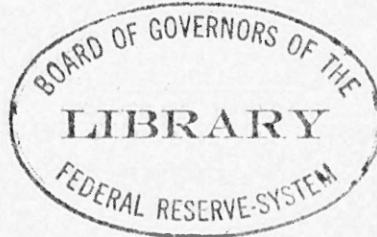


The Washington Post

1515 L STREET, N. W.
WASHINGTON 5, D. C.

EUGENE MEYER
CHAIRMAN OF THE BOARD

February 27, 1954



Dear Mr. Sutherland:

I received your request in this morning's mail for a copy of my Littauer Lecture, so-called.

I did not deliver it word for word as written, but used the typewritten material rather as a guide to my talk. I shortened it, but I think in doing so I preserved substantially the ideas contained in the written paper.

Quite a lot of this is from memory and there may be mistakes as to details.

Very truly yours,

A handwritten signature in cursive script that reads "Eugene Meyer".

Eugene Meyer

Mr. Alvern H. Sutherland, Librarian
Research Library
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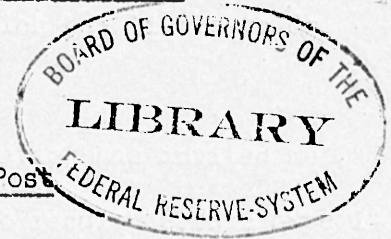
MAR 24
1954

FROM LAISSEZ FAIRE WITH WILLIAM GRAHAM SUMNER TO THE RFC

Littauer Lecture,
Graduate School of Public Administration, Harvard University,
February 24, 1954

by

Eugene Meyer
Chairman of the Board of The Washington Post



I. INTRODUCTION

This occasion stands apart from the general course of my life. Over the years, I've received a few honorary degrees from universities. Six Presidents have also appointed me to positions in which important changes in government administration were involved. Yet, in all of this, I've never been invited to address students of economics or public administration.

This, however, is only one side of the story. If there were professors of economics who felt that I had nothing to say that was worth an audience, there were times when I felt the same about the value of their work. In fact, I once in jest told my friend, the late Professor Taussig, that I was going to start a movement to abolish all college courses in Economics.

I explained that some of the students whom he and others had taught, a generation or more before, on graduation had started at the bottom of the ladder in banking. By hard work they had become officials in banks, married and acquired families. With all they had to do to make their way in the world, for the most part they had no time to follow economic events except in a sketchy manner.

As the country developed, the better university professors changed their views to keep abreast of changing conditions. Not so with their students of former years -- or at least some of them -- who had eventually come into the leadership of important banking institutions. I pointed out to Professor Taussig that this failure enormously increased the difficulties for government officials who had to grapple with new and unprecedented economic maladjustments. Too often

When these officials appealed to bankers for cooperation and help in matters affecting the public interest, the officials cracked their heads against the stone wall of economic doctrines taught 30 years previously, which had little to do with the problems of the moment.

But how that the Littauer School of Public Administration has invited me here, I hope it will not seem presumptuous if I venture to recall certain experiences which may throw a little light on the kind of problems you may face as public officials. Some of these experiences resemble each other in form and content. Others differ widely. But all touch on these leading questions:

How do you adjust government, its laws and administration to meet the needs of economic and military emergencies at home and abroad, without permanently surrendering or impairing the basic constitutional principles by which the powers of the central government are limited and those of the local government are safeguarded? When and how do you end an emergency device? When you lodge abnormal powers in an emergency agency, how do you guard against the abuses of power? And, above all, how in an emergency do you temporarily use the centralized powers of the national government -- use them with the object of making existing practices, procedures and institutions work more effectively in the public interest?

The questions come easily to the tongue. Yet how do you answer them, not in generalities but in the context of specific cases -- cases that constantly change as national conditions of production and distribution themselves undergo constant changes? It is, in fact, this aspect of constant change, which I have tried to suggest in the title of these notes: "From Laissez Faire with William Graham Sumner to the RFC."

II. CHANGING ECONOMIC AND SOCIAL ATTITUDES

Consider, first, what has happened to the attitude represented by William Graham Sumner, the teacher of my student days at Yale, and a foremost advocate

for the economic and social views held by many nineteenth Century Americans.

It is an irony of American history that the phrase, "The Forgotten Man" as created by Sumner, had for him a meaning diametrically opposite to the one the New Deal later gave to it. It was not raised as an image of those who were the victims of a remorseless individualism. Rather, "The Forgotten Man" was the one who applied himself with unremitting toil to his business and his family yet suffered from governmental interference. For Sumner was an uncompromising Darwinian philosopher of society. He believed that the good of the community could best be obtained if the laws of natural selection, operating among individuals, were allowed free rein. In political terms, this meant that the less government there was, the better.

In the closing decade of the Nineteenth Century, however, this widely held view underwent a vital shift under the impact of the populist discontent, the work of the muckrakers, and recurring panics and depressions. It came to be recognized, first, that coercion was not limited to the abuses the Bill of Rights was meant to check -- namely, those which a government could exert over the rights of individual citizens. It also included the economic coercion one individual could exert over another who, through no fault of his own, was less favorably situated to defend himself. From this discovery there arose the moral concept of the public interest, divorced from the rights of ownership and management and served by the regulatory powers of government. Second, it came to be recognized that the private individual had become less and less in control of his own well-being. With production and distribution organized on a national and also an international basis, an economic crisis could be met only by action as broad as the elements involved in the situation. And from this realization there arose the concept that government itself should take the lead in helping to correct economic maladjustments which no individuals or group of individuals,

however well meaning, could successfully undertake.

The First World War quickened the pace and enlarged the scope of this changing social outlook. Every facet of our society for the first time felt the impact of two questions: How do you initiate measures and how do you define the terms for the exercise of powers which the common interest requires in wartime? Also, how do you enlist private and local forces in the service of the common interest, not by coercion but by voluntary consent and cooperation? As I've already implied at the outset, the questions did not lend themselves to uniform answers. Each answer had to be custom built, according to the needs of the particular problem and the moment.

Let me draw on my personal experiences in World War I and sketch three situations where the price of three different commodities demanded three different methods of handling:

III. THE MANAGEMENT OF PRICES IN WORLD WAR I

(1) The first arose in connection with the price of cotton, following the outbreak of war in Europe. As the British embargo on the shipment of this commodity to Central Europe took hold, cotton dropped to 5 cents a pound. But this cold figure masked the real story. Cotton was the chief crop in the Southern states, and the key to the economic welfare of some 30,000,000 people. If 5 cent cotton undercut the basis of life for these many millions, the massive suction of their fall must vitally affect the remainder of the nation.

Here then was a case where a blind trust in the laws of supply and demand as the automatic guarantor of economic well-being was foolhardy. The laws themselves had been shattered by the impact of a foreign conflict for which the producers and dealers at home were in no way responsible. It was pointless to argue against governmental paternalism and against governmental interference in

production and distribution. The situation demanded a sound political solution to a set of hard facts that laissez-faire economic doctrine could not ease.

With this in mind, I approached the then Vice Governor of the Federal Reserve Board and urged that the United States Government should provide a mechanism whereby loans could be made to the farmers, so as to raise the price of cotton from 5 cents a pound to the then estimated break-even figure of 8 cents. But the Vice Governor denounced me for making this suggestion, and went on to assert that, if this was done in the case of cotton, it would lead to price fixing for every other commodity. Meanwhile, the situation got worse because the closing of the New York Stock Exchange at the outbreak of the war in 1914 barred the Allied powers from selling their American securities to finance the purchase of war materials in this country. Nor could they begin to do this until the end of 1914, when the Exchange was again opened. Only then, when their American securities could be liquidated on a gradually enlarging scale did they have the means for buying our cotton, foodstuffs, munitions and raw materials. Yet all this took time, and until the influence of the restored security markets became effective, our cotton growing area underwent great hardships that might have been avoided. Moreover, the adverse conditions in the South adversely affected the national economy.

(2) The second situation was the reverse of the first. The commodity in question was copper. At the beginning of the war in 1914, copper sold at about 13 cents a pound. But as war demands in Europe made themselves felt, the Allies began to compete with each other, and all competed with American consumers for our available stocks. Production had to be stepped up, and prices began to skyrocket. By February 1917, the little copper that was available sold at 38 cents a pound for spot delivery; copper "futures" for delivery at from 6 to 9 months later, were priced at 32 cents.

All this is by way of a prelude to what I want to relate.

On a Sunday afternoon in February 1917, Mr. Bernard M. Baruch, then head of the raw materials division of the Advisory Committee to the Council of National Defense, told me that he had been asked by the Navy to obtain forty-five million pounds of copper for prompt delivery. He asked my opinion as to the price I thought he should pay for this amount, and how he should get it.

By chance, I had been turning over in my own mind what the price of copper ought to be if we found ourselves in an actual state of war -- which to me daily was more inevitable. In the latter event, it seemed to me that the existing high price of copper had dangerous implications. The prices of other raw materials and finished products were also highly inflated. I felt that when young men would be called upon to risk their lives in the common defense, everyone -- capitalists, industrialists, farmers and laborers -- should also do their part.

Any price formula, therefore, had to have a twin aim. It had to take abnormal profits out of war, and it had to insure the government a steady supply of the materials it needed. I hoped that if the right policy were adopted in the case of copper it would inevitably influence policy in other cases.

The specific formula I suggested to Mr. Baruch was based on the average price of copper for the previous decade. This included eight low price years and two high ones. The average price came to 17-3/4 cents a pound. Mr. Baruch said he had not expected to get copper at that price when the market stood at thirty-eight cents. But then he asked again where and how I thought he might get it.

The largest seller of copper in the country was the American Smelting and Refining Company, headed by our mutual friend, Mr. Daniel Guggenheim. I said to Mr. Baruch: "Why not call on him at the St. Regis Hotel where he is at home every Sunday afternoon?" It was agreed that we should do this. On arriving there, Mr. Baruch explained his problem, and I explained my formula for establishing the price and the reasoning behind it.

Mr. Guggenheim said that he could make no decision until he talked to his brothers, who were his partners, and of course, to the other great selling factors in the industry. But he would try to have an answer by the following morning. On Monday morning, when Mr. Baruch and I picked him up in a car to drive downtown, we were told that the Navy could have its 45,000,000 pounds of copper at 17-3/4 cents, f.o.b. the refinery. The supply was to come from the four largest selling agencies, acting on behalf of certain producing mines which they represented.

When this news was published, of course it made a profound impression all over the country. Later on, it achieved the effect for which I had hoped, in that the producers of other commodities were compelled by an awakened public opinion to follow the pattern set by the copper industry. No coercive powers of government had been used. Mr. Baruch, in common with the other members of the Advisory Committee at that time, had no legal powers to fix prices. I was in no way connected with the government. Yet my proposal seemed right to the large producers. Later, because of wartime increases in production costs as determined by the Federal Trade Commission, the price of copper was raised about 6 cents. This was still 14 cents lower than the level prevailing when Mr. Baruch and I had our Sunday afternoon talk.

(3) In the third incident involving the price level, the commodity in question was lead. At the time the incident arose, I was in the government as the advisor of the non-ferrous metals section of the Advisory Committee to the Council of National Defense.

In the early days of the war, lead was in great demand for use in shrapnel. But through close cooperation between the lead industry and government representatives, the price of the commodity for United States Government and Allied purchase was cut from 12 to 8 cents. There was reason to expect that very large

amounts of lead would be required in the future as in the past, and production went forward on that assumption. Instead, however, the Allied armies began to place an increased reliance on the use of gas and high explosive shells. In the sequel, the demand for shrapnel was sharply reduced, and large surpluses of lead quickly developed. By November of 1917 the pressure of these surpluses had driven down the market price of lead to a low of 4-1/2 cents a pound.

The price was discouraging to production, and the lead mines began a rapid shutdown. The Chairman of the Advisory Committee for the lead industry at this point suggested that a survey be made of our future lead needs, so as to prevent any shortages due to a too sharply reduced output. The findings of the survey indicated that our future needs might exceed current production. To avert this danger, I arranged with the Canadian government to buy the total visible supply of lead in Mexico, and we urged the various departments of our government to make advance purchases suited to their prospective lead requirements. Similarly, we persuaded munitions contractors to take an inventory of their stock and to requisition lead at once against their future needs. The net effect of this was to raise the price of lead to 6 cents a pound, which maintained a sufficient amount of production for long-run purposes. If more mines had continued to shut down because of the abnormal market price of 4-1/2 cents a pound, there would not have been enough lead on hand to meet pressing military needs in the spring of 1918.

What I have tried to indicate in these three examples is that the form of the challenge differed from day to day. At times you had to support the price level. At times you had to restrain it. At times you had to stabilize it. Had we adhered to a rigid attitude in which all answers had been predetermined to meet a fixed theory of what should be done about prices, the result would have hampered our war effort.

IV. THE WAR FINANCE CORPORATION IN WORLD WAR I

May I now turn rather abruptly to another aspect of my theme. I have here the photostatic proof that an emergency agency can be ended, if the will is present to do so. The check you see here bears my signature. It is dated January 5, 1925, and it is made out to the Treasurer of the United States for what was then the unprecedented sum of \$499,000,000.

What it represents is the retirement of the capital stock of the War Finance Corporation. It was a retirement, moreover, that was agreed to and acted upon by the directors of the War Finance Corporation, to head off an attempt in various quarters to prolong the life of the agency after it had served its emergency purposes. Unfortunately, a later generation in Washington reversed this attitude and lent an air of truth to the saying that there is nothing so permanent as a temporary agency.

The activities of the War Finance Corporation may be divided into three main periods. They were, first, the financial and industrial needs of World War I; second, the emergency that arose after the war in the sphere of international trade and in what is now understood as the dollar gap; and, third, the collapse that occurred in agricultural prices and markets here at home. I should explain that during the war I was one of the directors of the Corporation, while during the postwar years of reconstruction I was the Corporation's Managing Director.

The act under which the Corporation was established had two parts. One part created the Capital Issues Committee, the purpose of which was to control and restrict the raising of capital that had no direct war application. The other part created the War Finance Corporation with a capital of \$500,000,000, all owned by the Treasury, with power to borrow an additional \$1,500,000,000 on War Finance Corporation note issues. By these means, the Corporation was to help

finance industries that were necessary or contributory to the prosecution of the war, including railroads and public utilities.

As matters developed, a key item in the work of the War Finance Corporation was the support of the public utilities. In my opinion, the need was due in part to the adverse effects of a precedent set in the case of the railroads. When the government took over the railroads, rates were not raised, but the contracts provided for a net revenue above operating expenses equal to prewar earnings, on a basis authorized by law and set forth in the contract. Nor were rates raised until long after the war, when legislation was enacted which returned the railroads to their owners.

This pattern appears to have left its mark on the conduct of various state and municipal bodies that regulated public utilities. Though they could offer the utilities no comparable arrangement whereby operating deficits would be met from public funds, the regulatory bodies generally continued to hold down the rates to low levels, despite a wartime rise in operating costs. In the sequel, though an expansion of utility services was urgent, the former sources of private credit for utility financing were either eliminated or reduced. The War Finance Corporation had to come to the rescue, the most ^{spectacular} ~~speculator~~ instance being that of the Brooklyn Rapid Transit.

The details of this and other wartime transactions lie beyond the scope of these remarks. Let me generalize, however, by saying that in the case of the utilities, the War Finance Corporation, as an arm of the Federal government, intruded in the local domain in order to help local people to help themselves. In instances where railroads, utility and industrial corporations needed new financing, we found we could produce the best results by assuming the function of underwriters for new issues sold to the public through the regular banking mechanism. This often led to the public's taking the whole of the offering.

Generally in such cases no government funds passed, and the transaction appeared merely in the correspondence of the War Finance Corporation. In other cases when only part of the securities were bought by the public, the Corporation took the unsubscribed portion that remained. These were later disposed of as opportunities arose.

Of course, some of the utility holding companies on inspection proved to be made largely of wind and water, and were beyond redemption. But where there was salvageable material to work with, as where good companies got into trouble which was not of their making, we tried to be helpful. In the case of a new New Orleans street railway, for example, we discovered that its parent company was drowning in water, and no business could be transacted with it. But we loaned a million dollars direct to the subsidiary, and at the same time, induced the City of New Orleans to grant the street railway a fare increase of one cent to help make it a solvent enterprise. So much for what was experienced during the war.

V. THE WAR FINANCE CORPORATION AFTER WORLD WAR I

At the close of World War I -- as at the close of World War II -- America stood alone in its capacity to help restore a stricken world, and in this way secure the peace for which the war was fought. Among many urgent needs, an immediate one was the revival of international trade by restoring the basis of European production. To this end, I drafted an amendment to the War Finance Corporation bill and, on February 25, 1919, in the course of testimony before the Senate Finance Committee which considered the amendment justified it in these terms:

"The countries associated with us in the war have used up an important part of their resources in the long struggle, especially when we consider their

resources from the point of view of international trade. They must economize nationally, and work to regain their lost peace industries as must we, as well.

"They have endured a longer and greater economic and financial strain than we. Left to the limits of their own resources, it will take them a long period to build up their international commercial relations. Unless we extend credits to them, they will be unable to buy from us largely until they can restore exports and sell to us and others.

"We need at once and on a large scale, an outlet for great quantities of our products. We cannot sell if we demand payment now, because our customers have neither the gold nor the goods nor securities marketable in this country with which to make payment.

"We should put our people in a position to extend credit for long enough periods of time to encourage and justify the purchase of our products. It is intended primarily to help our own industry, our own labor, our own finance, and thus our own national well-being.

"Nevertheless, a prompt restoration of international trade will do much more. It will enable Europe to restore its industry and employment of labor, and thus to hasten its political and social peace. Unemployment and hunger are the surest sources of social disorder."

It may be of interest to remark that I used this same language in May of 1946 before the House Banking and Currency Committee which was considering the British loan of \$3,750,000,000.

Under the 1919 amendment, as enacted by the Congress, the Corporation could extend up to \$1,000,000,000 in loans to exporters or banking institutions that financed exporters. As a part of this same process, the formation of export banking institutions was authorized to the extent of 10 per cent of the capital and surplus of the member banks in the Federal Reserve System. It was expected

that when these new export banking institutions were organized on a large scale, they would prove the main channel through which the War Finance Corporation could work in facilitating the financing of international trade.

A number of these new banks were in fact organized and ready to act at a time when Secretary of the Treasury Houston in May of 1920 requested the directors of the War Finance Corporation to pass a resolution suspending all further operations. The Secretary explained that "business is prosperous and involuntary unemployment negligible," and that, under the new conditions of peace, there was no place in our system for an emergency device such as the War Finance Corporation. Because of our relationship with the Treasury, which owned all the capital stock of the War Finance Corporation, the directors felt obliged to agree to the Secretary's request. A suspension -- but not a complete cessation or termination of activities -- was agreed to. Since I was opposed to the whole policy of deflation that was going on at that time, I resigned as Director and Managing Director.

Secretary Houston's action with respect to the Corporation was one of the more important elements that brought on one of the most drastic deflations in American history. That high wartime prices had to come down was acknowledged on all sides. But I maintained that to do this without an international credit mechanism that could ease the decline would prove disastrous. Unfortunately, this proved all too true. Commodity markets, led by cotton, our principal export crop, collapsed. Other agricultural commodities suffered a similar collapse and, in due course, this development was followed by industrial contraction and by widespread unemployment.

What, then, was to be done? At public meetings across the nation called in connection with the work of a Senate subcommittee to which I was attached as an advisor, I argued that the most immediate remedy would be for the War Finance

Corporation to resume its operations in extending export credits. All the funds, resources and legal powers of the Corporation were intact. All that was needed was a go-ahead signal from the Democratic administration. But the Secretary continued in his opposition and nothing was done.

Eventually, however, when the Congress convened in December of 1920, a joint session of the Senate and House Committees on Agriculture inquired into the causes and remedies for the prevailing distress. Here, the Secretary and I collided head-on in our opposing attitudes toward a resumption of the functioning of the War Finance Corporation. The Secretary had presented his case in such an elaborate smoke screen of laissez-faire economic platitudes, that I felt the truth could be seen only if I resorted to a bit of psychological warfare. An opportunity to do this arose when I was approached for a contribution to the European Relief Council which Herbert Hoover had organized to help feed European children. The Treasurer of the Council was Franklin Lane, Houston's former colleague in the Wilson Cabinet. In an open letter to Mr. Lane, I enclosed a contribution to his organization in the name of my "four happy, well-fed children", and then went on to say that "at least some of the underfed and suffering children of Europe are in their present condition as a consequence of the policy of the present Secretary of the Treasury." In America, too, millions of Americans, while not starving, "are nevertheless reduced to genuine mental and material distress because of the same policy so ruthlessly carried out."

The rest of the letter reads:

"We accept the idea that in war life and property must be freely sacrificed to maintain a great principle. History records no precedents, however, for the wholesale sacrifices imposed upon the civilized world by the Secretary's present policies for the purpose of maintaining the petty platitudes of the outworn political economy which he proposes.

"The cheeks of the children of Europe are gaunt with hunger, but the cotton seed that would furnish them the needed fats is rotting on the fields of Mississippi; they walk in tatters, and the cotton fields are white with cotton it does not pay to pick.

"The sleek, breeding herds of the prairies, whose get is needed for the coming years, are led to slaughter because our financial leadership in the Treasury confesses itself impotent.

"The corn and wheat of our great granary states lie in the bins because the farmer cannot sell, in the present demoralized market, without making himself a bankrupt, yet we are told by the head of the finances of this country that 'nothing can be done.'

"The factories of New England are idle and their labor unemployed, not because their product is not wanted, but because our domestic and international organization for the production and distribution of goods is suffering a breakdown, yet we are solemnly advised that 'nothing can be done.'

"I should feel like a slacker for the rest of my life if I failed to lift my voice in protest against such an absurd and disgraceful condition."

In publicly attacking the "do nothing" policy of the Treasury in 1920, I was not advocating any system of planned economy. As I made it plain on that occasion, and on all prior and subsequent occasions, I was opposed to a planned economy. As a staunch advocate of private enterprise, I was merely urging the adoption of short-run emergency measures that would meet an unusual and critical situation; that would stimulate and encourage the normal functioning of existing private agencies and, in this way, alleviate suffering and hardship.

As a result of these discussions and hearings, a Joint Congressional resolution was promptly passed, directing the Treasury to revive the activities of the

War Finance Corporation in the field of export credits. The reply from the Treasury came in the form of a Presidential veto which was overridden by a vote of 50 to 6 in the Senate, and 250 to 66 in the House.

Secretary Houston had promised that he would act according to the will of the Congress. Nevertheless, after the veto was overridden he justified a continuation of the do-nothing policy by claiming that there was no demand for the export loans contemplated in the act. I was therefore compelled to repeat again what I had said before the Joint Committee on Agriculture, namely, that the principal thing about doing anything is to want to do it. In this case, it was impossible to get the War Finance Corporation into full operation simply because the Secretary didn't want it to. The impasse, however, was broken when President Harding reappointed me to the post of Managing Director a few days after his inauguration.

At this juncture, however, a new aspect of the international trade problem, as it affected our agricultural exports, had to be considered. The situation, briefly, was this. In the days when Europe was the financial center of the world, the American farmer sold his export crops to Europe within a short time after they came to maturity, using the returns to meet his financial obligations and to provide a stake for the next operation. In varying proportions the burden of storing and financing these crops was carried by European buyers. They maintained large inventories which they gradually distributed throughout the winter and spring to their own and other countries while they waited for a new crop in autumn.

As long as the Treasury of the United States continued to make loans to our war-time Allies, European prewar financial and marketing practices of our agricultural exports remained relatively unchanged. But when the Treasury ceased to make these loans around June of 1919, international exchange conditions prevented Europe from making purchases except for current needs. This in turn demanded a change in the timing of our marketing system here in America. Moreover, the failure to apply a brake to the decline in the price level of our agricultural

commodities was paralleled by sharp fluctuations in the value of sterling and Continental currencies. In fact, these exchange fluctuations were as great and sometimes greater than the fluctuations in commodity prices. Since the European buyer had no way of determining whether he would gain or lose on commodities which he would have to pay for in dollars and sell in terms of an unstable currency, he was naturally reluctant to burden himself with inventories. Nor, for the same reason, did he have as great an interest in an extension of long-term American credits.

Meanwhile, here at home, the demoralization of the commodity market during the deflation, forced a similar policy of caution on to our merchants and manufacturers. They, too, hesitated to make bulk purchases for future use when they did not know whether the price structure would suffer a further decline or swing upward. So they generally operated on the basis of the lowest possible stocks, buying only to supply the current demand.

The combined effect of what was happening in Europe and in America forced large quantities of raw materials back on the original American producers and on the small banks which were incapable of meeting the unprecedented job of carrying crops for abnormally long periods. Large number of banks and our agricultural producers alike were unable to liquidate their loans or debts, and the result was a condition of acute distress in the agricultural sections of the country.

Thus we were confronted with a twin need to provide both a storage and financial mechanism for the orderly marketing of our agricultural commodities, to prevent their dumping in pell-mell fashion on the domestic market in order to get any sort of price for them.

The Agricultural Credits Act of 1921 was passed in August in response to the existing abnormal situation. It added powers to the War Finance Corporation to make advances to banking institutions, livestock loan companies and cooperative marketing associations for agricultural purposes, including the breeding, raising, fattening and marketing of livestock.

Here again it is beyond the scope of these notes to describe the nation-wide task the War Finance Corporation assumed under this new grant of power. I can only deal in generalities. We had to create an auxiliary banking organization administered from Washington, but operating at a grass roots level. At that level, the War Finance Corporation formed 33 agencies which covered all important agricultural regions, and which were in charge of committees of local bankers and businessmen. These committees received applications for loans, examined them, negotiated with borrowers, and recommended to Washington the decision they thought should be taken in each case. In summary, the auxiliary banking system that was brought into being under the Agricultural Credits Act of 1921 enabled the War Finance Corporation to meet the change in European buying and storing practices, by assistance to local banks, cooperative and livestock loan companies--all with the single aim of contributing to the orderly marketing of our produce on an annual instead of a seasonal basis.

At last, however, in the mid-1920's, the War Finance Corporation, which had dealt with one emergency after another--including bank runs, droughts and floods--seemed justified in terminating its activities. We wanted no further extensions of time in which to exercise our powers. So we took the lead by retiring our capital stock, as evidenced in the photostatic copy of the check I showed you a moment ago. I should add, however, that this liquidation would not have been possible had it not been for the Intermediate Credit banking system in whose creation the directors of the War Finance Corporation played an important part. These new banks took over the work of the Corporation on a permanent basis to fill an existing void in our credit mechanism. As for the War Finance Corporation, in the end it returned to the Treasury not only all of the capital funds which the government had subscribed. It also returned the cost of the money after deducting all operating expenses and losses.

VI. THE FARM LOAN BOARD

Thus far in these notes, I have withheld all mention of the moral factors which are involved in the management of public business. I know of no better way to introduce this new theme, than to quote from what William Penn wrote when he drafted the basic law for the Commonwealth of Pennsylvania. "Governments, like clocks, go from the motion men give them," William Penn said, "and as governments are made and moved by men, so by them they are ruined too. Wherefore governments rather depend upon men than men upon governments. Let men be good, and the government cannot be bad; if it be ill, they will cure it. But, if men be bad, let the government be ever so good, they will endeavor to warp and spoil it to their turn."

The force of this remark, while true in all operations of government, whether in periods of tranquility or crisis, acquired a special intensity in the course of an assignment which I undertook in May of 1927. At that time, I was appointed by President Coolidge to be the head of the Farm Loan Board, bearing the title of Commissioner. It was this Board which supervised the operations of the Farm Loan System.

The System itself, I should explain, had three parts. The first consisted of Federal Land Banks. They were cooperative in character and were joined together by mutual guarantees so that the strength of all could be summoned to the support of any one. The second consisted of the Joint Stock Land Banks. In part these were previously existing mortgage loan companies, privately owned and organized on an individual basis for private profit. In aim, both types of banks were designed to assist farmers in buying and refinancing land at reasonable rates of interest on mortgages, and for a sufficient period of time. They could do this because the banks had the privilege of issuing tax exempt bonds, and could thereby attract funds with which to make long-term loans at reasonably low rates. By the spring of 1927, the outstanding bonds of the Federal Land Banks were about \$1,700,000,000, while those of the Joint Stock Land Banks were about \$800,000,000.

The third part of the Farm Loan System consisted of the Intermediate Credit Banks which I have already mentioned in a different connection. In origin, they were meant to provide a mechanism suitable to the financial requirements of agriculture, including loans on livestock, and for the special benefit of the breeding end of the animal husbandry industry. All the capital for the Intermediate Credit Banks was originally provided for by the government, with each bank being entitled to issue tax-exempt debentures amounting to 10 times its capital.

For several years preceding the spring of 1927, there had been clear signs of mismanagement in the System. The chief source of trouble lay in the Joint Stock Land Banks. Three of these eventually went into receivership, while many others were seriously weakened. But in addition to the Joint Stock banks, a number of important Federal Land banks were also badly managed. Nor was this all. The Intermediate Credit Banks had not been directed in a way that served the main purpose for which they had been designed. In particular, they had been indifferent to the all important job of financing the breeding end of the livestock business. Yet the full story of this cumulative decay, originating in the Farm Loan Board itself, and spreading outward, could not be told publicly without imperiling confidence in the System as a whole.

In my other government assignments up to this point--in the War Industries Board and in the War Finance Corporation--I had been in a position where I could help develop an organization and procedures which materially influenced the course of public policy. But the Farm Loan Board and the System it supervised, represented a different sort of challenge. It did not involve the creation of a new program. It involved the rescue of an existing program that was intrinsically good, but which was threatened by entrenched administrators who in some cases were only lazy; in others, also incompetent; and in still others, who added dishonesty to their disqualifications.

To clear the ground from what was rotten and to build with solid materials, I found that we had to dismiss some officials; to transfer others to positions more suited to their abilities; or to refuse to reappoint those who could not adequately fill their jobs. As the chief executive officer for the Farm Loan Board, this brought down on my head a sustained and prolonged attack by powerful politicians who saw disappearing the patronage system which they had previously enjoyed. Ironically, one of the most hostile of these men was a Senator who was among the original sponsors of the Farm Loan Act of 1916 which had brought the Farm Loan System into being.

What does one do in the face of attacks of this sort?

The answer, as I envision it from personal experience, is simply this. It is to stick to the truth, and the truth will serve you well. It is to respect the law at all points, even if you must offend the very men who framed the law, and who want you to ignore it for their special interest. It is to give such consistent respect to your role as public servants, that you are prepared to resign from government rather than fail to do your duty.

VII. THE FEDERAL RESERVE SYSTEM

Here, the chronology of events would call for a discussion of the monetary and credit policies that were pursued during the troubled years of 1930-33, when I was Governor of the Federal Reserve Board. Yet that subject has so many ramifications, that to relate any part of it, while other parts are omitted, would leave you with an inadequate picture. I believe, therefore, that I can make the best use of my remaining time by dealing with certain administrative problems I encountered in the Federal Reserve System.

Preceding my appointment as Governor, the Reserve System was torn by strife at the very time when the Board in Washington, the banks of the Reserve districts, and the member banks should have worked in concert to deal with a gathering

economic crisis. Yet there was ill feeling between the New York Federal Reserve Bank and the Board in Washington, between the New York bank and the Chicago bank and other interior banks. And there was ill feeling within the Board itself. In the latter case, it often led to a 3 to 3 voting deadlock on important policies-- a deadlock that required the intervention of the Secretary of the Treasury who cast the deciding vote.

Within the Board itself, one of the root causes of trouble was that each member was assigned two Federal Reserve districts over which he had special charge. In turn, this division of work led to a fragmentation of information. That is, it prevented the Board as a whole from having access to all the facts required for any decision, whether it bore on national economic conditions, or on specific institutions. As rapidly as possible, I ended this system of divided jurisdictions and responsibilities. All the business of the Board was put under the Board as a whole, while we relied on the technical staff of examiners and lawyers to report and discuss problems with us. The Board sat as a unit, so that all the members were informed of conditions and problems at the same time.

Similarly, in my capacity as Governor, I adhered to a strict rule I had developed earlier in the War Finance Corporation and the Farm Loan Board, and which was applied at a later date to the affairs of the Reconstruction Finance Corporation. The rule was that I would bring the Federal Reserve Board's business before the Board, and would not try to dispose of that business in my private office.

In line with all of these changes, for the first time in the history of the Federal Reserve System, the Economics Division was brought into a proper relationship with the operations of the Federal Reserve Board. At the time of my appointment as Governor, one member of the Reserve Board seemed to be in charge of all economic and financial research activities, and the Division was scattered throughout different buildings in Washington, with the result that a great many of the

staff members did not know each other personally. I united them in a building near the Treasury.

Once this was done, it was possible to bring representatives of the division into close contact with the Reserve Board. Men from the legal and research staff also were invited to attend meetings of the Board and present their views when matters on which they were working were being discussed. This seminar sort of approach helped them in their work, and it also enabled the Board to have the benefit of the opinions and specialized knowledge of the technicians. These changes have since become permanent features of the Reserve Board, though with time and experience they have naturally been greatly developed and improved.

By these means, the friction that had existed in the Board was reduced. The friction between the Board and some of the Reserve district banks was due to the weakness of those who had been appointed governors of certain banks. This, in turn, however, resulted from the former weakness within the Board itself. The Board had failed to show the strong hand it could have exercised when these governors were selected. More specifically, regardless of who had the authority to elect the governors, the salaries of these men were under the control of the Board, and none, therefore, could really be elected without the approval of the Board.

The use of this device as an instrument of supervision over the quality of the governors was, I felt, entirely proper. One case stands out vividly in my mind where the failure to use it in a former day had a disastrous result in my day as Governor. A large bank--not a member of the Federal Reserve System--but of considerable size and importance, closed suddenly on a Monday morning. The Governor of the Federal Reserve Bank in the city where this occurred should have been alert to the situation. For the clearing house bankers in the same city had met Friday night, all day Saturday and Sunday to consider whether they should act collectively to save the institution. Yet the Governor of the Federal Reserve

Bank was without knowledge of the matter.

On Monday morning, I was called up by the Secretary of the Treasury and asked what I knew about the closing of the bank. I said I knew nothing. The Secretary then said that President Hoover had been called on the phone by interested parties and wanted the facts. I told the Secretary that I would get them for him. When I called the Governor of the Federal Reserve Bank at his home in the country, he confessed that he knew nothing about the closing of the bank. What the case boiled down to was that the big bankers of an important city had no respect and no confidence in the Governor of the Federal Reserve District bank, and therefore had not consulted him during their three days of deliberation. His lack of importance in the banking community weakened the proper operations of the Federal Reserve System--a weakening that could have been avoided had the Federal Reserve Board used its veto power when the man was first nominated for a key position in the financial mechanism of a great metropolitan region.

VIII. THE RECONSTRUCTION FINANCE CORPORATION

Now for a brief discussion of a big subject. If William Graham Sumner spoke for the laissez-faire theory of the 19th Century into which I was born, the RFC was the dramatic symbol of the opposite theory. It represented the need for far-reaching governmental intervention in the functioning of the private enterprise system--a system which had undergone a cataclysmic cycle of boom and bust.

At the risk of over-simplification, let me summarize the main factors which, in my opinion, caused that boom and bust. They included the gross mismanagement of war debts and reparations, unsound lending of American capital abroad, excessive and unsound real estate financing at home, the speculative frenzy which spread from the real estate market to the stock market and to the commodity market, no national supervision of the issuance of stocks and bonds, and the evil effects of the nation-wide expansion in the so-called "affiliates" of our larger banks and trust companies.

I list the mismanagement of our war debts and reparations as being first in importance because, in my opinion, it was the key to the world-wide economic maladjustments which followed the end of World War I. After a decade of temporizing, the Young Plan was agreed to in 1929 as the basis for a final and practical settlement of the reparations problem. It was, in fact, an absolutely impractical solution.

As I argued with the first American I saw who returned from the Young Plan meeting in Paris, Germany was poor in natural resources. Its only national resource was German labor. Thus, if Germany was to get from its exports a balance of \$500,000,000 in gold per annum to pay for its reparations under the Young Plan, the burden would fall on the German workingman. Imagine how many extra hours he would have to labor to create that balance, after Germany had bought 20 to 25% of its food supply, paid for all its cotton, and almost all of its copper and the other raw materials which it imported? The excess number of man-hours that would be required for the purposes of war reparations would be fatally and disastrously out of range with any human capability. And since Germany could not physically secure a balance of five hundred million dollars in gold per annum, neither could our former Allies pay their debts to us, since the discharge of those debts was linked to the amount of reparations those countries secured from Germany.

I would not venture an unqualified private opinion that the impossible burden of reparations was responsible for the rise of Hitler. But some of our able officials who were in Berlin when Hitler was making his bid for power, have felt that the economic disaster originating in excessive reparations, and which, in turn, was related to the attempt to collect war debts from our former allies, gave Adolf Hitler the means by which he turned the German state into a dictatorship.

In 1930 the handwriting on the wall pointing to a world-wide economic disaster was painfully clear to me. At that time, I urged President Hoover to call an international conference where war debts and reparations alike would be sharply

scaled down to a figure in line with Germany's capacity to pay war reparations. But neither the Republican nor the Democratic leaderships had been willing through the years to face hard facts. They insisted that war debts and reparations were separate problems, when they were in truth closely interrelated.

On September 21, 1931, the British went off gold, an event that had world shaking consequences. When this occurred I warned that it threatened calamitous results. I argued that a large part of world trade was transacted in sterling, and that, when sterling was shaken, trade would be violently dislocated. I stressed this point in conversation with President Hoover and suggested that he call an extra session of Congress so that the Congress would meet the domestic and international aspects of the emergency by reviving the War Finance Corporation with much larger and wider powers.

The President rejected this idea and suggested instead that a meeting of bankers and businessmen be called to create a national credit association with \$500,000,000 capital. Its purpose would be to help banks in need and to loan against the assets of closed banks, so as to melt their frozen funds. I felt strongly that this alternative plan was inadequate; that only through a revival of the War Finance Corporation could the emergency be met. But since the President was opposed to this course, after a good deal of difficulty, I arranged the meeting he requested. The place chosen was the Washington apartment of Andrew Mellon, the Secretary of the Treasury.

I regret to say that my files contain no transcript of what was said at this meeting. But, as I recall the general sense of what transpired, I believe the group was addressed by the President, and by the Secretary and Under Secretary of the Treasury. All of them urged the bankers and businessmen to organize the National Credit Association, but without visible effect. The three men then retired from the room and left me to do what I could. I realized that the group would not make the subscription requested of them except on one condition. And

in my remarks I stated that condition without consulting my superiors in the government. In asking the bankers and businessmen for their cooperation, I said that, if economic trends continued to develop so unfortunately that the National Credit Association proved inadequate, I would do all that I could to get the Congress to revive the War Finance Corporation, with greatly expanded resources and authority.

On the basis of this assurance, the group agreed to create the National Credit Association. As soon as it was formed, I went again to President Hoover and said that the Association was not big enough and powerful enough to meet the emergency; that, in my opinion, the War Finance Corporation would have to be revived. As I've already indicated, since this entailed an extra session of the Congress to which the President was opposed, my argument, once again, got nowhere.

Meanwhile, I started work with some staff members in drafting what eventually became the Reconstruction Finance Corporation Act. Though its scope and powers went far beyond those of the War Finance Corporation, the underlying philosophy was the same in both cases. The RFC was to be only a temporary measure to meet an extraordinary, unusual and critical situation. For this purpose, the power and credit of the Federal government was to be gathered in a single institution which, under proper safeguards, would serve to stabilize and strengthen the agencies through which the production and distribution process was conducted. Moreover, the RFC was to do this not alone with respect to operations which were nation-wide in character. Through a broad assortment of agencies, it was also to do this for the smaller and more local areas of economic activity.

It was not until a few days before the Congress convened in its regular course that President Hoover indicated he would approve the introduction of the RFC bill. In its original version, the measure was deliberately written in broad language so as to permit the Corporation the widest possible latitude in

its financial operations. For example, one field of activity I had in mind was that the RFC would make loans to financial institutions for the purpose of carrying raw materials, agricultural products and other American commodities. This idea was later developed in the Commodity Credit Corporation, created by the New Deal. But Senator Glass objected to the broad language in which the RFC bill was drawn, and claimed that I was asking for more power than any man should command. Upon his insistence, the version of the bill that was reported out of committee for Congressional enactment, itemized--and in this way, narrowed down the specific areas in which the RFC could act. My proposal for loans to institutions that would carry American raw materials and commodities fell a casualty to this straight-jacket, with results that were most unfortunate.

In the original draft version of the RFC bill, too, I did not plan to be a member of the Board. But the condition of the Democratic support, as stated to me by Senator Joe Robinson, was that the bill would be drafted under my supervision and that I would be the directing head of the operation. This was accepted by Mr. Hoover and, in turn, by Democratic leaders. And so the bill was rewritten to make me an ex officio member of the Board, the understanding being that I was to be elected chairman by the directors when the Corporation was organized.

Faced by the urgent requirements of the moment, there was good reason for me to serve in a dual capacity. With speed and efficiency being a prime requisite in getting the RFC launched, the new corporation would need great help from the Federal Reserve System. As Governor, I could at once mobilize the existing machinery of the Federal Reserve--office space, communications and above all personnel--for the use of the RFC.

The RFC began to function at full blast within ten days after Congress approved the measure in January of 1931. Subsequently, John Garner, Speaker of the House, pushed through a resolution in the House compelling the RFC to send him a monthly report which he published of every bank that borrowed money. All this

was advocated in the name of putting a curb on any favoritism. The principle of reporting was sound enough. But, as I then argued, the prudent course would have been to withhold publication until some time after the loans were made, trusting to the investigating power of Congress to call the RFC to account for any irregularities. What actually happened under the Garner resolution was that, in the frenzied climate of the period, publication of loans to banks shortly after they were made, tended to defeat the purposes of the RFC, in that it brought each bank into the fierce glare of a spotlight and induced panicky depositors to withdraw their funds.

Nevertheless, six months after its organization, the work and personnel of the RFC had developed sufficiently to warrant my request to be relieved of ex officio membership in the RFC, so that I could devote all my time to the Federal Reserve Board. The request was granted, by legislation passed in July 1932. As I recall, in a half year of operations to that date, the RFC had approved loans totaling \$1,800,000,000.

There is very much more I could tell you about this period. And, indeed, I feel at times to be very much like the minister who explained that he gave long-winded sermons simply because he was too lazy to stop. Yet my watch demands a stop, however arbitrary, at some point. And I do so now, saying only that as an emergency institution, the RFC took on a permanency long after the facts which brought that institution to life had undergone a fundamental change.

No institution which provides a pipeline from the Treasury to the voter can over any stretch of years be administered in a way that will avoid the corrupting influence of political pressure. As I hope these remarks have indicated, I have always believed that it is a sound principle of government in exceptional conditions involving the national interest, to depart from the ordinary rules of governmental activity and provide exceptional and temporary institutions and measures for dealing with temporary and unusual conditions. But I have always

emphasized that once conditions become normal, the men who are in charge of emergency institutions should themselves take the lead in putting such institutions on the shelf.

Under normal conditions, we don't look for emergencies or for crisis situations that may lie directly ahead. After we've experienced them, we feel that we now understand how to avoid them. This last may be true to a considerable extent. But conditions of life change and new situations arise where the critical factors are different. History seems to indicate, I am sorry to say, that in encountering new conditions we make new mistakes, so that with all the wisdom and knowledge of the past, no one has any assurance that he will be right the next time.

Because of the time lag involved in grasping the significance of the new critical factors which make a situation a dangerous one, the public administrator must hold himself ever ready to re-examine the principles of his own action and the conditions of the society in which he functions. He must bring to his task an independence of judgment, a vigorous power of analysis, and a will to act in the light of his own best conscience, despite the pressures too often encountered in public life which would have him act differently. In the supreme sense of the word, he must prefer to be right than to be President. And that takes honesty and courage above all. The future looks to the administrative leaders to bring the highest qualities of the human capacity to the consideration of all that vitally affects our public interest.

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