REMARKS MADE BY A. C. MILLER

IN THE COURSE OF A DISCUSSION ON

FEDERAL RESERVE CREDIT POLICY

at the

JOINT CONFERENCE OF THE CHAIRMEN AND GOVERNORS

of the

FEDERAL RESERVE BANKS

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There are one or two words, Governor, which I think I might say. I have been very much impressed by what the Comptroller has said. I think all of us must be very much impressed with the clearer appreciation of our problems which this discussion of rate policy has evidenced. In that regard it surpasses any preceding conference. I was particularly delighted at the frank avowal of Mr. Strong that the British discount principle of always maintaining reserve bank rates above going market rates was not applicable to American conditions. The whole tenor of the discussion here this morning indicates above all that there is increasing appreciation on the part of the managers of the Federal Reserve System that the Federal Reserve Banks are partners in American industry and enterprise and that the touchstone of the successful operation of the Federal Reserve Banks is to be found in what those banks do to assist the production and distribution of goods. They, therefore, function best when they help to promote and maintain a good state of industry and, as an essential to that, a healthy condition of mind on the part of the business and producing community.

I am sure that we would err egregiously in the administration of the Federal Reserve Banks if we overlooked the fact that the Federal Reserve System in our country occupies a much more intimate relationship to industry than the Bank of England does, for instance, to business and industry in that country. Our judgments are of very much more concern and are of very much more effect in their economic incidence than the judgments of any other reserve institution anywhere in the world. A good deal has been said in the discussions yesterday and this morning concerning the principles governing discount rates. Let me say frankly that I am very skeptical of the value of so-called principles in a matter that is so much a matter of judgment based as it must be upon conditions and circumstances. I, myself, would, therefore, be very hesitant in laying down a principle in the matter of discount policy. I may, however, say in contradistinction to the oft repeated statement that Reserve Bank rates should be above market rates that I believe our constant study should be not to see how high we can maintain rates but how low we can safely go in establishing rates without inviting dangers of unhealthful developments in business and industry. This is not inflationist doctrine; this is the economic view.

The cost of credit is an element of cost of production. Providing business and credit are in a healthy condition, there is no reason for the Reserve Banks doing anything that adds to the costs of credit. When industry discloses tendencies toward speculative expansion, then is the time to add to the cost of credit. I believe that it is the part of wisdom to recognize that in the formulation of a discount policy and in the adjustment of discount rates we should seek just as earnestly to avoid deflation as we should to avoid inflation. By inflation I mean an expansion of credit that eventuates in a rise of general prices. By deflation I mean a restraint of credit that eventuates in a fall of prices. Good economic and credit policy will endeavor to steer a middle course between these two dangerous shoals.

A year or fifteen months ago the business and industry of the country began their descent from the apex of speculative expansion into the trough of depression by way of the most violent reaction of prices that we have ever experienced in this country. Now, where are we at the present time? We are still in the trough of depression, but we are beginning to see here and there little symptoms of animation and recovery. It would not surprise me to see a condition of monetary ease develop in the United States where commercial rates would go as low as 4½ per cent. I mean market rates, not discount rates at the Reserve Banks. I hope no condition of extreme ease comes to pass. We have, however, in former periods of extreme business depression seen a great accumulation of idle funds at the great centers, so great that no rate could be made low enough to induce borrowing, because the outlook for the profitable use of borrowed funds was too unpromising. That was true after the crisis of 1873, again after 1893, and it may prove true in

1921 or 1922, though I believe and I certainly hope that before long there will be a business revival of healthy character and considerable proportions such as will make a demand for credit and keep rates from sliding simply because nobody wants to borrow.

I think the probability is that for a good many years to come, certainly I believe for five years and possibly it may be for a period as long as ten years, we shall have to deal with very rapidly shifting scenes in the business world. I look for very frequent alternations of periods of short lived and feverish activity in business and industry followed by periods of acute, short-lived depression. In other words, industry will have to travel an uneven sea. Such has usually been the case after all great economic crises induced by great wars. That was true after the Napoleonic war, which supplies the nearest analogy to the present situation. It was also true after 1873 when readjustment followed a badly disturbed course lasting at least five years, and on no one of these occasions was the whole structure of industry and commerce of the leading producing countries so badly dislocated as at the present time.

We have got to be prepared, therefore, to deal with conditions and circumstances as they develop and not according to fixed principles. This means that we must always strive to maintain in the Federal Reserve System great flexibility of mind. Our principal pre-occupation, I repeat, should be to deal with conditions and circumstances rather than with principles. We have got to do just what a wise physician does,when he at times hesitates to give a patient a small dose of some powerful medicine and at other times does not hesitate to give him a very heavy dose. We have got to base our judgments and bottom our policies upon facts rather than upon preconceptions.

Now, at the moment, what is the outstanding fact in the industrial situation? It is that industry is still pretty far down in the trough of depression. What does this suggest as to a proper rate policy adjusted to circumstances? I am of the opinion that at the present time no rate at a Federal Reserve Bank could be made so low that it would induce borrowing for the sake of what would be called illegitimate uses. Banks do not borrow from the Federal Reserve Bank for fun or simply because money is cheap. Nor do merchants and manufacturers borrow from their banks simply because money is cheap. You can lead a horse to water but you cannot make him drink. When he will not drink you cannot regulate the amount of his drink, but when he wants to drink you can regulate the amount he may drink by regulating the amount in the trough. And so it is pretty much with respect to the relation of money rates at Federal Reserve Banks. It is when things are on the upward move that the Federal Reserve Bank can become a very real influence in restraining what in its judgment is an unhealthful and undesirable tendency, by advancing its rates. It can, in other words, through a wise and timely application of increased rates do much to restrain, if not altogether to prevent inflation. At the present time, however, there are no undesirable tendencies of this kind in the business situation. Business is sick and it needs whatever modicum of comfort and support it can get from a cheapening of the cost of credit.

There has been some discussion here of the influence actually exerted by Reserve Banks' rates upon the rates charged customers of member banks. There is some difference of opinion as to how extensive is the influence exerted by changes of Reserve Bank rates. I think it is a fair reading of the mind of the conference to say that in one way or another the actual cost of credit to borrowers at this time is influenced by Reserve Bank rates to a sufficient degree to make it necessary for us to recognize the bearing that Reserve Bank rate changes have in the immediate economic and industrial situation. We have got to recognize the fact that when business is being done as it is at the present time on very narrow margins, an addition or subtraction of 1/2 or 1 per cent in the cost of borrowed funds is a matter of a great deal of moment. A reduction of Reserve

Bank rates in such circumstances may have a considerable effect in quickening the pace of industry and in accelerating its revival. On the other hand, I think it not at all unreasonable to anticipate that within a period of a year, or even possibly six months, we may have a spurt of activity in certain portions of the country at least that will make it very desirable to take a firmer grip on the reins. We may even see speculative and inflationist tendencies develop to a point where it will be advisable to press on the curb. That is not, however, the situation at the moment. The runaway horse has been brought to a standstill, let us relax our grip, giving him a little rein, if we think by doing so he will show some disposition to move along.

I am disturbed but not surprised by what the Comptroller has reported of a recent conversation with a gentleman whom he regards as a competent interpretor of public and congressional opinion. I have recalled a great many times to myself in connection with the perils through which the Federal Reserve System has been passing in recent months, what it was that really brought the Second Bank of the United States to the brink of dissolution. Aside from the mass of rather secondary political and factional charges, it was the great expansion of credit supported by that institution in the year 1832 followed by the violent contraction of credit in the winter of 1833-4. This begot in the minds of people, not all of whome were sympathetic with Andrew Jackson in his attack against the Bank, the conviction that the Bank had too much power, that it was an arbiter of economic destiny, that it could make or mar the prosperity of the country by assuming a liberal or illiberal attitude in the matter of credits. I think there are symptoms that not a few people in the United States at the present time are of a similar opinion with reference to the Federal Reserve System. I think the influence of the Federal Reserve System is in danger of being over-emphasized both by its enemies and by its friends. It is important, therefore, that our policies should be carefully and quickly adjusted to the trend of conditions in order to minimize the baneful effect of either exaggerated criticisms or unwarrented expectations. The people are in a certain sense partners - sometimes silent, sometimes active - in the Federal Reserve System, and what they think or what they believe, what they hope or what they fear is a factor not to be overlooked by us.

I have stated a good many times in Federal Reserve discussions that in my judgment the word <u>contraction</u> had no place in the vocabulary of Federal Reserve banking. Nothing is surer than that the American people will never stand contraction if they know that it can be helped. Least of all will they stand contraction if they think it is contraction at the instance, or with the consent of an institution like the Federal Reserve System, set up under public statute and public in its responsibility and character. I am glad, therefore, that the Comptroller has brought into this discussion the fact that the people are partners with us. But let me add by way of caution that I do not mean by this that we must let "politics" into the Federal Reserve System.

There is a great difference between "politics" and public opinion. The less we have of "politics" in the Federal Reserve System the better for the Reserve Banks and for the people. In the long run, however, the Federal Reserve System will not succeed and in my judgment will have no right to think it is succeeding unless it has the substantial approval of average public opinion; - and for this reason principally: that public sentiment and public opinion in economic and financial matters in our country reflect the experiences, the conditions and the difficulties the producing elements of the population are going through. The thought on public matters of an economic character of the average American is formed by his daily experiences as a bread winner more than by any other single factor or circumstance of his life. We cannot ignore the fact that the Federal Reserve Banks are a factor in industry, in agriculture, and in commerce. Still less can we ignore the fact that this is believed and understood by the average man. We cannot ignore the fact that states of trade and industry are very largely influenced by states of mind. Least of all can we ignore the fact that at certain times the policies, particularly the discount policy, of the Federal Reserve Banks can influence and induce states of mind. Timeliness of action is of the essence of successful Federal Reserve action. Right action, above all, means timely action. Herein I think the Federal Reserve System has need of improvement. I want to do all that I can to emphasize what the Governor said in his opening remarks, if I got his meaning, - that our action in the matter of discount changes has frequently been too slow. As I would put it, we have too frequently followed where we should lead. Action on the part of a Federal Reserve Bank is valuable in just the degree in which it correctly anticipates either an upward or downward swing in the movement of business and credit. It is a dangerous proceeding to wait till you are on a downgrade and then jam the brake on suddenly. Begin to set your brakes when you see what is going to happen. No Reserve Bank can develop a successful discount policy except on the basis of foresight. I repeat, we should lead. We should lead upwards in the matter of rates and we should lead upwards to prevent or mitigate inflation; we should lead downwards to prevent liquidation from becoming a straight-jacket of deflation. We should not hesitate for a moment to reduce rates when we believe that conditions are weakening, liquidation proceeding, and business slackening, just as we should not hesitate when we see that business is swelling unhealthily and its momentum is being accelerated by unhealthy market conditions, to anticipate and by anticipating to prevent their consummation in disaster by applying the brakes soon enough to prevent that extreme being reached. The Reserve System cannot "make" the business situation but it can do an immense deal to make its extremes less pronounced and violent.

It has been very interesting to me, as one who has devoted most of his time to the study of economics and economic history to note with what unerring certainty what are called business cycles recur. I have often wondered how long it would take the business man and the banker to appreciate the bearing of the business cycle upon him. It has long been recognized by economists that modern business moves through cycles; that one extreme of the cycle is the phase of violent speculation giving rise to extreme business tension and collapse of prices, that the other extreme is the trough of depression, such as we are in at the present time. If I were to make one general observation, call it a principle, if you prefer - that makes it sound a little more impressive - it would be that the discount policy of the Federal Reserve Banks should always address itself to the phase of the business cycle through which the country happens to be passing. In the degree in which it is successful in correctly interpreting the trend of affairs and anticipating the approach of the next phase of the business cycle and translating this into its equivalent in terms of discount policy, the Reserve System will be a great and useful institution - in brief, a success.

I see the Federal Reserve Banks in their larger economic relations as <u>moderators</u>. It is the business of a Federal Reserve Bank to moderate the pace of business when business is very good, because experience has demonstrated over and over again that when everybody thinks and feels that business is very good, it is seldom as good as thought. On the other hand, it is the business of the Federal Reserve

Banks to moderate the retreat of business when business is getting bad, because experience has demonstrated time and again that business need never get as bad as it will if it is allowed to go its downward course unassisted. If I correctly interpret the temper of this conference, much has been said that is extremely reassuring that we are looking in the right direction in the Federal Reserve System. I believe we understand our opportunities and our responsibilities. Above all should we understand that we must ourselves develop independently out of our own experience a discount policy suited to American conditions. We must recognize that the conditions which obtain in the United States are different from those which obtain anywhere else in the world; different from those which obtain in an old and conservative bank center like England or in a new and untamed country like, let us say, Argentina. We in the United States need to take an economic view of the discount function of the Federal Reserve Bank and we need to do it in a large and comprehending sense. We need to do it in the spirit of the Federal Reserve Act itself. It is well to recall the words of that Act (I have often wondered who was responsible for their authorship). They occur in Section 14, where, in describing the powers of the Reserve Banks and Reserve Board with respect to rates it says rates shall be fixed "with a view of accommodating commerce and business".

What does "Accommodating commerce and business" mean? I will not undertake to explain what I understand these words to mean further than has already been suggested in what I have said. I will, however, add that to understand what "accommodating" commerce and business is we have to understand what commerce and business require. By way of illustration I will add that you do not accommodate commerce and business by high rates when four million men are out of employment and business is sick for lack of markets and markets are lacking because the world is more or less in commercial chaos. On the other hand, you are not accommodating commerce and business in an economic sense and in that large public sense which should control the decisions of the Federal Reserve System when you allow a rate to drag on at an artificially low level at a time when business is speeding on the upgrade so rapidly that it can only be a question of time when it will take a headlong plunge into a sea of depression which will involve the whole community. That was the situation after 1919.

Speaking specifically about the rate schedule suggested by the Governor this morning, I want to call attention to one fact. For my personal information I have had a percentage computed for the Federal Reserve System which shows what the reserve percentage would be if the System were still operating on the same gold reserve as a year ago. In other words, so as to show the degree of improvement in the reserve position of the System due to liquidation of the loan account. What does this computation show? If we compute the percentage on the basis of what it would be had there been no increase in gold holdings and the reserve position consequently had been affected only by the diminution of the loan account, the System would show a reserve percentage today of approximately 52 per cent as against 70. In other words by far the greatest part of the improvement of the reserve position of the System has come not from liquidation of the loan account but from importation of gold. This is particularly true of the

Reserve Bank of New York. That Bank shows a reserve percentage of 83. On the basis of the liquidation of the loan account alone, its reserve percentage would be computed at something like 46 or 47 per cent. A computation of this kind made for each one of the twelve Reserve Banks will show which banks have in the vernacular of banking improved their reserve position by "cleaning up" and which appear to be strong largely because of heavy additions to their gold holdings. I would be inclined to suggest in connection with the Governor's proposal, the consideration of this thought: that in making a general revision of Reserve Bank rates, those banks, I think they are four or five in number, that show the greatest amount of cleaning up during the past year, that show the greatest improvement in their reserve position through liquidation rather than through increased gold holdings, should be the leaders in any downward revision of rates.

While on the subject of reserve ratios let me express my opinion in passing, in answer to a question asked in yesterday's conference, that I regard the reserve percentage of the Federal Reserve Banks at the present time as a pretty worthless indicator of discount policy. I regard it as almost worse than useless as a guide to changes in discount rates. It is utterly misleading and will be until some considerable number of leading commercial countries are operating upon something like a gold basis. I think we are likely to experience a good deal of embarrassment over the Reserve Banks showing a high reserve ratio simply because they are the dumping ground of the world's gold. This will occur when we get up against a situation where it will be good banking and economic policy to undertake to control the expansion of credit by a rise of rates. Sooner or later, and I think sooner rather than later, we shall find ourselves confronted with just such a situation, a situation which unless controlled will develop into a secondary inflation and culminate in a secondary crisis. Unless we are forehanded and resolute enough to apply rate pressure before business and credit expansion gets too much headway, and this quite irrespective of how high our reserves may happen to be, there will be trouble.

With regard to the matter of gold policy touched on in the discussions this morning, I may say that I do not feel very much enthusiasm for the suggestion that gold or gold certificates shall be put into circulation to an amount of a hundred or perhaps only fifty millions. If we are going to restore gold to circulation, let's do it boldly, not hesitatingly. The Federal Reserve System has reached a position, I think, where when it moves it should move on strategic lines, not on merely tactical lines. With respect to gold, as with respect to discount rates, let us take a big and broad position and not maneuver timidly. It is my belief and certainly my hope that the gold which we have received in unprecedented volume in the last year we hold essentially as economic trustees. The poorest use to make of this gold is to put it into circulation in this country. The best use we can make of it is, when the situation is right for such intervention, to use it to help the restoration of the currency in Europe and the restoration of the gold standard, there in at least some qualified form. We shall ultimately have to take a very positive part in the financial and economic reconstruction of Europe. Part of our assistance will, I believe, take the form, through specified gold loans, of sending some of the gold which we have received during the current year in such huge amounts, back to Europe to be used in effecting currency reorganizations there. The movement of gold into the United States in 1921 is absolutely without parallel or precedent. The countries which have sent us this gold have sent it not because they are rich, not because they can afford to dispense with it in their currency and credit organization, but because a crisis has been reached in their financial relations with us as a result of which an increasing proportion of business has got to be conducted on a cash basis. Practically one-third, perhaps more, of the excess of the exports we have sent to Europe during the current year have been paid for with gold. This is a very serious situation. Cash payments seriously restrict business. Nor can trade go on in considerable volume if the existing rapidly and violently fluctuating exchanges do not find correction. But there can be no correction except as some gold is put into the foundations of the currency structures of the now distressed countries of Europe.

My view has long been that the function of the Federal Reserve System is to continue to hold this gold in its vaults where it now is mobilized and whence it can be readily mobilized for use elsewhere when the moment arrives, and not to demobilize it. I should be very sorry to see the Reserve System pursue a policy which indicated lack of comprehension of the situation in Europe, lack of appreciation of our relation to it, lack of appreciation of the obligation which we must sooner or later assume, lack of appreciation of the stark fact that we are going to assume that obligation whether we now intend to or not. I repeat we are going to do it because we must in our own interest as well as in the interest of Europe. The proposal, therefore, to take this gold out of the vaults of the Reserve Banks and to dissipate it by putting it into circulation to my mind means either that we lack confidence in our ability to restrain an expansion of credit when we show a high reserve (should such restraint become desirable) or because we are proceeding as theorists in the matter of our gold policy and slavishly adopting the principle that there can be no gold standard in a country unless it is buttressed by a considerable dispersion of gold in the pockets of the people.

It is my opinion that there will be no gold standard in any useful sense for us unless there is at least a qualified restoration of the gold standard in the countries of Europe. So long as gold moves as it now does, not as a normal instrumentality of commerce but as the instrumentality of the pawnbroker, there is going to be no gold standard in a regulatory sense.

While it does not pertain to the present discussion, I am, nevertheless, tempted to indulge myself in this connection to express the thought that the Federal Reserve Conference having clarified the atmosphere with regard to credit conditions and discount policies, could not devote its thought more usefully than to investigate and study what there is that we can usefully do to help the restoration of a better currency and exchange condition in Europe and to devise some plan for intervention when the moment is ripe for intervention. I am inclined to think that the time is not far off when something can and should be done. If a general clarification and improvement of the general international situation follows the conference to be held in this city next month, if something is done to alter the practices and policies which have given rise to the need or the supposed need of extravagant expenditures for armaments, and furthermore if something is done to show the mischievous and obstructive effect of economic and financial barriers between countries, the time will be near when something can be undertaken to initiate a constructive program of currency and exchange restoration. As the strongest nation in the world and as the custodian of the greatest gold hoard that has ever been massed in any single control in the history of Christendom, the obligation to blaze the way - to do the thinking - to do the planning, rests with the group of men who are assembled in this room.