Federal Reserve Bank of New York
Addresses and Speeches
Sproul

Remarks of Allan Sproul, President,
Federal Reserve Bank of New York,
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I think you will agree with me that this is not the time for me to try to give you either an exposition and defense of past credit policies or a forecast of what may lie ahead. A new Administration has just taken over at Washington. The past is not buried. It can seldom, if ever, be buried. But I think we can be sure that the remains will not lie in state. New methods and new programs will be in the making. In these circumstances, I have no desire to rake over old controversies, nor would I want to complicate the development of new relationships by trying to anticipate the place and performance of credit policy during coming months and years.

It can be said with assurance, however, that the independence of the Federal Reserve System which I have called independence within the Government, not from the Government, will not be seriously challenged. Both the outcome of the hearings of the Subcommittee of the Joint Committee on the Economic Report which studied this matter last year, and the views of those who have spoken for the new Administration of the executive branch of the Government, make this assurance doubly sure. And I think it can also be said with assurance that the Federal Reserve System will now try to improve its performance in the administration of the country's banking reserves, and will concentrate its attention on making monetary policy contribute to economic stability. The war and immediate post-war phases of intermingled debt management and monetary policy are clearly over. And the Government security market, after a long period in military service, and then in a nursing home, has now shown that it can take care of itself without our continuous or even frequent intervention. This is not to say that appropriate, vigorous, and coordinated monetary, debt, and fiscal policies should not constitute a primary defense against economic instability. I believe they should and I believe they will, but I am not going to talk about them today.

Having ruled them out as subjects for discussion, and facing this audience, I find myself pushed, by a process of natural selection, into discussing some matters which may particularly affect savings banks. Since most of my contacts are with commercial bankers, and since the major function of the Federal Reserve System is the administration of the reserves of commercial banks, this is not wholly familiar territory. But you and I have some general interests in common which we might explore together.

Savings banks, as they have persisted in this part of the United States, are, of course, an anachronism. You should have begun to succumb years ago to the kind of department store banking which has developed in most other parts of the country. But here you are, making new records each month in the amount of your deposits and the number of your depositors. I dropped in, last month, at a savings bank which had just moved into new quarters in midtown Manhattan. I don't know whether I was more surprised to be offered tea and cookies in the lobby, or to be told that on opening day the bank had gained

more than 20,000 new accounts and more than $1,300,000 in deposits. That sort of thing, as well as the more comprehensive statistics of the Savings Banks Association, suggest that the savings bank habit continues pretty strong in these parts. Evidently, the passbook is still held in high regard by thrifty Americans, even though United States Savings Bonds have their place, and valiant attempts are made from time to time to convert small savers into stockholders.

Despite these evidences of strength, however, I know you sometimes feel that your continued growth is threatened by the savings and loan associations on one side and the commercial banks, with their time deposit facilities, on the other. At best, this is a healthy awareness of competition. At worst, it might lead you to seek advantages you don't need or to indulge in competitive practices you should avoid. If I might venture a word of advice, without getting caught in the middle of current controversies, it would be that so far as possible in a changing world you preserve your special character, and not try to become too much like your competitors. I would guess that a good deal of your strength comes from the fact that you have an institutional personality which recommends you to the saving public.

There is one worry in this competitive situation which perhaps I can help to dispel. As I understand it, some of you feel that everyone else, presently in the business of attracting the savings of the public on a deposit basis, or on what the public probably believes to be a deposit basis, has some place to go, some lender of last resort on which to lean in time of trouble. You, on the other hand, have to rely largely on your own resources and those of the cooperative institution you have created which is meeting here today. Commercial member banks can borrow from the Federal Reserve Banks. Savings and loan associations can borrow from the Federal Home Loan Banks. You are orphans; although you might become members of either the Federal Reserve System or the Federal Home Loan Bank System, or both. Membership in the former appears to be too expensive for you, and membership in the latter involves getting mixed up in the public mind with credit institutions having different characteristics - credit institutions which are not banks of deposit. It is this situation which has led some of you to inquire about borrowing at the Federal Reserve Bank, even though you are not members of the Federal Reserve System.

I assume that of necessity under present law - and rightly I believe so far as borrowing from the Federal Reserve Bank is concerned - the only kind of borrowing you have in mind is borrowing to meet the withdrawal demands of depositors, and then only in cases of emergency or threat of emergency. It would be possible for the Federal Reserve Bank to lend funds to you in such circumstances. The thirteenth paragraph of Section 13 of the Federal Reserve Act permits a Federal Reserve Bank to make a loan to a savings bank on its promissory note, secured by direct obligations of the United States, at interest rates fixed from time to time by the Federal Reserve Bank subject to the review and determination of the Board of Governors of the Federal Reserve System. At present, the posted rate for such borrowing is 3%.

Now I know that you are not so much interested in the "can you do it" as in the "would we do it". Well, that would depend on the whole bundle of facts at the time in your case just as in the case of a member bank. All of those who deal with the Federal Reserve Banks, whether members or nonmembers,

should understand that borrowing from the Federal Reserve Bank is a privilege, not a right. We do have special regard for the liquidity of our commercial banks, of course, because their demand deposits are so large a part of the money supply of the country. But on numerous occasions the Reserve Bank has taken steps to eliminate or reduce borrowing by individual member banks which seemed to be trying to use our funds in excessive amounts or over long periods to augment their earnings, or to avoid making proper adjustments in their own portfolios. More recently, the Reserve Bank has discouraged or refused loans to member banks when the principal purpose of the loans appeared to be or was admitted to be to increase income tax exemption under the excess profits tax.

I take it, however, that you are not concerned with day-to-day liquidity, nor would we have much interest in that aspect of your operations. I assume that there are two kinds of situations in which the possibility of savings bank borrowing from the Reserve Bank might be important. One is the case of a run or a threatened run on a fundamentally sound savings bank caused by local rumors or conditions. The second would be a serious decline in economic activity, which threatens or is accompanied by loss of public confidence in savings banks, as well as other financial institutions. In each of these cases the public interest would be served and the stability of the local or the general banking situation might be preserved, if the threat were prevented from becoming an actuality, or if the actual development were met by prompt and vigorous counter-action. These are emergency situations in which a savings bank could come to the Reserve Bank with clean hands, seeking help in working out its problems.

There have been discussions in the past, I know, as to whether in such cases there would be some requirement that you use the notice of withdrawal which is still part of your contract with your depositors. We recognize that custom and usage have pretty well habituated the public to ignore this possibility in committing their savings to you. We recognize that the mixture of demand and time deposits in commercial banks makes for difficulties in requiring notice of withdrawal of savings deposits. And we recognize that invoking notice of withdrawal might be just the wrong way to deal with particular situations. So long as the power to require notice exists, however, it is part of the "bundle of facts" I mentioned earlier as entering into our consideration of all loans. I think that you may assume, nevertheless, that either in cases of individual bank difficulties or threatened difficulties, or general banking trouble, or threatened trouble, the Federal Reserve Bank would be in continuing consultation with the State Banking Department and that use of the notice of withdrawal clause would become an important consideration, only if it appeared that its use would be constructive. I don't think that you can or should ask for more assurance than that, and I cannot properly commit further those who may be charged with the management of the Reserve Bank at some future time.

And now I would like to touch on a matter of more general significance which, nevertheless, has special meaning for the savings banker and, indeed, may condition his continued existence. I refer to the insidious and corroding influence of inflation upon the habit of saving. It is in many ways remarkable that the American people have continued to save in such large amounts, and in the form of dollar savings accounts, during the period since 1939 in which the purchasing power of the dollar has declined almost 50%. Some of this can be

ascribed to habit which clings to old ways of thrift, in spite of a growing reliance upon institutional arrangements for the care of the aged, the needy and the unemployed, and in spite of changes in prices which shrink the value of the dollar saved. Some of it can be ascribed to belief in the desirability or the necessity of having something always at hand for a rainy day which may be tomorrow - a hoard with which to meet the unforeseen hazards of daily life and the sudden financial emergencies of human existence. These are habits and beliefs not easily shaken, although they can be shaken if inflation goes far enough and fast enough, and a currency is thoroughly debauched. There are countries in Europe where savings as we know them hold no such high place as do savings here. Fortunately, we do not have to be concerned about a collapse of the dollar. But I am concerned, and I think you should be concerned, about the theories of permanent gradual inflation which are being put forward. This is not a matter of politics but of economics - in your case, passbook economics.

I think that savings in this country have continued to pile up in spectacular amounts because our people believe that the experience of the past decade was an aberration due to war. They do not expect a continuance of the process whereby their savings were tapped by an insidious concealed tax. Yet there are those who presently suggest, and more who believe, that a gradual but perpetual inflation is the lesser evil we must accept if we are to continue to have an economy which works at high levels of production and with a minimum of unemployment. These advocates frankly and honestly say that we must make a choice between stable prices with unnecessary unemployment and maximum employment with gradually rising prices, and that they prefer the latter.

Well, first let us take a look at what gradually rising prices mean with respect to savings. The figures most frequently mentioned are a price rise of 2 1/2 or 3% a year on the average. That is a modest increase and it wouldn't cause public fright about the currency, but over a period of years it would take a considerable nick out of savings accounts, life insurance, pension funds, and similar thrifty provisions for old age or future financial hazards. A rise in prices of 2 1/2% a year, on the average, means a decline in the purchasing power of the dollar of more than 50% in thirty years. A rise in prices of 3% a year means a similar decline in the real value of dollar savings of nearly 60% in thirty years. This is not too long a savings span to contemplate, but such an erosion of savings may be too great to contemplate. Prices have tended upward and the purchasing power of the dollar has tended downward in the past, and we must recognize that there are strong forces pushing us in that direction now. But I don't think acquiescence is the indicated response for anyone, and particularly not for savings bankers. The protection which the public is offered, by those who foresee and accept gradually rising prices, is investment in real estate and stocks and <u>keeping savings bank accounts to a minimum</u>.

Yet, if the only alternative to greater stability of the purchasing power of the dollar is unnecessary unemployment, defense of the dollar may not be a popular cause; it is likely to have few leaders and few followers. That adjective, "unnecessary", attached to the word unemployment might detain us a little, if we had time, because <u>unnecessary</u> unemployment is what would make defense of a stable dollar seem callous and unresponsive to human suffering.

Let's by-pass this bit of semantics, however, and put our problem another way. What we all should be interested in trying to achieve and maintain is a high level of employment and production, with provision for the relief of the hardships of whatever transitional amount of unemployment develops, from time to time, as a result of the free and dynamic character of our economy.

But we are now told that to have any chance of success in such an endeavor we shall have to jettison stable prices. Here is the way the argument goes in capsule form. It is the established policy of the country, and the only tolerable policy in terms of domestic social and political conditions, and international economic relationships, to see to it that whatever business recessions the United States may experience are kept as mild as possible. The more successfully the country checks depressions (keeping them mild) the more certain it will be that prices will creep upward; the price advances in good times will exceed the price declines in mildly bad times. This upward movement of prices will come about chiefly because, at some point short of full employment, the bargaining power of most unions becomes so strong that they are able to push up money wages faster than the engineers and managers can increase output per man hour. In other words, increasing labor costs are going to push up prices, because powerful labor unions are able to force wage increases in excess of increases in productivity. In these circumstances, expansion of the money supply is only the vehicle, not the cause of inflation, and credit policy in reality is made at the collective bargaining table, not in the Federal Reserve System.

That is the way the record of the past several years is being projected into the future. It may be the realistic, hard-headed way to view the future. There is another way, however, which may not be wholly fanciful. It would be based on a better division of the rewards of increased productivity than we have yet achieved. During the past fifty years it is estimated that the real national product of the United States has increased five-fold while population doubled, so that output per capita increased two and one-half times. Nor is that all. The greater product per capita was achieved with less effort, so that we have been able to combine satisfaction of our material wants and needs with greater opportunities for education and relaxation - for leisure and learning.

The record is a proud one even though the gains of the past fifty years were not distributed evenly over time, and even though some of the gains were shot away in two world wars. But in the future perhaps we can do better. Perhaps we can avoid the extreme ups and downs which are concealed in the averages of the past half-century. One approach would be through a better division of the rewards of increased productivity, in terms of keeping our economy dynamic while avoiding the payment of tribute to pressure groups. There were times in the past when the owners and managers of enterprises claimed and took more than was their due in the form of profits. There were times when the farmer was on the short end of the stick and times when he reaped where he had not sown. Now organized labor has achieved such strength that it tends to claim the lion's share of what increased productivity produces. Too little attention has been paid by these various economic groups to the possibility of giving the consumer - that is, all of us - a little more of the rewards of increased productivity in the form of lower prices or of greater values for money spent. With ownership that employs navigators

as well as captains of industry, with more mature leadership in a more mature labor movement, and with Government that holds the scales in balance between management and labor, not tipping them for political purposes, a great deal might be accomplished.

I am assuming, of course, that conditions of vigorous competition will be maintained, both to spur the utilization of our dramatic technological developments and to continue incentives for price reduction or improved quality as business searches for expanding markets.

Those who hold the opposite view are likely to fall back on the argument that even if attainable, stable or declining prices are inimical to high level production and employment. That, of course, depends on the reasons for the behavior of prices. Stable or declining prices have been and can be accompanied by declining production and employment. But if lower prices or greater values at stable prices are the result of more efficient production, and the vigorous competitive attempts of producers and distributors to broaden their markets, they are likely to lead to larger production, more employment opportunities, and better living for people generally. How did our great mass production industries become great? By this very process.

A somewhat contrary example may be found, perhaps, in the building industry. I understand that great strides have been made in this industry since the war, but there appear to be at least remnants of old practices, which prevent the consumer from getting more real value for his money. And so it still tends to be a boom and bust industry, subtracting from rather than adding to our economic stability, contributing to periods of inflation and deflation.

This has to do, of course, with the backbone of your business: loans on and investments in real estate mortgages, and particularly home mortgages. I do not know whether the savings banks have ever taken an interest in or done anything about trying to see that the mortgage borrower gets value received for his money. I am not thinking of value received in terms of relative prices or costs of similar structures, but in terms of what he might get for his money if all the possibilities of technological improvement and new materials were exploited in the building industry. If it is the case that restrictive practices in the building trades, restrictive practices in the building materials field, and archaic building codes still combine to give your borrowers less than their money's worth, I should say it is of interest to you and to your customers. I know it is of interest to those who are seeking a stable progressive economy without extremes of inflation or deflation.

We have adopted as a national policy the promotion of home ownership, but most of what is done to promote home ownership is to make credit easier to obtain in terms of Government or Government-guaranteed or insured loans, with low interest rates, small down payments and long runs to maturity. If there are restrictive practices in the building industry, and if there are archaic building codes, we are making it easier for people to go into debt, while condoning their being given less for their money than they should receive. This must be a concern of the savings banks, as the source and center of much of our mortgage lending. Would it not be desirable, therefore, to take steps, or to

prod the Government to take steps, to see if these conditions actually exist and, if so, what can be done about them to improve the position of the mortgage borrower? If private business condones such practices by acquiescence, or public officials connive in them by inaction, we are guilty of giving assistance to those who would undermine our system of democratic capitalism. It is not necessary to descend to the low level of a New York dock scandal in order to find a situation which is a denial of our better instincts and of our best performance.

I should like to see the building industry, generally, improve its production standards, and then give the consumer, the mortgage borrower, the home owner, a larger share of the rewards of increased productivity in terms of lower prices for wellbuilt modest homes, and for improvement of or repairs to those homes. Nothing would contribute more to the promotion of economic stability, the prevention of inflation, and the encouragement of saving.

This is supplementary to my general theme but perhaps I have said enough to indicate that I think we can refuse to make the intolerable choice between unnecessary unemployment and perpetual inflation. I think the core of the answer is to be found in increased productivity and a just sharing of the product. I think we must refuse to surrender in advance to creeping inflation which destroys the habit and rewards of individual or family saving. But if this is the stuff of dreams, and if the fatal choice must be made between unnecessary unemployment and persistently rising prices, then your business is in danger. You had better begin to look beyond the records you are making today to the problems of shrinkage or liquidation which your successors may face tomorrow.

I do not deny that we have to make a choice, and it is a fundamental choice. We can plump for a propped-up economy, with a perpetual bias toward inflation. That might well keep us going at a high level of production and employment for a considerable period of time. But, in my view, it would carry within itself the seeds of an eventual breakdown. The other choice, the one I have tried to point up in these remarks, is that of an economy which emphasizes increased productivity, taking some related ups and downs in its stride, and fitting into place those economic and social improvements which the rate of growth of productivity permits. It is an economy which asks value received from management and labor, from farmer and city dweller; an economy which implies a healthy degree of effort to make a profit or hold a job. To fulfill the possibilities of this choice we shall have to struggle in a variety of ways with the various causes of instability in our economy, as one or another of them assumes particular importance. This prescription is not so easy and so clear as a policy of perpetual mild inflation, but I believe it is the high road to real economic stability.