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AMERICAN BANKERS' ASSOCIATION CONVENTION
IN NEW ORLEANS, NOVEMBER 14, 1935

BY

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CHAIRMAN OF THE BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

(Stenographic transcript)

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Mr. Chairman, Ladies and Gentlemen: After the remarks of the Chairman, I assure you that it is rather embarrassing for me to appear before you. I feel he has given you reason to expect altogether too much.

I did not prepare a written address for this occasion, feeling that I should like to come before you in more or less of an informal way, as a banker talking to bankers, as a business man talking to business men. I should like to talk to you as I would talk to my closest friends and associates.

Most of my life has been spent in the field of banking and business and until I unexpectedly went to Washington, less than two years ago, I had never occupied a public position. I, therefore, can talk to you and approach the questions which I am sure we are all deeply interested in, only as a practical business man and banker.

I am reminded in meeting with you today of the contrast between the conditions under which we are now meeting and the conditions under which this same meeting was held three years ago.

Three years ago, after pursuing what were considered sound fiscal policies, after attempting through every effort to balance the budget, after maintaining the gold standard, after avoiding any increase in taxes, we found ourselves confronted with disaster. We found that the national income had diminished in less than three years from $81,000,000,000 to less than $40,000,000,000 and we found that tax collections also fell.

We found that we were confronted with an army of unemployed of more than twelve millions of people. We found the banking system in a state of collapse. We found deposits had declined by more than one-third as a result of credit contraction, bank failures and hoarding. We found that though every effort was made to balance the budget, some Government bonds had sold as low as 83 and other high-grade securities held by banks were selling at such a price that had they been sold on the existing market, there would have been few banks in the United States in which the capital was not either completely wiped out or seriously impaired; that under the auspices, gentlemen, of what is considered orthodox economics, under the conditions that were expected to produce confidence and induce private industry to undertake to put people to work and to result in increased borrowing from the banks and thus in restoration of the necessary volume of deposits, we found that the economic life of the country was in a complete collapse.

Today, in a recent compilation I had made with reference to the value of stocks, I find that as compared with the low prices of 1932, there is an appreciation of more than $20,000,000,000 in the quoted value of stocks listed on the exchange. That has not been brought about by an increase in credit extended by banks because neither brokers' loans nor bank loans on collateral have increased. It has been caused by the fact that those who had money were investing in securities because they were aware of the increase in the earnings and the prospective earnings of the corporations whose securities are listed.

Contrast that picture with the condition of the corporations in 1932, when the income tax reports made by all corporations to the Treasury of the United States showed a net loss before dividends and before income taxes of more than $3,750,000,000. The quoted value of bonds listed on the Exchange, of which there were some in your portfolios that meant bankruptcy and insolvency to you, has increased by more than $7,000,000,000 since early 1933. The bankruptcies, which had reached the astounding proportions at that time of more than 25,000 for the first nine months of 1932, with total liabilities aggregating more than $750,000,000, today are less than 9,000 for the first nine months of this year, with liabilities around $170,000,000.

Bank failures for the first nine months in 1932 exceeded 1,000 and the deposit liabilities for banks failing were nearly $600,000,000. For the first nine months of this year, bank failures numbered 80, with deposit liabilities of approximately $36,000,000. These figures include the banks which were not licensed after the bank holiday and which were forced to liquidate later because it was not possible to reorganize and open them; they comprise most of the amount.

Bank deposits, which due to credit contraction made on the part of the bankers had decreased greatly (and I do not blame any banker; I was as busy in the field of private banking as any one could be in an effort to remain liquid, to be able to meet the demands of the depositors due to lack of confidence in the banking structure) have increased from a low point of $12,000,000,000 to $17,500,000,000, or above the level of 1929. When I say bank deposits I mean the adjusted demand deposits of member banks, which exclude inter-bank deposits and Government deposits.

The national income which had fallen to a little less than $40,000,000,000 for the year 1932 rose to nearly $50,000,000,000 for 1934. The figures are not available for the current year but I believe that at the present rate of business activity the national income in the next twelve months will come close to $60,000,000,000, or about halfway back to the national income of 1929.

The Government receipts, which had fallen from better than $4,000,000,000 in 1929 to around $2,000,000,000 in 1932 -- as estimated in the last announced estimates of Federal revenue, will reach for the fiscal year ending June 30, 1936, a figure of $4,470,000,000, or an increase of approximately $2,400,000,000.

The foreign trade figures are approximately 40 percent in excess of the foreign trade figures in 1932.

Industrial production reflected in the Federal Reserve's seasonally adjusted index is now at 89 percent of the 1923-1925 average, raising it from a low point of 58 in 1932, a gain of more than 50 percent.

The wholesale price index of commodities, using 1926 as a basis of 100, had fallen to a low of 60 in February of 1933. It had risen to 81 in September of this year.

In the field of farm products wholesale prices had dropped as low as 41 percent in February 1933. They were up to 80 percent last September.

The farm income, which dropped from $10,500,000,000 in 1929 to something over $4,000,000,000 in 1932, is estimated for this year to be back to nearly $7,000,000,000, a gain in that field of $2,500,000,000.

I could go on and cite many other factors, such as increased building activity, revival in the capital market, increase in employment and payrolls, but enough has been given to mark the impressive improvement between the condition of three years ago and the present time in every field, financial, commercial, industrial, agricultural, and fiscal.

What is the reason for this change? It is not a result of accident; it is not a result of letting nature take its course. For three years nature was permitted to take its course in an effort to revive confidence. Little legislation that was disturbing to business was passed. No Banking Act of 1935 was pending to make bankers hesitate to make loans.

But a condition was reached, even as early as the spring of 1932, when Government intervention became unavoidable; not because the Government wanted to intervene, but because the entire financial and credit structure was in a state of disastrous contraction. The Reconstruction Finance Corporation was organized to support the crumbling structure.

The Government had financed the grain and cotton stabilization corporations in order to help agriculture.

The Home Loan bank system was organized in order to help the urban mortgage situation. But the scale of intervention was entirely inadequate and the forces of deflation had been so much underestimated that a complete collapse resulted in the following spring.

No one objected to an unbalanced budget in order to bolster up the banking, the insurance, the railroads, and the credit structure generally.

Is it consistent or possible to think that Government could intervene in the field of private credit through the banking, insurance, and other private structures and at the same time refuse to intervene in order to stop the foreclosure of farm mortgages, which reached an appalling figure, to stop the foreclosure of home mortgages, which reached a figure as high as 35,000 in one month?

Is it possible to justify the use of Federal credit resulting in an unbalanced budget in the fields referred to, and at the same time permit 12,000,000 men who wanted work to go unemployed?

Business claims the liberty of employing and discharging men when their services cannot be used profitably, and that is its right.

But what about the liberty of the men under the conditions that we were confronted with in 1932 and 1933? If a Government is justified in incurring an indebtedness of $25,000,000,000 to protect its citizens against the encroachment of a foreign enemy in times of war, is not a Government justified in using its credit for the purpose of taking care of those people who found themselves in a position of destitution because of the failure of private industry to give them employment? (Applause)

The Reconstruction Finance Corporation put a foundation under the banking structure. The Emergency Banking Act passed at the time of the bank holiday permitted the Reserve System to loan not only to national and member banks but to state non-member banks against any sound asset. When that was announced by the President of the United States over the radio, the people of the country who had withdrawn their deposits in the form of currency and who had attempted to transfer it out of the country stopped that practice, which was totally destructive to the entire credit and banking fabric.

When the people were told that the Reserve System could issue Federal Reserve bank notes against mortgages, against collateral loans and against other good assets held by the banks, without regard to gold backing, without regard to eligible paper backing, without regard to Government bond backing, they brought back into the banks during the next year $2,000,000,000 of currency which they had taken out.

The Reconstruction Finance Corporation has rehabilitated the capital structure of banks to the extent of approximately $1,000,000,000 and it has loaned over $800,000,000 to the receivers of closed banks so as to prevent the forced liquidation of assets and to give to depositors immediately available funds, so as to relieve them and to enable them to put that money into circulation.

The Home Owners' Loan Corporation was established for the purpose of relieving home owners in distress and up to the present time has loaned approximately $3,000,000,000. The work of that institution is nearly completed. The distressed mortgage is a thing of the past. Real estate values have been stabilized and are advancing. Rents have been on an increase for two years and doubling up is lessening. New home construction is increasing and the Home Owners' Loan Corporation will be through with the work it has done, with more than a billion dollars of unused authorization to its credit.

It not only served as a debtor relief but also served equally as a creditor relief. The mortgages held by the savings banks, the insurance companies and the commercial banks, which they were unable and unwilling to carry, were taken over and funded over a longer period at reduced rates by the Home Owners' Loan Corporation.

The Federal Farm Mortgage Corporation was organized and $2,000,000,000 of bonds were provided fully guaranteed by the Government, these funds to be loaned to Federal land banks in exchange for the bonds of these banks, backed in turn by mortgages and to be issued as proceeds of mortgage loans by the Land Bank Commissioner.

The Federal land banks are institutions going back about twenty years. In 1932 they were unable to sell their bonds on the market. These same bonds are now selling at a premium and a substantial amount of them have been refunded into issues bearing lower interest rates. When it was impossible to sell them, the Government agency set up for the purpose took those bonds and issued bonds guaranteed by the Government.

That has stopped the collapse of the farm mortgage market, until today I hear that there are more farms being sold than are being foreclosed upon. (Applause)

These three great creditor agencies have largely done their work. No one is more anxious than the Federal Government to have the private credit agencies take over the load.

The Federal Housing Administration Act was passed for the purpose of attempting to induce the private credit agencies of this country to make loans for construction purposes on insured mortgages and for modernization. Not one dollar of Government funds goes into those loans. The Federal Government was attempting to create a mechanism by which to attract private funds into the field of credit, and get the Government out.

The Reconstruction Finance Corporation is collecting far more than it is lending. It has loaned about $5,000,000,000 and has collected more than one-half of the total amount of the loans.

In the field of relief, which we so often refer to as "waste", we have the thousands of miles of public roads, we have the excellent work done in our CCC camps, we have repaired and rebuilt schools, water systems and sewer systems. Truly not all self-liquidating projects. It is possible for the Government to spend money for social purposes, and it should not always judge or gauge its expenditure by whether or not it is a self-liquidating project. (Applause)

The problem of private profit and self-liquidation belongs to the field of private business and not to the Federal Government. (Applause)

Now let us see if the results as enumerated are worth the cost of intervention, which resulted in an unbalanced budget. I would like to remind you that we had an unbalanced budget as early as the fiscal year ending in 1931 and that the deficit for the fiscal year ending June 30, 1933, exceeded $3,000,000,000, that the Government's interest-bearing debt increased from $20,584,000,000 in February 1933, to $28,432,000,000 in September of 1935, an increase of $7,848,000,000.

Deduct the assets, including cash on hand, the gold profit in the Stabilization Fund, the Government's proprietary interest in organizations such as the RFC, and you have a net increase in the Government debt of about $3,000,000,000. But let us take the larger figure for the purpose of comparison. Let us take the amount of the gross deficit.

Should we be alarmed over that situation? Should some of the increases which I have referred to -- such as the $20,000,000,000 increase in the quoted value of listed stocks without taking into account an increase of from $15,000,000,000 to $20,000,000,000 in the national income in one year -- give us any cause for concern about even the amount of the gross deficit? Does it mean that we are putting a great burden upon posterity?

If you will recall, during the ten years from 1920 to 1930, while the Government debt which had been $26,000,000,000 incurred almost entirely in a period of two short years, was decreased by about $10,000,000,000, this country at the same time added $100,000,000,000 or more to its new wealth in the form of increased productive facilities and we purchased $10,000,000,000 of foreign security issues and reduced the Federal income taxes during that period four different times. If we could do it then, why think that we cannot do it again?

I should like to commend to your attention Lord Macaulay's "History of England," in which he recounts how the British debt from the period of the contest with Louis XIV rose from £50,000,000 to more than £800,000,000 and how "at every stage in the growth of that debt it has been seriously asserted by wise men that bankruptcy and ruin were at hand. Yet still the debt went on growing; and still bankruptcy and ruin were as remote as ever."

I cannot read all of the statement but I am going to quote a few high lights from it.

After telling of the repeated outcries against the debt, he told how it kept mounting, yet how England prospered despite the prophets of disaster, and he continues:

"The beggared, the bankrupt society not only proved able to meet all its obligations, but while meeting those obligations, grew richer and richer so fast that the growth could almost be discerned by the eye. . ."

"While shallow politicians were repeating that the energies of the people were borne down by the weight of the public burdens, the first journey was performed by steam on a railway. Soon the island was intersected by railways. A sum exceeding the whole amount of the national debt at the end of the American wars was, in a few years, voluntarily expended by this ruined people in viaducts, tunnels, embankments, bridges, stations, engines. Meanwhile taxation was almost constantly becoming lighter and lighter; yet still the Exchequer was full. It may now be affirmed without fear of contradiction that we find it as easy to pay the interest of eight hundred millions as our ancestors found it, a century ago, to pay the interest of eighty millions.

"It can hardly be doubted that there must have been some great fallacy in the notions of those who uttered and of those who believed that long succession of confident predictions, so signally falsified by a long succession of indisputable facts. To point out the fallacy is the office rather of the political economist than of the historian. Here it is sufficient to say that the prophets of evil were under a double delusion. They erroneously imagined that there was an exact analogy between the case of an individual who is in debt to another individual and the case of a society which is in debt to a part of itself (which pays interest to itself); and this analogy led them into endless mistakes about the effect of the system of (Government borrowing and) funding.

"They were under an error not less serious touching on the resources of the country. They made no allowance for the effect produced by the incessant progress of every experimental science, and by the incessant efforts of every man to get on in life. They saw that the debt grew; and they forgot that other things grew as well as the debt (that taxes are high or low in relation to national income)."

At the bottom of the depression we would have been worse off with no taxes at all than we are today with the taxes that we have. (Applause)

"A long experience justifies us in believing that England may, in the 20th century, be better able to bear a debt of sixteen hundred millions than she is at the present time to bear her present load. Be this as it may, those who so confidently predicted that she must sink, first under a debt of fifty millions, then under a debt of eighty millions, then under a debt of one hundred and forty millions, then under a debt of two hundred and forty millions and lastly under a debt of eight hundred millions were beyond all doubt under a twofold mistake. They greatly overrated the pressure of the burden; they greatly underrated the strength by which the burden was to be borne."

That was a century ago when the debt reached £800,000,000. Today that debt is nearly ten times that figure, and the standards of the people of England, not only the working man, but the business man, are higher than they were then. They are far better off as a society after carrying the debt than they were at that time.

Have we not yet learned that what we cannot afford is not the burden of carrying the national debt, but is an army of idle men and unutilized facilities? For the cost of what we lost in the last few years as a result of permitting deflation to run far on its course before checking the devastation -- the loss in national wealth and the national income from idleness of millions of men and innumerable productive facilities would run into more than $150,000,000,000. The entire amount of our present national debt is less than four months of the normal national income.

It seems to me that it may be interesting to compare the picture of England with that of the United States so far as debt is concerned.

The debt of the United Kingdom (and that does not mean only the central Government, it means all public bodies) was 194 percent of the national income in 1934. In the United States, the debt of all public bodies was 74 percent of the national income. The total interest paid by all public bodies on their debt in England amounts to 8 percent of the national income; in the United States, a little over 3 percent of the national income.

I do not want to give you men the impression that a budgetary deficit is desirable. I only want to point out to you that it is not the serious thing it has been magnified to be. (Applause) The serious thing is the loss of $40,000,000,000 in our annual national income, which the capitalistic system, when left to itself without adequate Government intervention, brought about by the year 1932.

We shall not continue to have a budgetary deficit when the conditions that caused the deficit, the reduction in national income, are corrected. As national income increases, Federal income increases, and as Federal income increases the need for Government spending decreases, because of an increase in activity, employment, prices, etc.

And that is the trend today. From more than $4,000,000,000 in 1929 the Federal income dropped down at the bottom of the depression to $2,000,000,000, and is now back at more than $4,000,000,000.

The deficit which reached a peak in the fiscal year ending June 1934 was approximately $4,000,000,000, and it is estimated that in 1936 it will be $3,280,000,000.

I should like to sum up what I think all this means to bankers. I feel that you have every reason in the world to have confidence that the system of private industry and the system of private banking has a future if you will but profit by the lessons of the past, if you will but do your part and step out into the field and extend not the type of credit that you may prefer to extend, 90 days or 6 months credit, but the kind of credit that there is a demand for in your communities. You don't hesitate to buy in the market finance company paper and intermediate credit bank paper at as low as one percent. Why don't you short-circuit the funds and lend directly to those in the community that are going outside and paying from 5 to 12 percent for credit from the very institutions which you are financing at one percent? (Applause)

Why don't you, when you are the custodians of $10,000,000,000 of the savings funds of the people, invest those funds in the field where such funds should be invested? They are the same type of funds as the funds that the insurance companies, the mutual savings banks, and the savings and loan associations are investing, and if you are going to hold those funds and pay interest on them, you must put those funds in the long-term mortgage market, in the long-term bond market, and you can do it with every security.

You are loaning on a basis of values that is not inflated, and if you want the Government and the Government agencies to get out, then it is up to you to get in. (Applause)

If you prefer to buy Government bonds and bonds guaranteed by the Government, to act as your cushion, then you cannot complain about the Federal Government being a competitor with you in the field. (Applause)

If the Government had chosen or desired to destroy private banking, it needed to do nothing at all. In 1932, private banking had completely destroyed itself. (Applause) But the Federal Government believed in private banking, and in private initiative, and in private business, and for that reason it saved the banking system for the bankers to do a better job in the future than many had done in the past. (Applause)

It seems to me, in summing up the review I have made, that an analysis of the nature, the cost and the timing of Government intervention, and of the recovery factors brings out conclusions which are inescapable. First, in order to keep our productive processes going and expanding, we must maintain a reasonable balance between our productive facilities and consumer buying power. Failing this, money becomes idle because it cannot find profitable outlet for investment, unemployment develops because buying power is insufficient to absorb the output of industry.

This results in the commencement of a period of deflation. It causes a contraction of debt, a reduction in spending, and, if the cycle is allowed to continue, this inevitably results, because the cycle is self-accelerating, in general prostration and bankruptcy.

It is as necessary to intervene to correct a situation of this sort as it is to prevent a cycle of inflation.

There will be one thousand bankers saying that inflation should be avoided and that public authorities, public officials in the Reserve System and in Government should stop inflation, whereas there is possibly a handful who feel, or at least have felt, that deflation should not be allowed to go its normal and natural course; that the natural law should be interfered with.

I cannot reconcile these two positions. I see no greater evils in inflation than in deflation. In fact, I think of the two, deflation is far more destructive to bankers.

It is necessary to intervene to correct a situation of this sort, just as necessary as it is to prevent a cycle of inflation. Only Government, which is all of us, is capable of acting collectively to offset and neutralize the effect of the down-swing and by its spending and the use of its credit effect the necessary distribution that private capital, left to the individual, has failed to effect. Action taken promptly by Government to stop the process of deflation in its inception will tend to keep up the national income and correct maldistribution and inequitable distribution, and at an infinitesimal cost compared with the cost to society as a whole if deflation is allowed to run its natural and destructive course. For Government to decrease its spending at the outset of a deflationary period, when every one else is doing likewise, only accelerates the forces of deflation and does not create confidence. In such a situation capital does not flow into productive facilities because they are already excessive in relation to consumer buying power.

How can we say that individuals, corporations and banks, with funds to invest, will be inclined to use those funds to put people to work, when funds already invested are becoming less profitable daily, as buying power decreases and unemployment spreads?

Confidence in the business world is the outgrowth of an opportunity to invest funds profitably. Funds are invested profitably only when there is sufficient buying power to purchase the output of increasing productive facilities.

I have attempted to portray the effects and the evils of deflation. We hear much about the evils of inflation. How is it possible to have inflation when men are idle and plants are idle? There can be speculative excesses when surplus funds bid up stocks or real estate, but general inflation can only come about by increasing the means of payment in the hands of the people who are willing to spend faster than we can increase production. We are a long way from such a period of inflation. (Applause)

The idle balances of corporations and of individuals, even in 1929 with business going at a maximum, were very largely responsible for the stock market inflation.

It must be evident from what I have said that we are in no immediate danger of inflation as a result of a budgetary deficit or as long as we have the facilities to produce and the men willing to work. (Applause)

We have seen from the experience of the past three years that it is possible, through adequate Government intervention, to turn the tide of deflation to what has been termed "reflation." Is it not reasonable to conclude that had intervention come sooner and on a more adequate scale, it would have taken far less spending and lending by the Federal Government to arrest and reverse the process of deflation?

The bankers above all have been the beneficiaries of the Government's intervention. The Government alone could and did replenish the supply of deposits when individual borrowers were lacking and when banks had no other profitable outlet for their funds than the investment in Government securities. Banks bought Government securities, not because of compulsion, but because they had no other avenue of profitable investment.

The Federal Reserve System has purchased no Government bonds, has given no support to the Government bond market for two years, and the present amount of outstanding credit by the Federal Reserve System is less than it was in the spring of 1933. The excess reserves of the banks, which make money cheap, which induce them to purchase securities and make loans at present low interest levels, are a result very largely of gold imports.

Banks bought Government bonds, not because of compulsion, but because they had no other avenue for profitable investment. Government bonds, far from being a burden, have been a Godsend.

Those who talk about boycotting Government bonds suggest to me a drowning man to whom a life line is thrown out but who objects that it is an interference with his individual right and liberty to drown. (Laughter and applause)

Speaking as a banker, business man and capitalist, I urge you as bankers to contrast the conditions and the prospects under which you meet today with the conditions and the outlook of three years ago and to ask yourselves how the transition has been brought about.

I am not prepared to admit that we must always have with us a vast army of unemployed. I am not ready to confess failure in making our individualistic capitalistic society function so as to utilize to the fullest the nation's resources of which, by far, the most important is human labor.

I do not believe that we are so wanting in intelligence and courage, or that we are so blind to the lessons of experience as to conclude that we are incapable of managing our affairs more prudently and more efficiently in the future than we have in the past.

I do not see how any thoughtful man can challenge the conclusion that in order to preserve our capitalistic system, our institutions and traditions, we must use such governmental means of economic and monetary management as we now possess in achieving a greater stability in the economic order and in creating conditions under which our man power and productive capacity may be utilized to a maximum in the production and the distribution of wealth.

The Federal Reserve System, with its authority over margin requirements and -- under the Banking Act of 1935 -- its clarified responsibility for reserve requirements, discount rates and open-market operations, is in a better position than ever before to exert its influence toward the attainment of a greater degree of stability and the avoidance of inflationary and deflationary extremes.

These powers, if exercised harmoniously, in conjunction with those possessed by the Federal Government through the Treasury -- and to attempt to exercise the divided powers separately or conflictingly would be fatal -- can, I am confident, contribute much to the achievement of a stable, orderly economic progress, free from violent extremes, and conducive to a maximum productivity and distribution. This involves neither a regimented nor a restricted economic order. It calls for Government intervention only to the extent that the exercise of governmental authority affecting monetary and budgetary factors may be a stabilizing and corrective influence in an individualistic, capitalistic system when it, left entirely to itself, generates distortions, lack of balance and cyclic extremes.

The Government must be the compensatory agency in this economy; it must unbalance its budget during deflation and create surpluses in periods of great business activity.

In the light of experience and in the interest of the public in general and of private banking in particular, it seems to me to be conclusively demonstrated that business and banking leadership should lend its full sympathy and support to the kind and extent of Government intervention that I have outlined. Only then, it seems to me, can private banking be assured of safe and profitable operation in the future and be freed from the uncertainties due to recurrent evils of booms and depressions. (Applause)