

“Credit, Currency and Business”

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GOVERNOR, FEDERAL RESERVE BOARD



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FEDERAL RESERVE BANK of PHILADELPHIA

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QUESTIONS concerning credit and currency are of vital interest to all classes of the community. They concern producers, distributors and consumers alike. The entire population is embraced in this classification and, indeed, in the last analysis the single word "consumer" covers all. While there are many who produce more than they consume and who, therefore, naturally view economic problems from the producer's standpoint, it follows, nevertheless, that as everybody is a consumer the broadest interest is that of the consumer.

The distributors are consumers, but are not producers except in so far as they furnish the means of distribution. Many varied interests are included in the distributor class. All who are engaged in transportation are distributors in a sense and the banks, the dealers in credit, play a very important part in the process of distribution, just as they do in aiding production and in facilitating the economic processes of consumption. The great distributors of the country, however, in the ordinary acceptation of the term, are the merchants, both wholesale and retail. Through them goods and commodities pass from the primary producer or manufacturer to the ultimate consumer. The merchant comes necessarily in close contact with the banks, the purveyors of credit, upon which he calls for accommodation both in making purchases from the producer and in effecting sales to the consumer, with the railroads and steamship lines which make the physical transfer of goods from one place to another; and his association with the consumer is necessarily intimate.

The merchant buys in order that he may sell, and in ordinary times, in order to meet competition and

The Federal Reserve System

to satisfy the demands of his customers, he must sell at a close margin, depending upon his volume of business and frequent turnover for his profit. It is to his interest, therefore, that there should be no interruption in any of the various processes incident to the transfer of goods from the producer to the consumer; no congestion of credit and no stoppage of transportation. The merchant must watch the markets closely in order to assure himself, as far as he can, that he will be able to sell at a profit the goods that he buys. He must keep a watchful eye upon his operating expenses and upon his credits, in order that he may offer terms to his customers as favorable as those made by his competitors and meet obligations incurred in purchases by the proceeds of his sales.

Anything which interrupts the ordinary flow of goods to their ultimate market affects him adversely and his own buying power is gauged by the purchasing power of his customers.

Coming, as he does, in contact with practically all factors in the country's economic life, the merchant can sense better, perhaps, than any one else, that intangible but powerful entity known as public opinion, and he can, and does, exert a potent influence in moulding that opinion. In view of the facts to which I have alluded, I feel that it is appropriate to discuss before this audience, composed, as it is, of wholesale merchants, some of the problems relating to bank credits and currency with which it has been the particular province of the Federal Reserve Board to deal.

There is more or less confusion in the minds of some with regard to the three C's—capital, credit and currency. While these words are interrelated, they are by no means synonymous, and an intelligent

Credit, Currency and Business

differentiation of them is necessary for a proper understanding of our present financial and economic problems.

Capital is the permanent fund of productive wealth, the accumulation of the products of past labor capable of being used in the support of present or future labor. It is that part of the product of industry which, in the form either of national or of individual wealth, is available for further production. More specifically, it is the wealth employed in carrying on a particular business or undertaking. It is the actual estate, whether in money or property, which is owned or employed by an individual, firm, or corporation in business and implies ownership and does not, without qualification, include borrowed money.

Credit is the reputation of solvency and character which entitles a man to be trusted in buying or borrowing. The word "credit" is derived from the Latin word "credo," meaning "I trust or believe," and while credit itself is a liability and not an asset to the man who obtains it, the ability to get credit is one of the most substantial resources that an individual can possibly have, and is one which should be guarded with the most jealous and watchful care. One basis of credit is capital; but character—that is, good reputation as to veracity, integrity and ability—is also a basis of credit without which the capital foundation would count for little. The processes of production and distribution are profoundly affected by credit conditions. Modern business is done on credit. One of its life-giving principles is credit. The mood and temper of a business community are deeply affected by the state of credit. The ultimate test of the functioning of a credit system is found in what it does to promote the production and distri-

The Federal Reserve System

bution of goods. Business rests upon its surest foundation whenever there is a proper balance between the volume of credit and the volume of concrete things which credit helps to produce and which are the normal basis of credit. Abuse of credit means shock and disturbance, and gross and continued abuse spells disaster.

Currency may be defined briefly as that which is current as a medium of exchange, that is, which is in general use as money or as a representative of value. It may be gold, silver or engraved slips of paper, which do not require endorsement but can pass readily from hand to hand. By common consent of all civilized nations, based upon the sentiment and traditions of ages, gold is the recognized measure of value and medium of exchange, and is the basis of international settlements. Its purchasing power is, of course, not uniform with respect to all commodities and varies from time to time according to the supply of and demand for the various things for which gold is exchanged, but it is the universal standard, economically, even where it is not legally.

In this country, settlements growing out of business transactions are made for the greater part by checks drawn upon banks, which are negotiable by endorsement. Bank checks, therefore, form an important part of our circulating medium, although in regular course they are outstanding for limited periods of time, soon finding their way into the drawee banks for payment. The total amount of checks drawn by firms and individuals upon their bank accounts during the course of any single week of the year far exceeds the total volume of all forms of money in circulation.

The greater part of the money in actual circulation is in the form of paper currency, such as Federal
[6]

Reserve notes, national bank notes, United States Treasury notes, and United States gold and silver certificates. These forms of currency circulate on a parity with gold for the reason that they are redeemable in gold on demand, with the exception of national bank notes which are redeemable in lawful money, and silver certificates which by their terms are redeemable in silver dollars, but they in turn are protected by the obligation and ability of the Government to maintain them at a parity with gold.

The older generation of business men can remember the years following the Civil War, when the currency in circulation was composed of national bank notes and Treasury notes, known as greenbacks, which were not redeemed in gold. Consequently, gold coin ceased to be a medium of circulation and became an article of commerce, its value in terms of paper money fluctuating from day to day and prices and wages were expressed in terms of this irredeemable paper, just as is the case in Continental Europe and to some extent even in England today.

Merchants in those days who bought goods abroad paid for them on the basis of gold and resold them in terms of paper currency which had a fluctuating value in terms of gold. Since the first of January, 1879, the United States has been on a gold basis and the purchasing power of a paper dollar has been at all times the same as that of a gold dollar. There have been times, however, when the suspension of gold payments and a return to a fluctuating paper currency seemed imminent, but these crises have always been passed successfully and today all currency of the United States is redeemed in gold without question and is on a parity with gold both at home and abroad.

There has always existed, however, in this country

The Federal Reserve System

some latent sentiment in favor of paper currency based not upon gold but upon the faith and credit of the Government. This sentiment in favor of fiat money, that is, paper currency issued by the Government as such but not based on coin or bullion and containing no promise to pay in coin, has always become more intensified in the periods of reaction and depression which have followed those of extreme activity and prosperity. Before the panic of 1873 there was much agitation for paper money. Later on, however, the soft money advocates were divided; some favored a repeal of the Resumption Act and the issue of more Treasury notes, or greenbacks, while others clamored for the free and unlimited coinage of silver dollars. The greenback idea was defeated, but in 1878 the compulsory coinage of a limited amount of silver dollars began and continued until shortly after the panic of 1893.

Following that panic, soft money advocates united substantially in favor of the free and unlimited coinage of silver at the ratio of 16 to 1, although there was some sentiment in favor of state bank notes in addition. In due time the economic forces of the country asserted themselves, and there was gradual and continued improvement in commerce and industry. In the course of a few years the free silver doctrine ceased to be an issue.

It was realized, however, even during the good times which preceded the panic of 1907, that there were grave defects in the banking and currency system of the country. There were more than 25,000 banks in the United States, each standing virtually alone. In accordance with the requirements of law and in order to be able to pay their depositors, all banks kept certain amounts of gold and currency on hand and most of them maintained credit balances

[8]

with other banks in the larger cities, these balances being in most cases part of their required reserves. In ordinary circumstances, the funds on deposit with the city banks could be withdrawn in currency by the country banks whenever they desired, but when business and credit conditions were disturbed, and a spirit of mistrust and suspicion pervaded the country, many banks would seek to increase the amount of actual cash on hand in order to reassure depositors who might otherwise wish to withdraw their money.

It was in those times that the large city banks were least able to supply the currency, for the available supply was limited and there was no quick way of increasing it. A large part of the circulating medium in those days consisted of national bank notes which were secured by Government bonds. Under the law no national bank notes could be issued by any bank in an amount in excess of its own capital stock and as many national banks had already issued their maximum quota in order to realize the small profit obtainable thereby, while others found it impracticable to acquire the bonds which were necessary to secure additional circulation, it was impossible to increase the supply of national bank notes rapidly or to any great extent.

Our inflexible currency system had much to do with the money panic of 1907. Fearing trouble, many of the 25,000 banks sought, each for its own protection, to withdraw such currency as it could from other banks and pay out as little as possible to depositors. Emergency measures could not be resorted to in advance of actual panic, for they would, in themselves, have produced a panic, and while steps were taken finally to conserve the cash resources of the banks they came too late to prevent trouble and the existing banking machinery fell apart into thou-

The Federal Reserve System

sands of separate units. Each bank was obliged to rely largely upon its own cash resources, because, however willing, other banks felt that they could not surrender much of their own cash, for by doing so they might impair their ability to meet the possible demands of their own customers. Thus each bank, in seeking to protect itself, weakened the banking structure as a whole. The defenses were weakest when the danger was greatest.

The panic of 1907 convinced the country that something must be done to prevent similar occurrences in the future. In the following year Congress created a Monetary Commission which after a long and thorough study of the banking systems of the world submitted an elaborate report, and a draft of a new banking and currency bill. During the year 1912 a committee of the House of Representatives investigated banking methods in this country and in its report pointed out the fundamental defects in the system then existing. Early in the year 1913 Congress took up the matter of banking reform in earnest and the Federal Reserve Act was put upon the statute books before the close of that year.

There has been no money panic in this country since the Federal Reserve Act became a law. This statement, in itself, has no particular significance, for less than nine years have elapsed since the passage of the Act, and there have frequently been periods of more than nine years when the banks of the country have been able at all times to supply the currency demanded of them. But when we consider the events which have taken place during the past nine years, and what has been accomplished and prevented by reason of the operation of the Federal Reserve System, the conclusion is inescapable that the enactment of the Federal Reserve law was a

most conspicuous example of valuable constructive legislation.

The Federal Reserve Banks were not opened for business until nearly a year after the passage of the Federal Reserve Act and consequently the Federal Reserve System could do nothing to mitigate the shock which the banking, commercial and industrial interests of the country experienced when the great European War broke out unexpectedly in August, 1914. The Federal Reserve Act, however, continued in effect until June 30, 1915, the provisions of the Aldrich-Vreeland Act of 1908, which would otherwise have expired by limitation on June 30, 1914. Under this law it was possible for national banks, by forming themselves into associations, to issue national bank notes, on approved collateral other than United States bonds, such notes being subject to a tax at the rate of 3 per cent per annum upon the average amount in circulation for the first three months, with a graduated increase of one-half of 1 per cent per annum for each month thereafter until a maximum rate of 6 per cent per annum was reached.

Under the provisions of this Act, as extended, the national banks of the country were able to provide for themselves and for their state bank neighbors sufficient currency to meet the demands of business and of nervous depositors, without resorting to the suspension or restriction of cash payments, which expedients were employed during former crises.

After the Federal Reserve Banks began business in November, 1914, and up to the entrance of our own country into the War in April, 1917, the stabilizing influence of the new system was so great that events which otherwise would have been most disturbing produced not the slightest tremor in banking circles.

The Federal Reserve System

Let us now contrast the effect upon our present banking system of our participation in the greatest war of all history with the effect upon our earlier banking structure of the Civil War. It is true that the country had increased greatly both in population and wealth between the years 1861 and 1917, but wars in the '60s were conducted on a far smaller and less expensive scale than now. President Lincoln's first call for troops was for 75,000 men and in no battle of the Civil War were more than this number actively engaged on a side. One modern battleship represents a greater cost than the entire United States Navy in the Civil War, and aerial warfare was, of course, undreamed of sixty years ago.

With the imminence of the Civil War, the banks generally suspended specie payments and after a brief period of resumption later on were forced to suspend them again for many years. Both the United States and Confederate Governments were obliged to resort to the issue of paper money. The gold value of United States currency declined at one time to about 40 per cent of par, while Confederate currency, constantly depreciating, had its further decline accelerated with each successive new issue until toward the close of the struggle its purchasing power was hardly as great as that of some of the European currencies of today.

During the years 1917 and 1918 the United States had under arms at one time as many as 4,000,000 men, exclusive of its vast naval establishment. There were floated between June, 1917, and October, 1918, four issues of Liberty Bonds, aggregating in all \$16,978,000,000, and during these two years the Federal Government collected \$5,425,000,000 in taxes. Notwithstanding these vast financial operations, there was no money panic, nor at any time

[12]

any serious credit disturbance. The volume of Federal Reserve notes in circulation, which stood at \$376,510,000 at the beginning of the War, amounted to \$2,558,196,000 at its close, but the gold parity of these notes and all other forms of currency was maintained and there was never a time when the purchasing power of a \$20 Federal Reserve note was not the same as that of a \$20 gold piece.

The maximum amount of Treasury notes, or greenbacks, outstanding at any time during the Civil War was \$449,338,902, and the purchasing power of these notes at one time was little more than one-third of a corresponding face amount of gold.

The crucial test, however, of the Federal Reserve System came after the end of the World War.

It was realized that the signing of the Armistice which ended the war from a military standpoint did not end it in a financial sense and during the early months of the year 1919 there was a lull and much hesitation in business. The successful flotation, however, of the Victory Loan in May of that year was regarded as the end of the war in a financial sense and a period of great activity set in.

It was evident that four years of war had greatly impaired the productive capacity of Europe and had greatly reduced stocks of goods and supplies of all kinds. There was a general impression that there was a world-wide shortage of goods and that Europe in replenishing her supplies must continue to draw heavily upon the productive capacity of the United States, just as had been the case ever since the year 1915. This impression was deeply engrafted upon the minds of the public and for a time European needs were so urgent that they had to be supplied at any sacrifice. At the same time a substantial

The Federal Reserve System

part of the sum which during the war the United States had agreed to advance to foreign nations was still unexpended and these funds were used during the year 1919 in payment of goods exported to Europe.

Many shrewd business men looked forward confidently to several years of commercial and industrial activity and made their plans upon the assumption that prices would either advance or remain stable and that a return to the pre-war level or a serious decline in the immediate future was most improbable. Farmers incurred obligations for additional land at a valuation based upon the commodity prices then existing, merchants extended their business and manufacturers prepared to increase their productive capacity by making additions to their plants, regardless of the fact that such additions could be made only at costs much higher than normal.

The prevailing opinion was that we had entered into an era of high prices and that there would be for some time a serious shortage of goods. Many jobbers called in their salesmen and were obliged to scale down the orders which poured in by every mail. Prices advanced week by week and many producers and merchants were reluctant to sell, for advancing prices were accompanied by higher wages and greater production costs.

Credit was freely used, not only in production at high cost, but in withholding goods from the market, and inventories and bank statements everywhere showed an expanded condition which would have been regarded as unthinkable a few years before.

It is not difficult now to point out the essential fallacy in the position which was taken and to explain the logical and inevitable reaction which took place, a reaction, however, which many did not foresee until

[14]

too late. The error lay in the incorrect estimate of consumptive requirements. We can see now that instead of there being a shortage, there was in fact a fictitious demand, if not in some industries an over-supply. A grave mistake was made by manufacturers, merchants and farmers in basing their plans upon the normal relationship between production and consumption at a time when conditions were anything but normal. There was, indeed, no question as to the need of Europe for American goods and supplies, and estimates as to American consumption, perhaps justified potentially, did not take sufficiently into account the effect of extremely high prices upon the volume of consumption. A continued demand for goods depends in the long run upon the buying power of the consumer. What one can not get at all, he must do without, and when he cannot obtain all that he needs he must be satisfied with a part. The mere need for goods, however urgent, does not create an economic demand. There must be an ability on the part of those needing goods to satisfy the need, by exchanging other goods, by rendering service, by paying cash or by tendering some acceptable form of credit obligation.

Millions of people in some of the European countries were obliged to deny themselves a part of their accustomed food supply, to forego purchases of clothing and other things which ordinarily would be regarded as absolutely necessary. Luxuries were impossible and in many cases articles so classed were sacrificed in order to provide the irreducible minimum of the necessities of life.

The effect of high prices in this country was reflected finally in reduced consumption and in the latter part of March, 1920, those who had dreams of a long continuance of the conditions which had

The Federal Reserve System

existed up to that time were rudely awakened by the collapse of the silk market in Japan. By this time public opinion began to undergo a change and public opinion is a powerful force, more potent than banking boards, or legislative bodies. The curtailment of buying became more and more noticeable. What has since been referred to as the "buyers' strike" manifested itself everywhere throughout the United States and in other countries as well; and in quick succession the drastic reactions in commodity prices began to take place. Many who had been anxious to buy cancelled orders and withdrew from the market, while others who had been reluctant to sell became nervously eager to dispose of their goods.

Banks began to find that loans which they had regarded as being collectible at any time desired could not be repaid in the altered circumstances and must be carried along. Recourse was had in increasing degree to the Federal Reserve System which responded to all legitimate demands and which should be credited with preventing the commercial crisis which followed from developing, as would otherwise have been inevitable, into a most disastrous money panic.

During the year 1920, when these drastic changes in price levels were taking place, the total earning assets of the Federal Reserve Banks, which include rediscounts for member banks, increased from \$3,039,000,000 at the end of January to \$3,396,000,000 at the end of October. At the same time there was not only no contraction in Federal Reserve note currency, but on the contrary there was an almost continuous expansion in the volume of Federal Reserve notes in circulation, the amount increasing from \$2,844,000,000 on January 23rd to \$3,404,000,000 on December 23rd, 1920, a record high mark.

[16]

These figures should be impressed upon the minds of the public, for the unwarranted statement is often made that the Federal Reserve authorities deliberately set out to bring about deflation and to accomplish this purpose caused sharp curtailment of credit and drastic contraction of the currency.

The Federal Reserve Banks are required by law to maintain certain specified reserves against their deposit and note liabilities. Provision is made for the suspension of reserve requirements, under certain penalties, and the law authorizes the Federal Reserve Board to permit or require one Federal Reserve Bank to rediscount paper for another, in order that a part of the cash resources of a bank having excess reserves may be diverted temporarily to another bank which otherwise would be deficient in reserve. The Federal Reserve Board is also empowered by law to reject in part or altogether any application made by a Federal Reserve Bank for Federal Reserve notes, and it is permitted at its discretion to impose an interest charge on that part of the Federal Reserve note circulation which is not specifically covered by gold, but such a charge was never imposed.

At one time during the fall of 1920, when the strain was greatest, one Federal Reserve Bank was neither borrowing from nor lending to other Federal Reserve Banks, and three Federal Reserve Banks were lending large amounts to the remaining eight Federal Reserve Banks. Interbank rediscounting was a continuous process all during the year 1920 and during part of the year 1921.

Interbank rediscounts reached their peak late in October, 1920, when they amounted to \$267,000,000. In the autumn of 1920 the total accommodation extended by all Federal Reserve Banks to their member banks aggregated approximately \$2,750,-

The Federal Reserve System

000,000, as compared with a total of \$59,000,000 of rediscounts and bills payable for all national banks in the United States in the autumn of 1907, just before the panic of that year.

Had the Federal Reserve Board desired to curtail credits and contract the currency, it could have done so most effectively by the exercise of its legal authority to refuse to permit one Federal Reserve Bank to rediscount for another, and to decline applications for Federal Reserve notes. But the Board arranged promptly all rediscounts asked for, and approved immediately all requests for Federal Reserve notes.

The events of the past two years have shown that there is often no clear and immediate relationship between commodity prices and the volume of credit and currency. According to the quantitative theory of money, broadly speaking, as the supply of money increases its value decreases and consequently the value of the things for which money is exchanged increases. But it is obvious that this is subject to very definite limitations and involves other factors, such as the volume of trade and production, the rapidity of turnover or velocity of exchanges, and likewise public confidence. Loss of confidence may often lead to heavy hoarding, and what have recently come to be known as "frozen loans" slow up greatly the turnover of credit. Both may result in an actual contraction, although there is no apparent change in the nominal amounts outstanding.

During the years 1915 and 1916, when there was an influx of gold into this country of more than one billion dollars, in payment of purchases of American goods by the warring nations of Europe, prices and wages advanced sharply. On the one hand, there was an increase in our basic stock of money and on the other, no corresponding increase in the volume

of goods available for domestic consumption; an advance in prices and wages was a natural consequence. Had it been possible to increase the volume of goods and commodities as rapidly as the volume of gold increased, the advance in prices would certainly have been less pronounced.

Then again, when specie payments are suspended and a country undertakes to meet the enlarged requirements of its government and its commerce by increasing its issues of irredeemable paper currency, prices and wages naturally advance. It should be remembered that the issue of irredeemable paper currency, while sometimes unavoidable in times of war, is merely a forced popular loan and that one issue tends to bring on another, each successive step adding to the depreciation. Germany, by turning loose a flood of paper money has reduced its value more rapidly than she has added to the quantity. The German mark, whose normal value was about 4 marks to the dollar, has now depreciated to a point where one dollar of American money will purchase about 350 marks. Russia has carried its currency inflation to such extremes that she has practically destroyed the value of her paper money altogether. Normally a dollar would buy about 2 rubles, while now one dollar will purchase about 4,000,000 rubles.

Gresham's Law lays down the principle that a superior and inferior currency cannot circulate together, that the inferior drives the superior out of circulation and into hiding. The depreciation of currency in some European countries has gone so far as to make it very difficult and inconvenient to transact business through the medium of these currencies, the physical volume of an amount sufficient for ordinary retail transactions being so great as to make it impossible to carry it around

The Federal Reserve System

on one's person. Then again as the depreciation is continuous and constant, traders are unwilling to accept paper money unless they can exchange it immediately for something else. Consequently in those European countries where the currency is most greatly depreciated, direct exchanges of goods for goods are made; and in some places gold is being brought out of hiding and is performing once more, in a limited way, its accustomed function as a medium of exchange. Thus it is apparent that when a currency has depreciated to the vanishing point, Gresham's Law no longer holds good.

It is not the function of the Federal Reserve System nor of any banking system to attempt to fix or control prices; and the Federal Reserve discount rates have never been established with that idea in view. As a matter of fact, they have always been lower than current rates given by member banks to their customers, and due to peculiar circumstances have in fact followed rather than led the rise and fall of current rates. Banks are chiefly concerned with prices only in so far as the security of their loans may be involved, and they are interested more in the stability of prices and their margin of collateral than in the general price level itself. Banks do not create general conditions but they must adjust themselves to changing conditions, which, in recent eventful years, have been brought about by unseen and irresistible forces throughout the world.

Federal Reserve notes have never been issued or redeemed with a view to affecting prices. They are in fact but a very small element in the volume of credit through which the vast exchanges of the nation are made. Increases or decreases in the volume of Federal Reserve notes in circulation accompany advancing or declining business activity, prices and

[20]

wages. An increase or decrease in the volume of Federal Reserve notes outstanding is not the result of any preordained policy or premeditated design, for the volume of such notes in circulation depends entirely upon the activity of business, or upon the kind of activity which calls for currency rather than book credits.

Federal Reserve notes can be issued only against collateral in an amount equal to the sum of the Federal Reserve notes applied for, which collateral security must be notes and bills discounted or acquired by the banks or gold or gold certificates. The law requires each Federal Reserve Bank to maintain a reserve of 40 per cent in gold against its Federal Reserve notes in actual circulation.

The Federal Reserve Banks do not make loans direct to the public. They can rediscount only eligible paper bearing the endorsement of a member bank which paper represents loans made by such member banks to their customers. Federal Reserve Banks have nothing to say to member banks about what loans they shall make to their customers. In ordinary times member banks make such loans out of their own resources and do not call upon the Federal Reserve Banks for accommodation except for seasonal requirements or in emergencies. During the peak of the credit strain the maximum rediscounts and bills payable of member banks with the Federal Reserve Banks did not exceed 14 per cent of their total loans and discounts. It follows, therefore, that the volume of rediscounted paper carried by Federal Reserve Banks fluctuates far more sharply up and down than the total of loans and discounts of the member banks. As the credit strain relaxes, customers reduce their loans with the bank with which they deal, and that bank naturally reduces its line

The Federal Reserve System

of rediscounts at the Federal Reserve Bank, and thus as the credit strain relaxed during the year 1921, the loans of the Federal Reserve Banks to their member banks decreased in the natural and orderly course of business about \$1,500,000,000. Furthermore, concurrently with the payment of the paper discounted with Federal Reserve Banks, Federal Reserve note currency has come back to the Reserve Banks and in the absence of a demand for it, has not been reissued. When the demand for Federal Reserve notes falls off the banks which hold them send them to the Reserve Banks for credit, and there necessarily results an automatic increase in the percentage of gold reserve available for their redemption. Federal Reserve notes are not legal tender, nor do they count as reserve money for member banks. They are issued only as the need for them develops and as they become redundant in any locality they are returned for credit or for redemption to the Federal Reserve Banks or to the Treasury at Washington. Thus, there cannot be at any time more Federal Reserve notes in circulation than the needs of the country at the prevailing level of prices and wages require, and as the demand abates the volume of notes outstanding will be correspondingly reduced through redemption.

Federal Reserve notes being but a small element in the total volume of credit, and the bulk of our business being carried on by checks drawn against bank deposits, the really important thing is the total volume of bank credit and whether this can increase or decrease automatically according to the needs of business and agriculture. Under the Federal Reserve System, as business expands, as labor is more fully employed and as production increases and distribution becomes more active, there follows a

[22]

demand for greater discount accommodations and a need for more currency, and the increased volume of discounts furnishes a means of providing the increased volume of currency required.

While the general level of prices and the total volume of credit—that is deposits and currency—correspond roughly in their movements, prices of individual commodities often fluctuate in directions opposite to the general movement. For example, last September there was a sudden and marked advance in the price of cotton. This advance was not due to any increase in the loans of Federal Reserve Banks nor to any expansion of the currency. In fact, the amount of Federal Reserve notes in circulation on September 15th, when cotton was selling at about 21 cents a pound, was about \$500,000,000 less than when cotton was selling at 11 cents a pound in the Spring. The advance in the price of cotton was due to economic causes and to the operation of the law of supply and demand. After the report of the Department of Agriculture, early in September, the world awakened to the fact that the cotton crop was abnormally small, and it was thought at one time that less than seven million bales would be produced. As the ginner's reports were made, it became evident that the Department of Agriculture had under-estimated the size of the cotton crop and the price declined four or five cents a pound.

This decline took place notwithstanding the reduction which was made about the same time in the discount rates of all Federal Reserve Banks, including those in the South. The fact should be emphasized that the net advances which have taken place in recent months in the price of cotton and other agricultural products have been due, not to credit or

The Federal Reserve System

currency expansion, but to smaller supplies and to increased demands for consumption.

For reasons already explained there has been a steady and practically continuous decrease in the volume of Federal Reserve notes in circulation since the latter part of December, 1920, reflecting general conditions. As I have said, most of the business of the country is carried on through the medium of bank checks, and the volume of currency in use depends largely upon the activity of the industries and retail trade. Notwithstanding the smaller volume of Federal Reserve notes in circulation, bank deposits now show a tendency to increase. On March 10, 1922, the deposits of all national banks in the United States aggregated \$15,390,438,000 as compared with \$14,560,852,000 on September 6, 1921.

Prices of farm products, the things which the farmer has to sell, declined more rapidly than the price of merchandise and various things which the farmer has to buy. The result was a curtailment in farmers' purchases which soon had a serious effect upon commerce and industry. For several months past, however, prices of farm products have shown an upward tendency, while retail prices of goods have declined.

Prices of some commodities, as furnished by the Bureau of Markets of the Department of Agriculture, on April 15, 1921 and April 15, 1922, were as follows:

Commodity	Market	Description	Quotation	
			April 15 1921	April 15 1922
Cotton	New Orleans	Middling	.11 $\frac{1}{4}$.16 $\frac{3}{4}$
Corn	Chicago	No. 2 mixed	.53 $\frac{1}{2}$	* .58 $\frac{3}{4}$
Wheat	Minneapolis	Spring No. 2	1.45	* 1.57
Oats	Chicago	No. 2 white	.37	* .38 $\frac{1}{2}$
Hogs	Chicago	Average price	8.50	10.15

(*) Quotations for April 13, 1922.

[24]

Credit, Currency and Business

Interest rates have declined in all sections of the country. The $4\frac{1}{4}$ per cent Liberty Bonds have advanced from an average price on April 15, 1921, of about \$88.48 to within a fraction of par at the present time. Twenty-five representative railroad stocks advanced from an average of \$51.70 on April 15, 1921, to \$62.25 on April 15, 1922, twenty-five industrials from \$84.10 to \$96.19, fifty railroad and industrial stocks from \$67.90 to \$79.22, and forty listed bonds advanced from an average of \$69.89 on April 15, 1921, to \$79.97 on April 15, 1922.

The situation today in many respects is exactly the reverse of that which existed at the end of the year 1919. Surplus goods of all kinds have gone into consumption and statements of merchants throughout the country show a marked reduction in the volume of goods on their shelves. The fact that a revival in agriculture has come much sooner than had been expected by those who regarded the low prices of last summer as permanent has brought new hope and courage to the agricultural districts and affords a basis for the belief that there will, in due time, be a distinct business improvement in those districts.

While the situation abroad is still complicated and will doubtless continue so for many years, there are many indications of improvement. The exchanges of some of the leading European countries have become far more stable during the past twelve months and the pound sterling in particular has made a distinct advance toward its normal parity, the present quotation being about \$4.44 as compared with \$3.92 on April 15, 1921.

American tourists are flocking to Europe this summer in large numbers and the sums they expend abroad will add to the ability of the foreigners to buy American goods.

The Federal Reserve System

The past seven years have been full of momentous and stirring events and merchants have had their trials and their burdens to bear as well as all other classes. The world-wide reaction which followed the abnormal activities of the early post-war period had a serious effect upon the business of wholesale merchants, but it is gratifying to know how well they have stood up under the strain, and in view of the evidences of improvement which are now apparent in all sections of the country it seems to me that the time has come when the enterprising business man may well let others indulge in lamentations and recriminations over the past and devote his energies to working out the problems of today and preparing for the business of tomorrow.

Remember that this country of ours has never failed to demonstrate its tremendous recuperative power and that the processes of production, distribution and consumption will be continuous as long as humanity endures. Let the merchants exercise their function as distributors. If business is dull, send out your traveling men; use printers' ink—advertise liberally but judiciously, and the business that you thus create for yourselves will stimulate production and by reducing the number of unemployed will add to the purchasing power of your customers.

In the words of Edward Everett Hale, let us

“Look up and not down,
Look forward and not back,
Look out and not in,
Lend a hand.”