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ADDRESS AT THE
25th ANNIVERSARY OF THE OPENING
OF THE
FEDERAL RESERVE BANK OF ST. LOUIS
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I am glad that I could be here this evening to join with you in observing the 25th anniversary of the establishment of the Federal Reserve Bank of St. Louis. The quarter of a century that has passed has put the Federal Reserve System to the test of war and of peace, of the greatest boom and the worst depression in our history. Throughout this period the System has rendered an essential public service. Those who have played a part in making this public contribution have reason to look back over the years with a sense of pride in what has been achieved, notwithstanding the limitations in our banking laws and those inherent in the powers of monetary authorities to achieve by themselves that state of economic welfare to which we all aspire. We may say in fairness, I think, that the record of the Federal Reserve System is a creditable one; its shortcomings, as I see them, have been largely reflections of the times in which we live.

The Reserve System is no longer an experiment. It has justified the expectations of its creators. It is an established institution that is vital to the functioning of our economy. If it were done away with, other machinery would have to be created to furnish the services and perform the functions of the present System. Throughout its history, the Reserve System has been fortunate in attracting to its service many men of outstanding ability and a desire to be of public service. This applies not alone to the officers and staffs of the twelve Federal Reserve banks and their branches and to the Board in Washington, but to the men who have served and have regarded it as an honor to serve on the directorates of the banks and branches and as members of the Federal Advisory Council.

Inevitably the System has often been a target for political attack because it is a convenient scapegoat when the economic machine gets into trouble. This is in large part because of the persistent, but erroneous, belief that we can produce and maintain prosperity simply by pulling a few monetary and credit levers. The System has successfully withstood recurrent waves of political assault, largely, I think, because of the high character of the men who have been associated with it in all parts of the country, and because informed opinion was aware of the limitations on its powers and did not expect the impossible.

As the world has changed, as new conditions have arisen, the Reserve System inevitably has faced new problems and has been obliged to develop new means and to ask for broader powers in order to deal with changed conditions. It has not remained static in a changing world and it cannot do so and survive. I have found comfort in the reflection that those who resist change so often not only become reconciled but approve once it has come about. The effort to establish the Reserve System was stoutly opposed by influential financial and business groups that later became its defenders. Senator Glass recounts in his book, "An Adventure in Constructive Finance", that: "The fight for better banking methods and for an effective currency system was no holiday fray; it was actually a savage contest, in which entrenched power and privilege resisted at every point of attack." The battle for better banking methods and a sounder credit and currency system goes on. It can never be permanently won in this changing world. But enlightened men can lead the way to continuous improvement.

This Bank in St. Louis, as a part of the System, came into being on the eve of the outbreak of war in Europe in 1914. It is a somber fact that this 25th anniversary is being observed as another European War casts its shadows across the Atlantic. Those who constructed the Federal Reserve System out of long experience and study could not foresee the changes that were to be so quickly wrought after 1914. They were men whose experience had been with the operations of a gold standard world and with the rise of industrialism in the era of great expansion in this country.

While the Reserve System was conceived as a mechanism designed primarily for a peaceful, gold standard world, it proved capable of rapid adaptation to a world suddenly transformed from peace to war, and from a gold basis to a managed currency basis. The System discharged with great credit the heavy responsibilities that were thrown upon it, particularly in connection with financing our own participation in that struggle. But the System has never had an opportunity to operate in the kind of universe for which it was originally created. It is true that during the Twenties the leading nations, ourselves included, undertook to reestablish the economic premises and practices of pre-war conditions, without appreciating that the conditions had been radically altered. We had emerged as a creditor nation, but we continued to behave like a debtor nation. The gold standard was restored in name; it was in office but not in power, and it was not and could not be the pre-war standard. As we discovered too late in the Twenties, it could neither save us from nor rescue us once we were plunged into economic disaster.

It appears to most of us now that since the armistice of 1918 we have had what is more a truce than a peace. We cannot foresee now, any more than we could at the outbreak of war in 1914, what the future will bring forth, but all of us are necessarily concerned with the effects of foreign war upon our domestic economy. We can see the broad line of defense that we must take to minimize the disruptive consequences to our own people.

We are already experiencing the initial impact of war conditions abroad. In the forward movement in economic activity that has taken place recently, there is much that represents anticipatory buying and the accumulation of inventories without a corresponding rapid increase in consumption or purchasing power. Fortunately, there appears to be a more widespread recognition that as a matter of self-interest, restraint should be imposed by business and labor leadership to prevent a recurrence of the price distortions and inventory boom that led to the sharp relapse beginning in the middle of 1937.

To that end, business men appear more ready to cooperate in price restraints and in spreading out production. Even though there may be a glut of orders in some lines, including the steel industry, production and deliveries should be evened out over longer periods than has been the case under past practice. There is also a more rational policy in regard to liquidation of foreign holdings of American securities so that it may have a minimum of disturbing effects upon our markets and to the timing and spacing of foreign demand with a view both to more orderly production and the avoidance so far as possible of conflict between foreign and domestic needs for essential materials.

All of this is to the good, but in the brief time I have this evening, I want to call attention more particularly to some of the longer range problems as I see them from the standpoint of the bankers and the Federal Reserve System.

I doubt whether there are exact figures on the amount of cash resources that are available to belligerent governments for expenditure in the United States. Such figures as I have seen are at best estimates. They indicate that for the British Empire and France alone dollar balances in this country amount to about $1-1/4 billions, and readily salable securities have an estimated market value of about $1-1/2 billions. In addition, other resources and investments which are not so readily marketable aggregate another $1-1/2 billions. Beyond this, the British Empire and France have gold resources of close to $6 billions and they have an annual gold production of about three-quarters of a billion dollars.

No one, of course, can foresee how long the war will last or how much of these resources would be used for purchases in our markets. We should not delude ourselves, however, into supposing that whatever the volume of such expenditure may be in our markets, it would be just so much velvet for us. The fact is that our favorable trade balance during the last few years has been sustained through our willingness to accept large quantities of foreign gold and silver at high prices in exchange for our goods and services. We have been unwilling to exchange goods for goods. Fortunately, we have not extended foreign credits, as we did throughout the Twenties, which, while they sustained our foreign trade, were largely uncollectible. Looking to the future, my personal view--speaking unofficially--

is that our country would be far better off if, so far as possible, foreign purchases were to be paid for out of the sale of their goods in this country and out of the proceeds of the liquidation in this country of American securities held by foreigners rather than through further acquisitions of foreign gold and silver for which we have no present or prospective use, because they would only increase the present unprecedented volume of unused excess reserves and deposits of the banking system. Even the present volume of excess reserves, if used as a basis for credit expansion, would create a dangerous inflationary situation entirely beyond the present powers of the Federal Reserve to control. We do not need a further increase of our supply of bank deposits or currency. What we do need is a more effective use or turnover of our existing money supply.

This has an immediate bearing upon our banking and economic problems generally, and upon the question of interest rates which are of so much concern to bankers and investors. But I find that not many of my banker friends have analyzed the reasons why interest rates have been and are likely to continue to be at unprecedented low levels. Some, I have discovered, had a vague, but mistaken, notion that the Federal Reserve System was responsible and that I, in particular, am culpable because I have advocated since the depths of the depression what, for want of a better name, has been labeled as an easy money policy.

The facts of the case, however, are clear on the record. We have today more than $5-1/2 billions of excess reserves among member banks. This is a figure never before approached and the prospects are that it will continue to grow. A credit expansion of fully $30 to $40 billions could, in theory at least, be built upon this enormous base. Now, you cannot have such vast stocks of potentially loanable funds pressing upon the market, and such a volume of investment funds as has been and still is accumulating without having interest rates at extremely low levels.

I want to emphasize the fact that the rise in excess reserves in the past few years has resulted almost entirely from the vast inflow of gold and to a lesser degree from silver purchases. A strenuous, though unsuccessful, effort was made in the Banking Act of 1935 to obtain for the Federal Reserve System authority to absorb excess reserves. Under the limited powers actually granted, the Board of Governors of the Federal Reserve System absorbed approximately $2-1/2 billions of excess reserves. In other words, the present volume of excess reserves, large as it is, is $2-1/2 billions less than it would have been if the Reserve Board had not increased reserve requirements by using most of the authority granted in the Banking Act of 1935.

This action was not taken for the purpose of constricting credit or reversing the policy of monetary ease pursued by the System. It was taken for the purpose of putting the System in the position it had traditionally occupied and the position still occupied by central banking organizations in other leading countries, where, through open-market operations and discount policy, it could ease credit conditions if the situation required or adopt a reverse policy if necessary to restrain inflationary credit expansion through the banks. Unfortunately, this position could not be maintained because the great volume of gold and silver that was subsequently permitted to flow into the excess reserves again lifted them to levels beyond reach of the System's control.

I do not wish to be understood as favoring high interest rates at the stage of recovery so far reached or while we have a large volume of unemployment and unused resources. I favor relatively low interest rates as a continued encouragement to capital expenditures, including housing, and as a means of keeping down costs and stimulating consumption. But I am convinced that it is essential for the monetary authorities to be in a position to influence the availability and cost of credit in order to discharge their proper responsibilities. What purpose do they serve if they are powerless in their particular field of responsibility?

At the present time investment funds are accumulating in the hands of individual and corporate savers much faster than outlets develop for the profitable employment of these savings in new investment. The result is an intensified competition for the existing supply of investments--a supply so inadequate relative to the volume of funds seeking investment that, notwithstanding the great increase in the public debt during the past decade, the demand greatly exceeds the supply.

Foreign war will not correct this situation, but is likely to make it worse. The remedy must be found at home. It would be most unfortunate if the anticipation of profits from a so-called war boom were to obscure this and other unbalanced relationships in the domestic picture.

There has been recently some increase in the demand for bank loans for commercial purposes. This has given earnings to banks and somewhat lessened their need to invest in long-term governments. However, it is not reasonable to suppose that the demand from business and industry for increased bank credit accommodation will be sufficient to absorb any substantial amount of excess reserves. For one thing, most of the larger and many of the smaller corporations of the country have accumulated large cash reserves which, in some cases, have been invested in Government obligations since they could not be profitably used for increased production and plant expansion. In many industrial lines which have been operating far below capacity a great increase in production could take place without necessitating going to the capital markets or to the banks for more funds for plant or for operating purposes. Production can be stepped up greatly because of the rapid technological advances which require less plant expansion and less man power than was needed under old methods.

For another thing, under the terms of the neutrality legislation advocated even by those who opposed the sale of arms, it is proposed that only cash payments shall be made for such products as are purchased by belligerent buyers. Extension of credit is specifically barred. There is thus no present prospect of outlet for investment funds in foreign loans. Accordingly, I am unable to see that through the prospective operations of business and industry there will be a sufficient absorption of investment funds or of excess reserves to alter materially the present disproportionately large volume of such funds relative to the outlets for them. Therefore, I would not expect interest rates to rise and maintain levels that are higher than has been the average over the period in which we have had the combined effect of heavy excess reserves and slack demand for credit and for funds for new investment. We have witnessed, since the outbreak of war abroad, a readjustment from the low levels that prevailed earlier in the year, but the trend is again in the opposite direction.

All indications point to the continued piling up of excess reserves, and the longer war is continued and foreign governments obtain dollar exchange through the process of sending us gold, the greater the excess will become. If the effects of this were merely to add to bank deposits, which for a considerable period now have been greater than ever before in our history, it would be serious enough, but gold and silver acquisitions also add to excess reserves which are a basis for a multiple expansion of bank credit and bank deposits.

The other principal factor in the growth of bank deposits has been the Government's borrowing from the commercial banks. To the extent that this process restored our money supply after it had shrunk by about one-third as a result of the deflation after 1929 it was, to my mind, desirable and, in fact, essential for recovery.

We may as well face the facts of this question of interest rates and idle deposits frankly. I want to repeat that I do not favor restrictive money conditions and high interest rates while we still have millions of idle men and unused resources. Tightening of money rates is an appropriate weapon against unsound expansion of bank credit that threatens an inflation. It is wholly inappropriate at the present stage of recovery or at any time as a remedy for unsound developments of non-monetary origin.

While bankers and investors generally want higher rates, it should be evident that we cannot go on indefinitely having gold and silver purchases piling up both excess reserves and bank deposits and expect interest rates to rise. The effects of such additions to the money supply are bound to be just the opposite--the more so when at the same time billions of individual and corporate savings are piling up annually, although outlets for the profitable employment of these savings in new investment, or in foreign loans, are much less than was the case during the Twenties.

Are we willing to deal with the factors that are adding to the already unprecedented accumulations of excess reserves and bank deposits, and if we are not willing to deal with these factors, are we willing to approach the problem from the other side and take steps adequate to put these funds to more productive, profitable use? My own experience, in being unable in the Banking Act of 1935 to obtain adequate means of dealing with the excess reserve problem, and three years ago when I ventured to point out the effects of continued capital acquisitions from foreign sources, does not encourage me to think that as a country we are yet prepared to deal with the causes or effects of this growth in excess reserves and bank deposits.

Turning to the question of putting the supply to greater use, we find a field of the greatest confusion and conflict of opinion. I shall undertake here only to outline again what I believe to be the sound way of getting a wider, more profitable use of the accumulations of idle funds that are weighing down the interest rate structure and preventing the balancing of the Federal budget.

In my judgment, the time is here, if it is not overdue, to take certain steps that will increase domestic consumption, diminish the pressure of idle funds on the investment markets, and begin to close the gap between Government income and outgo. My longer objective would be to sustain existing investment and pave the way for as much new investment as can be profitably undertaken. That is in the interest of the banking system, the insurance companies and all other fiduciary institutions--looking beyond them, it is to the interest of all those whose savings are at stake.

We are hearing today proposals that the Government should reduce some of the present expenditures, particularly for agricultural benefits and for work relief, in order that funds for an expanded armament program may be provided without an increased deficit or an increase in taxes. In my opinion, it would be unfair, and unsound economically, to pass increased armament costs on to those of the low income groups who would profit the least out of foreign or domestic expenditures for armament, who are the least able to bear the costs and whose increased purchasing power is essential to our economic welfare.

Instead, in my opinion, we should follow the unpopular, but necessary, course of imposing additional taxation in order to meet the added costs of our armament program and to reduce the deficit, without sacrificing the low income groups whose sustained and increasing purchasing power is needed to sustain and increase production. Accordingly, additional taxation should be levied, not alone upon war profits, but upon those income groups now relatively undertaxed among whom the greatest proportion of savings that are unable to find profitable outlet today are now accumulating. At the same time, I favor increasing domestic purchasing power by decreasing consumption taxes.

It is beyond dispute that the great majority of our people at the bottom of the income scale would consume far more if they had the purchasing power. One way to increase their purchasing power is by lowering consumption taxes, such as excise and sales taxes, which have been heavily increased over the past few years. We need to understand more clearly just where idle funds accumulate, where our tax burdens fall, and how they may be better distributed with a view to increasing domestic consumption and hence increasing a home market for American business and industry, so that they will not have to rely upon the precarious circumstance of foreign wars and armament programs in order to utilize our resources and man power and thus to make profits.

I have been much interested in studies of the National Resources Committee which show that in 1935-1936, 59 per cent of our families had incomes of $1,250 or less. They had no savings, but incurred deficits of $1-1/2 billions which were partly made up by hundreds of millions of dollars of contributions from other private groups and public sources. It is on this majority group of our people, comprising nearly 60 per cent of our population, that consumption taxes, including social security assessments on those fortunate enough to have jobs in private industry, bear too heavily and have been substantially increased in recent years.

The next higher income group, that is, those families with incomes of from $1,250 to $5,000 a year and comprising 38 per cent of our population, was able to save $2.8 billions. The next higher income group with incomes of from $5,000 up, but representing less than 3 per cent of our families, saved $4.8 billions.

Our income tax rates applying to these groups with incomes of from $5,000 to $50,000 are much lower than the rates, even before the war, in England, France and most other countries. Moreover, our income tax structure has a much narrower base than that in other nations. I am in favor of spreading it out. The time has arrived, I think, when this should no longer be delayed, when additional revenue should be derived from the intermediate income groups that I have mentioned. The effect will be to offset continued over-accumulation of idle funds, to add less to bank deposits through the process of deficit financing, and to help close the gap between Government receipts and expenditures.

As part of a national policy of encouraging consumption, I have, over a long period, urged revision of our system of old-age and unemployment insurance, which at the present time is increasing rather than diminishing the volume of funds that must find investment outlets. If we are to accumulate reserves for old-age pensions, they should be built up in good times when their collection through taxes will tend to moderate unsound boom tendencies and will not have an adverse effect upon consumption. We have made the mistake, in my judgment, of accumulating a vast reserve in times of large unemployment, taxing it not out of those best able to pay or those whose savings are idle, but out of payrolls mainly of those who otherwise doubtless would have kept the funds moving in the income stream. The more we have taken out of consumption by this process at the time when we need above all to increase consumption, the greater the need has been to unbalance the budget still further in order to increase consumption. Other countries have built up social security programs and have adjusted their taxing and financing methods to the countries' economic needs by paying out in social security benefits sums much larger than they currently take in from contributors.

The volume of taxes on consumption, including social security taxes as well as sales taxes, excise taxes and tariffs, is at present much higher than at any previous time. We should undertake a far-reaching revision of our Federal and State tax structures so as to cut down these consumption taxes and to increase taxes on funds which would otherwise remain idle.

Also as a part of the general program, I would favor applying taxes that will have the effect of discouraging over-accumulation of so-called rainy day reserves which are being set aside in excessively large amounts, particularly by the larger corporations. These sums come out of the income stream and unless put back into the stream through being paid out in dividends to stockholders or spent for plant modernization or expansion are bound to diminish consumption, then employment and finally production. It would be preferable if these excessive accumulations were avoided in the first instance by reducing prices to consumers or by increasing the wages of the lower income groups of workers. If this is not done, then it is not logical to oppose taxation that will keep these funds that are unused for plant or for dividend purposes moving in the income stream. They cannot be taken out of the income stream without reducing it and thus reducing employment and production.

I opposed at the time and would continue to oppose application of corporate surplus taxes to the small businesses which do not constitute the heart of this problem of idle funds. But we should also consider increasing the normal income tax of corporations and revision of the inheritance tax, particularly a reduction of the present exemptions, to help pay for an increased armament program.

The broad effect of the tax policies I have outlined would be not only to reduce the deficit and ultimately balance the budget as national income reaches the levels we should and can have in this country, but to sustain and increase purchasing power and reduce the pressures of funds that cannot find adequate profitable outlets in new investment at this stage in our national development. Such a tax program would do much to keep otherwise stagnant funds moving in the income stream in a way that will augment consumption and thus not only sustain existing investment but open the way for new investment.

If we are unwilling to deal with the underlying factors that make for a continuing piling up of our money supply, now beyond the powers of the Reserve System to control, we should at least deal with the problem of idle funds and the stagnation in the turnover of existing deposits. In my judgment, we should deal with the problems of money supply as well as its use, but, in any event, we cannot ignore both sides of the picture. The banking and investment community cannot expect to do nothing about the piling up of idle funds on the one hand and, on the other hand, have the interest rates and earnings which they so much desire. It is the old story--you can't have your cake and eat it too.

I have sought to indicate in a general way what I believe to be a practical approach to some of these questions. I hope that none of us will be deluded into imagining that the tragic accident of European War will in the long run solve or even ameliorate our fundamental domestic problems. War cannot cure, but may make worse, the unbalanced relationships between tariff-protected industrial prices on the one side and, on the other, agricultural prices and incomes that are determined by foreign demand and foreign markets. War cannot cure, but may make worse, the monetary and credit problems arising from the continued swelling of bank deposits and excess reserves which, in turn, are a vital factor in the level of interest rates.

We cannot profit from disaster to other peoples. We can be alert, however, to protect our economy to the extent of our abilities from the dislocating effects of international chaos and destruction. We can, if we have the perception and the courage, put our own house in better order and keep it functioning so that it will produce and distribute a maximum of goods and services, under our political and economic system, for the benefit of all of our citizens.