VOLUME 1

PROCEEDINGS OF A CONFERENCE WITH THE FEDERAL RESERVE BOARD OF GOVERNORS AND CHAIRMEN AND FEDERAL RESERVE AGENTS OF THE FEDERAL RESERVE BANKS

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PROCEEDINGS OF A CONFERENCE WITH THE FEDERAL RESERVE BOARD OF GOVERNORS AND CHAIRMEN AND FEDERAL RESERVE AGENTS OF THE FEDERAL RESERVE BANKS.

Washington, D. C.,

Tuesday, October 10, 1922.

The Conference with the Federal Reserve Board of the Federal Reserve Gavernors and the Chairmen and Federal Reserve Agents of the Federal Reserve Banks was called to order in the Board Room of the Federal Reserve Board, Treasury Building, Washington, D. C., at 10 o'clock a.m. on Tuesday, Ootober 10, 1922.

Present:

Hon. Edmund Platt, Vice Governor of the Federal Reserve Board (Presiding)

Hon. A. C. Miller, Member, Federal Reserve Board.

Hon. John R. Mitchell, Member, Federal Reserve Board.

Hon. C. S. Hamlin, Member, Federal Reserve Board.

Hon. D. R. Crissinger, Comptroller of the Currency and ex officio Member of the Federal Reserve Board.

Also:

Charles A. Morss, Governor, Federal Reserve Bank of Boston.

Benjamin Strong, Governor, Federal Reserve Bank of New York.

George W. Norris, Governor, Federal Reserve Bank of Philadelphia.

E. R. Fancher, Governor, Federal Reserve Bank of Cleveland.

George J. Seay, Governor, Federal Reserve Bank of Richmond.

M. P. Wellborn, Governor, Federal Reserve Bank of Atlanta.

J. B. McDougal, Governor, Federal Reserve Bank of Chicago.

D. C. Biggs, Governor, Federal Reserve Bank of St. Louis.

R. A. Young, Governor, Federal Reserve Bank of Minneapolis.

W. J. Bailey, Governor, Federal Reserve Bank of Kansas City.

J. U. Calkins, Governor, Federal Reserve bank of San Francisco.

Also:

John Perrin, Chairman and Federal Reserve Agent, Federal Reserve Bank of San Francisco.

Frederick H. Curtiss, Chairman and Federal Reserve Agent, Federal Reserve Bank of Boston,

Pierre Jay, Chairman and Federal Reserve Agent, Federal Reserve Bank of New York.

R. L. Austin, Chairman and Federal Reserve Agent, Federal Reserve Bank of Philadelphia.

Caldwell Hardy, Chairman and Federal Reserve Agent, Federal Reserve Bank of Richmond.

Joseph A. McCord, Chairman and Federal Reserve Agent, Federal Reserve Bank of Atlanta.

William A. Heath, Chairman and Federal Reserve Agent, Federal Reserve Bank of Chicago.

William McC. Martin, Chairman and Federal Reserve Agent, Federal Reserve Bank of St. Louis.

John H. Rich, Chairman and Federal Reserve Agent, Federal Reserve Bank of Minneapolis.

D. C. Wills, Chairman and Federal Reserve Agent, Federal Reserve Bank of Cleveland.

Asa E. Ramsay, Chairman and Federal Reserve Agent, Federal Reserve Bank of Kansas City.

William F. Ramsey, Chairman and Federal Reserve Agent, Federal Reserve Bank of Dallas.

George L. Harrison, Deputy Governor, Federal Reserve Bank of New York, and Secretary to the Conference of Governors.

PROCEEDINGS

Vice Governor Platt: Gentlemen, we have a rather long program and I suppose it is advisable that we get started as promptly as we can. I know you all regret that Governor Harding is not here to conduct the proceedings, and it becomes my duty to open this conference.

The Board has no considerable number of things to add to the program, which I think you will be glad to know. The program is already long and has many interesting things on it, and it is the idea, I believe, of the Board and I presume of the Conference also, that the discussion of the Federal Reserve credit policy will come at the Joint Conference, after you gentlemen have completed your separate conferences as Governors and Federal Reserve Agents. That Joint Conference will perhaps be held on Thursday, although I do not know just when you are likely to get through, although I suppose it will probably be Wednesday evening.

I do not know that it is necessary to call particular attention to the various items on the program, that is, as to some of them being more important than others. Many of them are matters with which the Board has no very great concern, although the Board is interested in them. Richmond, I believe, is going to bring up the interesting question with regard to the interpretation of the word "borrower", having been in more or less discussion with the Board's counsel as to whether or not the endorser is the borrower or whether the borrower is necessarily the maker of the note. The question came up on the rediscounting of some cattle paper, a cattle dealer who sold cattle to various farmers and took their notes. In this case the Board is trying to help the farmer, theoretically, and the Federal reserve bank is trying to sit on him.

There is one question which is not on the program, but which is rather interesting and perhaps should have some little discussion, and that is the question of reserves. Following the long practice in the Comptroller's Office, and which may have some actual legal warrant, with regard to reserves for National Banks, that gold certificates, before they were made legal tender were legal reserve for national banks by a specification in the Act. Subsidiary silver was counted as reserve for national banks, and the Federal Reserve Act says that for purposes of reserve against deposits lawful money shall be reserve. Lawful money apparently means any kind of lawful money regardless of whether it is legal tender for only 25 cents or $10, or whether it is legal tender for any/unlimited amount. It looks as if the thing, if ever brought to the direct issue, would make it necessary for us to decide that even nickels and cents may be counted as reserve in reserve banks. However, it is not a matter that will affect the percentage of reserve at all. What we would like to do, and what the Board has voted to do, is to cut out the subsidiary silver from being counted as reserve, and this matter has been placed in the hands of the Executive Committee.

Mr. Curtiss: Is not that a legal matter?

Vice Governor Platt: It is a legal matter, but it deserves a little discussion, I think. I do not think it is of great importance, but I am mentioning it as one of the things that is not on the program.

Then there is a question, which perhaps should be given a little consideration by the Federal Reserve Banks, which have fiscal agency work for the War Finance Corporation, and that is the matter of reimbursement of expense. Kansas City has asked for some additional reimbursement from the War Finance Corporation for overhead, in the way of rented space, and so forth. They have kicked about it, but the Board has taken the position that the Kansas City Bank should not have any reimbursement for items which are not reimbursed to the other banks. We would like to have a careful accounting kept of all the items which should be reimbursed, so that we may have the thing on a strictly commercial basis, so that we may have some record of what the Federal Reserve System is doing for the War Finance Corporation in the way of helping it along.

I understand that after this joint meeting the Governors are to meet in Governor Harding's room, and that the Agents will meet here. As to the progress of the meetings, gentlemen, you will let the Board know when you are ready for the joint conference, I presume.

Mr. Miller: Isn't it desirable to have a committee of the Governors and Chairman get together in order to determine at what time they expect to finish their respective programs so that we will know when the joint Conference can be held?

Vice Governor Platt: I think that is very desirable.

Mr. Miller: I should think they could do that some time during the course of the day and report tomorrow morning in order that we may know whether the final joint conference is likely to be on Thursday or Friday.

Vice Governor Platt: If no other member of the Board has anything to say, I think that is all I have to say in the way of starting things off, and a motion to adjourn the Joint Conference is in order.

Mr. Hamlin: I so move.

(The motion, being duly seconded, was carried, and the joint conference adjourn at 10.50 o'clock a. m., to reconvene on Thursday, October 12, 1922, at ten o'clock a. m., pursuant to adjournment of the separate conferences to be held by the Governors of the Federal Reserve Banks and the Chairmen and Federal Reserve Agents of the Federal Reserve Banks.)

PROCEEDINGS OF A CONFERENCE WITH THE FEDERAL RESERVE BOARD OF THE GOVERNORS AND CHAIRMEN AND FEDERAL RESERVE AGENTS OF THE FEDERAL RESERVE BANKS

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SECOND DAY.

Washington, D. C., Thursday,
October 12, 1922.

The Joint Conference of the Federal Reserve Board with the Governors and Chairmen and Federal Reserve Agents of the Federal Reserve Banks reconvened in the Board Room of the Federal Reserve Board, Treasury Building, Washington, D. C., on Thursday morning, October 12 1922, at 10 o'clock a. m., pursuant to adjournment of Tuesday, October 10, 1922.

Appearances as indicated in Tuesday's proceedings.

PROCEEDINGS

Vice Governor Platt: Gentlemen, the meeting will please come to order. We have a rather long, but interesting program.

First of all I want to say that it seems to me that this conference, so far as I have heard of its proceedings, has been very successful and very expeditious in the way or transacting its business. Instead of having a general discussion this morning on the topics that have been discussed at the conference, I think we should have a brief report or statement from Governor Strong and from Mr. Perrin with regard to the separate conferences, and then plunge immediately into the reading of papers and discussion on the Federal Reserve credit policy, which is the chief matter in which I know you are all interested.

Governor Strong, will you please speak for the Governors?

Governor Strong: As I stated last night, our program for this meeting was, I think, the shortest in number of topics to be considered, that we have had at any meeting of the Governors that I recall, and in order to save time I think I will refer only to the one most important topic that we had to discuss, and that was the review of the work of the committee that was appointed last April to execute orders in investment securities for the twelve reserve banks.

When that committee was appointed last April, somewhat inspired, as you know, by the Reserve Board and by the

Treasury, there were certain specified things to be accomplished by the Committee, but the Committee was not invested with any discretion whatever, it was simply to execute orders, so that the interests of both the Treasury and the Reserve Banks and of the market for Government securities would be protected.

The work of the committee has, we believe, been handled successfully. It has executed orders aggregating, in round figures, $200,000,000 in the various issues of government bonds, securities and notes; and it is a significant thing that of the $200,000,000 buying and selling orders executed, only $84,000,000 were executed in New York, the rest being distributed among all the other reserve banks, all but one or two, and therefore certainly one of the results of the committee's operations has been to protect the market and the dealers in the other reserve bank cities.

Now, it was felt by Mr. Gilbert, and I think very strongly by some members of the Federal Reserve Board that possibly the scope of the committee's activities might be slightly extended, and at a meeting held in New York on October 2nd, which Dr. Miller attended, we discussed that matter at great length and found a good deal of difficulty in devising a formula, which would not appear to the reserve banks to be a surrender of some of their autonomy, and of the authority of their boards of directors to control their policies, which certainly was not the intention of the committee to suggest, and finally at our meeting yesterday we devised a formula, adding an additional duty to the work of the committee, in the following language:

The committee recommends continuance of making reports, and so on, as formerly authorized, and in view of the foregoing the committee further requests the conference to add to the duties of the committee the making of recommendations from time to time to each Federal reserve bank as to the advisability of purchases or sales of Government securities, which recommendations will in every case receive serious consideration by the officers or directors of the several banks.

It is not intended by that, speaking for the committee, to do any more than convey what they hope will be valuable information to the Reserve banks.

Mr. Perrin: Will you kindly read that paragraph again, Governor Strong?

Governor Strong: I will read the last paragraph:

"In view of the foregoing," that is the report in full--- "the committee further requests the Conference to add to the duties of the committee the making of recommendations from time to time to each Federal reserve bank as to the advisability of purchases or sales of Government securities, which recommendations will in every case receive serious consideration by the officers or directors of the several banks."

That was adopted unanimously by the Conference. It is the Committee's belief that, by frequent conferences among themselves, and by keeping close watch on the market and by keeping closely in touch with the Federal Reserve Board and with the officers of the Treasury, that these recommendations might serve to be some guide to the directors of the Federal reserve banks in carrying out a policy which will apply to the system as a whole; and the important part that I would like to emphasize in regard to this addition to the committee's duties is this: That between January of this year and the time of the Committee's organization in May of this year, May 17, I think it was, the Federal reserve banks, without any community of interest, or without any discussion of policy, or without any understanding, I fear, as to the significance of their collective action, went into the market and purchased a total of five hundred millions in Government securities in order to make earnings, and if you appreciate, as I am sure you do, the possibilities that might result to our credit position in this country from lack of a policy to shape our forces in making that vast investment, you will realize the possibility of danger to the country from the failure to have some regulation, some control, some understanding, and the committee wants to draw a very close distinction between any effort to control or direct the action or management of the twelve federal reserve banks and the supplying of those banks with information which will lead to the carrying out of an intelligent system or policy, the committee simply being the instrument to execute the orders of the reserve banks in carrying out that policy.

Mr. Mitchell: I would like to ask a question, as to whether you mean that before a Federal reserve bank could go into the market and make any investment in government securities, the matter should be taken up with this committee?

Governor Strong: It would automatically be so anyway, Mr. Mitchell, because, under the arrangement which has now been in force for nearly six months, the orders are all sent to the committee, with the exception of transactions which take place between the Federal Reserve banks and their members, over the counter, so to speak, and whenever a reserve bank intends to make a purchase or sale the committee is immediately notified and the order is distributed by the committee among the different Federal reserve districts, so that our attention would be brought at once to a decision by any reserve bank to make either a purchase or a sale. The present practice has been, as you all know, I think, to send a telegram to every reserve bank practically every day advising whether the Treasury has orders or whether the reserve banks are giving orders, and then every day a letter goes to each reserve bank giving a summary of everything that is done.

I want to emphasize, Mr. Mitchell, what I said before, that the committee isnot assuming to direct or control or manage the investment account of any reserve bank. It is simply an instrument through which the policy of the system as a whole will be executed in the market without disturbing the market. My hope is that the system, as a result of today's conference, will adopt a policy, and that the committee will be in a position to execute the orders that result from that policy, rather than attempting to shape the policy.

Mr. Miller: Would you mind reading the last part of that report again, Governor Strong?

Governor Strong: I might say, Dr. Miller, that the first part of this report simply states that it was prepared in New York---

Mr. Miller: I understand that, Governor.

Governor Strong: "In view of the foregoing the Committee further requests the Conference to add to the duties of the Committee the making of recommendations from time to time to each Federal reserve bank as to the advisability of purchase or sale of government securities"---

Mr. Miller: That is all I wanted. On what basis is the committee to make recommendations as to the advisability of purchase or sale?

Governor Strong: I think we will have to work that out with the Board and with the Treasury. The only object immediately to be gained by this is to create an instrument through which advice may be sent to the reserve banks, which we never have heretofore done--- the committee has never undertaken to say to any reserve bank to do this or that for the reason that it might be a good plan to buy something or that it might be a good plan to sell something.

Mr. Miller: It struck me, as you read it, that the committee was more for the execution of orders than systemization of operations, and that it was also a policy committee, with no policy indicated.

Governor Strong: There is no policy indicated. I do not think the committee could assume to indicate a policy for the system.

Mr. Miller: When you set up a committee to make recommendations as to advisability of purchase or sale it in fact is a policy committee, unless you elsewhere indicate that the policy for the Federal reserve banks in this matter is to be otherwise determined.

Governor Strong: Well, sir, I am hoping that this meeting may develop what that policy should be.

Mr. Miller: Yes.

Governor Strong: And to confine the work of the committee as nearly to purely ministerial functions as possible.

Mr. Miller: I think it would be well to cover that in your report.

Governor Strong: I do not think it could have been covered in the report.

Mr. Miller: I mean it is in accordance with whatever is at the time being formulated or adopted as the investment policy of the Federal reserve system.

Governor Strong: That has been outlined in the previous part of the report pretty well. The previous portion of the report was in fact an endorsement of a recommendation of the Federal Advisory Council at its last meeting, and the statement that the present conditions require primarily a regard for the money market, credit conditions and operations of the Treasury as the controlling factors in arriving at a policy.

Mr. Hamlin: The word "primarily" was stricken out.

Governor Strong: It was originally "exclusively", or "solely", and the word is "particularly", I think, now.

Mr. Hamlin: It is much stronger as it was left than it was as originally drawn.

Governor Strong: The Advisory's Council's action is. The action expressed in this report of the committee is not quite as strong as it was dictated in New York. I think that is all at this time, Mr. Chairman.

Vice Governor Platt: Mr. Perrin, will you report briefly for the Federal Reserve Agents?

Mr. Perrin: Mr. Chairman and gentlemen, on behalf of the Federal Reserve Agents I want to say a word of our appreciation of the hospit lity and courtesy that the Board always extends to us when we come here. It seems to me that these conferences are a good deal after the fashion of Antaeus, who renewed his strength by touching the earth; it seems to me we go back, after having contact with the Federal Reserve Board and with each other, having derived a broader understanding and much benefit in every way. We also have had a brief program. Most of the subjects were those which we provided ourselves, and upon those I will make no report. There were, however, three or four subjects referred for consideration by the Federal Reserve Board. One was with regard to uniformity in the penalty rate for deficiency in reserve, and our conference felt that it should be remedial rather than mandatory, with regard to the imposition of either a progressive or penalty rate, and even though ten per cent was made the maximum, it was agreed that if ten per cent was desirable as a maximum, it should not be obligatory to impose any charge, if the Federal Reserve bank should not desire to do so, beyond the regular discount rate, beyond the provision in the regulation of the Board that there should be a charge of two per cent.

The second was whether subsidiary coins and minor coins should be counted as reserve without reference to the requirement of the law. It was voted that it was undesirable to count them as reserve.

Second, there was a request, coming from Under Secretary Gilbert, that non-cash reserve be segregated in the weekly report. A vote of approval was adopted on that matter and it was referred to the Governors' Conference with a request for their action.

There was a general report, indicating general confidence, as we compared notes, that the opposition to the par collection system was gradually dying out.

That comprises all thesubjects that were referred to us and upon which we acted.

Vice Governor Platt: There is a proposition coming from the Secretary with reference to further itemizing, in the weekly statements, the holdings of government securities. Mr. Gilbert thought it would be advisable if we could have the United States bonds, Victory notes, and so forth, all separately stated. It would add a number of additional lines to the report and I do not know whether it is to be considered necessary or not, but there should be some consideration given to it.

I think the most interesting subject that is before us is that matter of investment ingovernment securities. You all know the Treasury's attitude and the attitude of the Advisory Council, which is what started the matter and got it on the program, and I want to ask, before we plunge into the discussion of credit policy whether any member of the Board desires to say something on that. Dr. Miller?

Mr. Miller: I think, Mr. Chairman, that some reference ought to be made, at one of these joint sessions of the Conference, to the work of the members of the committee on Economy and Efficiency, and the so-called Auxiliary Committee that is cooperating with the Board in this work. I gather that this matter has had some attention from the

Conference of Governors, has it not, Governor Strong?

Governor Strong: Yes, it has.

Mr. Miller. So that perhaps it is not necessary to say much more than to give some indication of what the further program of the committee is.

You all know that the committee was an outgworth of suggestions made at the time that we were in conference a year ago. The Board took the initiative in this matter because a great many criticisms of the Reserve System were being made on the score oftheir unnecessary expense of operation, and the responsibility of answering these criticisms--- many of which emanated from Congress--- fell to the Board. And that merely served to remind the Board that it had a very important responsibility in this matter, inasmuch as it is charged in the Reserve Act with the duty of approving compensation and expenditures that are voted by the boards of directors of the different banks.

The Board, in order to more fully inform itself, and to be in a bett r position to discharge its responsibility, set up a committee, and that committee, as the first step in its work, set about getting information fuller in character and more satisfactory in form than any that was available at the time. As you know, a call was sent out in December, 1921, to get, in comparable form, data from all the twelve Federal reserve banks with respect to the costs of operating their different departments, and it was not until March of 1922 that the replies were all in. When they were tabulated and set up it soon developed that they were not only unsatisfactory in themselves, but utterly inadequate for the purposes of the committee.

The method of reporting expenses by the different banks showed so many variations that it was impossible, as things then were, to get a conspectus of what the different banks were paying for the performance of different functions. I will say here, parenthetically, that the committee felt that that in itself was an extremely serious reflection on the way in which things have been managed in the Federal Reserve System, a serious reflection, and that it was impossible for the Board, or for any committee of the Federal Reserve Banks, to get a picture of how the different banks of the system were functioning in performing their different functions, when that matter was viewed from the standpoint of operating economy or operating efficiency.

The committee was, therefore, confronted with the alternative of either recommending to the Board and to the banks the adoption of an entirely new form of accounting, which would be uniform for all the banks, or, without disturbing the existing accounting methods, to devise some method of reclassifying existing set-ups so that it would give to our committee and enventually to the banks, something substantially or approximately accurate in form and so set up as to enable comparisons to be made between the costs of operating departments in the different Federal reserve banks, as well as certain unit costs of operation, stated both in terms of money expense and in terms of labor expense, by which I mean the number of men, or number of women, assigned to performa certain function.

For that purpose, then, a conference was called in Chicago on the 28th of April, as I remember it. I have the date set down here, but it is not of particular consequence. A schedule was worked out by the Auxiliary Committee, notably by Mr. Cramer, Deputy Governor of the Bank of Chicago--- who was made a member of the Auxiliary Committee because of the fact that Mr. Calkins resigned on account of the difficulty of attending frequent meetings of the committee--- and that schedule was submitted to the Chairman of the Committee on Procedure or Economy of the twelve Federal reserve banks, who met in conference in Chicago. It was subjected to a good deal of question and criticism; it was amended after a discussion of something more than two days and, together with a manual of instructions, was circulated to the banks soon thereafter, with the request that such banks would make a report covering the month of June, to be submitted to the Board in July. A limited number of the banks were able to do that, but it was not until the month of July that the returns under Schedule E came in from all the banks. Today we have received information that the reports under Schedule E, covering the months of July, August and September will soon be available. Those are not only in the hands of the committee, but one copy of this report has been distributed to each of the Federal reserve banks. Some of the banks have requested that as many as ten or twelve copies be furnished them so that they could be distributed to the heads of the different operating departments. The committee has felt that it was undesirable to do that, but that is a matter upon which it might be well, if you have any views on it at this time, to express an opinion, for the reason that we felt that the good purposes of this report would be best served if closely controlled, and that if copies of these reports got into the hands of many officers, particularly the junior officers, it would divert attention from the main object of the report and give rise to all sorts of captious criticisms, controversies and discussions.

It has developed that a considerable number of the banks have misunderstood many of the instructions contained in the manual of instructions, and therefore the data supplied in the report under the new Schedule E is imperfect, and we believe there is still a considerable amount of work to be done in equipping the banks, so to speak, with a common language--- we are still without a common language-- covering the things that are matters of daily routine in the operations of all of the banks, because things that the committee thought were clear and obvious in the manual apparently have given rise to misconstruction in certain reserve banks, and a volume of inquiries has been constantly coming in asking for detailed definitions of certain terms. We feel that that in itself, although it entails a considerable burden on the committee, is of great value.

It is a part of the process of education, a part of the process of development, so to speak, within the Federal reserve system, of a common mind, a common understanding, and as a necessary incident of that, of course, a common language. We want to have words used in one bank conveying exactly the same meaning which they convey when used in all the other banks.

Now, gentlemen, we have reached that stage. The Auxiliary Committee has been studying this matter with a good deal of intensity lately, and is of the opinion that there should be a conference of the Chairmen of the different economy or procedure committees of the twelve Federal reserve banks in the near future, some time before the middle of November. Mr. Cramer thinks that this conference should be held in Chicago. It is probable that the Board will authorize a call of such a conference some time before the middle of November.

Now, what the committee is after perhaps needs a word of explanation, and then perhaps a word of explanation is necessary as to why the committee chose the particular method of attacking this problem of economy and efficiency that it did choose. Two courses seemed open to us when we took up this problem in December of last year. One was what might be called the orthodox, theoretical course, with which engineers approach a problem; we could have the services of an efficiency engineer or expert, taken from one or more of the Federal reserve banks, or engaged from the outside, to set up a typical plan of organization and operation of a Federal reserve bank, with the object of getting the most efficient organization for the money and therefore the most efficient and most economical, and to have seen to what extent changes needed to be made in the operating organization and methods of the different banks in order to conform to this ideally perfect scheme; and the other was to assume that we would on the whole get the best results and make the most satisfactory progress if we utilized our own experiences and if we went on the assumption that right within the Federal reserve system we had the basis from which we could deduce standards of measurement and principles of efficient operation, and it was the latter of these two alternatives that the committee adopted, for a variety of reasons, partly because the committee never assumed that it was its problem to undertake to tell any reserve bank or all the Federal Reserve banks how they ought to organize themselves and conduct their business. We felt that our relation to this problem would be most satisfactory and most likely to produce good results if, at any rate in the initial stages of the work, we confined ourselves to assemblin data which would enable the Federal reserve banks themselves, and the different operating departments of the different banks, to determine how they stacked up, so to speak, in comparison with other banks. That was the psychology, so to speak, on which we were operating, to incite a certain amount of interest and curiosity, emulation, comparison, suggestion, conference and result. We have never presumed--- I think I can speak for every member of the committee on this matter, although we have never taken a formal vote on it--- and it is farthest from our minds of anything--- to develop or attempt to set up anything in the nature of rigid yardsticks of measurement. What we want to get is yardsticks of measurement--- if I may use that phrase with propriety in this discussion at all--- that grow out of the actual experience of the Federal reserve banks. We do not want to import anything into this system from the operation of commercial banks or other business houses; we want to develop our standards comparatively, and, if you please, competitively, from a close and constant study of what is going on in the Federal Reserve system and what has gone on; in other words, the method of experience, or, otherwise stated, the empirical method.

Now, we haven't gotten quite as large a yield in this matter from our Schedule E as we had hoped we might, partly because there are discrepancies in the reports due to misunderstandings, but also considerable discrepancies due to what we had already forecasted when we undertook this work, although we had not accurately forecasted the extent of the very divergent conditions with respect to certain departments, particularly those which the different Federal reserve banks operated, which is notably true with respect to the transit department in certain cities, the clearing house, for the affiliated members that clear through the clearing house banks, which relieve the Federal reserve banks of an immense burden of work. They do a large amount of sorting, and the transit department of the Federal Reserve Bank happily situated in that way, naturally compares favorably when you take into comparison a Federal reserve bank that operates under utterly different conditions. But these sources of discrepancy are now beginning to come to light. That is one of the things that we are discovering through this. A great deal is being learned, not only by the members of the committee and the auxiliary committee with respect to the different Federal reserve banks, but the different Federal reserve banks are already beginning to learn a great deal about the conditions under which each one operates as compared with another. We expect, in the course of three or four months, to bring to the surface a considerable number of these discrepancies, which will serve as checks, so to speak, of future data that will come in under Schedule E, so that by a gradual process of correction and elimination we hope, by the beginning of the next year, to be established in a position so that we can apply the proper discounts to figures under Schedule E and get a very close approximation of the actual and comparative costs of operating the different departments in the Federal reserve banks, stated both in terms of money and in terms of labor units. That, we believe, will be of some very definite value.

Now, I do not want to take too much time on this, but what I am saying is merely for the purpose of indicating that the Committee is hard at work on this problem and that we all feel satisfied that a very substantial beginning has been made---- although slow in its operation--- and there is just one word more: That we realize that no two banks, least of all the largest and the smallest, operate under conditions and with magnitudes that make a comparison between them a comparably useful and productive undertaking. We have always suspected, from the beginning, that we would sooner or later arrive at the stage where, for the purpose of setting up something in the nature of yardsticks applicable to reserve banks, that we should group the reserve banks, and that we should group those banks that had more similarities to one another than they had differences, that either operated under similar conditions or that were of similar size, or were in other ways fairly comparable. It has been extremely interesting to the committee, gratifying, and in accordance with our expectations in the matter, that the banks themselves are already beginning to group themselves, and that many of the inquiries they make grow out of the fact that they are not comparing themselves with the reserve bank average, including the largest and the smallest, but are comparing themselves with those reserve banks that they feel are properly comparable with them by reason of similarity of size and similarity of conditions.

At the conference in Cgicago next month we hope that, without very much intrusion or suggestion from the committee, the banks themselves will come with their own suggestions as to the groups that they think ought to be set up and as to the groups in which they think they ought to be included. The committee is of the opinion that, in some cases, a reserve bank may appear in not only one group but in two or three groups; in other words, that certain of its operating departments suggest comparison with some operating department in certain other reserve banks and certain other operating departments rather suggest that they should be grouped with a different group of reserve banks; and so, by a process of constant comparison, recomparison, by elimination and inclusion, we hope finally to get together those members of the Federal reserve family that are of like stature, like weight, and of likeness in other respects, and to treat that group as a group, and when we arrive at the point where it is necessary to bring in, if you please, the efficiency doctor, we will bring him into a group, and we should hope to find that efficiency doctor right within the group.

Now, gentlemen, that is the principle on which, as nearly as I can express it, the committee is operating. In other words, we are going to work from within out, and as the work becomes more and more concrete, it is going to become more in the nature of group work, in which the experiences of the group and the ability of the group are to be the main source from which development of new sources of efficiency and of economy will come.

Now, one word in conclusion: I want to repeat that this committee was set up originally in order to enable the Federal Reserve Board to discharge its very important function under the law of passing upon the operating costs of the Federal reserve banks. The Government has a stake in the proceeds, the earnings of these banks, and the earnings, of course, are in considerable measure dependent upon the operating costs. It is necessary, therefore, for the Board's information and for the proper discharge of its function, to have some method of informing itself, other than what it has had in the past--- which has been pretty near nothing--- and I should say--- and I am now speaking for myself individually, as I have not discussed this with any member of the committee--- but speaking for myself individually, I should say this, that I think it is the hope and expectation that this work will ultimately yield results that can be utilized as the basis of the salaried policy of the Federal Reserve Board; in other words, that the Federal Reserve Board, in passing upon the recommendations for salaries in the different banks, particularly where it concerns the operating departments, will have to give some attention to the evidences of efficiency and economy with which a givenbank or a given department is being operated. In other words, that whoever happens to be the head of that department is there as an operating officer; he is there to do his work efficiently and economically, and that that must become a factor in the decisions not only of the board of directors of the bank but also in the deliberations of the Federal Reserve Board in determining upon the propriety of a proposed salary increase. Inother words, my hope is that we will, through this, gradually bring into the supervision of the Federal Reserve System something in the nature of primary business principles.

My own view is that this ought to be extremely helpful to the operating officers and chairmen of these banks. To my mind there is nothing that any man who has an active sense of responsibility, dislikes more than to work without limit, to feel that he is the head of an institution where costs don't count, or don't count except as some politician in Washington, for example, objects, and Federal reserve banks are in this unique position, that they are great business organizations that are being protected from competition with any other type of institution, except in the matter of buying services. They are not competing for business; they are monopolists in their field; they have no large body of shareholders that are querulous about dividends; their own directors and officers have not any stake in the banks, except their reputations. To my mind the Federal Reserve Board was partly set up because of that rather peculiar and anomalous position of the Federal reserve banks, and I am extremely anxious to see the Federal reserve banks and the system as a whole give an account of themselves that will be reassuring rather than disturbing as to the potentialities of enterprising business, of a character such as the reserve banks are, where the stimulus, where the incentive of profit and the incentive of pecuniary advantage is altogether removed.

Now, that represents--- and let me repeat again, not the view of the Committee, because we have never discussed this--- but it represents my personal view, and I mention it only because I feel that the surest hope for the successful accomplishment of this work will come through a cordial cooperation of the banks with one another and the banks as a whole with the Board, in trying to utilize our experiences, as something that gives support and encouragement to the possibilities of government or semi-government handling of business, where it is largely public in character, rather than the reverse, and I think I speak for the committee when I say that all of the individuals with whom the committee has been brought into contact in the different banks, particularly the Chairman of the Procedure and Economy Committees who have this work more immediately in hand, have entered with real enthusiasm and zest into the work, and I think they feel that not only is there going to result from this a considerable improvement in the actual operating of the different banks, but that there is a good deal of institutional pride and enthusiasm in trying to make a record for the banks as being banks that will measure up to the best institutions of similar magnitude and character, when you apply any reasonable test of economy and efficiency.

And, further, on behalf of the committee I want to take advantage of this opportunity to bespeak for this work, which is your work, your earnest support. The Board's committee is handling this, so to speak, with hands off. We have no desire to intrude, no desire to interfere. We are working through the auxiliary committee, the auxiliary committee being a committee of the banks and being the real committee in this matter; we take no step without their approval, and many of the steps that are taken are taken immediately at their suggestion and on their initiative, and therefore I say advisedly, "your work", or "our work", and when you gentlemen do not hear from us, remember that we are not asleep, but that this work is going constantly forward. Remember that there are two men who are practically giving all their time and constant and close attention to the development of the method ofhandling this problem which we originally chose. weare more amd more satisfied that it is the right method, eve n though it is a little slow, and we are satisfied it is the right method, because it stimulates a little antagonism, a little fault finding, which seems reasonable and natural, because it is already bringing to light things which almost suggest their own immediate remedy.

Vice Governor Platt: Do you care to make any statement, Mr. Hamlin?

Mr. Hamiln: No sir.

Vice Governor Platt: Mr. Mitchell, have you any subject that you wish to bring up before the conference.

Mr. Mitchell: Gentlemen, I am very much in favor of a uniform policy among the different Federal Reserve Banks, that is, as nearly uniform as is possible, and one thing that I have in mind that I want to call your attention to is the rebate policy on unearned discounts paid to a member bank wishing to anticipate payment of the rediscount. I think that rebate policy ought to be uniform and I cannot see any reason why the policy to be adopted should not be a rebate based on the Federal Reserve Bank rate at the time the rebate is made, and not at the rate at which the rediscount was made.

Now, there may be arguments against that policy, but it seems to me that whatever policy is adopted ought to be uniform.

There has been some pressure brought to bear on the board by one of the districts in particular, the Dallas district, with regard to the eligibility of sight drafts for rediscount, secured by bills of lading conveying title to readily marketable and staple non-perishable agricultural commodities. I believe that the banks today have the right to give immediate credit to those drafts, unde r certain conditions, but we were threatened with congestion of cotton drafts, for instance, in the Dallas District this year, and the question came up how to handle them. It is true in some districts that these drafts were handled by the member banks through their correspondents; but it strikes me that there is a good deal of soundness in the position taken that this is a service that the federal reserve banks ought to render the member banks and that we ought to be able to give immediate credit for these sight drafts I have described, under certain rules and regulations to be prescribed by the Federal Reserve

Board. I think this is a very important matter and my suggestion is that a committee be appointed by the Chairman to consider this matter, to report at some later conference of the Agents or the Governors, and that is, I think, all I have to say.

Vice Governor Platt: There is one matter that has been, at various times, the subject of a good deal of discussion, and that is the question of how to handle par collections. I have here a letter from Mr. McAdams, who was recently president of the American Bankers Association, who came in to see me and who talked with other members of the Board with regard to a plan for making par payments of checks non-compulsory among member banks, but at the same time refusing to handle items with their endorsement, and I will read a few paragraphs of this letter:

"We believe if the Board will take action along the lines referred to, making remittance at par voluntary and eliminating the possibility of non-member institutions feeling that they are or have been coerced in this connection, a decided step toward the ultimate solution of this vexing question will have been taken.

"As stated to you, I believe this action should be accompanied by a statement that it would be unfair for banks not remitting at par to use the collection facilities of the Federal Reserve System and therefore checks bearing the endorsement of non-assenting banks would not be handled by the several Federal Reserve institutions. This action will, I am sure, result in making a large majority of the non-assenting banks agree to remit at par, as they will then appreciate the fact they are receiving a real service in return for the service rendered by them.

"Our First Vice President, Mr. W. W. Head, of the Omaha Bank, Omaha, Neb., stated that the Kansas City bank had notified nonOmember institutions in Nebraska they would not require them to remit at par and immediately the number of non-assenting banks increased from forty odd to over two hundred. The Omaha Clearing House, however, refused to handle items on banks not remitting at par, and despite the Clearing Houses in St. Joseph, Cedar Rapids and other places taking the opposite stand, the number of non-assenting banks has voluntarily been decreased again to slightly in excess of fifty."

Incidentally, I might also say, with reference to this suggestion, that when the Advisory Council was here, I stated to Mr. Rue, who sat alongside of me, that of course that would mean that if a cotton buyer bought some cotton in the south and gave in payment a check on Mr. Rue's Bank in Philadelphia, and that check was deposited by the seller of the cotton in a country bank, we will say in South Carolina, which was not remitting at par, that when the check got back to Philadelphia and went into the Richmond Bank, it would be thrown out and would not be handled. The Advisory Council did not seem to think that that was a practical proposition, and I am not quite sure whether it would be of advantage if handled in quite that way. It would give a lot of trouble, because it seems almost impossible that the Federal Reserve Banks's transit department could operate on the principle of looking at all the endorsements on a check, but if they once got it understood by the banks sending in those checks, that they would not be handled, probably they would not be sent, and they would be kept in the member banks. Some bankers say that so far as their bank is concerned it would simply be a matter of having an extra pigeon hole for checks for non-paying banks, and that all they would have to do would be to throw them in a separate pigeon hole and not send them to the

Federal reserve banks. Now, that looks pretty good theoretically, but the question is whether it will work or not, or whether we want to make any kind of change in a matter which seems to be working along fairly satisfactorily in most of the districts already.

Mr. Comptroller, do you want to submit to us the figures on the last call?

Mr. Crissinger: I think it may be of interest to you gentlemen to know that we have a tabulation from thirty of the cities, which shows a net decrease in total deposits of $15,215,000 a net decrease in total resources of $70,875,000, and in loans and discounts a decrease of $78,498,000.

Mr. Jay: From the preceding year or the preceding call?

Mr. Crissinger. No, the preceding call.

Mr. Miller: That is the September call?

Mr. Crissinger: The September 15th call. I thought it might be of interest, and if any of you care to look at it it is here. New York shows a decrease of $219,241,000 in deposits.

Mr. Miller: What does it show with regard to dis e counts?

Mr. Crissinger: Discounts show a decrease of $253,652,000, over that period from June 30 to September 15. I guess it is going the other way now.

Governor Strong: I think so, but only for a very short period.

Mr. Jacobson: Since August 30th it has been going in the reverse way.

Mr. Crissinger: But the whole banking situation, so far as it is reflected through our office, shows an improvement in every place except two or three spots in the United States, from which we anticipate a great deal of trouble during the coming winter.

Mr. Austin: Do you mind telling what trouble you anticipate is due to?

Mr. Crissinger: In the southwest, in New Mexico, part of Texas and part of Louisiana, it is due to a drought; they haven't had any rain there since I guess in the spring; there isn't any grass and the cattle all had to be moved or sold, and the sheep likewise. The same condition is pretty largely true, as I get it from the bank examiners, in part of Oklahoma. A certain section of Oklahoma is in very bad shape and we look for quite a little trouble there.

Outside of that, the other places would be up in the dry land farming district where they haven't raised anything for a good while, and where what they h ve raised isn't worth anything when you take into consideration the freight they h ve to pay. For instance, Governor Calkins was telling me about the potato crop, which is worth nothing up in that country, and that is true largely with their wheat crop on account of being so far from the market. We have more trouble in those three places than in any other places in the United States.

There are three spots now, to which I referred, but we are getting along pretty well with the reorganization and rebuilding of the banks. I think we have had about sixteen failures during this year, since the first of January, banks going into the hands of receivers, and I think we will open five or six of those. We have one bank that has been solvent, a big bank, for ninety days, but we are afraid to open it. It is a bank with a million and a half deposits, and will have something like $500,000, but we are afraid to open it. It is a peculiar situation. But on the whole there is not going to be so much loss in this year's business to depositors. A bank down at Corridon, Indiana--- this may be interesting to the St. Louis people---- will be disposed of so as to paythe depositors 94 per cent, and when it closed it looked as though it wouldn't pay over 25 or 30 per cent; but we have sold the bank so that it will pay to depositors 94 per cent. That will be helpful down there.

Mr. Mitchell: Mr. Chairman, I move that a committee of five be appointed to look into this matter of making sight drafts eligible for rediscount at Federal reserve banks.

Vice Governor Platt: For the purpose of recommending a change in the law, or something of that sort?

Mr. Mitchell: Simply for a consideration of the matter.

Vice Governor Platt: Do you want that committee appointed by me or by the separate conferences?

Mr. Mitchell: My motion is that it be appointed by the Chairman.

Vice Governor Platt: A committee of five?

Mr. Mitchell. Yes.

Vice Governor Platt. Gentlemen, you have heard the motion made by Mr. Mitchell that a committee of five be appointed by the Chair to consider the question of making sight drafts, secured by staple agricultural commodities, eligible for rediscount. Is there any discussion?

(The motion having been duly seconded, was carried.)

Vice Governor Platt. I will appoint that committee after consultation wih the Chairmen of the two separate conferences.

Now, Gentlemen, we seem to have gotten to the point where we can open the important discussion of the day. I might say, with regard to the Comptroller's figures, that they are certainly gratifying. We are glad to know that there are only a few bad spots, although those spots are pretty bad, particularly in the northwest and southwest, where it looks as though the cattle may have to be moved into Mexico in order to save them, and there this new tariff question stands in the way, as they hold thatthe cattle cannot be taken out of this country and brought back without paying the duty.

It seems to me that out of the period of stress through which the country has passed, and from which it is now happily recovering there should come considerable consolidation of small banks and the strengthening of the system in that way. Everybody know that there are altogether too many banks. There is no sense in having three or four banks in a little town that hasn't any business for more than one or two, and where competition produced is more or less a cutthroat competition, while, on the other hand, in apparently most of the cases there is practically no competition at all which leads to lower rates tothe farmer, a different kind of competition from that which prevails in ordinary business where price has something to do with it.

I suppose we are ready now for the discussion of topic No. 1, which is

1. What object should Federal Reserve credit policy seek to accomplish and by what test may we know that it is sound?

I will call on Mr. Wills to lead the discussion.

Mr. Wills: I understood that the preparation of these papers, and the submission of them in advance not only to members of the Conference, but to the Board itself, would preclude our reading the papers.

Vice Governor Platt: That is correct, Mr. Wills.

Mr. Wills: And I will briefly state what my argument was.

Mr. Miller: Give us your original view and your revised view after getting the benefit of the criticism of the members of the Conference.

Mr. Wills: My original view was not much at variance with that of my colleague, Mr. Norris, who wrote a paper on the same subject without any collaboration or conference with me. His statement in respect to the object of the credit policy of the Federal Reserve System was that trade should be served, and his test of whether that object was being accomplished was the same as mine, that it is to be discovered through instruments that were passing representing that trade.

I have not changed my viewpoint much because of the papers that have been submitted, although I do grant that there are other factors besides the ones that I stated. You will remember what my argument was, although I stated mine in a different way from that of Mr. Norris, that it was the object of the credit policy of the Federal reserve system to assist the member banks and the open market, which is the agency through which the Federal reserve bank operates, to take care of all proper trade, and the reason for that statement was that the general credit situation will be sound and take care of itself if we have a combination of clean doorsteps. I will admit some of the arguments that are here, that those words are proper, and that the word "trade" is a relative term; but it is my judgment that the laws on the statute books, both state and national, that are in existence, were put there for the purpose of protecting and promoting proper trade. In the first place, if we endeavor to say that the Federal reserve banks are operating according to law, to the regulations of the Reserve Board and the Federal Reserve Act, if we put an emphasis on that, the general situation will take care of itself.

Now, as to the test as to whether that policy is correct and sound, that is found in the kinds of instruments that are not only presented by the banks for rediscount, but are flowing in and out of the banks as well as in and out of the open market. In other words, my argument is that discretion at the source, and that being not entirely discretion, but something for which we have a yardstick in the laws that I have mentioned, and the regulations of the Board, that a combination of that kind of policy, beginning there, will result in a proper credit policy for the whole Federal Reserve System. Therefore, I think that the rate itself is not controlling. It was very illuminating to find that a number of the prepared papers by men who in the original days of this conference stood out valiantly for the rate as being the only thing, and thatwe should not meddle into the purposes and uses or into the management of the member banks, it has been interesting to me that some of those men have evidently, from their experience, come to the conclusion that an admixture, a very strong admixture of discretion at the source is now necessary. I think that is a fair statement, is it not, Dr. Miller, that we have some converts to that policy?

Another point that I wish to make before I sit down is that there is an obligation on the Federal Reserve banks to constantly survey and scrutinize the lines of discount of the member banks, through the open market, even though this paper is not coming into the Federal reserve banks or is not in them at the present time.

The result of this policy, as I see it, is that the very presence of the system, by the knowledge that that is the way these separate banks do operate is a very effective comtroller and inspiration for all sorts of banking policies which, in the finality, create a very sound credit condition.

Vice Governor Platt: I was a little too informal in introducing this subject. Some of you have not read all of these papers, and some of you may not understand just exactly what the topic is. The general topic is "Federal Reserve Credit Policy", and the subject covered by Mr. Wells and Mr. Norris is "What object should Federal Reserve Credit Policy seek to accomplish and by what test may be know that it is sound?"

We will now hear from Governor Norris.

Governor Norris: Mr. Chairman and gentlemen, in attempting to execute my assignment I found some trouble in confining myself to the "what" part of it; that is, what object should the Credit policy of the Federal Reserve System seek to accomplish, and in considering that I find myself constantly inclined to wander off into a discussion of "How" and "why". Particularly for the purpose of avoiding transgressing on the part of the subject that I was not concerned in, I tried to state it in the simplest possible form.

As Mr. Wills ha already stated, he and I prepared our papers without any consultation, and I think that weare in substantial accord. I looked past the member bank to what might be called the ultimate consumer, and said that our purpose was to assure an adequate supply of credit for productive enterprise. Mr. Wills stated that our object was to enable the member banks to do that, which, as Governor Morss has stated in his comment, is merely two ways of stating the same thing.

I suppose that a part of my difficulty arose from a lack in the beginning of appreciating the truth of the comments that Mr. Calkins makes, that this subject does not afford opportunity for didactic discussion. He goes on to say that it is not difficult to state the object which the Federal Reserve credit policy should seek to accomplish, as it is not difficult to state what an aeroplane stabilizer should accomplish.

I have read carefully all the papers that have been prepared on this first topic, and it seems to me that either the gentlemen who have prepared these papers are in agreement with Mr. Wills and myself, or, if they are not in agreement, they have been too polite to express their disagreement; or, if they have expressed their disagreement, I have not had intelligence enough to understand their criticism, because I cannot find any issue that is raised here, and the only point that occurs to me that I did mean to suggest, and which I do not think Mr. Wills touched on, and which does not seem to have been touched on in any of the comments and which, if there is to be any further discussion of the subject, I would like very much to hear discussed, and that is this; that while we are in agreement as to its being the object to afford an adequate and regular supply of currency and credit to the public, I put in, as a secondary object, to indicate to the public the effect which business as it is being conducted, is having upon the supply of credit, and to give timely notice of any distinct change which is anticipated in credit conditions. Now, that is going beyond the mere purpose of offering credit, and the thought in my argument was that in addition to that it was one of the duties that we ought to perform to, as far as possible, cut off the extreme peaks of inflation and deflation; that if we could hold out danger signals at one time and hold out what Judge Ramsey has frequently referred to as rays of sunshine at another time, that that is a proper and useful purpose that we might perform and which, it seems to me, is going beyond merely offering a supply of credit.

I think it would be interesting to have that subject discussed, and I would like to know whether any of the other members at this Conference consider that anything of that nature is or is not properly within the functions of the credit policy of the Federal Reserve System.

Vice Governor Platt: The topic is now open for discussion. The papers have been prepared by selection, that is, the people who prepared it selected the topic themselves, and those were Governor Morss, Governor McKinney, Governor Calkins, Mr. McCord and Mr. Rich, if my list is correct here, and we will be glad to hear from any of you gentlemen who want to discuss the matter further, and I think some consideration should be given to the last part of the topic, which Mr. Wills did touch on to some extent, and that is, by what test may we know that the present policy is sound?

Governor Morss: Mr. Chairman, I referred in the paper which I presented to the fact that most of our discussion on the first topic was about our discount rates, how they should be applied and when they should be applied, and that was a very natural condition, because that is the most important thing, to my mind, that we have to consider. We have taken care of our circulating currency I think at the present time in such a way that there is no question about it. Yet there is also the question of credit as related to open market transactions and that question is brought up in the most vivid way, and naturally by the New York Bank, because that is where they feel it every day and that is where they give it the best consideration. The rest of us do not have that so constantly before us all the time.

It is very proper that New York should do that, and that we should consider it. But the discount rate, how and when it should be applied, is the most important thing to most of us.

It is very satisfactory, I think, that all the papers I have read on this first topic agree that credit should be furnished for agriculture, industry, and distribution of goods. There is no disagreement on that point whatever. They also agree that credit should be furnished, an even flow of credit, as it may be expressed, at all times, and without the big ups and downs of credit rates. Governor

Norris says that these rates should be timed so as to give advance information to the business public of what is probably going to happen. I do not think that anybody would disagree with that at all. It is supposed that the Federal Reserve Banks, with their opportunities for information, and their constant study of the subject, are in a position to anticipate to some degree these considerable movement s of trade, and if they are not they ought to be. They ought to be able to see or to perceive when a movement is started and in its initial stages, what that movement is, and have some opportunity of estimating how far that movement is going, and I would agree with Governor Norris that that information should be given out to the public as soon as the officers of the Federal Reserve Banks are convinced in their own minds that it should be done.

As I say, there is no disagreement as to the objects of the credit policy, but as to just how that is to be accomplished there is some disagreement, although that really gets into the next subject more than into this one. I mean that that is quite noticeable from the papers read and the discussion of these questions of the relative importance of the discount rates and other things. We had a great deal of discussion about that thing a couple of years ago as to how far we could depend on the discount rates and how far we should depend on what is now called "discretion". I think that Mr. Wills is right, that there is more emphasis placed on discretion in the papers that have been presented than there was before. I, myself, am rather surprised to see that, and I think it is probably due, to a considerable extent, to the experience that the Governors of the Reserve Banks have had, each in his own district.

For my part, I would not care to use discretion any further than is absolutely necessary. I do not believe in prying into the affairs of the banks any more than is necessary. My whole measure of what should be done is the amount of credit that a bank demands of a Federal reserve bank. If it is not borrowing at all of the Federal reserve bank, I do not see what right the Federal reserve bank has to inquire into its affairs; if it is borrowing moderately and well within reason, I do not see that the Federal reserve bank can bother that bank with the question of what kind of business it is doing. It is only when the bank's loans with the Federal Reserve Bank get to a point where they need consideration because of their size that the Federal reserve bank should have the right to inquire of the bank as to what they are doing with that credit.

Governor Strong's paper--- if I may get off the subject, and this is a very interesting point to me--- figured it up that three fourths of the credit would be affected by a change in discount rates. I think that is probably true, but I, myself, will depend on discount rates, and not on discretion.

We are all more or less conscious of the fear that there will be a movement of inflation in this country, and that when, if it does come, it will find the banks with a very large reserve of credit, and that any attempt to raise discount rates would be resented by the public at large, because of our high reserve percentage. I wish to say that if this inflation movement should come we should not hesitate to raise the discount rates, if we thought it was desirable and necessary, no matter if our reserve percentage was 90 or 100 per cent.

The Federal Reserve Banks have the backing of the banking business community of the country. I believe we have their confidence, and that the business community looks to the Federal reserve banks to protect them against any changes that may come about, protect them in any inflation by a raise in discount rates, no matter what the amount of reserve may be, and I hope that there will not be the slightest hesitation to raise discount rates without paying attention to our reserve position.

Vice Governor Platt: The discussion is certainly taking a very interesting turn. Governor Calkins, I understand you prepared a paper on this.

Governor Calkins: Mr. Chairman, I wish to begin by expressing my gratitude to Governor Norris, who made my apology for me. My educational advantages were very limited, inasmuch as I had no opportunity to read over Governor Norris' and Mr. Wills' papers before I wrote my memorandum.

What I meant by saying that the subject did not lend itself to discussion didactically, as Governor Norris has said, was that it seems to me to be a narrow question. If it had been put in the form of a question as to what the policy should be and what we should accomplish, I probably could have written at more length.

I think that the conclusions at the beginning of my paper are about the ones that I would still submit, after having read the papers that have been written on this subject. The purpose of the credit policy seems to me to be a very simple matter. The object to be achieved by any piece of mechanism is relatively a simple matter. The plow is made to plow with. However I will not dwell on that point.

There is one point which has been indicated by Governor Norris and Governor Morss that I would like to say something about. They have both expressed the view that a part of the Federal reserve credit policy should consist of prophecy, and I am reminded at once that I once heard one ofthe members of the Board say very forcibly that we would never have a good federal reserve credit policy until we had good prophecies to base it on; and he added something to the effect that the prophecy produced so far had not been altogether satisfactory. I am obliged to feel that there is no way of judging the future but by the past, and that if too much is included in the word "prophecy", that it must be dealt with with considerable caution. If prophecy undertakes to go too far or looks too far into the future for the purpose of formulating a credit policy, I am afraid it will not be good prophecy in every instance. Prophecy and interference with the business of the member banks more or less hitch themselves up. I think we should refrain, so far as possible, from anything approaching interference with the member banks; but I put emphasis on "as far as possible", and in that connection refer to what Governor Morss said, and that is that we have no concern about the operation of the member bank until it is borrowing from the Federal reserve bank. I want to saythat in our experience, in our actual experience, probably the greatest difficulty that we have encountered in an effort to do what was right in an acute situation has been with banks which have previously never borrowed one cent from the Federal reservebank, but which, when examined, we found to be in extreme condition, so extreme that it was almost impossible for us to find a way to assist them. Now, it seems to me that that must be considered, that the opportunity to take care of theneeds of the member bank must be considered and it must be considered if we are to do our work effectively before the actual occasion arises, in some instances. I realize that there is great danger in going too far in that direction. I told the Comptroller a story this morning about a section of our district which illustrates very well what I have in mind, and I will tell it here:

In a certain section of the district the bankers encountered a good many unfortunate consequences from the financing of the cultivation and growing of beets last year. Consequently a group of them got together and decided that they would not assist anybody to grow beets this year. They told their customers that they had grown their beets with disastrous results, and that they could not furnish one cent for that purpose, and that they must grow something else. Whereupon these customers planted potatoes, with the net result that potatoes are not worth digging and that beets are a very valuable crop this year. Now, we do not want to do anything like that.

Vice Governor Platt: That is a very pertinent illustration. Mr. McCord, in the absence of Governor McKinney your paper seems to be the next on the list.

Mr. McCord: Mr. Chairman and gentlemen, I have tried to confine myself strictly to the heading of the Federal Reserve Act. The object of the existence of the Federal reserve banks seems to be carried in the title of the Act; "To provide for the establishment of Federal reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a moreeffective supervision of banking in the United States, and for other purposes.

The first thing under consideration is the elastic currency. We won't dwell on that because it is very apparent to every one. The next is the discounting of commercial paper. That is a very easy matter, and it was to the expression "For the better supervision of banking" that I led my thought; also to the latter part of the question, "By what test may we know that it is sound?" In reviewing the examination of reports of the banks in our district I found that those banks, whose officers and directors did not take up the majority part of a loan were in a better position to handle the general public without real assistance from us, than those who had the banks full of interested loans. I also found that such banks as had investment loans, unless they were Government obligations, were not in position to help the general public, by coming to the Federal reserve bank for rediscount, as well as those who had an open flow of credit to the commercial side of their business.

For that reason, I mentioned in my paper that the discounting officers of the Federal reserve banks should acquaint themselves with reports of condition in advance of whether a discount is offered or not, so that they may be familiar with the conditions in that particular member bank when it comes to re-discount. I see that my friend, Governor Calkins, takes the same view, that we should know the condition of a bank. I agree with the gentlemen who have spoken ahead of me that we have no right to interfere or to go into our member banks' business, except to a point of acquainting ourselves with their condition, so that when they come to us we will be in a position to know their troubles and handle them promptly.

Out of this great deflation that has come, the Federal reserve banks were not called upon the beginning, but when the withdrawal of deposits came we found that our member banks were loaded, and the only remedy we had was to go to their rescue and help them. They had to come to us, and without our having any knowledge, except these general reports, and as it was new business with us we were not fully prepared and did not have the experience. I believe we are in a better position today to know how to treat these matters than ever before. I believe the constant investigation and resume of the report of conditions and of the examination reports in the way of familiarizing the discount committee with these conditions is a very sound policy, and I am led to that point of view by the fact that those banks that keep an even flow of credit to their general customers, not overstepping themselves in investment loans, not permitting their internal loans to get the better portion of their resources, have most successfully aided the public in every way.

Vice Governor Platt: Mr. Rich, you also have a paper on topic 1.

Mr. Rich: I will not take up any time in discussing it. Mr. Norris has expressed my views entirely in better language than I could do it.

Vice Governor Platt: I do not know whether my list of papers is complete, but any way it is not intended to be exclusive and we do not need to stop the discussion. We will be very glad to hear from anyone else on the subject.

Governor Wellborn: I left home about two weeks ago and all these papers were sent to me here. I have not had time to read them carefully and did not prepare my paper until this morning, so with your permission I would like to read it. My paper is in answer to question 3.

Vice Governor Platt: We will come to that presently, Governor. Is there anyone else who cares to discuss Topic A?

Mr. Jay. May I say a word or two, Mr. Chairman, since in my paper I transgressed the rule and went back a little into question 1. My question is No. 2.

I was very much interested to hear Governor Norris say that in his opinion the policy of the Federal Reserve System should be to take off the high and the low points of inflation and deflation, expansion and contraction of credit, because that is the point that I speak of in my paper, because it referred back to the purposes of the Federal reserve policy, and it seems to me that we should consider it.

A number of the papers written on the topic refer to the title of the Federal Reserve Act, with its three objects, to furnish an elastic currency, to afford means of rediscounting commercial paper, and to establish a more effective supervision of banking in the United States, and for other purposes. Now, it seems to me that you cannot always rely on the title to a Congressional "ct for the whole scope of the purposes contained in it.

I looked this morning at the title to the bill prepared by Senato Aldrich, for the so-called Aldrich currency bill, and the title to that bill was "To incorporate the national reserve association of the United States and for other purposes", so that we would not have gotten, had that become a law, any guidance as to what our credit policy should be. It seems to me to say that we should furnish an elastic currency and that we should provide a means for rediscounting paper, is very much like saying that a man should eat three meals a day and sleep eight hours; but it does not go into the other things that go to make up a large part of a man's life. If we endeavor, as Mr. Wills suggests, to study every community in our district and see that they are handling proper paper, that is an important thing, if desirable. I am inclined to think that it is not desirable to the extent that he indicates, but if desirable it is unimportant because unsound movements stabt in the communities without any question, but we cannot always detect them by looking at the communities.

Sometimes when you are in the woods you cannot see the forest for the underbrush.

I feel that in the reserve system we ought to look at our own districts very carefully, each one of us, but we should also look at the system as a whole, and the system as a whole, in providing excess credit, seasonal or emergency credit and currency, is related to our whole problem of production and distribution. Credit in itself is not an entity, not an end; it only exists as a tool to facilitate production and distribution; and therefore, in dealing with our credit policy, we ought to look at what is going on in production and distribution, to see whether our policy is sound. It seems to me that Governor Calkins has expressed that view most succinctly by saying that we may know that the Federal Reserve credit policy is sound when the inevitably fluctuations in production and distribution have been met with the minimum of economical or financial dislocation. That was a point that I wanted to emphasize a little bit in considering the larger question of Federal reserve credit policy.

It seems to me that we should have some way of determining what our policy is. We may not be able to do it now; it may take two or three or four years to come to a conclusion from so many different angles as to what our objective should be, but I feel that when we can arrive at a conclusion and decision as to that purpose we ought, every time we make a change in our position with respect to market rates or open market operations, have some specific objective. In looking over some data with regard to the operation of the German Reischbank from 1876 to 1910, I find it stated that they have, during that period, made 58 changes in their rates, that they have assigned reasons for each of those changes. 13 of those changes were made to counteract gold outflows from Germany or to correct unfavorable exchanges; 28 have been made to counteract excessive demand for credit domestically, and 17 have been made to correct a combination of those two influences.

Vice Governor Platt. Those were all increases in rate, were they?

Mr. Jay: Those were all increases, I assume. I think it would help us very much, in coming to a conclusion as to what our policy is or should be, if every time we made a change in our rate we would definitely set down what we were trying to do when we made that change in rate.

Vice Governor Platt: Has someone else something to say on this topic?

Mr. Miller, or Mr. Hamlin, do you wish to say something?

Mr. Miller: I think we ought to hear more from the gentlemen present here, Mr. Chairman. I do not think the subject has been exhausted by any means.

Vice Governor Platt: I do not think so either.

Mr. Perrin: The view that Mr. Calkins expressed, of minimizing the inevitable fluctuations in volume of credit, appeals to me as the proper objective of the credit policy.

One point that I was struck with in the statements of one or two of those who have spoken, was that the objective should be to supply an adequate amount of credit. It seems to me that the word "adequate" needs a bit of explanation. The supply of credit may be of two kinds, absolute or regulatory. By "regulatory" I mean that temporary adjustment in the cash position of a member bank, and what I mean by "absolute" is the supplying of additional funds.

It appears to me that the purposes of the Federal reserve banks can hardly be regarded as primarily or immediately to supply an absolute addition to loanable funds, but that it should be rather for a temporary or regulatory purpose, to enable the member banks to adjust their cash position.

Then on the question of the test of the soundness of the credit policy, it has been suggested that the character of paper offered would be the test of that soundness. I submit that in a period of great inflation the paper offered for rediscount is substantially of the same characteras that offered in a period of greatest deflation. The amount of rediscounts with the Federal reserve banks constitutes but a very small part of the total loans of the banks, even at the period of greatest total of advancement. The main body of loans in the member banks may have been made with proper restraint, and the paper offered for rediscount may be without exception; butsuppose we come to a position where the total volume of credits had been doubled and the total volume of production had not been materially increased? The qualify of the paper offered for rediscount, both by the member bank and offered on the open market, would probably be of substantially the same character when the volume of credit was only one half, and therefore it seems to me that some better test of soundness than merely the character of the paper, with reference to its providing funds for "real trade", I think was one of the expressions used, should be adopted, and that the question of whether the Federal reserve bank should make an absolute advance of credit would also require careful consideration.

Governor Norris: Mr. Chairman, I know of no better way to get discussion on a subject than to submit a hypothetical question. It is objectionable, I think, to almost everyone, and therefore I would like to put a hypothetical question:

Suppose a reserve bank has a reserve percentage of 70 or 80 per cent, that its loans to its member banks are relatively small, that it observes that there is an active and constantly increasing speculation going on in either stocks or commodities; that it observes that the loans and discounts of the banks are out of proportion to their deposits, that there is going on an exploitation of lands, the building of railroads, and the extension of industrial plants on short time borrowings, with a constant conversion of liquid assets into fixed capital. Under those conditions should a reserve bank advance its rate or should it not?

Governor Morss: That seems to be aimed at something that I said.

Governor Norris: Not at all.

Governor Morss: About advancing the discount rates; It seems to me that the conditions that Governor Norris outlined would not take place unless it was reflected in the loans of the Federal reserve banks. As for raising the discount rates with a high reserve, as a matter of practice, probably, we would not be justified in doing it unless the situation had gone far enough to reflect itself in our loans.

The only thing that I wanted to emphasize was that perhaps a slight increase in our loans, indicating conditions which were taking place, or which indicated the trend of what was coming, should be met by us with an increase in our discount rates.

Governor Strong: Mr. Chairman, are we going to continue our meeting after luncheon?

Vice Governor Platt: I thought perhaps we could conclude Topic 1 this morning.

Governor Strong: But you do expect to reconvene after luncheon?

Vice Governor Platt: Yes.

Governor Strong: In that case I might intrude on this subject, although the topic was not originally assigned to me.

The topic on the program reads "What object should Federal reserve credit policy seek to accomplish", which is the first half of the question. Going back to the beginning of the war, I think it is clear to everyone in the reserve system that our credit policy was designed to facilitate the financing of the war, and that that policy continued until the conclusion of the war. After the Armistice I think you will find, if we had any policy at all, it was perhaps that of facilitating the Treasury in conducting post-war financial operations. Commencing withthe fall of 1921 I presume our credit policy was directed toward arresting further inflation. On the first of January we had a further change in the credit policy, which I think was brought out at the Conference of Governors held in April---

Vice Governor Platt: Of 1920?

Governor Strong: No, inApril of 1922, this year. Sitting in this room I asked each of the Governors of the reserve banks what their policy was of making investments, and everyone of them replied that it was to earn enough to pay expenses and dividends, and this thought is suggested by what Mr. Jay said, that it did appear at that time that, without consultation among ourselves, we had automatically and voluntarily started a policy in the system, and possibly a necessary one, of earning enough money to keep going, and in the course of doing so had advanced $500,000,000 to the market, so to speak, which was equivalent to importing $500,000,000 in gold. This occurred at a time when we were importing gold, and the object of theappointment of the committee and the extension of its duties somewhat I apprehend, is for the purpose of providing facilities for executing the credit policy in regard to these investments, when we decide upon a policy.

Now, as to the importance of it, I want to say just one word. We fix the rate at which the member banks discount paper with us. We have no position in the market; we have no influence upon the market at all; we are set in motion by an application from a member bank to lend it money, we then pass upon that, and, in most cases, we decide to extend the credit. In very few cases is it declined. If applications come in too fast and our reserves go down, we find it necessary to increase our rate, and we take advantage of the provisions of Section 14. Nobody sets this in motion, except our own desire to accomplish something, and I think it is important that we should find out at this meeting what we do desire to accomplish by purchasing Government securities, at least, in the market, under Section 14, establish a policy, determine what we are going to do, and take advantage of the machinery that has been established to carry out that policy.

This seems to bear directly upon this topic, and I am making the remark simply in the nature of a request, if it meets with your approval, that before this meeting adjourns this afternoon, we have a discussion of just what we are seeking to accomplish by buying Government securities, whether we ought to keep them or sell them, or buy more, and how it should be done.

Mr. Austin: May I ask Governor Strong a question?

Vice Governor Platt: Certainly.

Mr. Austin: I understood him to say that our buying $500,000,000 securities and putting that money in the market led to the importation of $500,000,000 in gold.

Governor Strong: No, Mr. Austin, I said it had the same effect as the importation of $500,000,000 in gold.

Mr. Austin: Oh, I misunderstood you.

Mr. Wills: May I ask a hypothetical question about a particular statement that Governor Morss made? I would like to ask this question: He said we were not interested in the borrowings of the member banks until they became excessive. I would like to ask whether a bank that wasn't borrowing at all, if that bank came in and requested a loan, and that bank was lending money on Wall Street, and had just turned in some paper that it had bought with Federal Reserve Bank money would it be good sound policy to accept that kind of paper at that stage?

Vice Governor Platt: That isn't a hypothetical question.

Governor Morss: I will say, Mr. Chairman, that I never ask any questions of any of our member banks when their loans are small. It seems to me that what the Federal reserve banks should do is to be prepared to take care of the situation and to check banks which have gone too far in some operation or other, so that they become in a sense overextended, and that is reflected in their loans with the Federal Reserve banks. It may be that they have money in Wall Street; they may have commercial paper, they may buy bonds, they may do anything. I do not think it is the object of the Federal reserve banks to protect everybody, or every bank, from the penalties of their own operations, and I do not think we should attempt to do anything of that sort. Banks are badly managed, some of them, they get into operations and make unsound loans and buy bonds, and it is quite well known that they do, and I do not think it is for us to protect them from everything that they might possibly do. They will suffer, and why should they not suffer the penalty of their own acts? Otherwise they are not much more than children. But we should always be prepared to take care of the situation, and that is the reason that, under the Act, we are instructed to make loans with due regard to the necessities of all the banks, and we should protect the Federal reserve banks from loans by over-extended banks. If a bank is doing things that it ought not to do, that is the business of the Comptroller to check them up, and not that of the Federal reserve banks, or it is the duty of the State bank commissioner, whichever it may be. We do not do that and I do not think we should do it.

What Mr. Wills would indicate or suggest should be done to my mind would make a supervision of the banks one that would be intolerable to them, would get us disliked to such an extent that, upon my word, I think we ought to be destroyed. My view is that we are not to run every bank, not to know everything that they do, and not to be responsible for everything that they do, and I diagree with Mr. Wills in the idea that he seems to have that we should keep supervision of the loans that the banks make and see that they are proper loans, looked at from the viewpoint that something might happen to the Federal reserve bank or to those banks.

Now that I am on my feet I would like to reffer to something that Governor Calkins said, and that is that prophecy was very dangerous. There is nobody who is more shy of making prophecies than I am, and I fully realize the danger of that. At the same time, movements in business are detected quicker by some people than by others, and they are more quickly detected by those who are in a position to see the whole situation and to give their time and attention to studying it than those who are not. Business men, as a whole, have their greatest attention given to producing goods at a price at which they can sell them, and they do not think so much of other things as perhaps they should, that take up the time and attention of the Federal reserve bank officers, and I think that the Federal reserve bank officers are in such position and should give such time and attention to the subject, that they would be able to detect the trend of events and give notice of it to the business community probably in advance of the time when most of that community would notice it.

Mr. Wills: May I just say that I think Governor Morss misses the point of my question. I had no intention of giving the impression that we were going to act as wet nurses for these banks; but I wanted to bring out the point that we were only protecting ourselves when we did that, because those two operations consist in taking the reserve bank involuntarily into the open market. In one case loan the funds to Wall Street, and in the other case we loan them in the commercial market. I just want to point that out as a difference in our viewpoint.

Governor Morss: It is very hard to define some of these things. Probably when it came to a matter of practice the practice of the Boston Bank would not be different from the practice of the Cleveland Bank. The statement that you should keep informed of the loans of a bank when they have made no câll on you is quite a broad statement. Probably Mr. Wills, in practice, would not go much further than we would.

Governor Strong: May I ask one question, which is perhaps of a hypothetical nature also? I would like to ask Mr. Wills, if I may, hypothetically, whether, when a bank in Cleveland, say, a member bank in Cleveland, which has loaned a million or five million or ten million on the stock exchange in New York, applies for a rediscount at the Reservebank of Cleveland because its reserve has become impaired by reason of withdrawal of deposits of money of that sort, how these stock exchange loans, which the Federal reserve bank requires the member bank to get repaid, should be liquidated, by what method?

Mr. Wills: They are going to be liquidated by the reverse method in which they were obtained; that is all I know. I mean they would go through the same process.

Governor Strong: There will be one of two methods; they will try to get some other fellow to lend them money or they will sell the securities.

Mr. Wills: Yes.

Governor Strong: Then aren't we ~~getting~~ back to the old system?

Governor Calkins: As was of course inevitable, we are discussing all the topics on the program. The discussion has shown a tendency to be full and undoubtedly will continue between two more or less opposing views, one of which stated extremely is that the rate alone must regulate, nothing but the rate. The other is not so extreme, that while the rate may influence some other things must be taken into consideration. Now, it may be true that in large cities like Cleveland, Boston, Philadelphia and New York the rate may be dependedt upon to a greater extent than elsewhere, but we have found by demonstration that the rate alone will not control the volume of credit, and we are brought to the consideration of the situation of a bank when it applies for rediscount. It is all very well to say that a bank should suffer for its own mismanagement. It undoubtedly should; but unfortunately other people suffer as well. It is all very well to say that mismanagement of the bank's business is the concern of the Comptroller of the Currency and not of the Federal reserve banks, but it happens to be a fact that the Comptroller of the Currency has no fund with which to keep a bank open when it is in danger ofbeing closed, and that is the business of the Federal reserve banks, and unless we pay some attention to the management of the bank we will suffer the consequences of that lack of attention.

Vice Governor Platt: I do not suppose that Governor Morss meant to say exactly that the Federal reserve bank has not any interest in knowing what the member bank is doing, but he came pretty near saying that.

Governor Morss: I take it that in every Federal reserve bank each of its member banks has a peculiar standing and character; they have banks that they know what it might be expected they will do, some of them may need extreme attention, while others may not require any attention at all. Now, with the knowledge that you acquire of those banks, in the course of time and experience with them, you know how to deal with each bank at any time, no matter what may happen to it. I would disclaim any thought that we should not pay any attention to our member banks at all. As I say each one of them has a standing and character with us as distinct as any man would have with his customers that he dealt with, good bad and indifferent. That is what your experience gives you and enables you to determine what ought to be done.

Governor McDougal: I was much interested in the picture drawn by Mr. Norris of a condition which might easily arise with the reserves of the Federal reserve system very high, a condition of wild speculation, and his inquiry as to what would be the proper rate policy to apply under those circumstances.

I was also interested inGovernor Morss' statement, if I understood him correctly, to the effect that a condition of that sort--- maybe I misunderstood you, Governor Morss--- would be inevitably reflected in the demands upon the Federal reserve banks. Now, as evidence of the fact that Gover nor Morss is mistaken,at least to some extent, I can refer to a condition which arose in one city in our district where, during a period of time when the banks in the district, under normal conditions, would have been liquidated, whe n they should have had their own loaning power available, they got into this period of a nature quite similar to that to which Mr. Norris has referred, and what happened? It was not reflected at that time in the demands upon the Federal Reserve Bank of Chicago. It resulted in applying first their own loaning power, which they should have reserved for agricultural purposes, then it resulted in driving them into the Federal reserve bank at a time when they should not have had to come there, perhaps. That was going on. We knew something about it, but we did not know the extent to which it was going on. That bears directly on the point that Mr. Norris raised.

I have been very much interested in this discussion so far and I am satisfied that the first factor to control is found to be the rate. We all know that the rates that have been current will not be a complete control, and do not control to any extent the rates charged by the small banks in the country districts. I believe what is true in our district is true in all districts, but nevertheless the rates that have been in force for anumber of months have, in my opinion, been ideal and have answered the purpose of discouraging misuse or abuse of the borrowing privilege on the part of the banks in the financial centers, from which centers we get most of our loaning power. I think with respect to that class of banks, with our 4½%

rate in Chicago and a 4% rate in New York that the results attained with the big banks have been satifactory, not for a week, but for months. It shows that we have some control there, because it is human nature of the banks, if they can borrow for profit, to do it, both big and little banks.

I think, however, that the matter of discretion is one which we must all exercise. I consider that Governor Morss' views are extreme. I think in the Federal reserve banks we must not forget that we are dispensingcredit an d that the underlying requisites should be the same as though we were conducting a commercial bank, giving, of course, due consideration to the fact that member banks have some privileges under the Act, and I do feel that it is our business to know each individual member bank, just as it would be if we were conducting a commercial bank, and that when we do learn to know our banks, as most of us have in most cases, Governor Morss, that the policy you have outlined can be followed. We know thebanks and we do not question the uses to which they are putting the money in most cases; but if there are reasons for questions, we do not hesitate to take the matter up. We have got to consider, of course, the uses to which they are putting the credit, the character of the paper they offer, but I tell you, gentlemen, we have got to consider also the present condition of that borrowing bank with respect to its assets, and particularly with respect to the tendency of the management, whether the management of that bank over a period of time has been efficient and satisfactory. That is a very important matter for us to bear in mind and to give consideration to at all times, I believe.

Mr. Curtiss: It seems to me, Governor McDougal, that what you have said in reference to Governor Morss' position being extreme, is perhaps based on misapprehension of what Governor Morss had in mind, which I think I can perhaps bring out.

Mr. Miller: Are you going to talk on the subject of discount policy?

Mr. Curtiss: I was just going to answer the question.

Mr. Miller: We are getting pretty far afield of the topic on the program as assigned, and I think the whole thing will be very much more fruitful if the discussion addresses itself to the topic, even though it makes reference to related things. However, if we go ahead and discuss questions that are schedules for this afternoon's discussion, we will get pretty badly balled up, and the interest that will attach to these papers which have been submitted will be diminished.

If nobody else wants to say something, I do. I do not think this topic has been scratched.

Governor McDougal speaks of the Federal reserve banks as dispensers of credit. They are; but they are very much more than that; they are manufacturers of credit, and they are in the rare position of being dispensers who are not limited by the fact that the accessible and available supply of that which they dispense is limited. They make the supply. There is no method by which you can get increased credit in member banks in this country except by an addition of gold, which is an addition to the reserves of the member banks, or by an addition to the volume of credit by a federal reserve bank. The important thing, as Isee it, is that we should realize at the outset that the Federal Reserve bank, whenever it acts to either restrain or to restrict or call in credit, affects the total volume of credit, and thereby hangs a very long tail, which we hope will be brought out in some of the papers submitted on the second topic this afternoon.

I have heard in Federal reserve discussions frequently statements to this effect, sometimes by the officers of a reserve bank : "I believe in letting the law of supply and demand regulate this thing." A statement of that kind, to my mind, overlooks the most fundamental and obvious thing in the Federal reserve bank, and that is that the bank itself is the supply. Whenever the strain upon credit reaches a certain amount--- and this is what makes the matter of policy so fundamental--- by a mere stroke of the pen, by the influx of a little bright ink into your reserve ledger, you create credit, a very much simpler process than the importation of gold in the olden days, or even now.

The question, therefore, which strikes me that is implied in this inquiry is: what is the object of a good credit system and by what test may we know that it is sound, is one that requires very much more toroughgoing analysis than has yet been given to it, and that that is what makes it a matter of policy. We can make credit easy, plentiful and cheap; we can make it scarce, by one method or another, by discretion, by rate or by a combination of both with other things, we can make it dear.

Now, then, the problem to my mind in this situation is: When shall we know; by what signs shall we know, whether or not there is not enough credit, too little credit, or too much credit? We operate on the volume of credit. When a cotton grower in South Carolina goes to a member bank and borrows a thousand dollars, that is not simply an addition to his credit; it is an addition to the total volume of credit in the country; he uses that credit to paythe bill of the implement maker, or the grocer; he sends a part of that money to New England; a part to New York and a part to Chicago, and it becomes an addition to the total volume of credit in existence, exercising the same effect, exactly, in time that any other addition to the total volume of credit exercises. That is what we have got to recognize at the very threshhold of this inquiry. I submit, therefore, with all respect, to both the difficulties of the problem and the manifestly sincere effort to solve it that have been made in the papers submitted on the subject by Mr. Norris and Mr. Wills, that to say that the business of the Federal reserve banks is to supply adequate credit, begs the question. To say that it is its business to see that the transactions of its member banks are proper---- in other words implying in that the extension of a proper volume of credit to those member banks --- begs the question. What is an adequate supply of credit? What is the proper volume of credit? What is a proper transaction? We do not primarily concern ourselves with the individual transaction, except as it bears evidence of the purpose for which the credit is going to be used. Our primary concern with the individual transaction, as I view it, is because one methof by which you add to the total volume of credit is through the individual spigot. Now, the addition to the volume of credit becomes of great consequence to the country as well as to the individual that gets it. I think when Governor Morss says that he does not view it as his business to protect an overextended bank against its own foolishness or mistakes that he is unquestionable ground, but I should say that far more important than his responsibility to the member bank is his responsibility to the community. It is our business to protect the community against all types of extension of credit that are unnecessary and that are unjustifiable additions to the total volume of credit in times when credit is expending, just as it is our business to protect the community against the consequences of too considerable a restriction of credit, under certain other conditions.

That means to my mind, that when we come to the second part of this question, admitting that we agree that it is our business to see that the commercial banks of the country may get credit from the Federal reserve banks on terms and conditions that will enable them to meet the economical and valid needs of productive industry, that it still remains for us to determine by what test we may know whether or not the needs which we are supplying are really valid needs or whether they are not valid needs.

Mr. Norris, I think, begins to approach that end of the question when he says to prevent the peak from being too high, in times of expansion, and from being too low in times of reaction. Why should you hesitate in saying to prevent any peak in time of expansion that has the snow cap or the mantle of inflation on it, frombeing too high? What do you mean by that? What is the proper height. Too much and too little, it strikes me, mean much or little according as we have a standard by which you can determine whether or not something is in excess. So I say negatively it will be a comparatively easy matter to define the proper objective of the Federal Reserve credit policy, although perhaps pretty difficult to define it in practice. But to give the discussion point, I would say to prevent inflation; I would almost go so far as saying that entirely apart from the technique of the instrumentalities for giving effect to the credit policy of the Federal Reserve System.

The primary negative test is that it never induces, supports, or assists preventable inflation. In saying that I use the word "inflation" with some discrimination. I do not mean simple expansion. I mean an expansion of credit that cannot justify itself by the results that that credit produces. An expansion of credit that justifies itself by a corresponding increase in the total volume of production does not wear, does not necessarily wear, the aspects of inflation, although it may possibly carry within itsself the seeds of inflation. So that when we mean by inflation an expansion of industry, supported by an expansion of credit, that gives rise to an inflated condition in industry, in which the addition of credit let out by the reserve bank does nothing, let us say, except to blow up the balloon of credit and raise the general level of prices, with the inevitable reaction that must follow that course, we are approaching this question in a negative manner. In other words, to my mind, it is a matter of degree, a matter of volume. The papers that have been prepared with great care in this connection use the terms as though they were self defining. One paper uses the term "proper and reasonable", as though they were self defining terms, and the other uses the term "adequate" as though that were a self-defining term. Now, that is the very question involved. What measure of adequacy, what measure of reasonableness, what measure of propriety can we set up. I think we are still confronted with that question, although I assume we will get some light on it in some subsequent papers or subsequent topics. In other words, by what sign or measure; by what sign do you know that there is an inadequate or adequate supply, and by what measure can you determine the amount of the superfluity, or the amount of the deficiency?

I repeat once more that, to my mind, it is fundamental to this whole discussion that we tell right now whether or not this proposition is correct, that every action by a federal reserve bank is an action upon the total volume of credit, just as much as castinga bucket of water intothe big reservoir in a city is an addition, not to meet the individual supply, but an addition to the total available supply. Therefore, if I am right in that assumption, I will go so far as to say that that is true as regards any one of our twelve federal reserve districts.

An addition in San Francisco is potentially an addition in New York and in South Carolina. It is bound to get theresooner or later. An inflation started in one district ultimately, unless controlled and checked, becomes an inflation in another district. To my mind one of the peculiarities and theoretical objections to our regional reserve system is that as yet there is no method by which one section of the country can protect itself against an inflation supported by a regional reserve bank in any one district, except through the intervention of the Federal Reserve Board. That is one of the reasons why we put down the fourth question, that touches on that. If it is true that the volume of creditis the thing upon which we operate, then it is most important that that volume of credit should be operated upon properly, if I may use that phrase, at every point. We cannot, I think, get away from that. I still long for light upon the question by what test may we know whether the supply of credit is or is not adequate.

Mr. Mitchell: Before we adjourn for lunch I want to say that I think that the rates of the Federal reserve banks can control credit policies to a very great extent. So long as the Federal reserve bank rate is such that it does not afford the member bank a profit in rediscounting, there cannot, in my judgment, be any great tendency to undue inflation.

I believe, as Governor McDougal has stated, that the rates of the Federal reserve banks today are pretty nearly right. Ihave always been of the opinion that the Federal reserve bank rates should be equal to or a trifle higher than the going rate. The borrowing by member banks from the Federal reserve banks for the purpose of lending in Wall street ata big profit is no doubt done in some of the districts, and that should be deplored. Ido not believe the Federal reserve banks should countenance such an operation, because it is tantamount to the Federal reserve banks lending indirectly for speculative purposes, and I believe that there should be some regulation on the part of the Federal reserve banks to control operations of that kind. But I want to impress it upon you that my views are that the rates of the Federal Reserve banks should not afford the member banks any profit in rediscounting, and if that condition of affairs can be maintained I am not fearful of any great inflation.

Recently, and I do not intend to criticise the policy of any one of the Federal Reserve banks, there was an inclination on the part of the Federal Reserve Bank of San Francisco to establish a 3-1/2 per cent rate, and I understand that it came very nearly passing, did it not?

Mr. Perrin: We were a divided board.

Mr. Mitchell: You were divided on the question of establishing a 3-1/2 per cent rate. Why the San Francisco Bank should think for one minute of establishing a 3-1/2per cent rate is beyond my comprehension. I think that is the most ridiculous proposition that has ever been put up to the Federal Reserve Board since I have been on it. The bank rate is going to control this thing.

Vice Governor Platt: Gentlemen, I understand there is a motion befor us to adjourn. The motion to adjourn is not debatable.

(Whereupon, upon motion duly seconded, the Conference recessed from 1:10 o'clock p. m. until 2:30 o'clock p. m. of the same day.)

AFTER RECESS

The Joint Session of the Federal Reserve Board with the Governors and Chairman and Federal Reserve Agents of the Federal Reserve Banks reconvened at 2:30 o'clock p.m., pursuant to adjournment.

Vice Governor Platt. The meeting will please come to order. The discussion of the morning wandered somewhat from the strict letter of the topic assigned, as was rather natural. I think perhaps one reason why it was not definitely stated that the chief object of the Federal reserve credit policy was to prevent inflation was because that fact was a little too obvious. It also struck me that, inasmuch as this is a regional system, that the conditions in one district are different from those in in another and the position taken by Governor Morss and representatives of the New York, Boston and Philadelphia Districts is naturally a little different from that taken in some of the other districts. The Richmond District would be in practically the same position if it was not for South Carolina, and perhaps a part of North Carolina, I presume. The discussion seems to be a very interesting one; it has been a little slow in getting heated up, perhaps, but we hope to get started this afternoon in good form. The next topic is:-

2. What relative importance should be given to the following factors in determining such policy?
   a. Federal Reserve reserves.
   b. Interest rates in the open market.
   c. Interest charged by member banks.
   d. Interest rates paid on time deposits.
   e. Balance of trade and inward or outward movement of gold.
   f. Credit conditions in, and exchanges with, leading foreign countries.
   g. Volume of bank loans and deposits.
   h. Business and industrial activity, present or prospective.
   i. Commodity price level.
   j. Condition of security markets.

The leaders on the program for this discussion are Messrs Jay and Seay. If you are ready, Mr' Jay, we will call on you first.

Mr. Jay: Mr. Chairman, I would like, if I may, to first inquire if it is the view of the Board that there should be any attempt at reaching any conclusion onwhat the Federal reserve policy should aim at? It is difficult to discuss the second topic unless some general understanding is arrived at on the first, because different factors would bear different policies.

Vice Governor Platt: I think you may assume that the purpose of the credit policy is to prevent inflation, at least.

Mr. Jay: To prevent inflation?

Vice Governor Platt. That that is the major purpose, perhaps.

Mr. Miller: Why do not you state your own conclusions, Mr. Jay, and take them as your starting point?

Mr. Jay: Mr. Chairman, I was talking with Mr. Miller during the lunch hour, and asked him whether he thought it might be possible to get an expression of opinion as to what we should aim at; in other words, as to whether we should aim at anything more than merely supplying our member banks with credit and currency. We did not have a chance to discuss whether or not he thought that practical, but he just now suggested that I might read something that I had written out by way of a hypothetical question. I do not know whether we want to go back into that or not.

Mr. Miller: That states your own position at the moment, does it not, and is it not from that position that you approach your discussion the second question?

Mr. Jay: Yes. Federal reserve credit policy should aim.

A In its district aspect to furnishing credit and currency to member banks for seasonal and emergency requirements.

B In its national aspect to prevent credit expansion from developing into inflation and natural contraction from developing into the converse of inflation, which I call here deflation.

C By whatever means Federal reserve credit policy is made effective the district aspects of the policy should harmonize with the national aspects.

Now, that is just something that I roughly penciled out.

Mr. Chairman, the second topic, which was assigned to Governor Seay and me to read the leading papers on, and on which two others, Mr. Martin and Mr. Austin, so far as I know, have helped us out by their views, is a very difficult one to discuss, first of all because the answer to question No. 1 is left indertminate, is not given to us either hypothetically or otherwise, and certainly because we were only given twelve hundred words to discuss ten different influences on determining of credit policy.

Of course the Federal reserve reserves are always an important consideration. Mr. Norri, in his paper, says that they are an easy guide, but a bad one. One of the others who has written states that they should be the main guide, and even goes so far as to suggest an automatic scale by which, when the reserves are at a certain percentage the discount rate should be at a certain percentage, and so on. I cannot help feeling with regard to that that conditions in the United States, in the Federal reserve banks, and in Great Britain in the Bank of England, at the present time are a pretty good argument against attempting to have a fixed scale to measure your discount rates by. We have this tremendous reserve in this country which has come to us due to abnormal conditions arising out of the war and, it seems to me personally because of this largely fortuitous supply of gold coming to us by force of necessity, whereas the English are getting along perfectly satisfactorily and have much lower rates than we have, with a reserve of only fifteen or twenty per cent on their deposits. Of course their notes are secured by a much higher percentage of reserve.

Feeling very strongly, as I do, that we should have a national policy which looks to something more than merely supplying credit and currency to the member banks for their needs, seasonal and emergency, I cannot help feeling, as I stated in regard to question No. 1, if we are to base our larger national policy on an attempt to prevent inflation, as you have suggested, and also possibly to prevent some of the rigors of constraction, which always follow a period of expansion, that we must have some way of measuring whether we have an inflation or not; and if you will look at the definitions of inflation in the dictionary, you will see it is almost invariably stated as an undue movement in currency or prices, that the two are grouped together; they follow one another as closely in the dictionary definition of inflation as they do in the charts of the two phenomena.

Therefore, the measure of whether our volume of credit is out of line with the volume of production is shown very largely in prices, so that in order to determine whether we should make a move in our national credit policy, we should endeavor to develop such a system of indices of production and prices, and such an analysis of the credit volume as would enable us to determine whether the credit volume is getting out of line with production; and not only the credit volume, but the activity of credit, because the two are very closely related. So that I have felt that the three topics, g, h, and i, were ones that, given such a credit policy as I have described, would be the ones of perhaps the greatest importance in considering what our credit policy should be after we take into consideration the condition of our reserves.

Now, on the uestion of whether or not we have been in a period of inflation in the past, of course there has been no banking system in this country to take any actio n in regard to inflation, and it has been to a considerable extent a matter of judgment. It has got to be a matter of judgment anyway; but there havebeen no statistical studies which have attempted to demonstrate it, and the work that has been done by the Federal Reserve Board, by the Harvard Bureau and other economists in this country in the past six or eight years, has provided a set of production and other statics which is quite superior to anything that has yet been produced, so much so that the English economists are taking the matter up very actively and feel that they should develop such statistics in Great Britain and other European countries for guidance there as to whether they are getting into an inflated period or not. So that we are moving gradually toward the development of indices which will enable us to tell, more accurately than has been possible in the past, whether we are getting into an inflated situation or not. The more this can be developed the more nearly shall we beable to tell whether we are going in the right direction in the movement of the cycle, or whether we are going into an inflated phase of it.

Of the other topics in this group, the rates seemto be of great importance, and I notice that of those who have written, besides myself, on this topic, the question of the relative importance of discount rates as related to market rates, and to the rates charged by member banks seem to be the point of issue. Mr. Seay, I think, feels that the local rates are the important ones to be considered, and Mr. Martin, who also wrote onthe subject, also expresses that view as I recall it.

My personal feeling was that for the Federal reserve banks, taking the national policy as a whole, the open market rates were of greater interest than the local rates because we know that in most of the districts, except in the large centers, the local rates are probably always and will be considerably above what the Federal reserve bank rate usually will be, so that there will be, on the face of it, a profit from rediscounts with the Federal reserve banks. We probably never can have Federal reserve bank rates high enough to prevent that situation from occurring. That Federal Reserve bank rates will exercise an influence when they get up to five or six per cent on the borrowing done by local banks, is undoubtedly true. Nevertheless, in many cases they will never so so high that the local banks cannot by discounting actually make a profit.

My belief is that the open market is a very important element in connection with the Federal Reserve System. I think possibly the term "open market" needs some definition. We are apt to think of open market operations very largely as our dealings with a bill market and to some extent in Government securities. It seems to me that the open market--- following the analogy that Mr. Miller made this morning of one great pool of credit--- is one great pool also, whether it be loans of securities on the stock exchange, on government securities, commercial paper, acceptances, or any other form of short instruments of the highest grade into which bankers and others having short term funds to invest put their money, surplus money that is not needed in industry and in the routine work of banking.

Now, when a bank in the country is loaning all that is necessary to its customers, has more to loan, but does not wish to put it into long time bonds, it puts it into one of these forms of short time investments. The same time as do individuals who have money that they do not want to keep in banks and yet do not need in their business, but which may be called on later. They too put the money into these forms of investment.

Now, this open market is a very sensitive thing. It is a small volume of instruments, compared with the total volume of banking credit instruments, yet the rates on this small volume, which fluctuates quite largely and frequently, have a great influence on the rates charged by the member banks and other banks. Perhaps an analogy would be with loans on the stock exchange. For instance, let us assume that there are a billion dollars in money loaned out on the stock exchange; the amount of loans that change hands everyday at three per cent, four per cent, five per cent or whatever it may be, is perhaps $20,000,000; yet, that small amount, that small moving margin, fixes the rate on the whole amount, on the whole billion dollars. That is notexactly true with regard to the relation of the open market to the total credit volume, but in the larger places movements in the open market gradually have an influence on the totalvolume of credit, and it seems to me that it is through the open market that the Federal reserve credit policy, whether exerted by rate or other wise, or by our own purchase and sales of bills and securities, is going to become primarily effective, and we might very well have a rate at which very few member banks are borrowing. That has been true for the last three or four months. If we feel that we wish to raise our rates for any given purpose we might raise them, but it might not affect the use of the Federal Reserve System at all; if, on the other hand, we were to sell some of our securities we might thereby cause such a shrinkage in the volume of funds available in the open market as to raise the rate quite materially and thereby bring our discount rate into play with our member banks; in other words, drive them to use our discount rates and obtain some of this credit back from us.

That is a method which has been employed for many years in England and other European countries, to do what they call make the bank rates effective. The market rate does not always move with the bank rate. If the bank has a portfolio of liquid securities they can throw upon the market, the market is obliged to absorb them, and thereby their actual official discount rate is made effective.

Now, with regard to the relation of reserve bank rates to the open market rates--- and by open market rates I mean the general rate at which surplus funds are invested in these various kinds of short term securities--- it seems to me that we ought to keep our rates above the open market rate, the general open market rate, in order that we may have some control of the use of our funds in the open market. There may very well be times when we would have a certain reason, which we ought to have, in my opinion, distinctly in mind when we do so, when we ought to have our rate below the open market rate, when we might wish to facilitate the use of our funds in the open market; but generally speaking, provided we do not wish to encourage the banks to syphon out our funds to use them in the open market for a profit, we should keep our rates above the general rates prevailing in the open market, and then we won't have that situation about which Governor Strong asked Mr. Wills, of asking a bank to call in its loans on the stock exchange. If our rate is sufficiently high to make it unprofitable to loan on the stock exchange they will do that of their own accord. Therefore I feel that we should take great cognizance of open market rates.

Some of us, I think, are inclined to feel that the open market applies to the New York banks. Now, it happens that Stock exchange loans are made in New York City but those loans may be made for the benefit of people all over the country. There is a large market in New York for bills and Government securities. There is a market in all other districts for bills and government securities, which market is increasing and will probably extend into any Federal reserve district where surplus funds are apt to gather, although it probably won't go into districts which seldom have surplus funds. So that the open market is not a matter of one city or district alone, but is a matter for the country, and the rates are pretty well uniform on the same classes of paper all over the country.

I simply state what I have, in addition to what I have written, about the open market in relation to local bank rates, to indicate how important an element it seems to me in Federal reserve credit policy. In other words we should keep our eye all the time on the open market rates because they represent the great volume of surplus funds which move up or move down and which affect the local bank rates in the cities and in the districts throughout the entire country.

I do not know that I have anything further to say on this subject, beyond what I have written.

Vice Governor Platt: Governor Seay, I think you are the second leader on this topic of what relative importance should be given to the following factors in determining such policy.

Governor Seay: Mr. Chairman, I was asked, as I understood, to give an opinion, for purposes of discussion, upon the relative value of ten factors put forward by the Board, which are supposed to have an influence upon the determination of discount rates. That is something like resolving a rate into its elements and reassembling them according to their commercial affinity with each other, and is something like articulating a skeleton. I might have answered them in order or rearranged them according to my opinion, which would have been a matter of dry bones, and it is a question now whether those bones can live. Therefore, while putting them in the order in which they should come according to my opinion it would give very little light upon the arguments which lead me to these conclusions; I judge from the discussion which took place this morning that these children between which you have asked us to distinguish have gotten so much mixed up that it would take a Solomon to unscramble them, and I therefore do not see how I can give the opinion at which I arrive without reading from or quoting from the arguments that led to my conclusion. Whether that will meet with your approval or not I cannot say, but I will endeavor to do it in that way, however.

Mr. Miller, this morning, stated, after the discussion which had taken place, that there were several factors entering into the matter which apparently had not been touched upon; that he hoped to have them touched upon in this afternoon's discussion, and I hope that some of them will be touched upon in this paper.

My discussion and my conclusions are so mixed up that I do not know which is which. I think my discussion is divided into a number of conclusions, and I cannot give them better by expressing them verbally.

Whether a definite and comprehensive credit policy can be laid down in advance and applied without modification or reappraisal of the relative importance of the different factors which lead to the determination of rediscount rates, under the widely varying conditions which arise in this country from time to time, may be doubted. Governing principles, however, may be stated. To illustrate: At the height of recent credit expansion, when the reserves of Federal reserve banks had seriously declined, and the tendency towards further expansion was unmistakable and dangerous, the dominating purpose in fixing Federal reserve bank rates was to protect reserves. At the present time, when Federal reserve bank reserves are at a high ratiom and the reserves of member banks of the country are in excess of commercial demand and seeking investment in securities, it is obvious that the protection of Federal reserve bank reserves cannot be the primary reason for fixing rates, and that other reasons will and must naturally come to the fore. Some regard must be paid, however, both to the current and ultimate effect of a given rate and of a rate policy.

The distress and losses to which very many people have been subjected as a result of a number of complex causes arising out of the war, the greatest emergency ever experienced in the banking business, have brought into existence many distorted ideas of the purpose for which the Federal Reserve System was formed, what it is able to accomplish and may reasonably and safely attempt to accomplish.

In considering a discount policy, it is well, therefore, to refer to the fundamental principles upon which the Reserve System was established and the chief purposes of of the system, which are fairly well defined in the title to the Act. "To furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking . . ." To effect these purposes, it was necessary to gather reserves into a common reservoir.

The most dangerous idea, or conception, in connection with the system that has been put forward is that it controls the bank credit of the nation; the charge that it has exercised that control tyranously grew out of that idea.

Up to a certain point, the system possesses no control but a most limited influence over the extension of bank credit to the commerce of the country, whatever may be contended by some. That control is, of course, exercised by the 30,000 banking institutions of the nation. It may be argued that whatever controls the extension of credit, in case of ultimate need, controls the credit supply, but that is not a practical statement or question under usual or normal conditions. It is the measurable control over the use of Federal Reserve Bank reserves for further extension of credit after member banks have exhausted their own surplus reserves that must be lodged somewhere, since it is essential to commercial welfare and safety. That is a distinctly different matter which has always been controlled by law. The floating supply of capital or credit in the hands of the banks of the country controls interest rates by competition, and the banks themselves control the grant of credit, and have the power to grant it, and do grant it so unrestrainedly as to make recourse to Federal reserve banks necessary, and they may cause embarrassment before the restraining influence of Federal reserve banks can be brought into play. It is only when the banks generally are compelled to call upon Federal reserve banks that the power of reserve banks to exercise any control over credit begins, and it is at such times that the rates and rate policy assume greatest importance.

The idea should be strenuously combatted that the three billion dollars of gold held by the Federal Reserve banks is an independent fund of their own, capable of indefinite expansion on top of credit already extended by the banks upon this selfsame fund.

Allusion is frequently made to this fund as if it were idle, performing little service, and as if it might be dissipated, or enormously reduced, without affecting the credit structure, and with nothing but beneficial effect to the people and the banks and commerce, and as if Federal reserve banks should seek to stimulate the use of credit or issue credit directly based upon this fund. It is not yet as well understood as it should be that this is the ultimate reserve of the banks of the country, the reserve or fund upon which all bank credits and most of our currency are based.

Before the war, in 1914, the bank deposits of the country amounted to $21,328,000,000, and the paper currency of the country (not including currency based on silver) amounted to $2,362,000,000, making an aggregate of $23,890,000,000 of bank liabilities and currency supported by gold in the entire country (not all of which was in the hands of the banks) amounting at that time to $1,844,000,-000. The percentage of gold to deposit liabilities and paper currency was 7.7. Of course, the percentage of gold actually held by the banks and Treasury was less. The volume of gold in the country at present amounts to $3,858,000,000, and this gold fund now supports deposit liabilities of the banks aggregating $38,558,000,000 and paper currency liabilities aggregating $4,450,000,000, a total of $43,108,000,000. The percentage of our present gold holdings to deposit liabilities and paper currency is 8.9, only 1.2 greater than in 1914. Our gold fund therefore is carrying a loan almost as heacy proportionately, as the more limited gold fund held in 1914.

There is now a much greater concentration of our gold in the banks, chiefly, of course, in Fed ral Reserve Banks, andunder the credit and currency principles of the Act, it can be made the basis of a volume of credit approximately twice as large as could have been extended under former banking methods. But well defined principles should govern theextension of this enormously increased supply of credit. Reserve Banks, therefore, are not the source of supplyof capital, but only afford the machinery by which additional credit may be extended on the existing capital supply.

We have had an example of the dangers of extending a volume of credit out of proportion to the volume of goods and the productive capacity and consumptive powers of the country which should last us for many, many years. It is undoubtedly true that too great a supply of credit will inevitably lead to inflation, and is in itself inflation, and unless new uses for credit arise to absorb the increased supply, garm and not benefit will result. Granted that its effect is to cause a rise in prices, high prices require and absorb a larger volume of credit, and the chain is endless. Continued effort should therefore be made to impress upon the public mind the fact that the Federal Reserve System is, in its essence, and should be in its plan of operation, a "Reserve System"; that the resources of the Federal Reserve banks are in the main the concentrated reserves of the member banks upon which their outstanding credits are based; that the gold held by the Reserve Banks, over and above the aggregate reserve of members, is held in the place of and to redeem the currency issued by Federal reserve banks, and that the process of rediscounting is retrenching upon reserves.

The primary function of Federal Reserve Banks is, and was intended to be, "To provide an elastic currency" to meet the banking needs of the country, which are founded mainly upon trade and commercial needs. The Reserve Banks cannot exercise this function without affording "means of rediscounting commercial paper." The second function of the Federal Reserve System, as set forth in the title of the Act, therefore, follows logically and necessarily upon the primary function.

It is probably right to say that the original conception of the Federal Reserve System was that only liquid commercial and agricultural paper would be rediscounted. The regulations of the Board are intended in the main to put that conception into practice. It has been thoroughly proved by experience, however, and is generally well understood, that a very large proportion of the lines of credit extended by member banks, while conforming to rules of eligibility, is nevertheless not liquid paper in a proper sense, and is in effect used by the borrower as permanent capital, since these lines are fairly constant; the volume of really liquid commercial paper is very much smaller. The volume of truly liquid paper which Federal Reserve banks could handle would be practically unlimited. Being live or liquid, a constant stream of it in any volume could be safely handled, and because that class of paper would be drawn for the purpose of producing, purchasing, carrying and marketing goods in one or more of the steps of the process of production, manufacture or distribution, there would be no danger of inflation, whatever the volume handled. Over production might, of course, occur and consequently overexpansion. These are incidents of production and trade which may never be overcome.

It is the use of Federal reserve bank resources in line of credit paper of a capital or semi-capital nature which needs to be most carefully guarded, and it can be guarded only through discount regulations; the tendency to liberalize these regulations will require restraint.

It is impossible to avoid being called upon by banks for a supply of funds for these capital and semi-capital purposes, as well as for seasonal and liquid purposes, and it brings us to the inevitable conclusion that Federal Reserve Bank rates to their members must as a governing principle be based upon and bear a close relation to the prevailing rates for bank funds on line of credit paper current in any particular part of the country, and cannot safely be made so low as to encourage the banks to expand their loans on this class of paper to the point which will necessitate rediscounting.

If this principle or opinion be accepted, a uniform discount rate throughout the country would be neither logical nor practical. A low bank discount rate, justified in some sections of the country, where excess capital tends to accumulate, is not expected to prevail, and does not prevail, generally throughout the country; a commensurate reserve bank rediscount rate might be justified in those sections where capital is plentiful, but if the same rediscount rate were applied generally, it would inevitably tend to increase demand for credit for capital purposes in those sections of the country which are lacking in capital, and the resources of reserve banks in those sections would become tied up in such uses or permitted. It should be better recognized that it is not the function of Federal reserve banks to furnish credit for capital purposes. This might be controlled by not permitting continuous borrowing by member banks anywhere, if that can be done. But if the rate is made so low as to lead them into borrowing for profit, then the damage is done.

While one of the most valuable features of the Federal Reserve Act, whether in emergency or for seasonal purposes, is the provision for rediscounting between Federal reserve banks, it cannot be reasonably contended that the banks of any one district should be encouraged or permitted to use through a relatively low rate of rediscount the credit resources of the Federal reserve bank of that district when money is borrowed and used for capital purposes to an extent which would cause that Federal reserve bank to rediscount with other Federal reserve banks.

It would seem, therefore, that the rates of Federal reserve banks need not be uniform, but should bear a relation to the rates prevailing with member banks in their respective districts. It is a complic ation that rates in the large cities of all districts are usually lower than the rate in the country banks.

This will probably cause member banks in one district to deal at times, not with their own reserve bank, but with member banks in centers where the Reserve bank rate is lower, and likewise cause complaint by members in one district that they have not equal advantages with other districts, but that is one of the complexities of an admittedly complex situation.

In laying down and adopting a discount policy, it is essential to determine or agree upon the fundamental factor which governs the interest rate. It is perhaps as near to the truth as we can come to say that it is the relative supply of floating capital. This floating capital is gathered into and commended by the banks of the country.

When these banks generally apply to the reserve banks for rediscount of line of credit paper, it is not until their surplus reserves are low or have become exhausted. This is usually preceded by some rise in the interest rate, and if it is not, it can only be because the banks have recourse to some large additional supply of credit, namely reserve banks, and because further they can obtain this additional supply of credit at a price which will enable them to continue the old rates at a profit. In that case interest rates would never change.

The interest rate is, or should be, a barometer of the credit demand and should rise and if not artifically controlled will rise, with credit demand, and the rediscount rate should be sensitive to the demand and reflect it, and should never be made low enough to encourage the use of Reserve bank funds for profit. This may be elementary from a reserve bank point of view, but apparently it is not from a public point of view.

The foregoing applies to the commercial rediscount rate.

The operation of Reserve banks calls for more than one discount rate, or different rates upon different classes of transactions. This is recognized in the Act.

The open market rate is and should be, governed by different considerations, since different principles and different classes of paper are involved.

Since the ability of the reserve banks to supply credit increases or diminishes with the supply of their gold, there should be, as there is, a distinct rate policy towards those open market transactions which tend to affect the flow of gold from one country to another, and which effect the volume of international business dependent upon the supply of international credit or the supply of credit in other countries.

Also thereshould be, as there is, a distinct rate policy towards bills of exchange of a liquid nature, whether domestic or foreign, purchased in the open market.

This phase of Reserve Bank operations does notpresent as many complications.

Conclusion.

Predicating conclusions upon the foregoing observations the discount policy of Federal reserve banks should be considered under two headings; The commercial discount rate and the open market rate.

COMMERCIAL DISCOUNT RATE.

The commercial discount rate should be governed by the factors submitted for discussion, in the following order or relative importance:

1 (c) Rates charged by banks to their customers.

2 (b) Interest rates in the open market.

3 (g) The volume of bank loans and deposits. (Indicative of the reserve position.)

4 (h) Business and industrial activity. (Presaging demand for credit.)

5 (i) Commodity price levels (as affecting the volume of credit required, but not with view of price control.)

6 (j) Condition of security market (as indicative of supply of investment or floating capital).

7 (d) Interest rates on time deposits. (This is merely a symptom of scarcity of capital).

OPEN MARKET RATES

1 (b) Open market rates (on bankers' acceptances).

2 (e) Balance of trade and inward or outward flow of gold.

3 (f) Credit conditions in, and exchange with, leading foreign countries.

PROTECTION OF FEDERAL RESERVE BANK RESERVES.

Finally: When the intricate play of these or other factors combines to effect a drain upon the reserves, present or prospective, then the protection of reserve bank reserves would become the primary consideration.

Mr. Jay. May I ask Governor Seay a question on his paper? He says "That federal reserve bank rates to their members must as a governing principle, be based upon and bear a close relation to the prevailing rates for bank funds on line of credit paper current in any particular part of the country, and cannot safely be made so low as to encourage the banks to expand their loans on this class of paper to the point which will necessitate rediscounting." May I ask how, in his judgment, the four and a half per cent rate of many banks in agricultural districts, where the rates are on line of credit paper from six to seven per cent, are justified, if his statement or analysis is correct?

Governor Seay: It so happens that in our district, which is comprised of six divisions, five of them are governed by the six per cent rate. It is not legal for the banks to charge more and they do not charge more, national banks do not charge more. There is one state, South Carolina, in which the legal rate is eight per cent. I am of the opinion that there should be a combination of rates and of restraint upon the banks in order to exercise the most benevolent and most effective control, and I think a four and a half per cent rate under present conditions would not greatly encourage any inflation in those five sections of our district to which I have referred.

Governor Strong: Is not South Carolina the largest borrower, in proportion, of any section in your district?

Governor Seay: She was the largest borrower in proportion, but there was a very great deal of restraint, other than the discount rate, a very great deal of restraint exercised in the South Carolina district, and without that restraint I think that worse conditions might have developed in that state. There is one other opinion that has been advanced in connection with that which I think is pertinent, if not illuminating, and that is that as a general principle you cannot state a principle or any governing idea which is not subject to certain variations because of the variety of conditions existing in this country and in any district. I repeat that one of the considerations which would govern the determination of the rate is the interest rate charged by the member banks in that district. I think it should not be made profitable for these member banks to borrow.

If we cannot have different rates, and we cannot, then in a case in which in one division the rate is higher than it is in the rest of the district, some other influence must be brought to bear.

Mr. Jay: Suppose that this were a branch system, and there was a central governing body, and the principle were adopted that we should not have uniform rates in all the districts, how would we deal with a situation if the current rate in a district is 6 per cent or four and a half per cent--- how would we deal with it in some other district where the current rate is eight or ten per cent? Would we still have the 4-1/2 per cent rate?

Governor Seay: In those districts?

Mr. Jay: Yes.

Governor Seay: I do not think it would be possible to have the 4-1/2 per cent rate. We have it now---

Mr. Jay: I am speaking of the present time.

Governor Seay: We have it now, as I understand, because it was thoughtthat the Federal reserve bank rate could be made without reference to the question of inflation. We were in a liquidating market, and that was one of the arguments for reducing the Federal reserve bank rate to seven, to six, to five and to 4-1/2. It was then held that whatever the rate might be there was no danger of recurrency of inflation at that time. My own opinion is that the Federal reserve bank rate should be made sensitive to the credit demand; that the interest rate in the country at large is the barometer. If, however, the member banks can apply to the Federal reserve banks and obtain an illimitable quantity of credit, then it will not control and inflation will be brought about.

Vice Governor Platt: We might ask the same question in a little more direct form. Suppose you had the right to make a different rate in South Carolina, would you do it?

Governor Seay: I believe I would.

Vice Governor Platt: And how would it work out?

Governor Seay: I will answer that by asking you one. What was the consideration which governed the Federal Reserve Board at one time when they fixed a commodity rate which was to be given only to those banking institutions in South Carolina or elsewhere which did not charge over six per cent to their customers?

Vice Governor Platt: It had undoubtedly an influence on the rate.

Governor Seay: It had some influence, or rather it had no influence, because those banks would rather charge eight per cent to their customers than to borrow from us and lend it at six per cent. They made more money by it. This is not a simple question, or you would not have referred it to us for discussion. It is an interesting and complicated question. There is another proposition, and that is that the City banks charge one rate and the country banks charge another rate.

Mr. McCord: You are going to have in Columbia, South Carolina a 6 per cent rate and the balance of the state eight per cent.

Governor Seay: It is very unfortunate that one legal rate could not be fixed, so far as we are concerned, but it is pretty well recognized that a uniform interest rate--- not a discount rate--- is impracticable. I think Minneapolis would argue that it would be a great hardship to that territory. I think Mr. Rich advanced the argument if the interest rates were made uniform it would prevent capital coming from other parts of the country and flowing into that part of the country where it is most needed.

Therefore the current interest rate in other parts of the country is not practical for you in the Minneapolis district. However, those are questions that will have to be worked out not only from the economic point of view, but from the practical point of view.

Vice Governor Platt: I think we have had very good leading papers. Several others have submitted papers on this topic, although not as many, perhaps, as on other papers. Mr. Austin, we will be glad to hear from you.

Mr. Austin: Mr. Chairman and gentlemen, in preparing my paper on this topic I had no idea of imposing my views about the effect of the Federal reserve bank rate upon the members here, but I did call attention to what I thought was a very serious matter for us to consider, and that is the variety of discount rates in the federal reserve banks, and I believe the way to determine what our policy shall be on the discount rate is by basing it on the reserve.

In Mr. Seay's very interesting paper, after giving all kinds of reasons for controlling the discount rate he winds up by saying "When the intricate play of these or other factors combines to effect a drain upon the reserves, present or prospective, then the protection of reserve bank reserves would become the primary consideration.

In all the papers I have read they have started off by giving a variety of reasons for controlling the discount rate other than reserves, but they all admit that at a time when the operations of the banks begin to draw on the reserve and reduce the reserve, that then the primary policy of the bank should be the protection of the Federal reserve reserves.

As I said before, my idea was to call attention to the different rates in the Federal reserve banks and to see if we cannot devise some way by which we could always be effective in control, by uniformity in principle; not uniformity of rate, but some uniformity of principle. I am sure that the public, after reading our statements containing different rates, feels that there is no uniformity of opinion among Federal reserve banks as to what controls the discount rate, as there should be, and their measure of the situation is our reserves. I am sure that when they see a four per cent rate in San Francisco, and 63 per cent reserve, a four per cent rate in New York with an 88 or 85 per cent reserve, with Boston and Philadelphia the same rate and about the same reserve, with a four and a half or four per cent rate in Chicago, and with Dallas and Kansas City and some of the other banks with a four and a half per cent rate, when Chicago has an 85 per cent reserve and Dallas and some of the other banks are down to 60, 62 or 63, that they most form some judgment as to whether or not we are acting on any well-determined or well-fixed principle.

I was very much surprised to hear Mr. Morss say this morning that he would favor raising the discount rate no matter how big the reserve was, if he thought business conditions warranted it. I was just reading the other day a statement by some economic writer who said he did not believe the public would accept a raise in discount rates which was out of proportion to the reserves of the banks, even though the business conditions did warrant it.

Vice Governor Platt: That is a pretty good argument for us to pay out some gold.

Mr. Austin: But it comes right back to you. You cannot hoard or bury it; it comes back. In some of the papers the writers say that they hope the public will form the habit of noticing the discount rates and the reserves of the reserve banks and appreciate what fluctuations in them mean.

Dr. Miller, in his very interesting talk this morning, referred to the cotton planter borrowing from a member bank as forming a distinct increase in the volume of credit, and that that money was paid out in Chicago, Toledo, and other places. Is it not likely that the proceeds of that loan went to parties who were indebted to banks and served to take up loans made by Federal reserve banks, so that the amount of credit was not affected? While he may have made a loan down south of $1,000, it was paid off in other banks.

Now, that same statement might apply to Governor Strong's remark about our purchases of Government securities. If the $500,000,000 proceeds of those purchases remained as a fund in the hands of sellers seeking reinvestment, it would work harm, but there is quite a probability of it having been used to take up other debts and to reduce loans of the Federal reserve banks, so that there was simply a shifting of ownership and no increase in the volume of credit. It seems to me we cannot say that any loan transaction results in an increase or decrease in the volume of credit. That is only reflected in the statements of the banks, which will show whether the volume of credit is increasing, or whether the proceeds of new loans are only used to pay off others. If they are not used for this purpose then a decrease in the percentage of reserves will indicate that, and the discount rates could be fixed accordingly.

Our discount rates are an expression of our willingness and ability to extend credit service in the way of selling credit, and there is no better way of determining that ability than by our reserves.

I do not know that I have anything more to say on this subject, but I would like to speak about a matter which has come up quite frequently, and that is the question of the member bank doing business with the Federal reserve bank at a profit. In discussing it we have referred to England a great deal, and the bankers over there tell me they have no experience that will help us in that, because no joint stock bank ever rediscounts with the Bank of England and never sells any of its paper, either discounted or bought. So we have no experience along that line to help us, but it seemsto me for us to talk about it as a loss or gain is wrong. The situation is this. A member bank has demands from its customers for loans that it cannot meet; and in order to meet them it applies to the Federal reserve bank and submits generally the best paper, short time paper, which has quite a variety of rate. It probably takes paper which bears the lowest rate, but that is immaterial. That bank has got a certain amount of money to supply its customers and it is immaterial what the paper they are discounting costs them. It is not material what they are going to get for it. If he rediscounts at the Federal Reserve bank at four or four and a half per cent I am very sure he does not make loans to his customers at a lower rate. If he has to make a new rate he is going to charge a high rate. It is immaterial what the paper they discount costs the bank; it is a question what they can get from the proceeds of that sale, and I do not think there is such a question as doing business at a Federal reserve bank at a loss or a gain.

Vice Governor Platt: Mr. Martin, we will now be glad to hear from you.

Mr. Martin: Mr. Chairman, it seems to me that any discussion of the relative importance of the ten factors mentioned in topic 2 must necessarily at this time be theoretical. It is true that the banks were opened up seven years ago, but war was across the water and the two and a half years succeeding their opening were spent in the education of the banks. Then we got into the war and we gained war experience and post war experience, as Governor Strong stated this morning, but we have had no experience at all under normal conditions, so that it is difficult to come to a conclusion if, in fact, we ever can come to one, as to the relative importance of these factors; and that is borne out by the fact that Mr. Jay put them in one order and Mr. Seay puts them in another order. Mr. Austin puts them in a third order, and I believe that these factors will change and should change, with each of the several districts, certainly right now when they are in the formative stage. Mr. Jay has little trouble with high interest rates authorized by the law of his state, and naturally the open market rate is the controlling factor. Mr. Seay, on the other hand, is troubled with a conglomeration of rates in various states, and the situation in his case it seems to me perhaps is more nearly like that of all the other banks than the situation in New York. You find him, therefore, looking to the rates that the bank charges the customer and giving them more importance than does Mr. Jay,

Now, as Dr. Miller said this morning, if a man borrows ten thousand dollars, secured by so many bales of cotton, the proceeds of that loan increase the total volume of credit and that is exactly the proper thing. It ceases to be a proper increase of credit only when it lacks the inherent liquidity to put that increase out of existence when the need expires.

Then, it seems to me that the basis of a sound credit policy would be in the fact that loans are made to meet the needs and loans go down when the needs are out of the way and there is no surplus credit on the market to be used in an extraordinary way. There is no use, it seems to me, of considering the rediscount rate in any other way than that it is an index of the Federal reserve banks' credit policy. We have got to give it that importance. Now, a rate set by a fed ral reserve bank that will enable member banks to borrow for legitimate needs, and at the same time does not encourage them to borrow forprimary purposes of profit--- understand now, I am not saying for purposes of profit, but forprimary purposes of profit---

because in most cases the reason banks borrow at all is for a profit; but the primary purpose of that borrowing should not be for a profit, or else our rate is wrong or our credit policy is wrong. It would be a fortunate thing, it seems to me, if the borrowing could be controlled automatically by the rate. That cannot be done, because we have a ten per cent rate here, an eight per cent rate here, a six per cent rate here and a seven per cent rate there, and unless a rate is set for each state it would be utterly impossible to automatically control the situation. Therefore, the possibility of controlling the situation automatically, by the rate, it seems to me is eliminated. The truth is the Federal reserve system is traveling an unblazed trail. You cannot take foreign experience as a guide.

Now, the rate cannot be set, as I see it, to automatically control the borrowing by member banks. They are going to borrow and they will be under temptation, at least, on account of the difference between our rate and the rate that they can charge their customers under the law to make a profit. That will be their constant temptation. Consequently I hardly see how we can avoid the conclusion that while we must give most careful attention to the rates, we might as well face the proposition that, unfortunate as it may be, the banks are going to be compelled to exercise a certain amount of discretion. As I said before, I would like to see it automatically done by the rates, but we are facing a situation where the rate will not do it, so while you have got to consider that rate, and in considering that rate have got to bear in mind the rate that your member banks charge their customers in the different operations of the district, at the same time I do not see how we can avoid the use of discretion in avoiding borrowing of any member bank for the primary purpose of making a profit.

I would also like to say that the public always looks at our rates in connection with our reserves, and the closer our reserves can be formulated in the published statements to approximate and correspond with the changes in rate, by just that much are we in less possibility of being misunderstood. I do not know that it can ever be done, but if our reserve percentage could be indicative of these ten factors a little bit, so that a raising or lowering of the rate would include them all, I believe we would stand less chance of being misunderstood.

I believe this topic is going to be on our program year after year and that some day we will find the general principle.

Mr. Austin: You said banks that borrow for profit altogether?

Mr. Martin: Primarily for profit.

Mr. Austin: Isn't there always a profit when the country bank rediscounts with you, between what they get and what they are charging?

Mr. Martin: That is where the discretion comes in.

Mr. Austin: But if they only borrow for profit why don't they use up all the reserve that you have?

Mr. Martin: For the simple reason that sometimes they will come to the office and by talking to them, saying, "If you borrow the money now what are you going to do when the crop season comes on", they listen to reason .

Mr. Austin: Don't that happen to only a very few customers?

Mr. Martin: No; I wouldn't say a very few.

Vice Governor Platt: Is that the only reason people are not borrowing now more largely than they are?

Mr. Martin: No, I do not mean to say that. There isn't the demand---

Vice Governor Platt: That is it, the demand isn't there.

Mr. Martin: There are two ways of borrowing for profit. One is to put his money out the other is to go and buy business with it. If the business isn't in sight he isn't under the temptation of going out and buying the business, and when it is in sight he is mighty liable to try to borrow to go get the business and he may need a word of caution.

Vice Governor Platt: There would be no profit in borrowing from the St. Louis Bank and buying open market commercial paper or acceptances?

Mr. Martin: Not now.

Governor Norris: I would like to ask Mr. Martin a question. If I understood him correctly he said that different reserve banks would attach different degrees of relative importance to these various factors.

Mr. Martin: Yes.

Governor Norris: I would like to ask him whether he does not also think that any one of the reserve banks would attach different degrees of importance to these factors at different times?

Mr. Martin: Why, I think so, yes.

Governor Norris: I had supposed you would answer it in that way. It seems to me really that this whole question comes down to what Mr. Jay said in the beginning of the discussion of this topic, that it all depends on what you are aiming at.

Vice Governor Platt: Is there anyone else who desires to speak to this Topic No. 2?

Mr. Miller: I want to take this opportunity to call attention to some charts that have been recently the subject of a great deal of study by the staff of the Board's Division of Analysis, in connection with that of three of the banks. They may perhaps serve to bring out the point of view that has been expressed in one or two of the papers but which I think has been implicit in some of the statements which have been made.

(Mr. Miller indicated to the conference two charts which had been placed on the wall of the Conference room.)

If you start with a desire to know what the volume of business is, and to my mind the most promising point of view from which to approach a credit study or a study of the credit situation, is at large; that is to say, viewed not in any particular town but in the country at large, you turn to the best single reflection we have of that, although it could not be called a measure, because there is no competent measure as yet available, and it will be found that the statistics that the Federal Reserve Board has been accumulating for some years past now, in the hope of devising an accounting that shows the volume of credit that is in use, in order to reflect the total volume of business transactions--- this (indicating on plat) is the line, and in order to eliminate the influence of the great volume of stock exchange transactions, New York is not included in the figures as they are presented here. To give the thing a little more point; in other words, to get some line upon the volume of business that concerns itself with the turn over of commodities and materials that enter into production and into distribution or enter into actual use in consumption, if you start here in 1922 (indicating on chart)you get something that is not the present situation, of which we have some knowledge, if you should undertake to superimpose upon this plat to show the trend, you would have a distinct upward trend in business, and it would be a curve inclined somewhat as follows (demonstrating on chart).

Unmistakably, then, these figures indicate that there has been, during the recent months, a very noticeable increase in the total volume of business in the country as reflected in the great mass of transactions that are affected through debits to the accounts of individuals with the banks that are referred to in this census and which may be taken as representative of the general movement.

Now, we want to know what has done that. There is an increase in business. Is it fictitious? Is it merely that there is a boom movement on and there is a bidding up of prices, such as we usually have normally in a period of inflation, or is it bottomed upon something that need give us any concern? Now, when we move from this and go to this line (indicating on chart) which indicates the cost of production, this line being an index reflecting the movement of production in certain of the representative basic manufacturing industries of the country, we see that at the same time that the volume of business has been rising there has also been a pretty steady rise in the volume of production, in the output of the soil, in the output of textiles, and so on and so on. Some have gone up more rapidly than others (indicating on chart) and some have not gone up at all.

Governor Strong: Is coal included?

Mr. Miller: That is included and it holds the thing down of course. In that particular instance if coal production has been normal this line (indicating) would have shot up very much more pronouncedly.

Governor Strong: Does that account for the sharp drop?

Mr. Miller: There is little drop. I suppose you would call that seasonal, probably a little seasonal drop.

Therefore the movement of that line for any particular month is not to be taken as a group barometer. It is when you take the trend over a series of months and that series of months expresses what is sometimes called by economists a new phase of the cycle, that it becomes significant.

This (indicating) indicates, or seems to indicate, let me say, rather, that we are now already getting fairly well advanced in a new phase of the business cycle; in other words that recoeery is now an actual fact; it is in process, and while it does not grow at a uniform rate it is, looking back over a period of six months or more, an undoubted fact, if these figures can be trusted, and they are the best that are available and have the approval of all experts that have studied the thing and are the most trustworthy that we have been able to find or devise in setting up the information for the use of the Federal reserve system and its constituencies.

Now, there is a rough parallel between the growth of the volume of business, excluding stock exchange transactions, and the growth of volume of production, despite the fact that there has been, during this period, a check given to fuel production, despite the fact that transportation has tended to still further restrict the normal, free and unimpeded movement of goods into the markets, and if those things had been eliminated, if we had had no railway strike, no coal strike, and no textile strike, undoubtedly the gain in the production chart would have been more marked.

Now, then, we go on to the third feature of thechart, that feature which has been the subject of reference in the discussions this morning and more particularly in the debates, and one of the most striking things in many of the papers and memoranda which have discussed the phase of credit policy. This again represents an index (indicating chart), computed on exactly the same basis as this production index (indicating).

Starting in 1919, so as to embrace within the frame only things that are definitely comparable, these are built upon exactly the same basis (indicating). Now, we have an increase in business, an increase in production and an increase in prices, which seems to indicate--- and I am talking now for illustrative purposes, rather than giving an account of what I think is actually in process--- it seems to indicate that the increase in business here (indicating on chart) is the outcome of two factors that are each one tending to strengthen the other, to wit, an increase in prices and an inchrease in the actual physical mass of goods that is being turned out to go into exchange, into use, and so on. Now, what the relationship may be between those two things I would not presume to say, though I do not hesitate to express the opinion, and in order to make clear the nature and the basis for that opinion, let me picture here a different situation (demonstrating on chart). Suppose we had this line as it is (indicating) still climbing upwards; suppose this line (indicating), instead of climbing upwards goes in a horizontal direction;

in other words, suppose the charts indicated an increase in the volume of business and not an increase in the volume of production; suppose this price line indicated a still more abrupt ascent. The inference that that would suggest to my mind would be that the increase in the volume of business shown by the chart was not due to an actual increase in goods produced, but due to an increased bidding for goods which reflected it self in a rise in prices; that it was not that more business was being done in tons and yards and so forth, but more business was being done in terms of value, and I should say we had better watch extremely carefully. If we take that sign alone, uncorrected by certain other values that we might find in the situation, we might fairly conclude that we were going into a period of inflation; in other words, that the volume of credit might outrun in its growth the volume of production. I will assume that the volume of production is stationary, with prices rising, and if that were reflected in an increase in Federal reserve bank credits we would be almost warranted in the inference not only that credit was sustaining something in the nature of an inflationary rise, in price of commodities which swelled the general volume of business, but that the reserve banks had issued credit that made that swelling possible, and it would at once suggest what action we should take and what our responsibilities in the premises were.

Coming back to the question as to the relation between this rise in prices and this rise in production, both of which reflect themselves in the increase here in the total volume of business, I do not think any competent analysis can show just what is the degree of responsibility to be attached to each of these two factors. My opinion is that normally what is going on now is what is normally to be expected in a period of business recovery after a severe crisis, followed by a period of liquidation and depression in industry. The prevailing attitude of mind is that men are remembering far more than they are anticipating, and they are more or less in the grip of fear and caution, which is the business residual of fear. The result is that the recovery at first shows itself in the determination on the part of different sections of the community to resume living and buying; there is a demand for goods on the part of consumers at the retail shops; the retail shopkeeper finds his shelves depleted and goes to the wholesaler; the goods are not there in adequate volume, prices are bid up, and that transmits itself back to the manufacturer. Bearing in mind that what we consume today has been manufactured at least three months or six months ago, there usually comes a bidding up of prices for goods in more or less finished state, or more or less ready for distribution at any rate, and that translates itself back to the manufacturer and sometimes to th consumer, for primary materials. So that my own view of this is that it is largely this rise in prices that has induced this increase in production.

I have not talked with Mr' Stewart to find out whether there is anything in the nature of a lag that gives us any line upon it, and I am therefore expressing merely an opinion and ndt a conclusion. This, however, I think is important, that the movement of prices upward in and of itself can never be taken as an indicator of what is a proper discount policy, any more than the rise in the temperature of a man indicates what medicine you are going to prescribe for him. You have got to see the other things in combination with it before you can tell precisely whether the rise in temperature is really a serious indication of any pathological condition, a condition that requires energetic treatment, or whether there are, as it were, certain neutralizing symptoms that indicate that it is a more or less transient thing. In any case you do not doctor the temperature; you doctor the patient. At most temperature is symptomatic.

I say, therefore, partly in view of the fact that many papers stress the importance of price level as a guide, not an exclusive guide, but at any rate an important guide, to credit policy, that prices should always be studied with reference to their accompanying conditions, or conditions that follow them. There is no objection to a rise in prices per se as long as we have reason to think that the rise in price is going to wash itself out and take care of itself through a commensurate increase in the actual production of goods; but we never want to lose sight of the fact that our modern system of economy is a price economy, that the signal for increased production in any commodity is the fact that the price of it is rising; that means that there is a shortage; that means that somebody wants more books or cotton or automobile tires, or whatever it may be, and if there is available plant facility to meet that, if there is unemployed labor available to meet it, it need give us no particular concern. I do not mean by that that it should not be watched, but I mean in reading the signs that there is no objection to seeing an increasing load upon the shoulders of the growing child, provided the child is really growing and equal to the burden. Our price line ought always to be checked and verified in connection with the production line. If we reach the stage, as we may sooner or later, and as we will sooner or later--- unless the Federal reservesystem is alive to the possibilities and intelligently as well as anxiously watching, and therefore grasps the point at which the productive organization of the country is all functioning at its full capacity, and that any further credit paid in at that time does nothing except to blow up prices, making it possible for those who are eager to buy and overbuy goods because they see gods are becoming scarce--- the productive organization of the country being at full capacity, we should probably get something in the nature of real inflation, and real inflation is something that is practically never controlled when it becomes real inflation. Prevention is the cure there, as has been brought out in several papers, or in certain of the discussions, and the only service that the Federal reserve system may properly be called upon to render is to stick up some signal, give some indication, by rate or otherwise, of what he believes is impending.

But to repeat once more, those are to my mind always the three important things with which to start. They will, to my mind, take very much the same place in the delibera-tions of the reserve banks, that the temperature, the record of pulse and respiration take with the physician. I do not mean to say that they alone sufficie, or that the same weight is to be given to those factors under different circumstances. On the contrary I have given you this illus-tration purposely to show that a rise in prices at times is on the whole a healthy symptom. We need not get frightened because prices are going up. I should have more concern, for instance, at the present time, if prices were not rising. The fact that prices are rising indicates that there is a considerable body of people who are going ahead, who have faith enough to make commitments, who have faith enough to consume, and that signal is being trans-mitted back to the productive industries of the country and the chart indicates that they are responding to it. When they cease to respond to it, the rise in price and the increase in volume of business is due mainly to the price at which goods are turned over and not influenced to any appreciable degree by the value of the goods that are being turned over, then we are coming about to the end of safe--- and by safe I mean economically safe, safe in the sense that we are doing our part properly to safeguard the public interest--- we are getting pretty nearly to the limit.

Now, gentlemen, that is a bald and rather dogmatic presentation of a thing which is subject to a good deal of qualification, criticism and objection. I should sit down myself and, if someone else had spoken some of the words I have used, ask a great many embarrassing questions which would bring out that this is a rather rough and sketchy presentation of what in fact is a more complicated subject and subject to a great deal of qualification by the introduction of other factors that are not noted on these charts at all.

Let me say this in summarizing: That these three things, the chart of business, the chart of production and the chart of prices, if properly related to one another, in attempting to make an economical interpretation, should enable us to test the volume of credit that is in existence, particularly at times when the reserve banks become a factor in the volume of credit, as at present you say they are not.

Governor Strong: May I ask what are the elements that enter into that curve of volume of credits? Are they the earning assets of the reserve banks?

Mr. Miller: Discounts. The upper line is the Federal reserve note circulation and the lower is the discounts.

Governor Strong: It does not include investments?

Mr. Miller: No; I was just using this for illustrative purposes.

Mr. Jay: May I ask Dr. Miller, when he speaks of testing this by the total volume of credit, if he doesn't mean Federal reserve credit, but outside credit?

Mr. Miller: Yes.

Mr. Jay: Dr. Miller spoke of the rise in prices, the increase in business, making necessary rediscounts in the Federal reserve banks, causing our curve to run up. Would he be willing to say a word about the effect of gold coming in from abroad as reflecting the volume of credit and Federal reserve bank rediscounts?

Mr. Miller: I think there are other men who are going to bring that out. I will say a word if you want. It is very obvious here that a very considerable increase in the last six months has taken place in the volume of business. There has been a rise in prices that ten years ago would have been alarming. That is a very marked rise in prices in the course of six months. We would have to go back a long way in our history to find anything comparable with it. Between the beginning of the war in 1914---1916 was when it began to take effect here--- and the Civil War--I doubt whether we could find any such marked rise of prices in so short a period of time, and there has been an expansion of about two billion in credit in the course of the last year.

Governor Strong: A little over that.

Mr. Miller: In other words, the credits have expanded two billions without being felt in the reserve system. There has been a little sporadic seasonal borrowing here and there, but it does not amount to anything.

Governor Strong: We have over two hundred million earning assets, two hundred and fifty million about.

Mr. Miller: Yes, you have, but that really represents a contribution made by the Federal reserve banks. You have supplied two hundred millions in money to the market. It is plain, therefore, that the banks have been able to expand their credit two billions without ringing the door beel of the federal reserve bank. It is due to the fact of these heavy importations of gold, which give the banks that receive the gold a basis of lending.

Mr. Curtiss: Does not the gold that comes in go into the reserve banks and is not the real increase coming from the actual lowering of the reserve rate? Does not the gold that comes into this countryultimately go into the reserve banks?

Mr. Miller: Yes, but that makes no difference. If a bank gets $5,000,000 in gold, that is the basis for extending its credit--- Mr. Jay or Mr. Strong can answer that--- but I will be very modest and conservative in saying that if it takes in five million it can loan twenty-five million.

Governor Strong: All the banks together can.

Mr. Miller: It means the creation of an additional twenty-five million to the total volume of credit.

Mr. Jay: Yes. On the other hand it is also clear that the Federal reserve banks with three or four hundred millions of securities, by liquidating their investment portfolios, could suck in funds from the market; in other words, they could begin to create a vacuum, as it were, into which credit from other sources would have to flow; it would start competition for funds in the money market--- let's call it the national money market--- it would begin at some local point such as New York, but it would soon make itself felt, and it would do something in the way of control before the banks found themselves at the end of their loaning tether and obliged to come to the reserve banks to rediscount paper. They can do exactly the same thing by selling bills out of their bill portfolios.

Mr. Wills: I would like to ask whether it would be safe, for instance, in our district, to follow one basic line of production. For instance, is pig iron sufficiently indicative to follow?

Mr. Stewart: Of course recently it has been lower. I think as a monthly index it would be much less satisfactory than it would be on a yearly basis.

Mr. Jay: Is it feasible for any district to take any particular commodities in that district as an indication of the whole? Considering this test here, isn't it necessary to follow it on a national basis rather than on a district or single commodity basis?

Mr. Miller: Of course I haven't offered this as a working instrument, but merey to illustrate certain points. These charts have been prepared for use in connection with a new form of presenting the Federal Reserve Board's monthly review of national . l economic and business conditions. It is my expectation that when this part of the job is completed steps should be taken by the seaprate banks to see what they can do to set up, as it were, similar graphs of schedules for their districts. That will be a matter requiring a great deal of time, but they should do it to see whether there are any single commodities, or some two or three commodities that, by test, can be shown to be good district indicators of the relationship between the movement of prices and the volume of business and the volume of production in so-called basic industries, and then test the volume of credit among the commercial banks in their districts and their own volume of credit where they are contributory to the expansion of credit, by the actual volume of what we call economic l, valid business.

Referring to the first question that was asked this morning, I think the thought was in the minds of many of those who spoke, but they never quite came to the bat, that the object of credit normally and in the most general formula, is to assist production, using the word production in the inclusive sense of including not only raising the products of the soil, digging products from under the soil, but their manufacture, their distribution until they are finally passed through the last stage of distribution, from the retailer to the consumer; transportation of them is included within production as I use the term, but it is goods rather than the dollar mark on the goods that is immediately the most important thing. Business volume is, roughly speaking, a multiple of the volume of goods, the frequency of turnover and the prices at which those three things are being done.

Let me also say, by way of possible question, that I do not regard these three things, or any combination of things, even though you assign different motives and different factors under different conditions, as competent to determine a discount policy. There are a great many things that are too elusive to admit of specification or mechanical measurement, and, to refer to the illustration I used a moment ago, just as a physican wants to know what the temperature, what the pulse and what the respiration of a patient is; so we want to know what certain of these basic reflectors indicate, and supplement them by a great many other things which may immediately or quickly influence any or all of those, and most of those are merely a part of the basis on which a judgment is based. It must not be overlooked that the formulation of a credit policy is, after all, good judgment, and good judgment can never be mechanically indicated, however it may be aided by scientific tests.and presentation of data in some form like this.

Governor Strong: Would not the chart giving the volume of credit be more illuminating if the curve as to discounts included all earning assets, and if another curve, taken from the semiannual reports of bank conditions were added, giving the total volume of bank credits in the United States?

Mr. Miller: Yes; we mean to do that in a separate proposition. The latter I think is particularly important. When it comes to the total volume of earning assets I should say yes and no. I should say yes, provided the volume of earning assets---

Governor Strong (Interposing): After all it doesn't make any difference whether we make these investments in order to get some earnings, or in order to supply the market with credit or for any other reason. It has the same effect on the volume of credit and would undoubtedly be reflected quickly in the total of bank loans and deposits in the country.

Mr. Miller: It would sometimes and sometimes it would not.

Governor Strong: It strikes me, looking at this picture as you describe it, that if we had these curves of absolute figures, irrespective of the motive which led to the making of the curve, and then got a curve by some sample process or other process of the quantity of goods as distinguished from the movement of the goods, we would get a pretty good picture.

Mr. Miller: Let us suppose that you replace the discount line by a line showing the total volume of earning assets. No one would have any clue as to whether or not those earning assets had been brought to the federal reserve banks by the process of rediscounting, because the member banks had reached the end of their loaning power and therefore were obliged, in order to go on extending their loans, to borrow from the reserve banks, or whether it came by a purchase of investment securities by Federal reserve banks on their own motion on the market.

Governor Strong: Does it make any difference in the effect--- I mean any effect upon the curve that we want to show here, whether a national bank comes and borrows some money or whether we voluntarily lend it to them?

Mr. Miller: It does under certain circumstances. I should say at the present time it would not make any difference, but a number of months ago it would have made a difference.

Governor Strong: Would not the effect of the gold imports be identical, wouldn't the effect of the gold imports be reflected in the growth of total bank deposits?--

Mr. Miller: (Interposing) Yes, but I say it was not reflected a year ago. It depends on whether there is a demand for credit or whether there is not. If there is a demand for credit then the gold imports are of more consequence than the purchase of securities by the Federal reserve banks--- but if you are in a period of liquidation it makes no difference, the money market has more than it can use anyway.

Governor Strong: I would say that would be true in a country like England, where they had no subsidiary reserve, and where under certain conditions the banks are allowed to build up a large excess of reserve and under other conditions to let it run low; but here in this country, where we have a subsidiary reserve, the minimum reserve will always become the maximum reserve.

Mr. Miller: But they put down the price of money, and under those circumstances when they put down the price of money until money in the open market goes down to 2-1/2 per cent--- it has been as low as three and a fraction, hasn't it--- but suppose it got to two and a half? It would seem to me that under those circumstances I would say that the total earning assets of the Federal reserve banks wouldn't cut any figure.

Governor Strong: I think it would in practice because under those conditions the banks pay off their loans and the certificates of indebtedness and other securities drift into the banks. It is a curious thing, Dr. Miller, that after that period of liquidation we had in the nineties, when the total bank resources in New York were not much over a third of what they are now, if they were that much, we had a period where there was at one time a maximum surplus reserve of banks in the clearing house of $111,000,000. In 1907, I think the maximum surplus was over $80,000,000 and money was practically unloanable. Now, that surplus is immediately employed to pay off at the reserve banks until it results in a condition where we do not have very low rates, or neither do we have very high rates.

Mr. Miller: Suppose in the beginning of this year, we will say through foreign transactions or through some interior trouble, we should not have had a resumption of business, but distinctly dull business and a continuation of the depression of 1921. What would have happened? As things have been, we have had a resumption, and that resumption has been most active in the stock markets by anticipating what is ahead. The movement in the past two years has been pretty true to form. Liquidation comes earliest in the great eastern cities and slowest in the interior agricultural centers. The interior was slow to liquidate and is just about completing its liquidation, while New York and the influences that center in New York have been distinctly resuming. The result is that the liquidated funds from the western sources flow into New York and find an outlet because there has been this tremendous outburst of speculation in anticipation of business---

Governor Strong: I believe I can tell you what would have happened. We probably would have refunded the government debt on a three per cent basis. If the member banks had completely repaid their loans to the reserve banks andhad the period of liquidation continued beyond that, the member banks would then have actually had a surplus which they must employ, and we would have had a great reduction in interest rates, far below what we have had, and very shortly the Government would have intervened with a refunding operation, and we might have had the soldiers' bonus also.

Mr. Miller: Refunding does not take money out of the market, but it takes it out of one pocket and puts it in another.

Governor Strong: I was just reflecting on some of the consequences.

Vice Governor Platt: I suppose we ought to go to the next topic, gentlemen. This has beena very interesting discussion and I should like to have taken part in it myself, but I will refrain. The next topic is

What light does the experience of the Federal Reserve Banks throw on the value of different methods of making their credit and discount policy effective.

a. Discount rates.
b. Open market operations.
c. Discretion in rediscounting.
d. Credit examination of member banks
e. Credit rating of commercial borrowers.

This discussion is to be led by Messrs Strong and Perrin.

Governor Strong: I was all prepared this morning, after hearing Governor Norris apologize for having encroached upon othertopics, to make such an apology myself, but what Mr. Perrin and I propose to discuss has been dissected to the bone pretty well, and I think possibly we might ask for some apology.

I read Mr. Perrin's paper with the greatest possible interest and a good deal of respect and admiration for the way in which he had presented a view which, I am frank to say, I do not hold myself, with regard to the effect of our policy. I do agree with him almost to the letter in the expression that he has given in his paper of these difficulties, and I think I agree with him entirely in his statement that a comparison of the effect of the discount rate of the Bank of England with the effect of our discount rates is almost wholly misleading.

I will not go into that because certainly on those two points I think we are in entire agreement.

The outstanding thing to me about Mr. Perrin's paper--- and I will address myself particularly to that because I want to stick to the subject as closely as possible--- is the way it exhibits differences in two wholly different districts in the nation, which are possibly extreme in their conditions, that is to say, the New York and San Francisco districts. We, in New York, are compactly within the central money market, it is a very sensitive money market, and in that respect we have a great advantage over any other reserve bank in establishing an effective rate. On the other hand in San Fraisco they have a very large territory, covering great distances, with a great variety of interests in the districts, and a great variety of interest rates in the district. There are many small banks as well as large banks in that district.

The value which I get from Mr. Perrin's paper, which I have read very carefully, is that it brings out in such distinct contrast the extent of the difficulties that are encountered in a district like his, and how relatively slight they are in New York. Those are the conditions that we want to have discussed in our bank and that we will profit by hearing discussed here, because they have got to be understood and the problems that they present must be solved.

I apprehend, in regard to Mr. Perrin's paper, that he is inspired to express a rather extreme view about conditions in his district, just as I was perhaps inspired in my paper in expressing possibly a more extreme view of the conditions in our district. Those views are illustrated by the conclusions drawn, and I would like to bring out what the contrast is.

Mr. Perrin's conclusion is, speaking of credit and discount policy, that credit and discount policy will be made effective through the exercise of discretion in kind of rediscounts, and not through regulation by discount rates.

My own conclusion is that the rediscount rate at the reserve bank regulates how much in general each member bank borrows, and possibly influences an increase or decrease in the total volume of bank credit, and I supplement that by saying that in sections where interest rates are high, discount rates may not prevent overborrowing by member banks.

Now, it seems to me that Mr. Perrin's paper is addressed to one thing and mine is addressed to another. After discussing the difficulties experienced in extending credit to individual banks upon the basis described in the statute, he quotes as follows: "The bank is owned by its member banks and a majority of the directors", and so on, and then he quotes "The Directors shall extend to each member bank such advancements and accommodations as might effectively and reasonably be made with due regard to the claims to be made by other member banks", and frankly, nowhere in his paper, from beginning to end, do I find a discussion of what seems to me to be the matter of paramount importance, and that is how the total volume of credit in the United States as a whole shall be regulated or controlled or kept within bounds. He does not say whether that shall be, if you please, by the policy of fixing rates, or whether it is possible to do it by telling each one of the 10,000 different banks how much it is entitled to have.

After all almost every argument he makes in his paper as to the judgment as to how each individual bank shall have credit from the reserve bank, is the identical argument that I make in a shorter space in my paper. I agree with that and I agree that as to individual banks in many cases, where interest rates are high and where conditions are difficult as they are in the San Francisco district to exercise rate control, that the other type of control is the only one that can be exercised; but that does not solve the problem. When you consider these charts, that does not solve the problem as to how much credit the Federal reserve banks are going to permit to develop in the United States, and it is my belief that the rule which applies to the individual bank does not, in point of fact, apply to the system as a whole.

This morning, as Dr. Miller, at the conclusion of the meeting, was about to speak, I had already started to write this very hasty suggestion to distinguish between Mr. Perrin's point of view which must be that of the managers of the reserve banks in many districts, and that which I think we are beginning to feel in New York, namely, that the regulation of credit volume, the amount of increase or decrease, must principally be governed, as to the whole country, by discount rates and open market operations. On the other hand, the exercise of discretion as to borrowings by many individual banks is solely a matter of individual credit.

Mr. Perrin: Will you read that a little slowly so that I can get it?

Governor Strong: This has been very hastily written and Ican improve upon the language. I merely want to introduce the thought that your paper is addressed to one subject and mine is addressed to another. Speaking for the New York bank we will say that the regulation of the credit volume, its rate, and the amount of increase and decrease must principally be governed, as to the whole country, by discount rates and open market operations.

Mr. Perrin: You mean by that Federal reserve discount rates?

Governor Strong: Yes, entirely. As to the other point of view, that the exercise of discretion referred to in the caption of the topic as to the borrowings of many individual banks, that is solely a matter of individual credit; I mean by that that even if we attempted to do it by nicely devised machinery it would not be possible for the managements of the twelve separate reserve banks to deal individually with 10,000 different borrowers, by bargaining, so to speak, or by a test of their credit or an examination of their business, or even of their needs; it would not be possible for us to accomplish the great object, which is one of our responsibilities, one of the principal responsibilities of the reserve system, that of controlling the total volume of credit in the country.

I want to very carefully distinguish between the two points, of controlling the total volume of credit and conducting individual business by the reserve bank with its members. They are two wholly different things, it seems to me.

Before discussing that let me digress a moment to refer to something that I have not heard discussed at our meeting, and which I think we have got to consider. If we had a system of branch banks in the United States we would, in fact, as in other countries where they have branch banks, form a direct communication of credit between money centers, where money was plentiful, and new and developing districts where it was deficient. That would be the normal way, under a branch banking system, by which the surplus of credit in some sections might be distributed from those sections to aid deficiencies. But we have no system of branch banking and the contact between the banks in the money centers and the banks in more remote sections, where eight, ten and twelve per cent is charged, is not sufficiently intimate to enable the creation or stimulation of that free flow of credit, say from New York to Wyoming when they are feeding sheep in Wyoming. Observing what has recently taken place, that the banks in the large cities throughout the United States, in particular federal reserve cities and the member banks in most of the large cities in all the districts, have practically liquidated all of their loans at the reserve banks, rather suggests this conclusion, that the reserve system, by bringing the membership of the district in contact with the central reservoir of credit is accomplishing, in quite a different way, the thing that would be accomplished under the branch banking system, because the country banks are the ones that have not liquidated. Until very recently the banks in the northern part of New York State, and some in New Jersey, were borrowing more from the Federal reserve banks than all the other banks in the district put together. There was a time when the banks in New York city were only borrowing $3,000,000 from us, and in those sections of the state where interest rates were still high they were still borrowing. That is pro b-ably true in every Federal reserve district. The city banks, where the surplus of credit accumulates, pay off their loans, and automatically, so to speak, without our having designed a system for that purpose, these country banks in sections where interest rates are high are getting relief. It may be a good thing. It may be we will have to close our eyes to the development of a perfectly natural tendency to have the reserve system act as a pipe, by the connection between surplus and deficiency, and by ironing out, so to speak, through this new methodof tying our bank-ing system together. I do not think that we can afford to put too many obstacles at the present time inthe way of the continuation of that, certainly not until Mr. Criss-inger's troubles are over with the problem of branch bank-ing.

Now, diverting once more, I would like to refer to something that has a very direct bearing upon this question of total volume of credit. When the authors of the Federal Reserve Act prepared the bill to reorganize our banking system, we were not at war, the world was not at war, and there was no contemplation of any war taking place. The Act was not designed to meet war conditions, because it had to be amended to do so; and had the Federal reserve system simply taken over the reserves which were then to be contributed, and having held just that amount of gold as reserve, which it was contemplated we should hold, a very slight extension of credit by the Federal reserve banks, a very small amount, would have brought our reserves down to the legal minimum. Probably that amount of credit, from what we can gather in New York from experience abroad, probably that amount of credit would simply have reflected higher prices; those higher prices would undoubtedly have caused the importations of goods and the importations of goods would have put the exchanges against us, and we would have exported gold and we would have very shortly been obliged to put our discount rate up, if you please, in order to protect our reserves. We would have been in a normal situation had there been no war, and had we, through ignorance, indulged in a little inflation with these new instruments, we would have paid the penalty right away in gold exports, and those exports would have forced upon our attention right away the necessity for a rate control of the total volume of credit. We could not have gone to each member bank and told them that they had to pay off ten or twenty per cent of their loans because we had to stop these gold exports. Only the rate of discount would have done it.

Now, the exigency of the war had resulted in a change in the reserve act, the importations of gold had not only increased, to what would probably have been a normal gold reserve of a billion dollars, but they had dumped two billion dollars more of gold upon us, and with the world having suspended gold payment entirely, with the dollar, if you please, at a premium in almost all parts of the world; we could go on here forever; we would not lose the gold under the present conditions unless our prices got to such excess levels that the exchange came back to par, and irrespective of any other argument with regard to rates controlling the volume of credit, if it had not been for the war, we could not have helped the very fact of our gold exports producing a penalty for a little indulgence in inflation, which would have been the cause of foreing rate reduction upon us irrespective of anything we might otherwise have attempted to do.

I regard the difficulty that has now developed--- and I mean the difficulty of regulating bank borrowing, as being very largely due to the fact that, with this enormous mass of gold in our inside, we are not subject to the influences and penalties of the misuse of it. Consequently with this fine showpiece of three billions of gold there is nothing liable to develop except that it is liable to be a very expensive show piece, and we had better put it to use. The penalty will be additionally severe if we do put it to use, because of the exportation of gold which cannot take place in order to correct it promptly enough--- it did not correct it in 1919 and 1920, as otherwise it would.

As to New York and the effect of the rate there, I can assure you, from personal experience, and without going into detail or giving figures, that there is a rate which does control the amount that the member banks borrow from us, and that rate today is effective through practically the entire banking community of New York, and, as you gentlemen have noticed, as to the rest of the second district. In inverse ratio as you get further from New York and other money centers, the rate becomes less effective and the personal control becomes more necessary as to a larger number of banks. I doubt if it is very large as to the volume of bank credit, but take the Second District, Mr. Perrin, and you have Los Angeles, San Francisco, Seattle, Portland and Tacoma, and I suppose today that rate is effective im all those cities, or pretty nearly so, and probably is in San Francisco.

Mr. Perrin: I will touch on that point.

Governor Strong: If it isn't it won't take very much of a change to make it so. When you get up to Utah and over into Arizona and other intereior sections where interest rates are higher, you may have ten times as many banks in your district who must be controlled by the personal influence and domination of the officers of your bank as we have in our district; but the principle is just the same in both cases. That kind of control, which is called "discretion" in this program, exercised on many individual banks, regulates the amount of credit extended to those individual banks. It may be because of the character of business they do that makes you cautious, or makes it necessary to admonish them, or it may be for any one of a number of reasons, but the total of all the regulation or discretion will never accomplish the main purpose of the reserve system, as to credit regulation, in regulating the total volume of credit in the United States as the rate will do it. That is my belief.

I am going to say a few wordsin conclusion on a more personal aspect of this matter of control. I am firmly convinced from the experience that we have had in the last three years that a Federal reserve bank, which is an institution of enormous influence and power, is operated by men who are no different from other human beings in one respect; they are like government boards and commissions, possibly somewhat like Congress, in that they get power and they want more power. There is an insatiable craving in the human mind to exercise the powers of regulation, to exert influence, to be a factor, so to speak. Ithink we are all subject to that influence.

Now, the law of this country provides that bank regulation and supervision shall be in the hands of certain officers of the government and of the states. I think it will be most unfortunate if, through this common human weakness, that I do not believe any man in this room will deny exists--- or even from a desire to improve banking in the United States, and the way it is conducted as to the individual member banks, I say it would be unfortunate, and I think it would be a great mistake for the reserve banks to intrude upon the exercise of these regulating powers of supervision that are now held by competent officers in most cases, to inject themselves as another regulatory authority upon the member banks, beyond the very minimum that is necessary to protect the reserve system itself. It will give rise to complaint; it will make enemies among our members. I will admit that we have to distinguish, that there are many banks where the individual credit transaction requires it; but generally, as a system policy, to intrude upon the autonomy of the banks and in the exercise of power that it has under the law, I cannot helpfeel will be a great mistake. I am inclined to think that some of the difficulties that we have encountered in our par collectionsystem, and possibly in some other matters recently, have been due to too much reliance--- and we are just as guilty as anyone else if there is any guilt--- upon that type of intrusion, regulation, and imposition of our views upon others. Right among the councils of the reserve banks now and then I have heard th suggestion that the directors of those banks enjoy a certain autonomy under the law that they do not like to have interfered with, even by the Federal Reserve Board I frankly fear it and I fear that it would result in animosities and ultimately in an attempt by Congress to modify the Act, which, just now, I think is pretty good.

Now, in conclusion, a word about the other side of thisquestion, the regulation of the total volume of bank credit. The reason why I asked Dr. Miller about that curve was because of certain things we have observed in New York, certain things that we feel are going on just now, that are of interest to us.

The loan account of the brokers on the New York Stock Exchange is probably 80 per cent above what it was at the low figure last year. That is nothing to frighten us, but is simply a fact that we want tostudy. I have with me a list of forty commodities, some of the most important commodities that we produce in this country, and have compared and listed the monthly average price, 1921-2 with the September 30 prices, and with the sole exception of flour they all show advances which range up as high as 336 per cent, in the case of coal, and excluding coke, which has been subject to very unusual factors, the average for the whole list of forty commodities is 37.2 per cent.

Dr. Miller referred to the increase in prices shown by that chart, which I think is about 16 or 17 per cent, as unusual. We have seen a chart of that character carried back to Civil War days and there has been no such change in values ina period comparable with that since the readjustment took place after the Civil War. Mr. Jay happens to have it here, and it illustrates the exact point which you make, Dr. Miller (exhibiting chart).

Now, the third thing that has taken place is an increase in totalbank deposits of something over two billion, between January and July.

The fourth thing that has taken place, which may be a coincidence, is that the earnings assets of the Federal reserve banks have increased two or three hundred million dollars and that we have imported something over ahundred million dollars in gold. All those things marching along together have all indicated to my mind one outstanding thing, and that is--- let every man in this room, who has a theoryof how he should lend money to his individual member banks--- I am frankly not very much interested in that; some men do it one way and some another--- the thing that

I am interested in is the fact that we shall have a system policy, that we shall have our eye on the ball of credit, the extent to which we are exercising control over it, and that we do not minimize or overlook that fundamentally, in the last analysis, the thing that controls borrowing by the great mass of banks of this country, that is those banks representing the great mass of banking resources, and the control that they are going to feel, is what that credit costs them.

Vice Governor Platt: We will now hear from Mr. Perrin.

Mr. Perrin: Mr. Chairman, I feel that I am almost in the position of some of those soldiers of whom a gentleman now dead alleged that many were executed without trial. When a member of the Federal Reserve Board made the statement this morning that the most absurd proposition that has ever been put up to the Board during his encumbency was a suggestion from the Federal Reserve Bank of San Francisco that the rate be fixed at 3-1/2 per cent, my case had not been submitted to the jury but I was already executed.

However, any feeling that existed upon my part on that outrageous charge by Mr. Mitchell was paliated by a very delicious luncheon which I enjoyed with him, and I forgave him when I partook of his hospitality.

I feel that even with the disposition on the part of the gentlemen present to be fair I am almost in a position of great disadvantage when I undertakedto speak of conditions in New York, about which Mr. Strong is so familiar, and about which I necessarily am very unfamiliar, but I feel very much pleased that in so many things Mr. Strong has agreed with the ideas that I had advanced in my paper. But he remarked that we seemed to be discussing different things, and I believe that I am not incorrect in saying that Mr. Strong has not been adhering closely to the topic.

Governor Strong: I guess you are right about that, Mr. Perrin.

Mr. Perrin: The topic is not what we would like to have, not what we would like to believe. I might like to believe that the Heavenly gates are of pearl and that the streets are very heavily paved with gold; I might like to believe in a personal God; I may believe all those things, and if I do no amount of argument is going to change my belief. But I submit that those things have never been demonstrated in fact, that they are simply what one may like to believe.

Now, the topic is not what we would like to have as a method of regulation. The topic is what light does the experience of the Federal reserve banks throw on the value of different methods of making their credit and discount policy effective, which is merely what in the experience of the Federal reserve banks is of value.

Now, as I believe, there are very strong preconceptions in favor of what is known as the penalty rate. I myself, for so long as I have known anything about central banking, have been thoroughly convinced that the only proper control is by a penalty rate. That was one of the first things that I learned about central banking years ago in my first experience in Europe, when I made some little study of banking.

Now, it is perhaps worth while to stop for a moment and consider what is a penalty rate, and the Bank of England comes up as the best illustration of the application of such a principle. When a penalty rate is referred to, and by that I mean a rate at which rediscounts will not be profitable, will either cause a loss or at least produce no profit, we consider what are the bills that are subject to rediscount. The bills handled by the bill brokers in London, as middlemen, are those which are sold in the open market. Those brokers are dealers in those bills just as our acceptance people are dealers in acceptances here. Their purpose is, of course, to sell them at such a profit as they can. It is usually an extremely small margin of profit because they have a tremendous turn-over. They buy and sell and they do not ordinarily rediscount. The only time when they rediscount is when they are called upon to pay up a loan which they have negotiated against those bills they are dealing in, and then their recourse is to go to the Bank of England and rediscount those; but that is an unusual and exceptional thing. The Bank of England does not rediscount for the bill brokers as amatter of considering the necessities of the bill brokers primarily; they are considering merely the necessities of the general situation, and the bill brokers must take their chances as to whether they make a profit or lose in their dealings.

Now, let us assume that the Bank of England rate was lower than the market rate at which these bills were going in the open market. Who would get the bills? Of course the entire volume of bills would go to the best bidder, and if that was the Bank of England, the Bank of England would get all the bills. But of course the resources of the Bank of England are relatively small compared to the average volume of bills--- I am speaking of the time before the war--- in the market, and it is perfectly obvious that the Bank of England rate must be above the market and that it mustimpose a penalty rate.

Now, what do we do in this country? The thing is diametrically different. The bills there are of one general, uniform class, with very slight variations, have like maturities, and there is a definite market rate on those bills that the Bank of England would accept for rediscount, although there, as Governor Strong has mentioned, the banks do not--- I think this is correct, Governor Strong?

Governor Strong: It is a fact, and I think Mr. Jay mentioned it.

Mr. Perrin: That the banks do not rediscount, nor do they ever sell the bills. My most intimate information regarding the operation there comes from a man who worked for a good while in London in one of the joint stock banks, and he said they tried to camouflage a good many of their operations, and when they sold their bills they sold them without endorsement, but that selling was a very common and usual thing; in other words, due to the operations of the bill market, they adjusted their cash position. Now, the member bank in this country goes to the Federal reserve bank with whatever paper it has which is eligible. Mr. Strong has said a good deal about the San Francisco district and the operations of similar districts, and that it is an excellent type of--- shall we say country district?

Governor Strong: It is a high rate district in some sections.

Mr. Perrin: You paid us a compliment when you said that the present rate was probably effective in San Francisco, Los Angeles, Seattle, Portland and Tacoma.

Governor Strong: I said I should imagine it was under present conditions.

Mr. Perrin: We have a four per cent rate. Let us take theother cities outside of San Francisco, and there is not a city on the Pacific Coast in which the lending rate to their best customers, outside of San Francisco, is at the present time less than six per cent. What does effective mean with a four per cent discount rate and a six per cent lending rate? The minimum rate in San Francisco at the present time is five per cent. What does "effective" mean if a five per cent lending rate is up against a four per cent discount rate. Obviously there is a profit, just as distinct from the penalty rate of the Bank of England as can be.

Now, what I was going to say--- and first of all I want to say that I am not trying to prove anything--- but I started to say this and did not finish, that my earlier convictions, until within the last two years, were that the only proper r gulation was by rate, and any change of view which I have has been obtained against my will, but simply because of the experience in the Federal Reserve bank, which has proven to me that the views which I had previously held were absolutely without warrant, that they were preconceptions, that they were like religious beliefs, they were not subject to proof.

Now, with regard to the distinction made by Governor Strong between credit extended to an individual bank and the total volume of credit, I probably did not understand just what he had in mind, but I cannot see in principle any difference between creditextended to the National City Bank and credit extended to the First National Bank of Pocatello, Idaho. Each is a credit transaction, though one is a larger transaction than the other, but they are, it appears to me, identical in principle. If they go,and all such transactions go to increase the volume of credit, I can see no differentiation.

Now, we are not concerned with the purposes, in this discussion, or the object of regulation, but merely with the value of different methods developed by the experience of Federal Reserve Banks. Please bear in mind that I am not trying to prove anything, but I am simply trying to find what is the experience of the Federal reserve banks when it comes to the question of what influences an increase in the extension as refusal to extend credit. Of course there are a multiplicity of influences. You might not like a man because he doesn't belong to your church; I am speaking of the individual banker; and you might not like a man because he is profane or drinks, or something else that you don't like; and you refuse that man credit. Another man, with no better statement, but in whom you have more confidence, you extend credit to.

You remember some years ago Mr. Vanderlip made an address before the Bankers' Association, I think it was in Virginia, in about 1906, which created a good deal of disturbance in the public mind because he predicted difficulties--- and some of you may remember this better than I do, as it just occurs to my mind at the moment--- that would have a very important influence upon credit expansion.

Now, let us assume that things went along swimingly and that the effect of that would shortly be dissipated. The penalty rate influence will not be dissipated. It is a continuing influence, and I wish to differentiate in my talk between those influences that are external and influences that are persistent. By "external" I mean sentimental, perhaps, those things that directly influence the question of profit or loss in rediscounting. It is not a question of what I shall say or what I shall omit, because I am going to burden you with a good deal of talk upon this.

There is no market rate within for the paper rediscounted by the federal reserve bank. I am now talking about Mr. Strong's district, about which I know so little, as he did about San Francisco, where I am living. Mr. Strong, however, was expressing beliefs, and my statement is based upon a few facts which I wish to present to you. First I have a letter from the Federal reserve bank which I obtained from one of your subordinates, Governor Strong. I did not ask you for this because I did not want to bother you with it, in which it is stated "In accordance with your wire, which we received from Mr. Sargent, your assistant, we take pleasure in advising you that at the close of business October second we had under discount unsecured paper amounting to $20,720,000; discounted, interested customers' paper amounting to $18,745,000, and $117,000 of others." That is not of itself significant, except that it shows that the banks in New York on that date were rediscounting with you paper which had no market, in the sense of being readily salable.

Governor Strong: That is true.

Mr. Perrin: Paper that is taken in rediscount, no matter how high its grade--- I mean paper that is taken by the Federal reserve banks in loans to its customers, no matter how high the grade, has no established market. I think that is not a matter of belief, but is a matter that any one of you who have been in the commercial banking business, will know to be true.

Governor Strong: How about the commercial market rate on commercial paper?

Mr. Perrin: I am not speaking of that at this moment. This is customers' paper. At this date you will observe there was in commercial paper in rediscounts--- I am glad, however, that you raised that inquiry---- I believe, Mr. Mitchell, that you have had large experience in commercial banking, and you know that the rate on commercial paper, when sold through brokers, rules ahead of the rates charged to customers, because in lending to customers, as you know, you take the responsibility of meeting that customer's requirements so far as you are able to, and you require of him a compensating balance, and in consideration of thathe buys the right to call upon you for loans at his convenience and not at the convenience of the bank and you undertake to lend it. Of course that isn't absolutely carried out in all cases, but that is the implied obligation in such a relation, and that justifies a higher rate on customers' paper over the country than that at which commercial paper ordinarily rules. Of course in times of extreme stringency that would not be true.

Mr. Mitchell: About one half of one per cent.

Mr. Perrin: Whatever that may be is immaterial. We do not need to determine that. I have before me a list of figures with regard to the rate, and that paper referred to on which ruled at less than customers' paper, the rate is still above the rediscount rate for the New York Bank. Therefore, I submit that it is not a practical suggestion that the Federal reserve rediscount rate be maintained above the market rate, because there is no market in the sense of salability. There is no way of ascertaining what the market rate is. You can ascertain what the market rate is, as Mr. Jay pointed out, upon bankers' acceptances, short time government securities and call loans, but those are not the things that are presented to the Federal reserve banks for rediscount.

You are limited by the topic to what in the experience of Federal reserve banks has been shown. Now, the only way in which a penalty rate could be imposed would be to charge a fraction above the lending rate. Of course technically there is one difficulty. If the rate on loans is 4-1/2 we would rediscount at 4-3/4, if it was 12 it would be 12-1/4, and of course that is notfeasible, because once you go up you are lending money on Wall Street at 4-1/4 and charging out in Idaho 12-1/4, and that is not to be considered.

Now, Governor Strong, in justification of my discussion of New York, when I said that the views that I advocated, I meant the experiences of the Federal reserve system prove. I am talking facts and I shall be glad to be corrected in facts. I do not want to put any beliefs in this at all. I said this will hardly be questioned in any western or southern Federal Reserve District, but even in New York, the money center, that would be true.

Governor Strong: What would be true, Mr. Perrin?

Mr. Perrin: That the discount rate will usually be less than the rate charged customers of the lending banks. I think you made that statement, Mr. Jay, and in that statement Mr. Jay and I concur.

Now, from the standpoint of an effective repression of credit expansion, I submit that a rate cannot be stated that is above the ruling rate to customers, whether those banks making the loans are in New York City, lending to the biggest borrowers, the best borrowers, whose credit is of the highest, and who might have their paper sold through brokers and command a rate at the present time of 4-1/4 or probably a higher rate than that, or whether it is the paper of banks in Idaho, Arizona or Texas or some other very high rate ditrict. Of course there is no contention that a four per cent rediscount rate has any restraint upon a bank lending at eight, ten or twelve per cent.

Governor Strong: May I interrupt to raise a point there? Do you mind being interrupted, Mr. Perrin?

Mr. Perrin: No.

Governor Strong: Don't you think that the rate of discount, in order to be effective in a central money market like New York or San Francisco, must necessarily be above the general level of customers' rates?

Mr. Perrin: If it is going to be effective, in the sense in which I am using it, if we make a bank hesitate to extend credit because it will incur a loss if it goes to the Federal Reserve bank, as the bill brokers hesitate when they go to the Bank of England to rediscount their bills--- if New York had a rate of four and a half or five per cent there would be a discussion as to what that signified---

Governor Strong: Aside from that--- do you mind these interruptions, Mr. Perrin?

Mr. Perrin: Not at all. I am not arguing to prove anything; I am simply wanting to find the facts, and we are all equally interestedin that.

Governor Strong: Is it not a fact that a bank which borrows at a reserve bank--- I mean a large bank, that watches its affairs very closely and knows just what its money costs it, that the bank does not regard the special rate which it is receiving on any individual type of loan that it makes to any particular customer, or on bond investments or anything else, but when it borrows from the reserve bank at four or four and a half per cent it has regard to what it is going to get for all its money,the average of its return on its money?

Mr. Perrin. You are speaking still more strongly for the view that the average on all investments will be very materially above the rate on the lowest grade of paper?

Governor Strong: I am inclined to think that the rate becomes effective in the broad sense, and I do not mean to apply it particularly to customers' rates, open market rates, or any other rates, when it so encroachesupon the margin of profit that the bank is receiving upon all of its loaned funds that it is not profitable for the bank to use money at four or four and a half per cent. As a matter of fact under our system, and that is why I think we are misled by a comparison with London--- I think the rate does become effective to restrain borrowing at some point below the customers' rate that Governor Seay referred to. I cannot define it exactly because there is such a variety of rates, but from our experience in New York I am inclined to think the fact is that the rate becomes effective at a considerable level below the average of what you describe as the customer's rate.

Mr. Perrin: Mr. Calkins, who has been good enough to share with me the view which I hold, brought me this very pungent line a moment ago.

" No rate that has ever prevailed has had any considerable effect upon the volume of credit."

When you take the rate, and this comes directly to the action that Mr. Mitchell hadme hung, drawn and quartered for, and I was responsible for the suggestion that the rate go to 3-1/2 per cent--- it was not that there was anything sacred about a 3-1/2 per cent rate. I wanted to put it up to the Federal Reserve Board with the hope that they would think it out and tell us what would be a proper credit policy. And it was as a result of the facts, which I think prove this, that led to that kind of a rate: That after we had come to a point where we passed the peak in 1920 and liquidation began, we might not have known the first day that liquidation had begun; but we did know in a relatively short time. I submit that if at that time we had adopted a rate, in the fall of 1920--- the Board wanted to come down in very gingerly fashion, and they were afraid of what? My contention is that if we hadin the fall of 1920, dropped our rate to 3-1/2 per cent nothing untoward would have happened. This is what the suggestion of a 3-1/2 per cent rate meant, that we were entering upon a period, such as ensued after we passed the peak in 1920, when no manipulation of rates could possibly have checked that liquidation at all. People had come to the conviction that it was more profitable for them to hold the goods than to exchange them for money. That whole period of liquidation was one in which each day, each week, each month, the owner of the goods--- and when I say goods I mean in the economic sense--- the owners of the goods saw that they were daily, weekly and monthly becoming of less value, measured in money, and therefore they wanted to exchange anything they had, which was exchangable in money, to avoid further loss.

Governor Strong: You are sure you do not mind interruption?

Mr. Perrin: Not at all. I am not trying to prove anything, but am trying to find out what experience shows.

Governor Strong: Don't you think that an increase in rate in 1919 would have had an effect upon the expansion that took place?

Mr. Perrin: I want to touch upon that as a subsequent topic, and I will come to it in a moment.

Let us take a concrete illustration or two. Would a dealer in wheat--- I think that is Mr. Rich's great commodity, have been willing to buy wheat at today's prices--- I am speaking of the middle of 1920--- for delivery three or six months thereafter, if he was given a six months dating, with no interest whatever? Would the drygoods merchant, having bought in the spring his fall supply for 1920, after he was satisfied the peak had been passed, have bought his 1921 spring stock if he had been given April or May datings, with no interest whatever? Without dialating upon that, I think you will admit that with a value of goods, measured in money, steadily ascending, you could not bring about speculative undertakings, and I am not now referring to speculation in the stock market on the bear side, which is entirely another matter. If that is true, then it makes no difference what rate you have under those conditions; I mean how low a rate.

Governor Norris: Granting that it would not cause inflation, might it not check unnecessary deflation?

Mr. Perrin: Anything we could do to lend a little of Judge Ramsey's sunshine to a depressed situation would have been helpful, and to the extent that we exerted a sentimental influence upon it, might have been beneficial.

Governor Norris: Even at the beginning of the period.

Mr. Perrin: You could not have stopped it.

Governor Norris: That is my belief too.

Mr. Perrin: If reduction in rates would have checked that liquidation, how does it happen that the process of liquidation never ceased, but was accelerated with successive drops in rates?

Governor Fancher: And it hasn't ceased yet.

Mr. Perrin: That is what I think the facts prove.

with a declining market it doesn't matter if you drop to 3-1/2 per cent. This is not a jury, of course, but I would be willing to have the jury go out and lock itself up and think that over and see whether that proposal was so absurd as it seemed to be.

Mr. Curtiss: But whyt a 3-1/2 per cent rate?

Mr. Perrin: There is nothing sacred about a 3-1/2, a 3 or a 4 per cent rate. To my mind our experience with the Fed ral Reserve System shows that reductions in rate have very little influence and are of very little consequence. We might just as well, so far as the effect went, retain the high rate, a six or five per cent rate, and liquidation would have gone on without any appreciable acceperation. You are going to have that persistent exchanging of goods for money until the people came to the conviction that goods were not going to be worth less tomorrow than they were today. I do not think there is anything in the experience of the Federal Reserve System; I do not know of any fact, I have not been able to unearth any facts, that the rate, from the standpoint of the Bank of England principle of the adoption of a penalty rate, has ever been effective, just as Mr. Calkins has said, that it hasnotbeen appreciably effective in limiting the volume of rediscounts.

Mr. Miller: When to dothe reserve banks want to advance this rate?

Mr. Perrin: That is not the topic, Mr. Miller.

Mr. Miller: But it is immediately involved in this discussion. We are talking here about the value of different methods of giving effect to credit policy and discount policy. I do not believe there would be any quarreling with the assertion that it is on a rising market, and particularly a market where prices are rising, at a rate that awakens concern and gives cause to the belief that the time has come to exercise control through making credit dearer---

Mr. Perrin: Yes.

Mr. Miller: The term "effective" has been used in the discussion, but without defining against whom it is that we want to make the rate effective. It occurs to me that you perhaps might make the mistake of thinking that it is the member banks against whom the rate is to be madeeffective, rather than the borrower from the member bank. The ultimate user of the credit is the member bank's customer.

Mr. Perrin: Yes sir.

Mr. Miller: Now, when you have an advancing market where credit is in demand, an advancing market, when it gets to a certain point, such as it did in this country in the early part of 1920, it is a market that has got to keep on advancing or otherwise it cracks, and often it will crack of its own weight; but when advancing has once gotten to a certain point, it has got to keep on. It means, then, that if the Federal reserve bank would advance its rates at a time when the member bank is charging 6-1/2 or 7 per cent to its customers, to 6 per cent, and charges the member bank six per cent, what happens with regard to the customer's rate?

Mr. Perrin: There is always a sympathetic influence.

Mr. Miller: It is an actual influence.

Mr. Perrin: It is not an influence of loss.

Mr. Miller: It is an influence of loss to the customer, and he is the man that we really want to get after. I think you are thinking of the market as a static market and of the rate as a static rate, where as a matter of fact the market is not static, but it is one that is increasing in its accelebation, and every time that you give it a punch through your rate you are forcing acceleration under difficulties, or rather you are increasing the difficulties of acceleration and the member bank at once tries to, and usually succeeds in passing on your increase to its customers. Ultimately the man you are after is the customer of the member bank. It is not necessary to penalize the bank, but it is necessary to put practically any pressure you choose between the member bank and the customer. At a time when the market is speeding up the customer offers far less resistance to an advance of rate by the Reserve Bank, and the result is that under circumstances of that kind the member bank has got a chance to lift its rates to its borrowing customers, and in that way it tends to become effective.

Mr. Perrin: I have one subject, regulation by discretion which I want to touch upon a little bit. Governor Strong asked me about 1919---

Governor Strong: Let me put my question a little differently. You have partly answered it already. You do believe, do you not; I think most of us do, that changes in discount rates are the dignificant things that are you have in your mind, as a definition of an effective rate, a penalty rate.

Mr. Perrin: A penalty rate. It is that to which I am referring.

Governor Strong: I haven't had it in my mind for a variety of reasons.

Mr. Perrin: I have a topic here "the significance of rate", which includes that.

Governor Strong: There is a difference between what may prove, under our system, to be an effective rate, and what you describe as a penalty rate.

Mr. Perrin: I was trying to differentiate the sentimental influences, which are not persuasive influences if conditions do not warrant, and the persistent influence of the penalty rate.

Governor Strong: I think if Dr. Miller had prepared a chart which would exhibit the curve of psychology, that we would have the whole picture.

Mr. Perrin: These collateral influences are largely psycological.

Dr. Miller: When you use the term "penalty" and "effective", that the rate is not effective unless it is a penalty rate--- I know you do not believe that, Mr. Strong, but I think Mr. Perrin believes it---

Mr. Perrin: Pardon me, Mr. Miller; I was trying to distinguish between two rates. I have another subject upon the significance of the rate and the way in which the rate can be made very influential.

Now, as to 1919, if the lesson taught by our experience is that credits could not be controlled through a penalty rate, then the question is what could we have done in 1919. I believe that our experience demonstrates that if we had recognized the ineffectiveness of the rate control in New York and in San Francisco, and had set up the regulation of the volume of credit extended by discretion, that we could have prevented to a considerable extent the vast expansion that came in 1919, or we could have flattened that peak a good deal.

Governor Strong: May I interject just one thought?

Mr. Perrin: Certainly.

Governor Strong: Could we have done it despite the fact that every time the Treasury made an issue of Treasury certificates it created a volume of credit which ultimately would flow from one bank to another, and we had to support it by loans to maintain reserve against deposits?

Mr. Perrin: I think perhaps the most effective answer to that would be that the 7 per cent rate in New York--- I venture to say it, you have not told me, that you did not start with the imposition of that 7 per cent rate, but you called in your big borrowers and reasoned with them; that is to say, you exercised your discretion and said, "This must not go on." If you will hold up your hand and tell me that you didn't do that---

Governor Strong: I will hold up my hand and tell you this, that it wasn't effective until we put up our rate.

Mr. Perrin: But the exercise of discretion was what made the rate effective. It wasn't the loss, because in 1920 money would have loaned in New York at more than seven per cent, because even in January of 1921 your average rate on commercial paper was 7.94.

Governor Strong: Yes, but don't forget that New York lost a billion dollars in deposits to the rest of the country and we had to loan money to make that good, at any rate.

Mr. Perrin: That is not the topic, Governor.

Mr. Jay: But that is a fact.

Mr. Perrin: Yes, and there are a lot of other facts; but that was not the topic under discussion.

Mr. Chairman, I had other topics to discuss, and may I be pardoned for continuing this discussion?

Vice Governor Platt: I think we shall have to have an evening session to finish up now.

(After informal discussion, at 6 o'clock p. m., upon motion duly made, seconded and carried, the Conference adjourned until 8 o'clock p. m. of the same day.)
