

The Need for the Conservation of Credit

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THE HISTORIAN deals with the past, but the active man of affairs lives in the present and directs his vision toward the future. Yet it frequently happens that in order to arrive at a thorough understanding of present conditions and to interpret the significance of the shadows which coming events are said to cast before them, it is necessary for the business man to review the past, or at least the recent past, in order to draw logical conclusions from the sequence of events.

We are living today in extraordinary times, when lights and shadows present contrasts more marked than we have ever seen before. In some localities and to some individuals the scene is illuminated with the radiant intensity of a July sun at noonday, while in other places and to other peoples it is enveloped in the murky darkness of an arctic midnight. We realize that such conditions are unusual and transitory, for extremes so violent cannot continue indefinitely. In our own country we question the permanence of the lurid prosperity enjoyed by some while so many others are struggling with adverse conditions; and in our world relations there is no basis for the hope that this country can prosper long when other great nations are plunged into the depths of depression, poverty and famine. More than sixty

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years ago Abraham Lincoln said that this nation could not exist half slave and half free, that it must be all one or the other. So also neither this country nor the world can continue to live half in the glaring sunlight and half in utter darkness. We cannot, of course, look for universal sunshine, but we should undertake to soften the contrast now existing, taking pains to accomplish the result by diffusion of light rather than by extension of the shadows.

To the superficial observer who considers only large figures and volume of business, gross profits and demand for services and goods, it appears that the people of this country have never experienced such exuberant prosperity. Prices and wages have never been so high, opportunity to work so abundant, demand for goods so great and bank deposits so large as now; but with all the conditions present which are usually regarded as concomitants of prosperity, there is a wide-spread feeling of unrest, of dissatisfaction with the present, and of apprehension for the future. There is general complaint that while there has been no approach to uniformity in rates of increase of personal incomes there has been a sweeping and universal advance in prices of necessities as well as luxuries affecting all, and resulting in deprivations and hardships to a very numerous unorganized intermediate class whose earnings and incomes have remained practically stationary.

The high cost of living therefore has become the subject of universal interest and concern and various methods have been proposed for its reduction. In considering the problem it is well to review briefly

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the course of events during the past five years in order that we may understand clearly the causes that have led to present conditions and by analysis be able better to reach conclusions as to the proper corrective.

There can be no doubt that the world war is directly responsible for many of the successive advances which have taken place. The withdrawal of millions of men from productive operations and their conversion into fighting units, and the expenditure of billions of dollars in processes of waste and destruction created an abnormal and urgent demand for supplies of all kinds, not only for the necessities which are required in times of peace and war alike, but also for arms, munitions and all sorts of military and naval equipment. Production could not keep pace with demand notwithstanding reduced consumption and rigid economies on the part of civilian populations. The world was drained of its tangible liquid wealth as represented by raw materials and manufactured goods; in many countries currencies were inflated, and everywhere there was credit expansion on a vast scale. Industry was diverted into the most essential channels, and building operations and construction work generally were suspended except where necessary for the production, storage and transportation of war material.

When hostilities terminated upon the signing of the armistice nearly fourteen months ago, the world had been deprived of the productive power represented by perhaps fifteen million men who had lost their lives or who had become permanently disabled. It was deficient in supplies of foodstuffs, fuel and

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textiles, and its manufacturing capacity and transportation facilities were greatly impaired. Millions of people found themselves homeless, not only in the war stricken areas but also in countries whose soil remained untouched by invading armies, for normal building operations were four years in arrears. The belligerent nations staggered under a stupendous burden of debt, which had been increased during the war by the equivalent of more than two hundred billions of dollars, most of which had been expended in destructive energy involving uneconomic consumption of goods. The largest country and great granary of Europe was torn by revolution, anarchy and civil war, and the populations of other European countries, many of them crippled by loss of man power, by lack of domestic animals and agricultural implements and by the impairment of productive capacity generally and the loss of their foreign markets, were unable to supply their domestic requirements. They were obliged, therefore, to turn appealing eyes to the Far East, to Colonial possessions, and across the Atlantic to North and South America.

By reason of its stronger financial position and greater ability to produce foodstuffs, raw staples and manufactured articles, these appeals have been made in larger part to the United States. The assurances given by our Government of its humanitarian impulses in entering the war, and the financial aid extended through loans from the Treasury amounting to ten billions of dollars have also served to focus the eyes of all Europeans upon the United States as the most dependable source of supply for Europe's wants.

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Unfortunately the trend of events in this country during the year 1919 was not altogether satisfactory. Following a period of waiting and hesitation during the early part of the year, the policies of thrift and economy, of self-denial and conservation which during the war proved so effective were soon discarded, and the pent up energies of a people which had subrogated so finely all pleasures, ambitions and impulses to the task of winning the war were released and found expression in activities of every kind. In many instances these activities were commendable for they were devoted to the constructive work of bringing the industries of the country back from a war to a peace basis, but advantage was taken of the ease with which credit could be obtained, to avail of speculative opportunities for profit. Speculation became rampant in all sections of the country and individuals everywhere gave free rein to extravagant tendencies hitherto restrained.

Advancing prices served to stimulate rather than to check demand, and the evident necessity for conserving essential commodities known to be scarce failed to curtail consumption. As the year progressed bank loans and deposits increased, and reserves declined. Frequent warnings issued by the Federal Reserve Board had only a temporary effect; dangerous tendencies developed into a dangerous situation, and corrective measures were applied, now conceded to have been necessary and salutary, but which at the time were denounced by some who ought to have known better as a conspiracy against the prosperity of the country.

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Meanwhile it became evident that those who had predicted that the year would witness a marked falling off in our exports, because of the decline in the cash purchasing power of European nations and their inability to secure credits as indicated by the spectacular drop in the exchanges of most European countries, had reached premature conclusions, for the total value of exports from the United States during the year 1919 has exceeded imports by at least four billions of dollars. Notwithstanding this fact, the movement of gold for the year was heavily against us, the net outgo having been \$278,723,000, up to December 20th, or taking into consideration the balance of the gold received from Germany for foodstuffs and held in London for future shipment to this country or for use abroad, the net loss has been \$147,403,000. In addition to this there have been, to December 20th, net exports of silver amounting to \$145,220,000.

While the value of raw materials and of manufactured articles produced during the year was the greatest in the history of the country, the physical volume proved to be smaller than for any year since 1916. During the last few weeks it has become increasingly evident that active steps must be taken if our exports are to be maintained, especially to European countries, in anything like their present volume. The fact that we have had a favorable trade balance of four billions of dollars accompanied by a large net loss of precious metals shows conclusively that exporters have either taken payment in foreign currencies or that they have accumulated credits in foreign banks. Just how these credits have been ar-

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ranged it is impossible to trace fully or even measurably, but it is very probable that a large part of the financial burden has been thrown directly or indirectly upon American banks. There is no reason, however, to question the security of bank loans for there is an abundance of prime collateral available including more than twenty billions of dollars of United States Government bonds.

It is highly important, however, that all long credits granted in connection with exports be kept out of the banks, whose policy should be to maintain themselves in a liquid condition. Apart from the loans which the War Finance Corporation is authorized to make, there is no provision for Government aid in financing exports. The fund of ten billions of dollars which Congress authorized to be advanced to foreign governments associated with us in the war has been practically exhausted, and barring a possibility that for humanitarian reasons, in order to prevent actual starvation a further advance of two or three hundred million dollars more may be permitted, there seems to be no reason to expect that any more large loans by the Government for financing exports will be authorized. Such a policy would mean either more taxation or more bonds; it would mean a return to wartime methods of financing after we have turned our backs upon such methods and are directing our steps towards the methods and policies of peace financing; it would mean that funds belonging to all the people would be applied in time of peace to the more direct benefit of exporters and of those who produce goods for export.

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Without discussing at this time the effect of credit and currency expansion, it is evident that decreased physical volume of production, higher prices of raw materials, and higher operating costs, coupled with increased domestic consumption and heavier movement of exports, have made higher costs of living inevitable. As regards the responsibility of the commercial banks of the country, of the Federal Reserve Banks, and of the Federal Reserve Board for present conditions, and as to the policy that should be adopted in the future, much can be said. But first let it be understood that there is as wide a difference between war financing and proper banking policies in time of peace as there is between martial and civil law.

The story of our war financing will constitute a brilliant chapter in the country's history. While the Federal Reserve Banks and the member and non-member banks are entitled to the greatest praise for their most effective co-operation, neither they nor the Federal Reserve Board are responsible for the policies and methods adopted in financing the war and deserve neither praise nor blame for them. Responsibility for these methods and policies rests with the President, the Congress, and the Secretary of the Treasury, who authorized and adopted them, and to them the results should be credited.

No great war has been financed entirely by taxation, and invariably resort has been had to expedients such as inflation of currency or abnormal expansion of credits, and sometimes to both. Wars with us have always caused higher taxation, and during the

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civil war recourse was had also both to credit expansion through bond issues and to currency inflation. Irredeemable paper money was issued to defray current expenses, and as this currency was made a legal tender for all debts and dues, it was in effect a forced popular loan without interest. It proved to be a very expensive currency, however, because of its effect upon prices, and not until nearly fifteen years after the end of the war did it circulate on a parity with gold. The legal tender notes were a disturbing factor again in 1894, 1895 and 1896, because of their repeated redemptions in gold and immediate reissue, and were described as an endless chain.

The policy adopted by the Secretary of the Treasury in financing the requirements of the Government during the war with Germany excluded the issue of uncovered paper money, and provided for sales of interest-bearing obligations, consisting of short time certificates of indebtedness, and bonds of various maturities, which could not be used directly to secure circulating notes, although indirectly through Federal Reserve Banks they were used to some extent as a basis for circulation.

In the clearly defined limitations prescribed in Section 13 of the Federal Reserve Act, in the description of the kinds of paper eligible for rediscount by Federal Reserve Banks, a special exception is made in favor of bonds and notes of the Government of the United States. During the period of actual war, demands made upon the Treasury were greatly in excess of current receipts from taxation, and the offerings of bonds within a comparatively short time

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amounted to far more than the investment capacity of the country. In order to insure the success of the respective bond issues it was necessary to anticipate the investment capacity of the public as represented by future incomes and savings. Banks, manufacturing concerns, business houses and individuals were urged therefore to subscribe for bonds without regard to their immediate ability to pay for them, and an effective appeal was made to the patriotic impulses of the people to borrow heavily from banks upon the security of bonds, and as a special inducement preferential rates were established for such loans and easy terms of payment were promised.

The inevitable result was a great expansion of credit, which was reflected not only in the statements of individual banks, but also in the position of the Federal Reserve Banks. At the same time, no opportunity was lost to impress upon the public the necessity for increased production and reduced consumption, for thrift and rigid economy. As long as the war was in progress and its issue in doubt, appeals of this kind were far more effective than could be expected after the war had been brought to a successful conclusion, after the tension had been relieved and a period of reaction and relaxation had set in.

The end of a world war in a military sense does not synchronize with its termination from a financial point of view, and abnormal expenditures incident to war cannot be curtailed immediately upon the suspension of hostilities. The armistice was signed shortly after the flotation of the Fourth Liberty Loan, many months in advance of popular expectation. The lia-

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bilities of our Government were greatly in excess of the amounts which had been raised by taxation and by the sale of bonds; there was a very large floating debt in the form of Treasury certificates of indebtedness besides heavy unascertained liabilities of various kinds. It became necessary for the Treasury to float another great popular loan, and notwithstanding the fears expressed by many that an appeal to patriotic motives in time of peace would not meet with an adequate response, the campaign for the Victory Loan, the last appeal of the Treasury to the generous impulses of the American people, proved to be an unqualified success and the loan was oversubscribed.

As a logical sequence the loan accounts of the banks generally were greatly increased and more so because commercial demands were not restricted as they had been during the war period. Receipts from the Victory Loan, however, were not sufficient to liquidate entirely the liabilities of the Treasury, and a large floating debt represented by nearly four billions of dollars of Treasury certificates still remained to be cared for. It was deemed necessary to continue the wartime banking policies until such time as the Treasury had completed its plans for the periodical reduction of this indebtedness and its refunding from time to time as quarterly tax payments were made.

A few weeks ago the Secretary of the Treasury advised the Federal Reserve Board that the plans of the Treasury had reached a stage where they would not be imperiled by resumption on the part of the Board of its statutory powers to regulate discount rates. Revisions were made immediately. First consideration

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will be given to the industrial and commercial requirements of the country, and everything possible will be done to restore the proper balance between the volume of credit and the volume of goods. The process will necessarily be a gradual one, and can be completed only when very considerable redemptions of bonds have been made, and the remainder thoroughly absorbed by the public.

Our banking system is therefore passing through a transition period, intermediate between that of war finance and a stage regarded as normal according to pre-war standards. Owing to the necessity in the meanwhile of aiding in the financing of Europe, it is probable that several years will elapse before an ideal relationship between goods and credit can be established and normal conditions restored. During this transition period there should be an effective control of credits, gradual liquidation, and such temporary expansion only as may be necessary to meet seasonal requirements or emergencies. There should be a less lavish but more efficient use of capital and credit, extravagance should be discouraged in every way possible, and the production of essential commodities increased. It is important that the world should get back to work, but in order to provide steady employment for the people of our own country even, it is necessary that there should be a sustained demand for the products of our fields and factories, mines and forests, and in order to maintain this steady demand it is necessary to provide markets abroad for our surplus production. In order for the populations of European countries to get back to work and to pro-

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duce the things needed for their own support and for exchange with other nations, thus restoring tranquility to a war-torn world, it is necessary that we should send them the raw materials, commodities and equipment which they need so urgently. In order to send commodities to Europe we must have commodities available, for we cannot send abroad what we consume here. With every appeal to aid Europe attention should be called to the necessity for voluntary restriction of domestic consumption in order that we may have an adequate exportable surplus.

The domestic demand has been competing with export demands, and the result has been that prices have been bid up on both foreign and domestic consumers. By some means or other credits have thus far been arranged which have enabled shipments of goods to Europe to be made, but for more than a year there has been no systematic or direct curtailment of domestic consumption in order to provide a surplus for export.

The result has been that to the extent that our consumption has been restricted it has been accomplished through competition and constant advances of prices. Had shipments to Europe been accompanied by corresponding voluntary curtailment of consumption at home, prices would not have been forced up and from the resulting savings there would have been accumulated a capital fund available directly or indirectly for the purchase of whatever Europe may have had to sell in order to finance her imports.

During the war the popular response to appeals for conservation and saving was magnificent. The re-

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action, however, has been correspondingly violent, and a systematic campaign of education may be necessary to arouse our people to the consciousness that we may after all be living in a fool's paradise and that hard work, economy and liberal investment in foreign securities are necessary if we wish to make our present apparent prosperity real and permanent.

The bill introduced and sponsored several months ago by Senator Edge, of New Jersey, is now a law and will be known for all time as the "Edge Act." It is a great piece of constructive legislation and provides for the incorporation of associations under Federal charter and under Government supervision to engage either in international or foreign banking or in such financial operations as may be necessary to promote exports of goods from the United States. The Edge law affords an opportunity to all exporters, producers and manufacturers to co-operate, to extend their connections abroad, to invest in foreign securities of various kinds, and to offer their own obligations, specifically secured by their foreign collateral, to American investors. It opens a way for private financing of exports on long time, not by the banks, but through the investment market. The development of our foreign trade under the Edge Act may be slow, and probably will be. At first, perhaps, shipments of only the most essential articles will be financed by corporations organized under the Act, but this may be really desirable, for in view of the present wave of extravagance which is sweeping all over the world, throughout Europe as well as America, it is best that the stimulus for production

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be concentrated upon essentials and that sales on credit be confined to such articles.

The sale of foreign securities, either directly or indirectly, through corporations operating under the new law will create, of course, additional demands upon capital and credit. This demand is coming at a time when there will be other urgent demands. The great railroad systems of the country, soon to be returned to their owners, will require very large amounts. The problems ahead of us are stupendous, but the United States as a nation has reached the years of maturity, and it has never failed even in its infancy and during the period of its early youth to meet successfully every issue and to overcome every obstacle and danger. As a sturdy giant it turned the scales to victory in the war in which we are still technically engaged but which, let us hope, will soon be a thing of the past. It is necessary only to have the people of this country understand the nature of the problems confronting them and the need for their proper solution, for our national spirit when once aroused is invincible.