

***"Monetary Problems of Recovery"***

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**Washington, D. C.**

**Before the**

**OHIO BANKERS ASSOCIATION**

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**THE HUNTINGTON NATIONAL BANK  
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Believing that the full text of the address delivered before the Ohio Bankers Association by Governor Eccles will prove a helpful document during the coming discussion of the proposed Banking Act of 1935, The Huntington National Bank of Columbus is pleased to present this copy to you.

## MONETARY PROBLEMS OF RECOVERY

(Address of Marriner S. Eccles, Governor of the Federal Reserve Board, before the Annual Midwinter Meeting of the Ohio Bankers Association, at Columbus, Ohio, February 12, 1935.)

I am grateful for this opportunity to address the members of the State Bankers Association of Ohio and their friends who have joined them on this occasion.

In taking up my duties in Washington, first with the Treasury and then with the Federal Reserve Board, I was of course under the necessity of resigning my own banking connections. Nevertheless I have every reason to feel entirely at home in an assembly of bankers, and I am genuinely glad to be here. This is, in fact, the first opportunity I have had to address a large number of bankers since I became connected with the Federal Reserve Board.

When I accepted the invitation I received from your President in December, I was somewhat at a loss to decide what subject to discuss with you. Since then the Banking Bill of 1935 has been introduced and I feel sure that there is no subject in which bankers will be more interested than the provisions of that bill. I am especially glad to be able to present to you my conception of the objectives of this measure, because I believe that all who are of the banking fraternity, no less than those of us who are identified with the Administration at Washington, have every reason of common interest and common purpose to desire the solution of the monetary problems of recovery in the manner in which the Banking Bill of 1935 seeks to solve them.

But it is not my intention this afternoon to go into a detailed discussion of each provision of the bill. There will be ample opportunity for that on other occasions. I propose this afternoon, rather, to discuss the general philosophy underlying the bill as a whole. I have chosen this method of approach because I believe that it will enable you to appreciate more fully the significance that we attach to its various provisions, and the result that we hope to accomplish through their practical operation.

Broadly speaking, there are four main objects which we seek to accomplish. In the first place, we wish to make the banking system a more efficient instrument for the promotion of stable business conditions in the future; secondly, various proposals in the bill are designed to bring our banking system into closer conformity with modern conditions and, more immediately, to aid in business recovery; thirdly, we seek to make certain rather fundamental changes in the law relating to deposit insurance in order to make the system sounder and more equitable; and, finally, we seek to correct various inequalities, ambiguities, and abuses that have developed in the banking system in the course of time. In the limited time at my disposal I shall have to confine myself to a discussion of the broad principles behind the proposals which are designed to secure the first two objectives mentioned, stability and recovery.

How may our banking system be so regulated and adapted that it may become a more efficient instrument for the promotion of

business stability and the mitigation of industrial fluctuations? A complete answer to this question demands much fuller treatment than I can possibly give it here. Book after book has been written on this subject. Because of the need for brevity, I fear the statement of my views may appear to be dogmatic. I shall, however, have to run this risk, as I feel that in no other way can I indicate to you the significance I attach to the various proposals.

The fundamental premise underlying the bill and underlying my discussion this afternoon is that business stability is a desirable objective. I feel sure that no one will disagree with this premise and to my way of thinking agreement on this one vital point alone will lead you to lend your whole-hearted support to the Banking Bill of 1935.

The second fundamental premise upon which I proceed is that business stability cannot be achieved without real thought, real effort, and real courage. To establish this point it is not necessary to accept and defend any one single explanation of the business cycle. It is merely necessary to call to mind that in the heyday of *laissez faire*, before any attempts at conscious control were undertaken, business fluctuations on a disastrous scale occurred with distressing regularity. If we had a perfectly flexible cost and price structure—which would have to include, I may remind you, an equally flexible wage and interest structure—our economy could probably adjust itself to rapid expansions and contractions with little resultant unemployment. Without such flexibility, however, expansion and contraction, instead of calling into play forces that adjust and correct such movements, tend to feed upon themselves and for a considerable period to generate further expansions and contractions.

It is not realistic, however, to say that all that is necessary is to introduce more flexibility into our system. Numerous rigidities and inflexibilities have developed in our economy, and the trend in the recent past plainly points to more rather than less rigidity in the future. If there is one thing that to me seems clear, it is that, unless conscious effort is made to prevent them, booms and collapses will continue to recur in capitalistic democracies. It also seems evident to me that neither capitalism nor democracy can survive another depression of the magnitude of the one from which we are just emerging.

Proceeding then on the assumption that business stability is a desirable, nay, a necessary objective which cannot be achieved without conscious effort, I wish to develop the thesis that the banking system can and should be one of our chief instruments for the promotion of stability.

The first elementary principle which it is essential to grasp and which it is not necessary for me to expand upon, is that the bulk of our money supply today is composed of deposits subject to check. Out of a total volume of \$24,000,000,000 of money, or units of purchasing power, nearly \$19,000,000,000 is composed of checking accounts in commercial banks.

The second general principle in the theory of monetary control is that variations in the community's supply of money have an effect on

the state of business activity. There is no general agreement as to the extent or nature of the effect such variations have on business conditions. If I presume, as a layman, to enter this controversial field, it is because I feel that the question, "What effect have variations in the supply of money on business conditions?" cannot be answered in general terms or in a dogmatic manner. The effect depends on a large number of circumstances. Thus, at certain times an increase or decrease of five percent in the money supply may modify substantially the course of business. At other times the effect of a variation of twenty percent may be barely discernible. One point on which I think there is general agreement, and the only point which it is necessary for me to make here, is that increases in the money supply **tend** to stimulate business activity while decreases in the money supply **tend** to restrict activity.

The third principle in my general thesis of monetary control is that the operation of the banking system left to itself with no conscious effort of control tends to intensify rather than to counteract business fluctuations. The sequence of events may be briefly outlined. When business activity is increasing there is an increased demand for bank loans and a growing disposition among banks to loan liberally. When banks lend more, thus increasing their assets, they also increase their deposits. Consequently at the very time when the community is increasing its expenditures there is a tendency for the supply of money to increase. Similarly, when expenditures are decreasing the demand for bank loans falls off, bankers become more cautious, maturing loans are repaid, and deposits are extinguished. Our banking system, therefore, not only fails to act as a compensatory agent, but actually intensifies fluctuations. For example, in the period from 1929 to 1933, when expenditures were falling rapidly and the national income was being cut in half, the supply of deposit money decreased by approximately one-third. Part of the decrease can be attributed to bank failures, accentuated by withdrawals of cash for hoarding, and part to the contraction of loans and investments by surviving banks. No one person or body is responsible for this decline. The responsibility must be shared by the entire system.

The fact is that **laissez faire** in banking and the attainment of business stability are incompatible. If variations in the supply of money are to be compensatory and corrective rather than inflammatory and intensifying, there must be conscious and deliberate control.

The difficult and controversial question is who should do the controlling. I would gladly follow the course of the worthy divine who looked a difficulty boldly in the face and passed it by, but that is not the kind of boldness that will lead us out of the wilderness. I shall state, therefore, as my fourth principle, that the controlling or regulatory body must be one which represents the interests not of any particular class, or group of people, but of the nation as a whole.

There is no political or economic power more charged with the general or social interest than the power to increase or decrease the supply of money. If the sovereign authority delegates this power to a particular group or class in the community, as it has done in

a large part in this country, it divests itself of a part of its effective sovereignty. The purposes of the nation, as expressed in its national administration, can be completely nullified by those who control the money supply.

The story of a democratic state presupposes that the will of the majority shall prevail. If minorities feel that the acts of the majority make life unbearable, they may try to change the views of enough voters to change the complexion of the majority, or they may revolt and try to establish a rule of the minority. If they succeed in the latter course, the state ceases to be democratic. Majorities may and sometimes do abuse their power. It is necessary to remind ourselves, however, that so long as we remain a democracy the will of the majority is expected to prevail in monetary policy as well as in other matters of national concern.

It is my personal conviction that our system of broad political representation, faulty as it may be, constitutes a better guarantee that the general interest will be served than would control by a group of individuals chosen, let us say, entirely by bankers or business leaders.

The power to coin money and to regulate the value thereof has always been an attribute of a sovereign power. It was one of the first powers given to the Federal Government by the Constitutional Convention. The development of deposit banking, however, introduced into the economy numerous private agencies which have the power to create and destroy money without being aware of it themselves and without being recognized as creators or destroyers of money by the Government or the people. The trend since 1913 represents a gradual recognition of this condition and a reassertion by the State of a power which it always possessed.

The President stated the underlying principles controlling the relation of the Government and the banks last October in his speech before the American Bankers Association. He then remarked that "the old fallacious notion of the bankers on the one side and the Government on the other as more or less equal and independent units has passed away. Government by the necessity of things must be the leader, must be the judge of the conflicting interests of all groups in the community, including bankers. The Government is the outward expression of the common life of all citizens." That, I think, expresses the matter very effectively.

I am here merely stating the broad principles involved. I should not like to be understood as arguing for a highly centralized control of all banking activities. Local versus national control is not a subject on which one should take sides irrespective of the question at hand. The administration of certain interests can obviously be handled more efficiently locally. Similarly, there are other things which can be handled more efficiently on a national scale. We should consider each case on its merits and provide for local control or national control, whichever is in the public interest. Let us now apply this principle to banking.

Banks in this country perform two main services. They act as middlemen for the investment of a substantial portion of the community's savings, and, through the provision of checking facilities, they supply the bulk of the community's means of payment. So far as the investment of savings is concerned, a large degree of local autonomy should be left with the individual bankers. The state should lay down minimum standards to be observed in the interests of protecting savings of individuals, but these standards can only be minima, and chief reliance for the safe investment of the community's savings must rest on the judgment and knowledge of the individual banker.

When we come to the second function of banks—namely, that of providing the community's money supply—a different range of factors must be taken into consideration. The effect of variations in the supply of money is nationwide and cannot be localized. The Reserve Administration may make conditions favorable for the creation of new deposits, but it cannot insure that the new money will be used in any particular section of the country, or spent on any particular kind of goods. Since, therefore, the effect of monetary policy is nationwide, the formulation of monetary policy should be by a body which represents the nation, and which is activated by national considerations. It is inconceivable that variations in the community's money supply should be left to the individual decisions of some fifteen thousand local bankers. It is scarcely more logical that the variations should reflect uncoordinated decisions of the twelve Federal Reserve banks.

It may be helpful if I here summarize the various steps in my argument to this point.

My fundamental premise is that business stability is a desirable objective which it is worth making every effort to achieve. Variation in the supply of money, which in this country is furnished largely by our commercial banks in the form of checking accounts, influence business activity to an unknown degree but in a known direction. The banking system left to itself behaves in an intensifying rather than a compensatory fashion. If it is to be made to behave in a compensatory fashion there must be conscious and deliberate control, and this control must be exercised by a body which represents the nation.

Let us now examine the Federal Reserve System in the light of the preceding discussion. I propose first to discuss the development of open-market policy.

In 1913 the framers of the Federal Reserve Act has certain definite purposes in mind which did not include, as the bill was enacted, any reference to national monetary policy. They wished to prevent the periodic suspension of payments which occurred under the old national banking system, and to provide an agency where banks could rediscount commercial loans in order to supply temporary, seasonal and emergency needs of their customers for credit and currency. Broadly speaking, I think it is true to say that the Reserve banks were looked upon as emergency lending institutions. From this viewpoint

it was proper that the regional Reserve banks should have almost complete autonomy, and that the Federal Reserve Board should have only a limited amount of supervisory and coordinating power.

In the post-war period our concept of the functions of the Reserve Administration gradually changed. It became evident that through the control of the reserves of member banks the Reserve Administration could influence the volume of deposits and hence the volume of loanable funds of commercial banks. The trend away from autonomous regional action to a more coordinated and centralized control was evidenced by a significant development in 1922 and 1923. In 1922 certain of the Reserve banks began to buy securities, mainly for the purpose of increasing their earning assets. The purchase of these securities, however, took place in New York and gave deposits and reserves to New York commercial banks. These banks utilized these increased reserves to reduce their borrowings from the New York Federal Reserve Bank. It appeared, therefore, that the attempt of other Reserve banks to increase their earning assets resulted in a decrease in the earning assets of the New York Reserve bank. It also became evident that increased or decreased purchases of securities by the Reserve banks affected member banks' reserves, and in this way member banks' deposits, and loans and investments. A small committee of Governors was thereupon set up to coordinate purchases and sales. In 1923 this Committee became the Open Market Committee, composed of the Governors of the Federal Reserve banks of New York, Boston, Philadelphia, Chicago, and Cleveland. Its stated duty was to formulate open-market policy, subject to the approval of the Federal Reserve Board, with primary regard to the accommodation of commerce and business, and to the effect of such purchases or sales on the general credit situation. This marked a step toward the theory of conscious and continuous control. From this date onward the volume of money in the United States was influenced greatly by actions of the Open Market Committee and the Federal Reserve Board.

It appears, therefore, that the System itself, **by virtue of necessity**, has developed a large measure of coordinated activity in regard to open-market operations, the single most important instrument of reserve control. This coordination, while it represented a great advance over the situation which prevailed up to 1923, nevertheless leaves much to be desired. The body which is charged with the formulation of open-market policy is the Federal Open Market Committee, which is composed of the Governors of the twelve Federal Reserve banks. These Governors are independent of the Federal Reserve Board. After the Open Market Committee has formulated its policy, its recommendations may be adopted or rejected by the Federal Reserve Board. Even after the policy has been formulated by the Committee and approved by the Board, any Federal Reserve bank through its Board of Directors is free to decline to participate in the policy. Since you are all administrators, I do not think that I need spend much time in pointing out to you how bad this setup is from an administrative point of view. The body which is ulti-



mately responsible for policy, the Federal Reserve Board, legally can take no part in the formulation of the policy. The body which formulates policy, on the other hand, legally has no power to bring the policy into operation. The Boards of Directors of the individual Reserve banks, who take no part in the formulation of policy, have the power to obstruct its operation. It is a well-known fact that the more people there are who share a responsibility for policy the less keenly does any one of those people feel his own personal responsibility.

The theory, therefore, back of the open-market provision in the recent banking bill becomes clear. The bill provides for a small, responsive body which is charged with the duty of acting in the national interest in formulating open-market policy and in accepting responsibility for its consummation and results.

You will observe next that we propose to leave the essentially regional organization of the Federal Reserve System virtually unchanged. I feel that in a country the size of ours the regional system of Federal Reserve banks must always play an important and necessary role in our banking system. They afford, for one thing, an essential link between the thousands of individual member banks on the one hand, and the Federal Reserve Board on the other. Besides keeping in close touch with member banks the Reserve banks examine member banks, admit banks to membership, provide check clearing facilities, make loans to individual member banks, carry the reserves of member banks, and supply the currency needs of their localities.

There is but one change in the internal organization of the Reserve banks which in the interests of economy, efficiency, and coordination, I think it is necessary at this time to effect. Officially the Federal Reserve Board has no relations with the Governors of the Reserve banks. In their dealings with the Reserve banks the Board is supposed to work through the Chairmen who are not the chief executive officers of the banks. It is proposed to end the dual administration of the Reserve banks under the Chairmen of the Board, who is appointed by the Federal Reserve Board, and the Governor, who is appointed by the local Board of Directors, to give the Governors a legal status and to combine their position with that of Chairmen of their Boards of Directors. Inasmuch as the Federal Reserve Board is surrendering the appointment of the Chairmen, it is obviously desirable in the interests of coordination and harmony that the appointment of Governors by the local boards be subject to the approval of the Federal Reserve Board.

In laying down a guiding principle for the President in his selection of future members of the Board, it seemed desirable to substitute for the somewhat meaningless phrases in the law the unequivocal requirement that the members should be persons qualified by education and experience to take part in the formulation of national economic and monetary policies. This is a recognition in the law of the principal function of the Federal Reserve Board.

In view of the enormous difficulty of the task of the Federal Reserve Board, the bill attempts to make a position on that Board as attractive as possible for the purpose of securing and retaining the services of the best talent in the country. The attractiveness of a position on the Board will be increased by the added powers granted to it and by providing that its members shall be relieved as far as possible from financial worries. A position on the Board is one of the most important posts in the nation and recognition of this fact is accorded in the bill.

I turn now to proposed changes in the operation of the Federal Reserve banks.

Two of the proposed changes now in the bill have been widely commented upon and have been widely misunderstood. I refer to the provision that the type of paper eligible for the rediscounting at Federal Reserve banks shall not be defined in the law but shall be subject to the regulation of the Federal Reserve Board; and to the provision that segregation of collateral for Federal Reserve notes shall be repealed.

In order to understand our reasons for wishing to modify the present requirements in the law relating to eligibility, it is necessary to recount briefly certain developments that have occurred in the history of the Federal Reserve System. Apparently it was the theory of the framers of the Federal Reserve Act that borrowings on commercial paper from the Reserve banks and the issue of Federal Reserve notes would be closely connected. It was provided, therefore, that Federal Reserve notes issued by Federal Reserve Agents should be secured by 100 percent collateral in gold or eligible paper and that Federal Reserve notes in actual circulation shall have a 40 per cent reserve in gold. It was apparently believed that the demand for notes arose from commercial borrowers, that the collateral requirements would restrict the issue of notes to such borrowers, and that this would afford elasticity and prevent the danger of over-issue.

This line of reasoning did not take cognizance of a profound change in our monetary habits. In a deposit-using country such as the United States, currency is seldom borrowed from a bank. Borrowers normally receive deposit credits and pay their bills with checks. The demand for currency arises chiefly from individuals and businesses who for the sake of convenience desire to convert a portion of their checking accounts into currency. The volume of money in circulation fluctuates with changes in the volume of those activities which employ the largest amount of cash, namely retail trade and factory payrolls. A consequence of this development is that the Reserve banks play a passive role in supplying Federal Reserve notes for circulation. If they issued Federal Reserve notes in payment for securities purchased, the sellers of the securities would immediately deposit the notes in the member banks and the member banks would send them in to the Reserve banks. If they sold securities for Federal Reserve notes, the buyers of the securities would get the notes from their member banks and these banks in

turn would get them from the Reserve banks. Thus it will be seen that the framers of the Federal Reserve Act were mistaken in two of their expectations regarding note issue. Notes are not associated in any direct or immediate way with the needs of business for commercial loans. Neither is there any need to place restrictions on the issue of Federal Reserve notes since, as we have just seen, the volume outstanding is not susceptible to control in a predominantly deposit-using country.

Although the requirements that Federal Reserve notes be secured by eligible paper or gold does not serve as a restriction on the issue of Federal Reserve notes, it may in the future, as it has in the past, severely restrict the ability of the Reserve Administration to increase the volume of deposits through open-market operations. Thus, in 1931 there occurred simultaneously a demand for gold for export and for notes to hoard. Owing to the shortage of eligible paper held by the Reserve banks, more than a billion dollars in gold in excess of the 40 percent gold requirement had to be earmarked for the account of Federal Reserve notes. Had the Reserve banks bought securities in order to build up member banks reserves, the rediscounts would have decreased and more gold would have had to be pledged against Federal Reserve notes. The Reserve Administration felt at that time that its hands were tied and that it could take no action to stem the course of deflation so long as the note issue provisions remained in the law. The Glass-Steagall Act of 1932, by making Government securities bought in the open market eligible as collateral for Federal Reserve notes, permitted the Reserve Administration to buy securities, get member banks out of debt, and thus stem the process of deflation. This Act expires this year unless extended by the President for a maximum of two more years.

It is realistic and desirable at this time to do away with the collateral requirements altogether. They add nothing to the safety of the Federal Reserve notes since these notes are an obligation of the United States Government and have a prior lien on the assets of the Federal Reserve banks. This does not mean that notes will be issued without adequate backing. Any increase in the note issue must be counter-balanced by a corresponding increase in Federal Reserve bank assets. It makes no change in the requirement for a 40 per cent reserve in gold certificates or lawful money. It is merely a proposal to get rid of an antiquated feature in the Federal Reserve Act which has never served a useful purpose and has in the past at times prevented the timely launching of an essential monetary policy.

The restriction of the rediscounting privilege to a particular and narrowly restricted type of bank loan is in accordance with a theory of reserve banking which I think we have now outgrown. The major task of the Reserve Administration is not to encourage the extension of a particular type of loan. The restriction of the borrowing privilege to commercial loans has no connection with regulation of the volume of bank credit or of the access to the

Reserve banks. The aggregate amount of paper eligible for rediscounting has been at all times greatly in excess of the volume of rediscounts. Moreover, banks have been permitted to rediscount their own notes secured by Governmental obligation. To control the amount of borrowing from Reserve banks the Reserve Administration relies upon the rediscount rate and the general policy, amounting to unwritten law, that borrowing should not be continuous and should be for emergency and seasonal purposes only.

Hence, the elimination of technical restrictions on eligibility does not involve any danger of excessive use of Reserve bank facilities. But it does enable the Reserve banks to come to the assistance of banks who may have sound assets but may be devoid of eligible paper. For the emergency such a provision was made by the Glass-Steagall Act, but not until great harm had resulted from the inability of the member banks to receive help from the Reserve banks in the emergency.

The bill provides for admission of nonmember banks into the Federal Reserve System prior to 1937 without regard to the size of their capital. This will enable small banks, which would otherwise be confronted with the dilemma of either foregoing the protection of deposit insurance or promptly raising additional capital, to join the Federal Reserve System with their present capital, and thus to become eligible for admission to the insurance system. The resultant unification of banking under the Federal Reserve System and the provision in the bill giving the Federal Reserve Board power to change member bank reserve requirements will contribute to the Board's ability to exercise effective monetary control.

Let us now consider the proposals in the bill that are designed more specifically to aid in business recovery. I shall confine my discussion chiefly to the one proposal which I regard as the most important in this respect and at the same time the one most susceptible to misunderstanding. I refer to the provision permitting banks to make loans on improved real estate up to 75 percent of its appraised value and on an amortization basis for a twenty-year period, and in an aggregate amount up to 60 percent of their time deposits.

It has been asserted that this is an invitation to banks to make loans of a character that does not conform to sound banking principles or standards. The collapse of real estate values is cited as an illustration of the dangers associated with such loans. It is constantly stated that the troubles of our banking system were due entirely to the acquisition of long-term assets by the banks. It is suggested that banks in the future should confine themselves to short-dated commercial loans and investments. But I need not tell you that, if this suggestion were acted upon, the result would be fatal to the banks. In October 1934, the eligible paper of member banks, within the meaning of the Federal Reserve Act, amounted to only slightly more than two billion dollars. No doubt, based upon your past experiences, you would find that a much smaller amount would be acceptable if it were offered to the Reserve banks.

Even in 1929 this paper amounted to only 4½ billion dollars. Banks cannot live on the interest of such a small volume of loans and in attempt to confine themselves to these loans would greatly curtail the scope of banking. The more business the banks refuse the more will be handled by other agencies, including the Government, and the less room will remain for the operations of the private banking system.

I am fully aware of the fear with which bankers view the extension of other lending agencies and the uneasiness they feel at having to rely more and more on holdings of Government obligations, or those guaranteed by Government, to keep up their income. I might point out, however, that these developments are a consequence of the failure of the banking system to perform its functions adequately. If the banking system would utilize in real estate loans and other long-term investments the savings and excess funds that it now possesses, business activity would be greatly stimulated, and the Government would then be able to withdraw rapidly from the lending field.

The bankers also feel a deep concern about the constant growth of the Government's deficit and of the public debt, and yet a considerable part of this debt is incurred in refinancing mortgages and in undertaking other functions which the banks have failed to perform. The release of banking funds in these fields would enable the Government to diminish its expenditures and to reduce the rate of growth of the public debt.

I am, you will carefully note, criticizing the banking system and not the bankers as individuals. I do not see how you as individual bankers, having to secure liquidity alone and unaided, could safely have followed a different lending policy than you did.

This, then, is the dilemma that faces the banks. If they go into the longer term lending business, they run the risk of depreciation and of inability to realize quickly upon their assets in case of need. If they do not go into this business, they cannot find an outlet for their funds. Their earnings will suffer and the justification for their existence diminishes. How can this dilemma be solved? It is proposed in the bill to solve it by removing the problem of liquidity as such from the concern of the banks, by bestowing liquidity on all sound assets through making them eligible as a basis of borrowing at the Reserve banks in case of need. This will enable the banks to concentrate their effort on keeping their assets sound and to pay less attention to their form and maturity.

Reliance on the form of paper as a guide to soundness and eligibility has not protected the banking system from disaster. We wish to divert bankers' attention from the semblance of paper to its substance; to emphasize soundness, rather than liquidity. To require that a real estate loan shall be repaid in five years, as the present law requires, does not even improve liquidity but rather, through the excessive strain it places on the borrower, acts to promote foreclosures and insolvency.

What we are proposing is that the problem of liquidity shall cease

to be an individual concern and shall become the collective concern of the banking system. A single bank which adopts a policy calculated to pay off all of its deposits at a moment's notice, even though the national income is cut in two, cannot adequately perform its duty of serving its community. Since good local loans go bad when a depression sets in, the bank's portfolio would have to consist of super-liquid open-market paper. What we want to accomplish is to make it possible for banks, without abandoning prudence or care, to meet local needs both for short and for long time funds. We want to make all sound assets liquid by making them rediscountable at the Reserve banks, and then to use the powers of monetary control in an attempt to prevent the recurrence of national conditions which result in radical declines of national income, in the freezing of all bank assets whether they are technically in liquid form or not, and in general unemployment and destitution. If we can bring this about, then the banks, as well as all other enterprises, will be safer than they can ever be under a policy of each for himself and the devil take the hindmost.

In conclusion, let me make myself clear that I do not expect the passage of the Banking Bill of 1935 to solve the problem of the business cycle. What I do expect is that its passage will make conditions more favorable for its eventual solution. My own view is that, while through the compensatory action of the banking system much can be done to moderate fluctuations, it will be necessary for the Government also to help in offsetting and counteracting rapid expansion and contraction of expenditures on the part of the community at large. It can do this by varying its expenditures and by the use of the taxing power in securing a better distribution of income so as to insure employment, thus maintaining the necessary distribution of wealth production as currently produced.

One thing is certain. We will not obtain stability unless we work for it. A policy of *laissez faire* presupposes an economy possessing a flexibility which I think it is hopeless for us to expect to achieve. Therefore it is absolutely essential to develop agencies which by conscious and deliberate compensatory action will obviate the necessity of drastic downward or upward adjustments of costs and prices, wages and capital structures. If we do not develop such agencies our present economy, and perhaps our present form of government, cannot long survive.

For this reason it behooves all of us, who are charged with the responsibility of managing our money and credit mechanism, to devote our best thought and greatest effort to promote an intelligent understanding of the monetary and economic problems confronting the nation. By supporting the proposed legislation which I have outlined to you and, what is even more important, by cooperating with the policies for the promotion of which the changes in our banking structure are proposed, the bankers of the country will be working not only in their own best interests but also in the interests of recovery and the establishment, within our economic and political framework, for a more stable and equitable national economy.

I thank you.