

W. RANDOLPH BURGESS
55 WALL STREET
NEW YORK

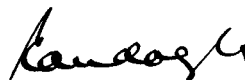
January 26, 1940.

Dear Marriner:

Enclosed herewith is a proof copy of my address last night before the Connecticut Bankers Association. With some of it you will agree, and with some of it you will differ. I think I could almost mark the paragraphs. However, honest discussion is good for the soul, and people ought to be doing more thinking about these matters. If I can get the pot stirring a bit faster I shall have accomplished my purpose.

I spoke from notes, and this text will be changed slightly before printing.

Sincerely yours,



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

WRB.H

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**WHAT ABOUT MONEY
MANAGEMENT?**

by

W. Randolph Burgess, Vice Chairman of the Board

of

The National City Bank of New York

An address before the

CONNECTICUT BANKERS ASSOCIATION

New Haven, Connecticut

Thursday Evening—January 25, 1940

WHAT ABOUT MONEY MANAGEMENT?

WITHIN the past few weeks there have appeared two discussions of this country's long term monetary problems which are of great importance both by reason of their source and their content. Mr. Winthrop Aldrich has proposed that we should return to a full gold standard, and Mr. Russell Leffingwell has reviewed a span of 22 years of monetary policy and reached the conclusion that we should be better off with less management. I am sure that these proposals are put forward only after mature deliberation. They deal with questions bearing not alone upon business and finance, but upon the welfare of all the people. The discussion should be carried forward until the main points at issue are publicly understood. In these days when we are so much and so rightly concerned about more immediate problems, such as how to put idle money to work, these more basic problems may seem academic. But in reality they are necessary parts of any reemployment program, for confidence in money is the basis of our system of free enterprise.

It is within this general area of longer term monetary policies that I propose to make some comments. I shall not discuss except incidentally New Deal silver and gold policies, unbalanced budgets, or deficit financing, or such other fascinating and important questions as the long term effects of present low money rates, or the effects of war. But, like Mr. Leffingwell, I want to think not on a 24 hour basis, but in terms of a long span of years. While he mentioned 22 years I have been thinking of 25 as a significant number because the Federal Reserve System has just celebrated its 25th birthday. For any conclusions about monetary management shorter periods are misleading. We thought we were managing money pretty well in the

middle twenties, but Mr. Leffingwell comes to the conclusion that we were sowing then the seeds of our later discontent. It may well be said of monetary policies that "the sins of the fathers are visited upon the children."

In dealing with so large a topic so briefly I shall necessarily omit many qualifications, and run the risk of appearing dogmatic.

MONEY, BUSINESS AND EMPLOYMENT

First a few words should be said as to the relation between money and business and employment, even at the risk of being a little theoretical. The central facts as I see them may be summarized as follows.

In the history of this and other countries business activity tends to move in waves, from prosperity to depression and back again. The changing psychology of these periods is their outstanding characteristic. At one time business men and individuals are optimistic and conduct their affairs with an eye to the long future. At another they plan only a few weeks ahead. These periods tend to be cumulative and lead on the one hand to over-enthusiasm and speculation, and on the other to undue pessimism and despair. The problem of achieving greater stability of business and employment is largely one of checking the periods of optimism or pessimism before they go too far and carry the country either into over-speculation or depression. One of the most important conclusions which now appears to be justified is that control, while more unpopular, is more effective on the up-side than on the down-side. For, once over-expansion and over-speculation have gone too far and finally crashed, a compensatory period of readjustment and depression is almost impossible to avoid.

A recently published study by Col. Leonard Ayres, which goes on the list of required reading, demonstrates more positively than heretofore the influence of monetary forces at the turning points of the cycle. The relationship indicated in these studies, covering a long period of this country's economic history, is that the fluctuations in

business respond to conditions in the security markets and in particular to the supply of funds made available to business through the public sale of stocks and bonds. This in its turn is linked with changes in the money supply and its price. The nature and timing of the cycle are of course influenced by many other factors, but none appear so consistently present at the turn of the cycle as this money factor.

THE TWENTY-FIVE YEAR RECORD

Against this general background I suggest that we take aerial observations of the record of the past twenty-five years of business since the Federal Reserve System was established. For with the Federal Reserve we adopted a form of money management which might be hoped to operate towards stability. What are the facts. They are readily available in a number of measures of production, employment, and of various other aspects of business. The facts as shown by these measures are that the fluctuations in business have been greater in the past twenty-five years since the Federal Reserve System was established, than heretofore. The depression of 1921 while not unusual in duration was more severe than any of its predecessors; business activity dropped further; unemployment was greater both in numbers and percentages. Then the depression of the thirties made 21 look like a pigmy; it has been far and away the worst both in extent and duration.

It would, of course, be foolish to leap to the conclusion that the Federal Reserve System was really responsible for the extent of these depressions. One can think of a good many reasons why the depressions have been worse in this twenty-five year period.

The first is, of course, that this has been a very difficult period. It has reflected the economic dislocations of the world war. These depressions are properly called the primary and secondary post war depressions. Unstable currencies and vast gold movements have reflected world-wide economic disorder.

A second reason arises curiously enough from our very prosperity and high standard of living. When a large part of a country's pro-

duction consists of luxury goods, the possibilities of postponement of purchases are multiplied. When a cloud appears in the sky and people postpone buying, it may cut production 25 to 50 per cent, and the cut is cumulative, for every man thrown out of work in turn decreases purchasing. Another corollary of the high standard of living is that more people live in cities, and fewer on farms. In more primitive periods men out of work went back to the farm. Today that door is less open and hence the economy is less elastic to take up the shock of depression.

But even when allowance has been made for these causes of instability I want to raise the question whether there is not in addition a change in the monetary mechanism which has tended to encourage bigger booms and deeper depressions than formerly.

CHANGES IN THE MECHANISM

Let me remind you of a change in the operation of the business cycle due to the establishment of the Reserve System. As basis for the comparison suppose we examine first what happened in 1907. The story briefly is this. 1905 and 1906 and the first half of 1907 constituted a period of great prosperity. Industrial production was active. Workers were well employed. Stock prices were rising and reached, in fact, the highest level for many decades. The amount of new capital issues was large. It was a period when the dangers of over-speculation and over-production of one sort or another were imminent. What happened to bring it to a close? There seems general agreement that the primary check to further expansion was that the supply of money ran out. The expansion of business and of prices had brought with it an expansion of the amount of currency in circulation. That, together with the expansion of bank credit, used up the available supply of funds, and bank reserves began to show deficits. There existed at that time no ready means by which the supply of money could be increased and given elasticity. As a result there was a brief money panic. It was difficult to obtain currency. As a consequence industrial production promptly declined. Stock

prices went down. Capital issues diminished and business and finance went through a period of rapid readjustment.

Comparing this sequence with more recent periods the surprising thing is how rapid the period of readjustment really was. The decline occupied only a few months, and by the middle of 1908 business was well started on another upward swing, but with the situation readjusted so that a number of weak business and financial institutions had been liquidated and over-speculation had been pretty well squeezed out.

It may be noted that the process of readjustment in 1907 and 1908 was painful, but that the pain did not last very long. It was painful enough, in fact, so that the experience was vividly in the minds of the legislators who devised the Federal Reserve System.

Turning to the more recent period, and ignoring other differences, we may ask ourselves what are the principal differences in the monetary mechanism, which distinguish it from the sequence of events in 1907.

First, as to 1920 and 1921. The conclusion of the war at the end of 1918 found this country's credit structure greatly expanded. There was every expectation that the war would be followed immediately by depression, but there was, among other influences, a new money element in the situation. Whereas in 1907 the money supply was limited, in 1918, 1919, and 1920 it had elasticity through the mechanism of the Federal Reserve System. Even though credit and currency were over-expanded, money could still be obtained at the Reserve banks through the rediscounting process; and that is what happened. Thus, without the restraint of any definitive limitation upon money, bank credit continued to expand through 1919 and the early part of 1920; prices continued to rise, and with favoring money rates the Treasury was able to take care of its final bond issues for the war. It was only after the expansion of money and prices had gone to an extreme point that the Federal Reserve authorities, delayed by Treasury influence, finally used their powers vigorously to check the expansion.

The important difference between the two periods, as far as money

mechanism is concerned, was that in 1907 the check to over-expansion was automatic, the supply of money ran out, whereas in 1920 there was no automatic check. The reserve reservoirs of the banking system were open until the authorities made a decision about closing them. In other words, money management was substituted for automatic limitation. It also seems clear that the extreme depth of the 1921 depression is largely accounted for by the extent of the over-expansion in 1919 and 1920. If the expansion had been checked earlier the depression in all probability would have been less severe.

The story of the late 20's is somewhat similar with reference to the monetary mechanics. The business boom was kept going with the use of Federal Reserve facilities. In 1924 and in 1927 incipient depressions were checked by expansive action on the part of the Federal Reserve System. In 1928 and 1929 at the height of the boom there was no automatic limitation on expansion, and restraining action in the form of discount rate increases and open market operations proved ineffective, partly because they were regarded as artificial and money was still readily obtainable. The movement was checked only after decisive increases in discount rates in August, 1929. Here again it seems a reasonable conclusion that if the expansion had been checked earlier the succeeding depression would have been less severe.

This is, of course, presenting the case in very bald outline and leaving out all mention of a great many complicating factors such as the world monetary position, the longer term influence of the war, increased mechanization of industry, etc., etc.; but none of these qualifications seems to me sufficient to offset the central core of evidence that since we have had elasticity of credit and currency, so that a money shortage no longer acts as automatic check, and restraint is dependent on money management, the mechanism tends to be less effective in checking over-expansion.

In this connection it is interesting to recall that when the Federal Reserve Act was under discussion Senator Elihu Root made a speech in which he foresaw something of this difficulty and said that the proposed new banking legislation would launch the country "on a

career of inflation." Events in 1919 and 1920 and in the late twenties lent some support to this proposition.

HANDICAPS OF MANAGEMENT

Even aside from the extraordinary economic confusion of the recent period money management has encountered grave difficulties. The first was a general failure to recognize the responsibilities of management inevitably involved in the notion of elasticity. The Reserve Act quite failed to define the problem: discount rates were to be fixed simply "with a view of accommodating commerce and business," not as an influence toward stabilizing the economy or avoiding inflation and deflation. It took almost ten years of operation of the System before its true and unavoidable function was recognized.

The second problem was to know how and when to act in a very complicated economic situation. Take early 1937 for example, was that the beginning of a real inflation that should be nipped in the bud, or merely a fluctuation that could safely be allowed to run its course? We don't know yet. Every policy decision is in reality a prediction of the economic future; the lack of success in such predictions even by the ablest is notorious. Even after the fact, you can never prove that the dangers you feared, and acted to prevent, would really have occurred.

The third handicap is pressure, political and otherwise, on those who have to make the decisions. Both businessmen and politicians love expansion and don't want it stopped. When the job is to stop expansion before it goes too far, the whole environment is in opposition. Witness 1929. In Washington the Reserve Board remembered the violent attack in Congress on the so-called "deflation policy of 1920" which had in fact unseated Governor Harding. In New York State a speculator even brought suit against the New York Reserve Bank for raising its discount rate. The money manager who does his job is the world's champion kill-joy.

Perhaps under these handicaps it is a wonder that the System has done so well. And it should be added that at all times both in

Washington and in the Reserve Banks the decisions have been made by earnest conscientious men seeking to do their duty as they saw it.

Even after making these allowances the facts in themselves go far to support Mr. Leffingwell's indictment of managed money. The results so far have been unsatisfactory.

WHAT CAN BE DONE?

The next question is, "What's to be done about it?" One is tempted to suggest that we turn the hands of the clock back, abolish all powers of monetary control, and leave the Reserve System simply as a service station for the banks and Treasury, to handle money and checks and other semi-mechanical service. That would mean no rediscounting, no open market operations, no changes in reserve requirements; for all of these are the mechanisms of money management, make no mistake about that.

To spell the proposal out is to answer the question. It can't be done. Politically it is impossible. Once the people have taken over money management they are going to keep it, partly for fear that if they don't, private interests will in fact manage money for private gain.

I doubt if we as bankers think we should be better off with a return to an automatic mechanism. Without the Reserve System, financing our part in the World War would have been harder; the gold flow afterwards would much more surely have inflated us; and any depression comparable with the recent one would have brought us management in different and perhaps worse form. It is hard to conceive any method of bringing our present gold hoard and tremendous gold movements within the framework of any effective automatic mechanism.

No, we cannot, if we would, turn back to the simpler monetary system of the past, and I doubt if seriously we would. The alternative seems to me to explore the possible means by which the management we have might be safe-guarded and improved.

Let me suggest very briefly some of the more promising avenues for exploration.

1. *Limit and Simplify Management.* First, we should consider ways in which the problem of management may be simplified both by narrowing the area within which decisions must be made and embodying in the mechanism such checks and limitations upon unsound practices as are feasible.

The first and most obvious move in this direction is to repeal some of the legislation for dealing with emergency conditions now past, which now have the double effect of confusing and complicating the problem of monetary management and of impeding the restoration of confidence. Since a number of these laws provide for administration by the Treasury they divide authority for monetary policy between different arms of the government, with almost inevitable resulting confusion. There is clearly no longer need for the provision authorizing the issuance of unsecured greenbacks, and there never was any sound economic reason for the silver legislation.

With respect to the power to devalue gold and to deal in gold or buy securities with the stabilization fund, there is more room for difference of opinion, especially in view of the continued unsettlement of world finance. It must be recognized, however, that as long as these powers exist in the Treasury the responsibility for monetary policy is divided. The return to a fixed gold parity, supported by free movements of gold, would simplify this problem, and would be something of a safeguard and restraint in that it would make over-expansion, the use of inflationary devices, or long continuance of unbalanced budgets less easy. For policies of these sorts tend to result in gold movements. The gold standard is a little like a fever thermometer. It sometimes frightens you unduly and at the wrong time, but it is usually helpful, and smashing the thermometer is a dangerous way to deal with a fever. I am inclined to agree with Mr. Aldrich in advocating going the whole way and putting gold in circulation as a means towards restoring confidence in money and of making still more difficult in the future changes in its gold value. In the long term history of money such changes have been made more frequently for political than for sound economic reasons. With our present strong gold position we can afford to lead the way. I see

no important advantage in delay. In those areas of the world where trade is still possible we shall be in a much stronger position to advocate and assist in achieving that currency stability which is essential to trade if our own position is definitely assured. Such action is a logical part of any program for lowering trade barriers.

We should, however, have no illusions that the restoration of the gold standard would eliminate management. With our present huge gold supply we must still have management, but the area for management would be somewhat narrowed, and responsibility would be less divided.

As to the more permanent establishment, question might be raised as to limiting and simplifying certain powers of the Reserve System. As a protection against possible abuse, there is much to be said for a limitation, such as is in force in a number of other countries, on the amount of government securities the system can hold. The power over reserve requirements needs much study. In the face of enormous excess reserves the power to increase reserve requirements should probably be continued and enlarged. On the other hand the power to reduce them once they are raised is a horse of another color. Changes in reserve requirements are a method of adjusting to a new gold situation, and clearly should not be used as a current operating mechanism.

2. *Improve management.* The prime essential is to improve over a period of years the experience and capacity of the people who exercise powers of money management. To some extent this will take place naturally: the managers are to-day more experienced, more aware of their function than they were a few years ago. But there are serious faults in the set-up. The best way to bring this out is perhaps to compare our money management board with the Supreme Court. The Reserve Board exercises powers no less important for the well-being of the people than the Supreme Court, but the provisions for getting the best personnel are far less good. As to salary, Supreme Court justices receive \$20,000, which is too little, appointment for life, and may retire on full pay. A Reserve Board member receives

\$15,000, with no retirement allowance, and must retire on completion of his 14 year term. That is a serious block to getting the best men. There is no legal geographical limitation on Supreme Court justices, but good men have often been unavailable for the Reserve Board because not more than one may come from any Federal Reserve District. Every member of the Supreme Court is a lawyer, with years of legal experience behind him; but membership in the Federal Reserve Board must by law provide for representation of the financial, agricultural, industrial, and commercial interests. It is not required that every Reserve Board member shall have had experience in finance. These rules have meant that in many cases the best men in the country could not be appointed, and even when very good men were appointed many of them did not have the particular training or capacity to fit them for one of the most exacting and important responsibilities in the country. I have long thought that the System might be strengthened by a provision under which a number of the members of the Board would be presidents of Reserve Banks, serving in rotation, receiving their salaries as presidents and continuing on the pension system. It would assure a body of practical experience on the Board, would be valuable training for the presidents and make their work more interesting, and would improve the relations between the Board and the Reserve Banks. Federal Reserve Banks have provided an effective mechanism for the training of men in central banking, which is different from commercial banking, not subject to the same limitations as the Board. By a curious perversity the tendency of recent legislation has been to make less, rather than more, effective use of this personnel.

Of course we must all recognize that this question of the organization of the Reserve System is a political as well as a monetary question, and it is mainly for that reason that the suggestions I have just made are very hard to carry out. Central banking is so vital to the public interest that there must be assurance that no private interests and no section of the country can control it. Its action moreover is so related to the whole economic program of the government that com-

plete independence from the executive is difficult, especially in periods of emergency. And yet the political atmosphere is not one in which central banking does well. For as we have said the decisions to be made are hard and often have painful immediate consequences, especially when the job to be done is to check over-expansion. Politics does not like to make that kind of decision, or to take the consequences. Thus the central banking system has the double responsibility of cooperating with other agencies of government, while at the same time preserving a certain freedom and independence of action. It is a tight-rope kind of job. This again calls for the finest personnel, equipped for the task by both experience and tradition, whose opinions will command the respect of both the political authorities and the public. With our new understanding of the nature of the work to be done it seems to me clear that the present provisions of the Federal Reserve Act bearing on the organization and personnel of the top control of the System need overhauling.

3. *Support Management.* Up to this point we have been exploring very frankly ways in which other people might do their jobs better. Before concluding we might well ask the question what our own responsibility as bankers may be in these matters. One principle seems clear from the foregoing. It is that monetary management deals with a constantly changing problem in public psychology, and its success will depend upon public understanding of its objectives. The only way the law and organization of money management can be changed is with the support of public opinion. That is where our job comes in, and we shall get as good monetary management in this country as the bankers really want badly enough to work for. Our first task is to understand the problem ourselves. We are doing something about that through the American Institute of Banking, the Graduate School of Banking, and the research programs of the American Bankers Association, and the Reserve City Bankers. Our second task is to furnish leadership for public opinion on these financial questions, and on this task I fear we should all admit we

have not made much progress. We have been busy with some very pressing problems of our own, and, moreover, the public has not exactly been clamoring for our views. Time is gradually changing that situation. The public is more ready to listen when we have something to say. From here out it looks as though the future of our profession would be largely up to us.

February 8, 1940.

Dr. W. Randolph Burgess,
55 Wall Street,
New York City.

Dear Randolph:

Thank you for your letter of January 26 enclosing a copy of your address on the preceding evening before the Connecticut Bankers Association. As you pointed out, to my amusement, that you could mark the paragraphs with which I would disagree, I need not indicate them myself.

You would not wish to engage in a public controversy with Mr. Leffingwell or Mr. Aldrich, but I am less restrained, as you know, or perhaps I should say that I am less tactful. [In any case, I could not agree that the facts of the past quarter of a century go far to support Mr. Leffingwell's indictment of managed money.

To reach such a conclusion, I would have to believe, as Leffingwell evidently does, that the ups and downs of business can be largely smoothed out by monetary management alone. That must be his idea of it or he could not so glibly ascribe the 1937 downturn to such simple causes and ignore what seem to me the important underlying factors; notably, the vital relationship between investment on the one hand and consumption on the other, to say nothing of other unbalanced relationships, labor policies, etc., affecting costs and prices.

A much more rational analysis, in my judgment, of the past quarter-century would indicate not that monetary management had failed, since at best it can do so little, but that the difficulties are to be found in this very relationship between factors of investment and consumption. To suggest that we should create an arti-

February 8, 1940

ficial money shortage so that we would have recurrent 1907 panics as a check on booms is to my mind almost the height of absurdity in remaining blind to the important factors that affect economic stability.

Likewise, I am not inclined to agree with Mr. Aldrich in advocating going the whole way and putting gold in circulation as a means toward restoring confidence in money. If the purpose of this is to deal with the excess reserves problem, then, as I saw it expressed somewhere, it is like attacking the tide with a medicine dropper. If the purpose is to make people feel their money is sounder, then I think it is somewhat on a par with a profound statement that appears in the Congressional Record of a few days ago made by a western representative (not from my State) who, deploring the fact that the dollar is no longer convertible into gold coins, declared that our money is now absolutely worthless except for what it will buy from day to day. Nobody ventured to challenge this profundity.

But whether gold is paid out or not is relatively unimportant. If I were discussing monetary management I would think it essential, first of all, to define what the objectives should be and to recognize the inherent limitations at best in monetary control. I would not feel that I had come to grips with the problem at all unless I related monetary factors to the economic system as a whole and indicated that the factors of the supply and cost of money were not an end in themselves but merely one of the means to the end of achieving reasonably full employment and stabilizing economic progress. That would lead me inescapably to the vital matter of the way in which the national income is currently distributed. And, of course, I would immediately collide with most of the standardized cliches with which we are both very familiar.]

However, I shall not pursue this fertile subject, except to say frankly that I would like to see you get the pot stirring faster, as you put it, by coming to grips with some of these fundamentals, especially since you have the experience, the knowledge and the commanding place to be of

Dr. W. Randolph Burgess

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February 8, 1940

real influence in causing some thinking and in shaping opinion both in and outside the banking field. And, heaven knows, it is badly needed, in these times above all.

I need not add that, in any case, I am always interested in your utterances and take it for granted that you do not want from me mere polite and indifferent comments thereon.

With kindest personal regards,

Sincerely yours,

M. S. Eccles,
Chairman.

 ET:b

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W. RANDOLPH BURGESS
55 WALL STREET
NEW YORK

February 16, 1940.

Dear Marriner:

Many thanks for your careful comment on my speech, which is in your usual effective and pungent style, and is therefore welcome.

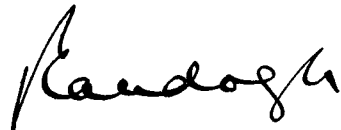
Of course, our difficulty is that our central explanations of business fluctuations are totally diverse, and I cannot go along on the theory that the explanation is to be found mainly in the relationship between investment and consumption, and do still attach a very great amount of importance to more strictly monetary factors. It seems to me Leonard Ayres' book, which I assume you have been over, presents evidence which is difficult to escape.

I, of course, recognize that money does not do the whole job, and have repeatedly made such statements. I thought I threw in enough qualifications in this case. Admittedly in the past half dozen years monetary policy has been a relatively subordinate factor. There seems to me some danger that this more recent and vivid experience may blot out the longer experience of the great importance of monetary policy in the cycle, particularly at crucial turning points.

However, you hammer at the boys your way, and I'll do it in mine, and between us we may help make them think.

With best wishes,

Sincerely yours,



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

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