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Speaking before the Commercial Club of Boston Tuesday evening, November 17th, on the operation of the Federal Reserve System, Mr. A. C. Miller, member of the Federal Reserve Board, took occasion to point out how the scope, influence and importance of the Federal Reserve System under present credit and business conditions had increased since the establishment of the System eleven years ago.

"Originally conceived as a system of elastic bank note issues and reserve credits to overcome the disabilities from which our banking system formerly suffered because of the rigid provisions governing reserves and restricting note issues, the Federal Reserve Banks, by force of the unprecedented conditions growing out of the World War that have shaped their development along broader lines almost from the day of their establishment, have had to form a larger conception of their function in the country's credit and economic system - one best to be defined to be to steady credit conditions, to give at all times a firm basis of strength and health to the country's credit organization so far as it lies in the power of the Federal Reserve, and through the wise and intelligent exercise of this function to give steadiness, stability and strength to underlying business conditions. It is more widely recognized now than ever before what a vital and shaping influence credit is through-

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out the whole economic system. The good functioning of trade, agriculture and industry, experience has demonstrated, can be greatly aided by good functioning of the Federal Reserve System. The good functioning of the Federal Reserve System means that the current productive industry of the country shall be at all times supplied with all the credit it needs from the Federal Reserve Banks to meet its legitimate operating requirements on the lowest terms consistent with economic safety. This statement needs no extended argument. But the American public does not yet fully understand that at times when industry and trade through excessive optimism or speculative enthusiasm are getting into a state of feverish activity they must not get the credit facilities of the Federal Reserve Banks on too easy terms - that is, on terms so low as to encourage needless borrowing and invite inflationary developments. While credit wisely extended can do much in a healthful way to stimulate, the dangers of overstimulation can never safely be lost sight of."

"This, briefly stated, "continued Mr. Miller, "is the philosophy of variable discount rates."

"There is a prejudice of long standing in the United States" said Mr. Miller "against variable discount rates. This prejudice constitutes one of the difficulties in the administration of the Federal Reserve Banks. The discount rates of Central banks are made to be moved. This is well understood in England, where the Bank of England for decades has employed the changeable discount rate with marvelous effect

in giving stability to the British banking and credit system. The banking and business public there, before the World War, understood very accurately the basis of the Bank of England's discount policy and the meaning of changes of the Bank's official rates. There resulted from this a cooperation between the Bank and the business public. The success of the British banking and credit system was largely due to this intelligent cooperation."

"We may expect that in time a similar situation will exist in the United States. As the Federal Reserve System itself more fully works out its guiding and operating principles and as these come to be understood and accepted by the business public, we may expect to see the prejudice against changes of discount rate and other methods of credit control overcome and the good functioning of the Federal Reserve System promoted by intelligent cooperation between the Federal Reserve Banks and the general business public." Mr. Miller expressed the fear, however, that "until this result is attained we are likely to suffer from hesitant or tardy action in the matter of Federal Reserve discount policy."

"Time is of the essence of success in matters of credit and currency regulation by Central or Reserve banks. There are times on an upward trend of industry when the intervention of the Federal Reserve System by suitable discount policy can stimulate a forward movement in industry by maintaining a low rate; and later on by an advance of rate restrain the speculative extension of industry and thus serve to maintain a good condition of activity and prosperity. The function of rate policy

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is thus at times to accelerate the flow of reserve credit by a rate that invites borrowing and at other times to retard it by a rate that discourages undue resort to the facilities of the Federal Reserve Banks. On a downward trend of industry when the thing most to be feared is hasty liquidation under the pressure or fear of monetary stringency, Federal Reserve Banks through their rate policy can do much to make the inevitable liquidation gradual and orderly by lowering the terms upon which their credit is made available.

"Action by the Federal Reserve Banks on the all important matters of discount policy and open market operations to be competent must, of course, be based upon insight into the economic factors governing the state and trend of industry, trade and credit. Without such knowledge there can be no real conviction and, consequently, no real policy. But more than conviction is necessary to make Federal Reserve action effective. Such action when taken must be rightly timed and be prompt. Hesitation and delay are the deadly causes of miscarriage and failure in the matter of central banking administration. They have beset central banking administration in all countries. To overcome them must be a primary concern in the development of our Federal Reserve System. As yet our System lacks that high degree of initiative essential to its most effective operation. This is in part due to the complex character of our Federal Reserve organization and the resulting wide distribution of authority

and responsibility for its management. But it is also due to the fact that the larger economic and credit problems with which the Federal Reserve System is called on to deal are lacking in the definiteness of character which makes for definiteness of action. The processes of inflation with which our Federal Reserve System, like other central banking systems, is called upon at times to cope are insidious in their character. Inflation does not announce its coming in advance. It is not born full-fledged. It begins as expansion. It becomes inflation when expansion has gone beyond the limit of economic safety, that is when further additions to the country's supply of credit can not be digested by the body economic in alimending productive industry. The excess goes to feed the appetite for speculation, and that appetite, more than most appetites, grows by what it feeds on. Thus inflation makes rapidly for more inflation unless its incipient stage is clearly perceived by those responsible for the maintenance of a healthy credit and business situation and subjected to appropriate restraining influence."

Turning to the present situation in the United States Mr. Miller pointed out the various evidences of the high state of activity of the country's productive industry and trade. "We are in the midst of a very considerable industrial expansion with many of the factors that make for prosperity gaining in momentum. Production, trade, employment and payroll

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disbursements are all in materially greater volume than a year ago. There can be no doubting that we are already in an era of prosperity. The year 1925 has brought a great many new constructive factors into play in our economic situation. Of these, the most important is the recovery, even though not yet complete, of agriculture. Of very great importance also is the marked economic recovery of Europe in the past two years. The leading industries of Western Europe bid fair before long to be on a normal basis of productivity. Our export trade will benefit. The atmosphere of the world at large, moreover, has become more conducive to economic adventure by reason of the settlement of many of the perplexing economic and political problems left at the end of the war. Among these, of particular interest to the United States are the Dawes Plan of reparation payments and the progress made in arranging funding terms of debts owed to the United States. The outlook has never been so bright since the close of the war. Whether the prosperity which beckons is to be short-lived or of long duration will depend largely upon the wisdom and skill with which we handle ourselves in the United States. The business community of the United States learned several great lessons from the disastrous crisis and depression of 1920-1922. It has developed in recent years a capacity for economic self-government that should go far toward insuring preservation of business sanity and the avoidance of the extravagances and

excesses that inevitably culminate in prosperity booms. The Federal Reserve also has a very great responsibility for the maintenance of sound conditions to the extent at least that this can be helped or accomplished by maintaining the credit situation healthy.

"The floating supply of credit in the United States has never been so large as at the present time and never so much in excess of current and prospective requirements of commerce, agriculture and industry. The principal factors that have contributed to this result are (1) the large influx of gold in recent years; (2) economy in the use of credit resulting from the smaller volume of credit required for carrying inventories because of improved transportation conditions and the promptness with which plant facilities in all leading lines of industry are able to respond to increased demands for their products; (3) the thawing out, largely as a result of improved agricultural conditions in this and the last crop season, of credits that became frozen after the crisis of 1920; and, finally, to rapid seasonal liquidation this autumn. These factors account for the comparatively slight growth in the volume of credit taken for commercial uses from the banks of the country in the course of the last year. The great growth in the loan account

of the banks of the country has not been in the commercial loan account but in the collateral loan account. And the great growth in this branch of banking operations is due mainly to the huge volume of credit absorbed by the call market in the country's great speculative center since the opening of the year. This condition, along with the considerable volume of credit absorbed by land speculation in some parts of the country and speculative building operations constitute the danger spots in our present situation. There is evidence that a section of the public is losing its bearings and being drawn into the arena of thoughtless speculation. Cheaper and more abundant credit than the country has ever known on so extensive a scale are giving them aid and encouragement. It is time for a halt lest a speculative frame of mind should be engendered which might in time invade the field of legitimate trade and industry.

"It is not the duty of the Federal Reserve System to undertake to regulate stock or other speculation or to interfere unnecessarily in the affairs of their member banks. But it is well to recall that the Federal Reserve System was not established to provide a life preserver; for the speculator. It was set up as an aid to industry, agriculture and commerce. It is a system of liquid productive credits. The use of Federal Reserve credit for speculative or investment purposes is precluded by specific provisions of the Federal Reserve Act. It is clear, therefore, that no bank has a proper status as an applicant for Reserve Bank accommodation, which is supplying credit for speculative uses. It is the duty of the Federal Reserve Banks to hold true to the course plotted for them in the fundamental provisions of the Federal Reserve Act!"