimately the outlay of \$850,000,000 a year. The proposed addition of some six million more persons to social security provisions would certainly add more than twice that amount. In place of making effort at reduction in expenditure the Administration had adopted a new theory of federal finance defending deficits.

Up to now deficits were apologized for as departures from sound and desirable practice. Deficits were described as due to the emergency: they were temporary, for recovery and relief: they were never ordinary financial procedure. In the President's message of this year, however, we find deficits at once domesticated and glorified.

According to the new theory deficit spending will increase the income of the people - the national income - by amounts far greater than the amount of the deficits, and will, sooner or later, increase the Government's own revenues under an existing tax structure, so as to catch up with the deficits. Expenditure from deficit dollars is conceived of as more potent than expenditure from revenue dollars, as it is said to represent a new addition to purchasing power.

Mr. Eccles in his advocacy of this theory still maintains that he would like to balance the budget. It is obvious, however, that serious reliance upon the new theory makes the attainment of balance impossible. This is not merely because continued spending means the maintenance of vast spending agencies, hard to dislodge, and of classes of recipients of Government expenditure still harder to dislodge. It is also because if this theory is good it would be too much to expect that balance of the Government expenses and income would ever be reached, as the Government would always be pushing on for new increases in income through new deficits.

It would be pleasant indeed to feel warranted in believing in the enriching nature of deficits. History and experience, however, do not seem to indicate that states or peoples have flourished under such procedure. It was not through deficit financing that England pulled out of the great depression, but on the contrary by the course of rigid balance of her budgets. It was not through increased Government deficits that this country recovered from the depression of 1921, but rather by the process of reducing expenditures and lowering taxes.

Governor Eccles earnestly maintains that it was not natural economic forces that brought about the upswing from the great depression which occurred in 1933, but rather Government spending and Government measures. As a matter of fact, economic recovery from the depression was

much in evidence in 1932, was halted in the fall of that year, but was resumed and attained its greatest **rapidity** shortly after the New Deal came to office, and before the policies of deficit spending and excessive experimentation had developed. If it was contraction of Government deficit spending that brought about the slump of 1937-38 it would seem clear that business activity developed by such spending is dangerously short-lived.

As a matter of fact, increase in the national income depends upon the more active functioning of all industry and agriculture, all along the line. Of course spending of the deficit dollar by the Government results in some business activity, but that Government spending may prevent the spending of two or three dollars or more by private individuals or agencies. The total business activity depends in large measure upon the effect of the sum total of all Government measures and policies. More important than spending policies are policies making for peace in labor relations, for adjustment of the great difficulties of the railroads and of the public utilities, and for a general atmosphere which would be favorable to business development and expansion. The necessity of such policies has been obscured by the very process of deficit spending.

Under the terminology of the new theory, the Government is not spending but is investing: the disturbing word "spend" is stricken out and the comforting word "invest" is substituted. It is suggested that in accordance

with recognized business practices the Government can place upon a balance sheet many items resulting from outgo, now classed as current expenditure, and show that what appears as a deficit is in reality a surplus.

No such comfort as to the state of the Federal Government's finances is warranted by the business analogy. All it justifies to a business man in recording an ownership of an asset in his balance sheet is the idea that in some form or at some time the item will turn into cash either through sale or the production of earnings - cash that can be used to pay bills and reduce debt.

However desirable it is to have court houses, roads, parks, and the like, these do not answer the test of assets in the business sense. They will not turn into cash and produce income. Generally, they produce further expense.

The table contained in the President's budget message sets forth that as against a total deficit of something over \$27,250,000,000, sixteen billions will be represented by such assets. The aggregate of items which may possibly be collectible appears to be a little over three billions. So far all collections made have simply been swallowed up in expenditure.

Even assuming that a much better case can be made for federal investment than seems to appear, we cannot be blind to the great danger of making even what seems to be sound investments with money that is borrowed. Many a private citizen, who looked upon himself as an investor but

who had made his investments on credit, awoke after 1929 to find himself ruined. How can Government financial plans be regarded as sound if based upon continued borrowing on assumptions as to increases in national income at relatively distant dates which cannot even be estimated and which may never be realized?

We are urged by Mr. Eccles not to worry about the Government debt because after all it is mostly owed internally - that is, to people of the United States and not to those of other countries. The idea is that if this debt is not really paid, it would not matter because as the people we would have the same physical things, the same economic plant, and life would go on as before.

To get to talking about the national debt as if payment does not need to be made is certainly a danger signal. Any process of repudiating the debt, whether by inflation or otherwise, would destroy the results of individual thrift and prudence and weaken the springs of all economic effort. Repudiation would for a time, at least, wholly upset the economic machine and would probably lead, as it did in Germany, to a degree of Government intervention in the daily affairs of the people that is wholly inconsistent with the maintenance of our liberties.

We have been told very positively by the President that the amount of the Government debt is not too much because the aggregate of the debt, public and private, is no more than it was in 1929. Assuming that to be true, it is

hard to believe that the President would now maintain that the debt total in 1929, just before the depression, was safe. The amount of that debt has been supposed to be one of the chief causes of the depression and of the severity of the decline. And it is also true that the same aggregate of debt is now a relatively heavier burden upon the lessened national income. It is also true that the tax burden back in 1932 was but about 12% of the national income in contrast to over 22% now, with an additional 5½% for what is borrowed. And today a much larger proportion of the debt is debt of the Government itself. We are relying far more heavily on our last line of defense.

Getting away from formula and down to fact, the striking consideration is that expenditures of the United States Government have been pushed up in peace times to the nine billion dollar level, more than twice the depression level. It has now been declared by the Administration that that level cannot be materially reduced. On the contrary, it appears that under present doctrines expenditures are likely to be continually increased. We are now told that there is no need of increasing taxes but that we can safely keep on spending billions of borrowed funds in the hope of increase in the national income and the Government's revenues.

We can all agree that we wish to have the unemployed kept from want: that we wish the farmers to have the

farmers' special needs met: that old age security must be cared for: that Government administration is more expensive and costly than it used to be. Yet the fact remains that continued deficit financing makes the whole conduct of national affairs a great gamble - gambling far more serious than the private gambling of the late twenties. Then at least we had a relatively strong government to fall back upon. The Administration leaves us now with no guiding principle for the sound conduct of Government finances - only a vague hope that the easy way may prove to be the safe way.

Tackling real reduction of expenditures will take immense courage and resolution. It is no partisan matter. The virus of easy spending spreads everywhere. Raising taxes takes even more courage, but the issue cannot honestly be dodged.

To promote the idea that we do not need to worry about spending and deficits is not a humanitarian service, but the reverse. It will be true in the future, as in the past, that in the end spending in excess of revenues produces chaos and threatens our form of economic life and the liberties which depend upon it. To destroy that conviction is to invite disaster.

BANKING AND THE GOVERNMENT

Remarks of Arthur A. Ballantine, former Under Secretary of the Treasury, at the Meeting of the Historical Society of Pennsylvania, Philadelphia, Pennsylvania, January 8, 1940

I am honored to participate in appreciation of the gift of the records of a Philadelphia financial institution that played a significant part in the economic history of this country. However, I do not intend to repeat to you anything about the story of the historic Bank of North America: It would be presumptuous for a citizen of New York to tell this audience anything about what happened in Philadelphia.

History, which you serve in this Society, has a many-sided appeal. On the human side, what those who preceded us did is the subject next most interesting to what we are doing ourselves. Then there are the fruitful lessons of history. And in any case, the history of a man, an event or an institution, such as we honor here, serves as a point of departure for considering what is going on today in the corresponding field.

Banking and finance are of course indispensable instruments of economic life today, just as they were when the Bank of North America opened its modest but prophetic doors in 1782. Indeed they have become still more important as the processes of business and commerce have become

more extensive and complicated.

One might suppose that today, 158 years after the first real bank in the country began operations, we could say that problems of banking and finance are substantially solved. The fact is that they are almost as numerous as they were in those early days, although very different. We have learned how to avoid some dangers from which earlier generations suffered, but we face others on a larger scale which call for our very best thought.

In the field of banking and finance today the dominating presence is the Federal Government. In early days the government was encountered almost exclusively when it came to the issue of charters and their renewals, with the many attendant contests, as notably in the case of the Bank of North America. Now the Government appears every day in one capacity or another, in some quarter of the banking field, and the future of banking depends very largely on government policy. The old phrase was "banking and currency". The new may well be "banking and politics".

THE CURRENCY

The currency of course remains intimately associated with banking. We have today what was lacking in early days - a serviceable, convenient and elastic paper currency. Yet we have also an elastic dollar, and that presents new problems.

Lack of a sound circulating medium caused acute

troubles in the early days. During Colonial times there was no authority to mint money or create banks, yet the mother country supplied no currency. Commodities were often used as money, not only tobacco and cotton, but in New England even fish, I believe. Improvised and often dubious bills of credit were sometimes employed, although in Pennsylvania some good bills were provided by the government. Coins used were largely foreign, this ultimately resulting in dependence upon the Spanish dollar.

The separation from England was followed by an outpouring of government paper currency issues. These were improvidently set up and the depreciation of the Continental currency made its name a by-word, caused great inconvenience and loss, and almost destroyed our credit standing abroad.

One of the services of the Bank of North America, established shortly before the independence of the States had been acknowledged, was to issue notes which were dependable. This medium of exchange greatly assisted commerce and industry and laid the groundwork for the establishment, under Alexander Hamilton, of the first Bank of the United States, incorporated in 1791. Yet paper currency long had a checkered course, through the failure to re-charter that bank, and the second bank, in its historic contest with Andrew Jackson. These difficulties continued until the establishment of the national banks in 1863.

In all those years the multiplicity of the paper currency issues, and their varying quality, were such that every alert merchant and banker equipped himself with a manual of bank note issues - a so-called "ready detector." Regulation of banking procedure was sketchy and losses through bad issues were distressing. The federal treasury also suffered from lack of adequate facilities for its financial operations. The sub-treasuries, originally established in 1840, operated in specie and were a clumsy expedient.

Salmon P. Chase, the Civil War Secretary of the Treasury, met the problem, not by establishing a new central bank, but by providing for decentralized individual banks operating under federal charter and supervision. These national banks, first established in 1863, were authorized to issue paper currency adequately secured by government bonds, for which the banks furnished a welcome market - with moderate cash reserves. State bank notes were soon taxed out of existence.

The national banking act of 1863 was the most important banking act until the creation of the Federal Reserve System in 1913. The Bank of North America became a national bank. Its past services were recognized by permitting it to keep its old name without incorporating the word "national."

National bank notes proved to be a good paper currency. Yet as the great expansion of industry proceeded it was found that a currency fastened to the volume of the public debt, which was modest and growing less in those very different days, was inelastic and unresponsive to fluctuating business needs.

This inelasticity of the currency contributed largely to the so-called 'money panic of 1907', when clearing house certificates had to be extensively employed in place of currency. That panic was a primary consideration in the establishment of the Federal Reserve System in 1913. That constructive development worked out after extended investigation, provided for vastly improved facilities for government financial operations and for banking operations, for the nation-wide clearing of checks, for pooling instead of pyramiding bank reserves so that they could be applied where most needed, and for a modern elastic paper currency.

The new paper currency, the Federal Reserve note, like the national bank note, had to have a 100% cover, but was not tied to government bonds. The cover prescribed was 40% in gold, and the balance of 60% in proper commercial obligations. This currency could be expanded as needed, and when no longer needed flowed back into the banks and was retired. Money scarcity, a great trouble and fear of earlier times, appeared to be eliminated.

Under the original act, government bonds could not be used toward cover for Federal Reserve notes. Under the stresses of the great depression, however, they were made so eligible by an emergency measure, and that eligibility has since been continued.

Establishment of the Federal Reserve System before the outbreak of the Great War was providential. It is doubtful whether the operations of the Treasury could have been conducted without it. To business and industry the aid of the system was enormous. Yet the existence of the system, even with its developing powers, has by no means solved our currency problems.

No business man offered a Federal Reserve note needs a "ready detector": he knows that it is good. Nor need he, in planning his affairs, fear a scarcity of dollars. What he does have to consider is just what the dollar itself means.

Take a \$10 bill - if you have one. The back says: "United States of America - Ten Dollars." The face states:

"The United States of America will pay to the bearer on demand Ten Dollars."

But how, and in what will the United States make that payment?

Compare the promise contained on the Federal Reserve note with that in the notes of the Bank of North America issued after the United States currency system became established under Alexander Hamilton. These bank notes, issued

even for 1/90th of a dollar, were promises to pay objective dollars, specie having tangible value.

The phrase used in the Constitution granting authority to the Congress is: "To coin money and regulate the value thereof." The basic idea of money was that of coin possessing an intrinsic value, because made of precious metal universally desired and accepted. As we outlived the cumbersome use of coin, except for limited purposes, the conception of convenient paper substitute was a call for coin backed by proper security. The silver certificate, which is your ordinary \$1 bill today, is still a call for coin, though the commercial value of the silver is only about 27% of the theoretical value of the silver dollar.

Our standard dollar is still expressed in terms of gold, nine-tenths fine, and is now 15-5/21 grains, reduced under the Gold Reserve Act of 1934 from the former 25-8/10 grains, or to 59.06% of the former value. But today if you take your \$10 note to the Treasury you cannot obtain a \$10 gold piece, or any gold piece, but only silver dollars or another note. You may with paper dollars buy from the Treasury gold at \$35 an ounce for use in the arts, and, so long as the Secretary of the Treasury permits, gold for export to settle certain obligations abroad.

Most of the gold in the country, both coin and bullion, is held by the Government in the Kentucky hills. It now constitutes an unprecedented stock of over seventeen billions,

nearly 65% of the world stock. The certificates issued by the Treasury against it go only to Federal Reserve Banks, and they need be honored with gold only if the Secretary of the Treasury deems it in the national interest. Just what is the future of that great gold stock no one can say.

The issue of Federal Reserve notes, calling for dollars and circulating as such, is of course limited. The notes must still have 100% cover. They can still be issued against Treasury gold certificates to the amount of not less than 40%, with collateral for the balance made up of commercial paper or government bonds. The notes constitute a claim on all the assets of the issuing Federal Reserve Banks. At the present time the gold certificates held by the Federal Reserve Banks exceed the amount of the Federal Reserve notes in circulation.

The dollar in the old sense, something convertible at will into gold, is gone. The standard dollar is largely a concept and approaches a "fiat dollar," the value of which depends on the stamp of the government rather than upon extrinsic value.

The value of the dollar can be vitally affected by government decision and policy. The President has authority, at any time, to reduce the theoretical gold content by as much as 15% down to 50% of the former value. Its value in international exchange can be reduced at any time by refusal of the Treasury to give up gold for export. Furthermore, the value could be affected by the issuance at any time, by authority of

the President, of unsecured circulating notes of the Treasury--greenbacks--up to an amount of three billions. The dollar stands vulnerable to any crisis in government credit.

Of course there are arguments for leaving the dollar so far detached from gold - arguments founded on its bearing upon freeing the domestic price level from the world price level, upon the business cycle, money rates and the bond market. Yet there must be recognition also of the dangers of possible run-away prices inherent in the detached dollar. Convenient dollars we have attained, only to find that we have by no means attained a universally accepted view as to what the dollar itself is to be, or how it is to be managed and protected. Difficulties on the point may prove to be greater than the currency difficulties of earlier days.

DEPOSITS

In these days bank deposits, readily cleared between banks everywhere in the country, largely take the place of currency. At times difficulties with bank deposits have been a source of widespread loss and distress. Utilization of deposited funds by the banks has not always proved consistent with their repayment. Deposits are today better protected than ever, yet here also ultimate protection rests largely on government action.

Until the establishment of bank deposit insurance on a national scale, security for deposits depended wholly on the integrity of loans and investments of the banks of deposits.

Yet anything like adequate supervision of banking operations was surprisingly long in developing, especially while state banks alone were in the field.

The National Banking Act of 1863 made a new step in protective requirements and also in providing for systematic examinations. State protection was stimulated. As the use of deposits in place of bank notes developed, state institutions, particularly trust companies, multiplied. Many were well managed and kept sound, but it was well said that there proved to be in this country more banks than bankers. Institution of the Federal Reserve System brought some improvement, but its control was limited to member banks.

The great depression, beginning in 1929, brought into startling relief the insecurity of deposits in many banks under the practices prevailing in this country. Perhaps no protective plan could have withstood the devastating decline in underlying assets which occurred in the depression. Yet it is to be observed that no such losses in liquidation occurred in England or in Canada where the plan of branch banking is followed, as contrasted with our unit banking.

Between July 1, 1929 and the declaration of the bank holiday on March 6, 1933, nearly 6,000 banks suspended operations. Combined loans and investments of national and state banks sank from about forty-nine billions on June 30, 1929 to thirty billions on June 30, 1933. Total loans declined by 54%. These figures represent the most drastic and prolonged

bank credit liquidation that has ever occurred in the United States.

Under the emergency Banking Act of March, 1933, most banks which had survived up to March 6th of that year were successfully reopened, but the losses to depositors over the previous three-year period had been disastrous.

Various measures were undertaken for alleviation and prevention. Government aid was extended to the needed building up of the capital structures of banks through purchase of preferred stock and debentures of banks by the Reconstruction Finance Corporation. These purchases carried with them a good deal of control over management.

Institution of deposit insurance on a national scale was the most important continuing change begun by the Banking Act of 1933. Deposits of any one depositor are insured to a maximum of \$5,000. The insurance is backed up by assessments on insured banks of 1/12th of 1% annually on total deposits. Insurance is compulsory for national banks and for state banks that are members of the Federal Reserve System, but is not required for non-member state banks.

The Federal Deposit Insurance Corporation, an administrative agency, has extensive power of inspection and supervision of insured banks, including the power to terminate the insured status of any bank.

Under this plan the safety of deposits in insured banks, constituting about four-fifths of total net deposits,

no longer depends solely on the assets and management of the individual bank.

Ability of the Federal Deposit Insurance Corporation to meet its guarantees depends mainly upon its holdings of internal debt of the United States, now amounting to some \$344,000,000, against deposits of about twenty-two billions covered by the insurance. The debt so held is not cash, but if need arose would have to be converted into cash by the Treasury through marketing operations. And if a heavy demand occurred it would likely be made at a time of pressure upon government bonds, of which the insured banks themselves are such large holders.

In administration the Federal Deposit Insurance Corporation has done a great deal to improve the condition and practices of many banks. Yet the banks find themselves today pulled by the Government in two opposite directions. On the one side is the Federal Deposit Insurance Corporation pulling for security in loans and investments, while on the other are high government officials and members of Congress pressing the banks to make more liberal loans.

Under changes in the banking laws, banks now make loans of a different character and for longer terms than formerly. Banks are examined now not only for the loans and investments they make, but also for those they reject. Where the greatest weight of the government influence is to be placed it is difficult to say.

Mutual insurance by the banks of their deposits, however well administered, is at best a make-shift. Fundamental questions relating to the intrinsic treatment and security of bank deposits remain unsettled. The Federal Reserve Board said in its last annual report that

"The banking picture emerges as a crazy quilt of conflicting powers and jurisdictions of overlapping authorities and gaps in authority."

We still have to consider whether we should continue to have both national banks and state banks operating under competing laws, or should bring all banks under one system of law and supervision. And in the administration of national laws, should all authority be brought under a single agency, or left scattered as now through four or five agencies? Should we adhere to unit banking, with branches generally limited to a single state or city, or follow the apparently successful developments of branch banking in England and Canada? These issues cut deep, present conflicting considerations, and still call for legislative solution.

SUPPLY OF CREDIT - GOVERNMENT COMPETITION

An important development which is familiar today, but which would have astonished bankers of earlier days, is the making of loans to private business by the government. After providing for loans to farmers, the next great step was the setting up of the Reconstruction Finance Corporation, under the stresses of January, 1932. The original purpose of that emergency agency was to make loans to banks, railroads

and insurance companies to help them to pull through their depression difficulties. The service of the Reconstruction Finance Corporation under the able management which it has always had, in the depth of the depression and later, has been invaluable.

Yet what is begun as an emergency practice has an impressive way of becoming permanent, and the serious question now is, what lending the Government shall engage in as a continuing policy?

To promote housing construction, agencies have been created having the power to guarantee approved loans now outstanding in an amount approaching three billions, while Government guaranteed farm mortgages now approach a billion and a half. Government loans on commodities are over eight hundred millions.

The powers of the Reconstruction Finance Corporation were extended to cover the making of loans to almost any business. Chairman Jesse Jones of the Reconstruction Finance Corporation stated in a hearing before a Congressional Committee last spring that such loans have been made to the amount of something over five hundred millions, and that 37% had been for \$5,000 or less.

The new Congress has before it different proposals, such as the Mead Bill, for "An Industrial Loan Corporation," for the extension of the government activities in business lending, particularly in furnishing accommodation to small

industries, and they will undoubtedly be given serious consideration.

It is the position of bankers generally that they are not only willing, but eager, to make, at very reasonable rates, any loan, however small, that is good. Extensive examinations which have been made seem to verify this position.

Today, as in recent years, the banks have funds that are not merely ample: they have excess reserves now exceeding five billions, a truly amazing figure, more than five times the peak reached before the boom of 1928 and 1929. These excess reserves could probably support a commercial credit expansion approaching the size of the national debt. Today they are but idle funds.

Whether under these circumstances the Government should enter further into the banking field, taking further risk on loans which are not regarded as good by bankers, with the danger of encouraging unsound business enterprise, is a question of government policy. The possibility of such action, however, tends to put pressure on the banks to sacrifice the quality of their assets.

CREDIT CONTROL

Regulation today seeks to deal protectively not merely with individual loans, but also with the total flow of credit - the amount of money that is loaned by the banks. That flow is intimately associated with the activity of industry and with the price level, and these it is sought to affect

favorably through credit control.

The Act of 1913 setting up the Federal Reserve System provided two means of control. The first is through the rediscount rate at which member banks may borrow from Federal Reserve Banks, thus replenishing their reserves when depleted. The second is through open market operations, including the purchase and sale of bankers' acceptances and government securities in the market. When a Federal Reserve Bank makes a purchase, additional funds are put into the market, and when a Federal Reserve Bank sells, funds are withdrawn from the market.

Both of these powers proved to be useful. Yet they were wholly unequal to controlling the sharp depression of 1921 and still less able to check the great depression beginning in 1929. Experience has shown that many factors other than the volume and cost of credit affect business activity and the price level.

In recent years the powers of the Governors of the Federal Reserve have been increased. Their authority over the directors of the regional Reserve Banks in the making of the discount rate has become clear, while the conduct of open market operations has been placed mainly in their hands. In addition, the Governors have the power to specify the percentages which may be loaned against the market value of securities, and also the important power to raise or lower reserve requirements.

These increased powers over credit control, however, must be operated under conditions presenting new difficulties. A vast increase in bank deposits has come about, resulting in large part from government deficit financing, and an amazing increase in bank reserves, resulting in large part from the huge importation of gold subsequent to devaluation. Action of the Federal Reserve Banks is also conditioned by the fact that they now have some two and a half billions of Government securities. In addition, the Government itself is in the market from time to time for large loans for refunding and for new money. These considerations materially hamper any real limitation of credit.

Even granting the theoretical effectiveness of powers over credit, experience has shown that it is by no means easy to know when to apply them. Great discussion has taken place and will probably go on for years as to whether the Federal Reserve Banks should have sooner increased the discount rates before the 1929 debacle; also whether the increase in reserve requirements in the spring of 1937 was wise or caused unnecessary business contraction. When it comes to apply the credit control, there are always conflicting considerations.

The Federal Reserve System, important and helpful as it is, does not supply a panacea for all financial ills. We can hope that those who manage the System will always be wise and their decisions sound, but no automatic method of credit control has been discovered, and such control is but one factor in promoting healthy economic life.

THE GENERAL OUTLOOK

The Government today dominates the banking field, not merely as supervisor and regulator, but also as determining the policies upon which business activities so largely depend, and again as the supplier of government obligations, which have become for the time the principal reliance of the banks.

The great question of the future is how the Government is to perform these many functions. One cannot help wishing that some of the newer duties of the Government could be discharged with more financial independence than under the conditions of continued deficit financing. Even the hardiest believer in government deficit spending must recognize that the consequences of such spending create conflicts of interest between the Government's own needs and the need for independent and long-range banking.

In spite of all the progress that has been made, we must humbly admit that the problems of banking and finance are far from solved, and that there is as yet no one set plan for financial security and progress. Yet we may hope that the working out of ultimate decisions, now so largely in the hands of the Government, will be characterized by much of the same practical sense and independence as was displayed by those responsible for the Bank of North America, which we honor here today.