MISC. 3B.2—4/67

FEDERAL RESERVE BANK
OF NEW YORK

OFFICE CORRESPONDENCE

DATE 9/14/22

TO

FROM

SUBJECT: Bankers + Existing Financial Situation before A B A Oct 3, 1922

Mr. Snyder Many thanks

For Gov. S.- Sept. 19-22,

Draft by Snyder for Strong's address before Executive Council ABA Oct 3, 1922 but different from that given. See pp 139-144 of Strong's Interpretations

THE BANKER AND THE EXISTING FINANCIAL SITUATION

Because of the very remarkable conditions now obtaining, in the United States and in the chief nations with which it has closest relations, there are matters of unusual import which it seems to me it is the present business of the bankers of this country to consider with the greatest care. I mean our relations as bankers to the economic, social and, I would even add, political welfare of this country.

I need not remind you as to the nature of these present conditions, nor need we delay over questions as to how they have arisen. I would dwell upon one point, and that is that, in an economic sense, the four years which have elapsed since the end of the great war have been for the United States without any parallel in its history. It is usual at the close of a long war that there should be a large and often precipitate decline from the high levels of prices which modern wars almost invariably engender. We had, following the world war, no such decline. Contrary to the widest general expectation, instead of a decline we had, piled high upon the enormous increases in the war, the greatest rise in prices which this country has ever known in peace times. This was accompanied, as is almost invariably the case, by a great wave of speculative activity which swept the whole nation.

Then, following this post war boom, as it has been termed, came the most drastic collapse in prices, measured in percentages, which this country has ever known; and with this collapse an unusually severe decline in production and trade, in some lines probably beyond any previous precedent.

But this critical depression proved as short lived as it was intense and we have now had, from the lowest point of that depression, a recovery in the last twelve or thirteen months that is likewise probably without a precedent in its rapidity. In many lines, at least, this is a certainty.

Now, I have no need to remind you that in all these abnormal movements our banks and our bankers participated to an unusually intimate degree. The post-war rise in prices and the speculative boom that went with it was accompanied by perhaps the most rapid expansion of bank loans, in peace times, of which we have any record. I think it is clear to everyone that, in its extent, this post-war boom and this rise in prices would have been impossible without this corresponding expansion of bank loans. Without dwelling upon causes or upon extenuations, these are the certain facts.

Now, gentlemen, I venture to suggest to you that at the present time we stand in much the same position as, let us say, the late summer of 1919; but with certain very vital differences. We have not now any huge and ominous floating debt. Imperative necessities for Government funds do not now exist. General interest rates have undergone an extended decline. We have gone through a period of very thorough liquidation. A large amount of bank loans has been funded and largely absorbed by investors, though not to the degree which might have been desired. Our banks have been heavy investors, especially within the present year, in Governmental and other securities, and this fact has undoubtedly been a potent factor in arresting the precipitous decline which began in the spring of 1920. From the depths of the depression we have had not only this remarkable recovery in production and trade but an equally notable rise in wholesale prices. In times of very wide fluctuations wholesale prices are not an authentic index of the general price level, meaning by this the general level of wages, salaries, rents, and prices at retail as well as wholesale. Nevertheless, it is clear that the broad movement of wholesale prices precedes and determines the general level of all prices; and these prices are, therefore, barometric to and in some degree prophetic of the general price level.

The broadest index of wholesale prices which we have is that of the Department of Labor, and I wish to point out to you that this index, within the present year, has risen already 17 points, and in percentages more than the widest variation in wholesale prices, from low to high, that occurred in the five years which preceded the opening of the world war. For the month of July the rise in wholesale prices was one of the heaviest ever recorded by this index, and only a few times exceeded, even in the violent activities of the war. At the Federal Reserve Bank we maintain an index of the twenty most important commodities, basic to all industry, and this index, which has clearly marked the tendency of wholesale prices in advance of any other, gives now no evidence of any arrest of this movement of rising prices. I believe we must squarely face the implications of this fact.

It is A. B. C. that if this tendency to advancing prices continues it must, with the rapid recovery in production and trade, soon lead to a renewed demand for funds to finance industry. For more than a year and a half there has been a steady though, for the last ten months, very slow decline in so-called commercial loans, that is to say, loans other than those upon Government and corporate bonds and stocks. This liquidation, as I have pointed out, has been in part achieved by the inflow of more than a billion of gold since the summer of 1920, and in part by public issues to a very considerable degree taken by the banks themselves. It is clear that the banks cannot long continue to absorb these securities, and maintain a condition of healthful balance, nor can they continue to absorb Government funds.

The demands of industry and trade will soon utilize all of the funds available. I think it is clear, likewise, that beyond this the banks will inevitably be called upon to finance a higher level of commodity prices. And this, gentlemen, I need not point out to you is the beginning of the vicious circle.

The banker understands clearly enough the simple mechanism by which prices rise and fall; but this mechanism is not clearly understood by the laity and is the occasion, as I believe, for a very large part of that unrest, social discontent, ill feeling, and violent propaganda which has been so much in evidence since the war closed. The mechanism, as we know, is simply this: If trade becomes unusually brisk, and the retailer finds his merchandise slipping from his shelves, he is promptly alert to see that it is replenished in order that he may serve his customers and conserve his trade. Now, in such times he usually finds that others in his line are doing exactly the same; with the result that deliveries are retarded. Jobbers' stocks are quickly reduced and the mills must be speeded up to meet the increased demand. To obtain quickened deliveries the retailer may offer or the wholesaler and the jobber may may suggest a slight premium for preference orders; or, simpler still, the jobbers first to fell the effect of this demand may advance their prices.

At the same time they make increased demands upon the mills, and here again the pressure is not upon a single mill but upon all, with the result of an unusual demand for labor. And if this demand for goods is sustained the result is the offering of higher wages in order to attract more hands to the mills. So the producer finds his costs advancing and increasee his prices, and this increase must be passed along to the retailer and by him to the consuming public. There is no mystery about it in it, and, as you gentlemen very well know, extraordinarily little of all this "conscienceless profiteering" of which we heard so much in and after the war.

Now, it is equally clear that this unusual demand for goods will soon come to an end, first by the natural check of advancing prices but more distinctly by the consequent reduction in the purchasing power of the public at large, unless there be a corresponding increase in this purchasing power. But this latter is impossible in our present-day money and credit economy, without an exactly equivalent increase in the outstanding volume of money and credit--for all practical purposes in the amount of actual currency in circulation and of bank credit extended by banks.

Without considering activating causes, which is perhaps a barren waste of time, it is clear, and there is practically no one to deny, that in the final analysis the limiting factor in a continuing rise in the general price level is, for all practical purposes in this country, the total amount of bank credit. For us the actual amount of the currency is now a very minor although still an important item. It is perfectly clear that the movement of the cotton crop, from the cotton plantation through the mills and the shops to the final consumers of cotton goods, cannot be financed, as it must be financed, with the same amount of credit, with cotton at 20 or 30 or 40 cents per pound as against, say, 10 or 12 cents.

Our vast wheat crop will require, roughly, twice the amount of credit to be moved from the farms through the mills and the stores to the ultimate buyer, at $2 a bushel, than it would at $1 a bushel.

Special causes may operate and do operate to produce the widest oscillation in the prices of individual commodities, or even of great groups of commodities, like the products of the farms. But it is clear that a general advance in the level of all prices, or even in the larger number of prices, cannot take place without a corresponding increase in the nation's purchasing power. You cannot sell the total of the nation's product valued, let us say, in 1913 at 25 billions, at, let us say, 50 to 60 billions in 1918, with but a moderate increase in the actual quantity of goods exchanged, without a corresponding increase in the total of funds available for these purchases. We simply have no mechanism by which this miracle could be achieved. The business habits of our people are more or less fixed. The average turnover of goods from year to year appears to change but little. The only thing that can and apparently does change is the total of circulating currency and the total of bank loans.

Now, if all this be reasonably true, and it seems to me incontrovertible in the light of the experience of the last ten years, if not throughout all known economic history, then, gentlemen, it seems to me that, as an association of bankers in charge of the actual financing of the nation's business, we must at this time more than ever consider our relation to and responsibility towards the general welfare of the whole people. I do not need to remind you that the present situation is radically and vitally different from that which obtains in what we may call ordinary or normal times. In normal or ordinary times the banker has little to consider beyond the condition of his own portfolio, the statements of his customers, and the general banking position. In times of crisis, such as have been characteristic with such curious regularity in our business life, the banker has, indeed, then a far wider responsibility

~~[illegible]~~ and that is his duty towards the community and, in a considerable degree, towards all other banks.

It seems to me that we have now a much deeper responsibility, partly engendered by the steadily advancing importance of the banker in all our business and economic affairs, his increasingly vital economic function, but directly precipitated by the extraordinary condition which now subsists. Never before in the history of this country did we ever, in the space of eighteen months or of twice or three times that period, import, as we did just preceding our entry into the war, a billion dollars of gold.

Never before, in the history of this country, in the space of about a year, or in two or three or four times that period, did we ever suffer a loss of more than 400 millions of gold as in 1919-'20.

And never before in the history of this country, in peace times, did we ever import a second billion of gold, as we have done within the last two years. I do not need to review the conditions which have brought to us this huge and profitless accession of gold. And it has come to us at a time when, of all times, it was least needed and perhaps most dangerous.

At the present time the total of banking loans and investments in the United States is roughly double to that preceding the war. The average of all commodity prices at wholesale, on the Department of Labor index, is now but 55 per cent. above the 1913. If we combine all the indices we have of the averages of wages, retail prices, security prices, rents, the average cost of living and the like, it is certain that the average of all prices, the general price level, can scarcely be more than 75 per cent. above the pre-war level, if it be so high as that.

It would seem therefore that the present volume of our currency and bank credit should be more than completely adequate to the full financing and carrying on of all our industry and trade, even at a high pitch of activity. We now know, definitely and conclusively, that the total of the nation's physical product of goods, the total of all crops and coal and iron and lumber, with all the immense machinery for transportation, manufacture and distribution which these require - can increase but very slowly from year to year, and only with the increase of population and economic and industrial efficiency, and by ingenious invention.

The average rate of this increase of the whole product of the nation we now know to be very close, throughout the last half century and more to 3½ per cent per annum; and [redacted] this increase can rarely be greatly augmented save momentarily in the change from very slack to very active times, and through an unusually abundant yield of the soil. And [redacted] at constant general price levels the normal credit and banking requirements of industry and trade can grow only at a slightly higher rate.

Any increase in the credit volume beyond this point can in time mean only a rise in the general price level. This rise will be reflected first in the average prices of the great basic commodities, next in the general average of all commodities at wholesale, then in prices at retail, then in wages, salaries, rents and security prices.

These seem to be the unequivocal facts which recent research and the experience of the last 50 years have established.

The thing that I now wish to bring to your attention is, I believe, almost the most vital of all. It is simply that any undue and needless expansion of bank loans and banking credit and of the currency as well, can take place now only through the medium of the Federal Reserve banks.

The resources of the member banks of the Federal Reserve System now constitute about two-thirds of the resources of all the commercial banks, excluding the savings banks, of the country. Neither in these member banks, nor in the 20,000 or 21,000 chiefly smaller banks which still remain outside of the Federal Reserve System, are there any considerable cash reserves upon which to posit any notable expansion of credits.

Practically speaking the banks of the nation now keep in cash only needful till money and very little more. They no longer carry any large cash reserves as heretofore. Practically speaking, the entire monetary reserve of the nation is now deposited with the Federal Reserve Banks.

This means that no notable expansion is now possible without drawing upon this central reserve. To expand their loans and to obtain the needful currency which in the long run will accompany any considerable expansion, the member banks of the system must rediscount at the Federal Reserve banks, in order first to increase their required reserves, and secondly to obtain the needful supply of additional currency required. Beyond very modest proportions therefore the control of the financial situation is today to an unusual and, I would say unexpected degree in the hands of the Federal Reserve banks.

Now I have no need to remind you gentlemen that the Federal Reserve System was established as a vast cooperative institution, not merely for the safety and increased efficiency of the banks, but for the public good and for the good of the whole nation. It ~~This~~ requires for its working the active cooperation and the friendly support of the larger part of the banks of the country. There ~~was~~ and is no compulsion that any bank should be a member of this system. Any national bank that wished to decline this support could give up its charter as a national bank. But, on the contrary, practically every national bank has remained in the system and in addition more than 1600 of the most important state banks and trust companies which were eligible have become members.

This vast cooperative organization, with resources now exceeding 3 3 billions, was not created as a source of additional profit, but for mutual protection and for the public welfare. The Federal Reserve banks were ~~created~~ established to hold the reserve and not to be a source of profits at all.

As you know, all of their net earnings beyond the 6 per cent on the modest amount the member banks contribute as capital, and a small allowance for surplus, goes entirely to the Government. Into the hands of a Governmental body is given the final supervision and control of the system. And that body is appointed not by the shareholders, the member banks, but by the president of the nation.

It was never in the conception of those who, for more than a generation labored to perfect and secure the passage of the act creating the Federal Reserve System, that this system should become an engine of needless expansion of credit, with all the demoralizing and disrupting industrial and social consequences which such an expansion invariably entails. I may add that probably not one of the long and distinguished line of those who labored towards the creation of this system ever dreamed of the curious situation which has been precipitated upon us, in consequence first of the war, and secondly of the abandonment of the gold standard, by the chief commercial nations of Europe. The repercussion from the European situation and our ~~own position~~ possession of vast natural resources have presented us with a problem such as the banking fraternity and the economic minds of this nation have never faced before. I think it may be added that no other great commercial nation could supply us with any precedent for our present guidance. But the nations of Europe in the war and after the war, not merely the actual participants but the neutral nations which did not participate, and the new nations which have been created out of the old, with no debts and no burdens, have abundantly and overwhelmingly supplied us with the proof that we cannot increase the real wealth of a people by fictitious additions to the money supply. If we could do that, then all that would be necessary would be to chop our own paper dollars and our gold dollars in two, to double the product of our machines and of the 40,000,000 of our people gainfully employed. All this every sane man knew long ago. It is so clear now that he who runs may read.

Ricardo & Mill.

But it is not so clear, I think I may say, even to many of our bankers and our publicists and our statesmen that it makes no substantial difference whether we increase the purchasing power of our people by excessive expansion of bank credit than as though we printed billions of paper money as have Russia, and Poland, and Germany and other states. The effect is essentially the same. This is the fact which must become a part of the consciousness of all enlightened opinion in America. It must so become because of the peculiar and unusual conditions of banking development in this country. In other great nations like England and Germany and France and the rest, banking is carried on largely through the agencies of a small number of great joint stock banks, with large numbers of branches throughout the several countries; usually also with a powerful central bank. In this country, as you know, over 30,000 individual banks are locally owned, locally managed, locally controlled, accustomed but little to cooperation or even to very wide mutual consideration.

Of this enormous total of 30,000 banks, more than 20,000 of them are outside even of the cooperative influences which were created in the new Federal Reserve System. And in turn the support and maintenance of that system itself is dependent upon nearly 10,000 individual banks, scattered through every state of the union. and with widely varying interests, associations and prejudices.

In other lands the influence of a relatively small number of experiences men, usually men of distinguished ability and training, is pre-potent. In this country nothing of the sort exists. So far from that between the different banks there is often a wide divergence of policies and view and often a real feeling of antagonism. The so-called country banks have likewise a certain jealousy of the large banks in the larger cities, and these in turn something of the same sort of feeling towards the great banks of Chicago and New York. And there is always with us the universal apprehension of the supposed influence of Wall Street and the "money power." I need not remind you that Thomas Paine and Thomas Jefferson were writing against this same money power even in those far days, and this sort of writing has never ceased from that time to this, the agitation against the imagined policies of the Federal Reserve Banks is but a part of a feeling that is as old as the oldest bank in this country.

The second Bank of the United States certainly, and probably to a large extent likewise the first Bank of the United States, had its career terminated by the antagonism and jealousy of the State Banks which were then springing up in such extraordinary number, laying then the foundations for that powerful prejudice against any form of a central bank which for three-quarters of a century prevented in this country the adoption of a sound banking and currency system.

Wide and steadfast cooperation between even ~~a~~ any large portion of the 30,000 banks of the United States is, therefore, an extremely difficult matter. I will even add that I have found in my experience, even among Member Banks of the System, a certain prejudice, and almost a feeling of antagonism, towards the Federal Reserve Banks. And yet there never was a time in the history of the country, it seems to me, when a solidarity of policy and purpose, and that policy and purpose one of enlightenment and high public spirit, was more needful than at the present time.

Gentlemen of the Executive Council, it is my deep belief that your body and the Association of American Bankers has before it no more important function than the achievement of such a solidarity of policy and purpose, to the end that, in so far as our banks may be a contributing factor, the profoundly agitating instability of our economic conditions growing out of the war and its consequences may again be reduced, as in the five years just preceding the war, to the normal and utmost minimum.