STABILIZATION OF COMMODITY PRICES

HEARINGS

BEFORE THE

SUBCOMMITTEE OF THE COMMITTEE ON BANKING AND CURRENCY HOUSE OF REPRESENTATIVES

SEVENTY-SECOND CONGRESS

FIRST SESSION

ON

H. R. 10517

FOR INCREASING AND STABILIZING THE PRICE LEVEL OF COMMODITIES, AND FOR OTHER PURPOSES

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HOUSE OF REPRESENTATIVES

SEVENTY-SECOND CONGRESS, FIRST SESSION

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STABILIZATION OF COMMODITY PRICES

WEDNESDAY, APRIL 13, 1932

House of Representatives,
Subcommittee on Banking and Currency,
Washington, D. C.

The subcommittee met, pursuant to call, at 10.30 o'clock a. m., in the committee room, Capitol Building, Hon. T. Allan Goldsborough, chairman, presiding.

Present: Messrs. Goldsborough (chairman), Busby, Prall, Strong, and Beedy.

Mr. Goldsborough. The subcommittee will come to order. We have with us this morning Governor Harrison, of the Federal Reserve Bank of New York, and I am going to ask the governor whether he would like to proceed in the discussion of this measure in his own way and then have the subcommittee ask him any questions they would like to ask after he shall have finished.

STATEMENT OF GOV. GEORGE L. HARRISON, OF THE FEDERAL RESERVE BANK, NEW YORK CITY

Governor Harrison. Mr. Chairman, I am very glad to come here to discuss this bill with you because I, with you, consider it one of the most important subjects the country now has before it; that is, the problem of dealing in some fashion with the commodity price level. I am not here, however, to speak for the Federal Reserve Bank or for the Federal reserve system, but to give you whatever I can individually of the best of my own personal opinion. I have no prepared statement. The subject is so large that if I endeavored to make a prepared statement, it would take many volumes I am afraid. So I should be glad to discuss whatever features of the bill, or whatever aspects of our operations the committee might be interested in.

Mr. Goldsborough. You have a copy of the bill, have you not?

Governor Harrison. Yes, sir; I have the bill. You were good enough to send it to me.

Mr. Goldsborough. Do you care to discuss it without questions?

Governor Harrison. I would not object to being interrupted.

Mr. Goldsborough. Will you proceed in your own way?

Governor Harrison. Mr. Chairman, I think we can best understand the problems we have before us if we consider certain definite periods through which we have been and which demonstrate the relationship between the volume of credit and prices and business

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activity. There is no doubt that the quantitative theory of money in its effect upon the price level is a theory which, without interrupting factors, will ultimately work. We have charts as you no doubt have, which show that over a period of time the ratio of the volume of credit to the normal expansion of business as a rule fairly well coincides with the general price level. But the volume of credit line is one which we can not always rely upon; and it is certainly true that it is a line you can not rely upon so far as the Federal reserve operations alone are concerned, because whether fortunately or unfortunately, our operations do not necessarily have any effect upon the total volume of credit except indirectly, and except as it is an encouragement or incentive to bankers to expand or contract their credit.

We know that as a rule when we buy securities and reduce the discount rate, the influence is towards ease and expansion of credit. But we know also when we sell securities and raise discount rates, the whole influence is a depressing or restraining one, and bank credit as a rule should decline.

We know also as the economists tell us—and I am not one of them—that the volume of bank credit and the activity of its use, which is important, have some effect upon the price level. The difficulty is that you can not be dogmatic in the application of this principle to any given set of circumstances. There have been certain periods in the past when the purchase of Government securities and the reduction of the discount rates have been very influential in expanding bank credit, and through the expansion of bank credit, in raising the price level and encouraging business activity.

There have been other periods, however, where we have bought even more substantially of governments, and where we have been even more rapid in our changing of discount rates where that result has not taken place, and the reason of it is clear: That there are so many factors that come into play that the reserve bank's policy may itself be very quickly defeated by the other factors.

Assume that there are no other extraneous factors. Take the position as it is to-day. We have had a more rapid deflation of bank credit than the country has ever experienced in any comparable period. Concident with that, we have had a very drastic decline of commodity prices—more drastic, indeed, than at any time except after the war in 1920–1922. The general commodity price level is about one-third less than it was in 1929. We have had a decline in productive activity which is estimated very conservatively by some of the best economists and statisticians, to be approximately 50 per cent from the high point. We have had a decline in security values and we have had a decline in incomes and dividends and wages.

Now, facing a situation like that, what has the system done? We have increased the volume of our Government securities from a low point of $136,000,000 in 1929 to well over $900,000,000.

We have reduced our discount rate from 6 per cent to 1½ per cent. During the better part of that period we had huge imports of good. But even so, bank credit did not expand and the price level did not go up.

Now, there are two principal factors perhaps that defeated the ordinary operation of that economic principle. One—and the

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broader one which included really the other—is lack of confidence. Lack of confidence of the bankers themselves; lack of confidence of depositors in banks. That resulted in two things. A more conservative policy on the part of the individual banker about making loans or investments, and the "panicky" and really unjustified withdrawal of deposits all over the country in the form of currency. Those withdrawals of deposits which have been termed "hoarding money" have aggregated perhaps $1,300,000,000; although, there are certain causes involved which would make me reduce that amount somewhat, as I believe a lot of that money has been withdrawn, not because of fear, but for other reasons.

Now, the purchases of Government securities were more than off-set as I say, by currency withdrawals. The question might well be raised, and no doubt will be raised, as to why we did not buy even more Government securities. Well, there were various reasons. In the first place, is it a futile thing for the reserve banks to expend their resources for the purchase of Government securities unless the money we put out is going to operate as a basis for expansion of bank credit. The mere purchase of Government securities by the Federal reserve banks, stopping there, has no effect directly upon the volume of bank credit in the country; and therefore, has no direct effect upon the price level which you are all aiming at.

In the first place, what usually happens when we buy Government securities? We go out and purchase $10,000,000 worth of Governments from a banker or individual, perhaps from a dealer in securities, and we give a check for $10,000,000 on the Federal reserve bank. That check is taken by the seller of the securities and deposited in a bank. That bank then finds that its deposits have gone up $10,000,000, just as though they had imported gold in the amount of $10,000,000. The first thing they do is to turn it into the Federal reserve bank. That increases their reserve deposit by that amount. If the bank is indebted to the Federal reserve bank it will no doubt pay off its debt with the excess reserve at once. When that happens and at that stage there has been no increase in Federal reserve credit and no increase in bank credit.

Mr. Goldsborough. Prior to the passage of the Glass-Steagall bill?

Governor Harrison. No.

Mr. Strong. Of course, if they get nothing but credit on their debt to the Federal reserve bank; but suppose after paying this debt they get additional credit with the Federal reserve bank?

Governor Harrison. I will get to that. I am trying to state what happened in the first instance. In case the bank which gets the $10,000,000 check is in debt, the chances are it will pay off that debt, because no bank wants to be in debt to the Federal reserve bank, if it can readily avoid it. While at that point it does not expand Federal reserve credit, or expand the volume of bank loans or investments, it does put the bank that much more out of debt, and makes him (the banker) a little more easy minded. To that extent it is a favorable factor; but it is largely psychological, because credits have not been expanded.

Now, take the case of a bank that is not in debt. We go through the same procedure exactly, and the bank then finds that it has

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$10,000,000 excess reserve. The question is: What are they going to do with it? They can either make that the basis of new loans or investments at a ratio of 10 to 1, taking the banks as a whole, or, the individual banker will say: I have no use for that money, I will sell it to some other bank which is in debt and which needs to pay off its obligations. This is a very common practice, and a very wise and helpful one, though I understand there has been some feeling in Congress that it ought to be stopped.

Now, if there is no market for Federal reserve funds, no bank in the community, we will say, is in debt, and we give the bank $10,000,000 of excess reserves, then you have a situation where the bank has $10,000,000 more on deposit with the Federal reserve bank than is required by law. If there is no other bank that wants that $10,000,000 to pay off a debt; if there is no other place they can use it, they keep it as excess reserve, and usually in the past, when conditions were normal, it would be a pressure upon that bank to make loans or investments. But that pressure does not work and will not work in a period where you have bank failures, where you have panicky depositors, where you have a threat of huge foreign withdrawals, and where you have other disconcerting factors such as you have now in various sorts of legislative proposals which, however wise, the bankers may not feel to be wise. You then have, in spite of the excess reserve, a resistance to its use which the reserve system can not overcome.

Mr. Strong. Suppose this process had been started before the deflation reached the low point, then what would they have done before this fear had seized upon these bankers and they had $10,000,000 in excess reserves? Would they not have loaned it?

Governor Harrison. Mr. Congressman, during 1930 and 1931, various periods during those two years, the banks in New York City had an excess reserve ranging from twenty-five to one hundred million dollars week after week, and they would not use it and did not use it because they did not feel the situation was such as to justify them in doing so. Others might differ with them, but even so that was the fact.

Mr. Strong. Then I arrive at this conclusion: If a surplus and abundance of money is in the hands of the bankers to loan, that these distressing times can be brought about because they will not lend it, or are afraid to lend it; and if that be true, our banking structure in this country is absolutely on a wrong basis.

Governor Harrison. Well, I myself am a firm believer that if you have two factors, the excess of reserves plus confidence, the principle will probably work. That is, you will have the expansion of bank loans and investments, and you will have the repercussion in price level, provided no other factors interrupt.

Mr. Strong. If we build a banking system on the basis of confidence of bankers regardless of money conditions or business conditions, and whenever the banker gets scared this country is going into a panic, then we had better build on some other system.

Governor Harrison. I do not think that is an entirely fair statement.

Mr. Strong. If the pyschological condition or the mind of the banker is going to produce hard times in spite of the fact that there is plenty of money—well, there is something wrong somewhere.

Governor Harrison. That presupposes something I would not agree with, that the volume of credit is the only answer to the price

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level. I do not think that it is a complete statement, because you have the whole question of overproduction and the rapid falling off in the market for goods all over the world during the last three years, due fundamentally, I think, to the loss of capital throughout Europe and the rest of the world after the war, which was impossible to restore without borrowing.

Mr. STRONG. But you say they are in condition where they can not get money. You say loss of capital brought about this condition. Now, you come to the condition where the banker can pay his debts and feel easy. But because his mind is in such a condition from fear, we can not have a restoration of prosperity.

Governor HARRISON. I want to come back to that because I do not think it is a fair way to leave it in the record.

Mr. STRONG. I will make a list of these things as we go along and ask you about them when we get through. I understood you to say you did not mind the interruption.

Governor HARRISON. No; I do not, except an interruption to an unfinished statement.

Mr. GOLDSBOROUGH. Let us wait until his statement is finished. We do not know until then what Governor's Harrison's completed statement is to be.

Mr. BUSBY. It is my conviction, regardless of how much bank credit the banks may possess, before they make new loans or new investments they must have some reason to believe that there is dependability in commodity prices so that when they go to make a collection on the loan when it matures they will not find the commodity is shrunken in value and that it will not measure up to what they expected when they took the loan. That, to my opinion, causes the lack of confidence in the banks. It is looking to the thing they can reasonably expect in the trend of price levels, and that is shrinkage in price level which they may find insufficient to secure the loans.

Governor HARRISON. I am very much obliged to you for making that statement, because I think it is a fair explanation of what I had hoped to expand a little bit myself.

Mr. BUSBY. I did not mean to interrupt you in the least.

Governor HARRISON. Let us go back to the point where we had a bank with excess reserves which does not feel free for one reason or another to use them. There are a great many reasons why they may be wise in not using them as bases for expansion as I just pointed out. If a bank is in a community where price levels are going down very rapidly, where borrowers are in difficult circumstances and in a way perhaps overborrowed at the time, you can not say from the viewpoint of the individual banker that he is unwise to refuse to make loans on commodities which he has a right to feel are going down further. I am talking about the individual banker.

Mr. STRONG. Do you want to add in there whether he had reason to expect or desired that result?

Governor HARRISON. Well, you are going pretty far there. It is very difficult to expect a bank with excess reserves to go out wholesale and buy large amounts of bonds in a period when bond prices are shrinking rapidly, when the fixed charges of corporation, the obligors, are proportionately too heavy on income at present price levels. If you were running the bank and if you were responsible to your depositors and shareholders, you would have great hesitancy if any

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one gave you a million dollars excess reserves, to lend it, or invest it under such conditions.

Mr. Strong. But I would have thought about that in 1928 when they were lending money on shoe strings, backing up the stock market all the time. Somebody ought to have thought about it then.

Governor Harrison. That is another aspect of the situation which I think is worth a little time to discuss. While it is true that during that time of expansion, loans in the banks went up, it is also true that the increase in brokers' loans was not due so much to the banks. They went up principally, not because banks were expanding credits, but rather because corporations and others than banks were making loans to them, wholly beyond any control of the Federal reserve or any banking system. I think that had it been impossible for others than the banks to make loans to brokers during that period, and had the reserve banks been in position to raise rates as rapidly as some of us would have liked, you would have had a very different picture. You can not blame the commercial banks if as a result of the very efforts to restrain speculation rates on brokers' loans go up to a point where you and John Brown and Tom Smith, and A, B, C, or D corporations think that is a pretty profitable place for them to lend their money. There was no real control over such loans and has been no control till the last few months.

Mr. Strong. But as I think of it, if the mind of the banker at the present time is such that he will say, "Stocks are low now, I will not lend money on stocks that may go lower;" but where were the same minds of the same bankers when prices were three or four or five times as high as now? Why did they not then say," They are not earning money to pay dividends no these inflated values; I am going to quit lending money on them"?

Governor Harrison. You will find that banks throughout the country, as those stocks went up, required higher and higher margins, even to 40 and 50 per cent.

Mr. Strong. Suppose the Federal reserve system instead of selling their bonds in a rather hesitant way, has gone into the market and sold enough hundred billions and put up the discount rate not one-half a point every two or three weeks, by 1, 2, 3, and 4 points in a few weeks, would not that have stopped the inflation?

Governor Harrison. What did we do in that period?

Mr. Strong. You want up so slowly, that the speculators felt that "regardless of such action of the Federal reserve system, we think we can make enough money out of the advance in stocks to pay this additional rate."

Governor Harrison. We went up slowly in the light of conditions as we now see them. I think we would do differently now. We also sold over $400,000,000 of Government securities, and we lost $500,000,000 in gold during that time, which was basis for 10 times that amount of credit.

Mr. Strong. And that had no effect on the market?

Governor Harrison. I can not say that.

Mr. Strong. Suppose you had sold a billion dollars' worth of securities?

Governor Harrison. You are talking about selling now?

Mr. Strong. And had tried to stop this inflation?

Governor Harrison. Had we in 1927 or 1928 told you in advance that we were going to sell $400,000,000 of Government securities and

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were going to export $500,000,000 of gold which would take the basis for nine billions of credit out of this country, you would have vigorously condemned such action.

Mr. STRONG. Now I feel like legislating you out of existence because you did not do it.

Governor HARRISON. But we sold all but $147,000,000 of the Government's that we had and we liquidated huge amounts of bankers' acceptances in addition to the $500,000,000 of gold we lost. We liquidated in addition over $400,000,000 of bankers' bills. It was a tremendous pressure and I think that that pressure, plus more decisive and courageous and prompt action on the discount rate, would have done much to check the speculation in securities through proper and orthodox means of central bank control. But there were two difficulties: One, that some of us were not authorized to go as high in our rates as we wanted. Second, that the pressure of rates even as high as they were, did not operate on the huge volume of credit which was outside the control of the banking system, which amounted to something like six and one-half billion dollars. That six and a half billion dollars was the factor that increased brokers loans all through the peak period. I think the expansion was due more to these other loans than to the direct loans of New York City member banks, which averaged all during that period only about one billion dollars, which was a very small part of the brokers' loans.

Mr. STRONG. If we have a gambling system in New York that through bringing about higher brokers' loans can bring such a condition on the country, we had better get rid of it.

Governor HARRISON. We never had that condition before. We did not have the machinery to stop it, although the New York banks did raise the price they charged for placing loans for account of "others." But since that time, the New York Clearing House has ruled that they will not place any loans for any lender other than a bank, so that there is not any likelihood of a repetition of that experience.

Furthermore, I understand that one provision in the so-called Glass bill in the Senate prohibits these so-called loans for "others."

Mr. STRONG. You have to buy fire apparatus before the fire starts. A man ought to know, but how can we know when the fire is going to break out again? They may again change the rules.

Governor HARRISON. There is no doubt that the New York banks will not place these loans for "others" now. They can not do it under the rules of the Clearing House. In addition to that the stock exchange has recognized the danger of these loans, and have evidenced their desire to make them impossible.

Mr. STRONG. Yes, but where were these brilliant minds when this fire was raging, that they did not pass that rule then?

Governor HARRISON. All our minds are a little more brilliant now than they were then.

Mr. STRONG. I would hate to again let a lot of minds bring about the ruin of the country.

Governor HARRISON. One of those factors was beyond the control of the banking system and what seemed at that time to be reasonable steps to check it. Now, I think they have taken effective steps to stop it.

Mr. GOLDSBOROUGH. Speaking as one member of this committee and all that you are here for and all that we are here for is to try to be

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helpful if we can—my view is that no human agency that has almost unlimited power in the matter of credit, and which has enormous pressure inevitably brought upon it from various sources, can be relied upon to exercise at all times the judgment which is going to be to the best interest of the people as a whole; and that there should be some measure of control over the judgment of those who are to exercise this enormous power. I think it is helpful to them. For instance, we will leave out this question for the minute, of raising the price level, and speak about stabilizing the price level.

Governor HARRISON. Yes.

Mr. GOLDSBOROUGH. I feel that in anything like normal times, specific directions to the Federal reserve system to use its power to maintain a given price level will tend to decrease very greatly these periods, or stop these periods of expansion and these periods of deflation which so destroy confidence and produce the very mental condition that you are speaking about. And I feel very strongly that there ought to be legislation to stabilize the price level.

Now then, there is in this measure which we are considering a direction to raise the price level, and for the Federal reserve system to use all its power for that purpose. I do not think in the condition the country is now in we can rely upon the action of the Federal reserve system without the announcement of a policy. A banker may look at his bulletin on Saturday or on Monday morning and see that the Federal reserve system has during the previous week purchased $25,000,000 worth of Government securities. But that does not restore his confidence under present conditions because he does not know what the board is going to do next week. And the mental condition of the individual banker is that he is trying to get in all he can and lend as little as possible. If this legislation just as it is, with its mechanics corrected, were passed, the Federal Reserve Board could call in the newspaper reporters and say that Congress has given us legislative directions to raise the price level to a certain point, and to use all our powers to that purpose, and we want you to announce to banks and public men at large that we propose to go into the market with the enourmous reserves we now have available under the Glass-Steagall Act and buy $25,000,000 of Governments every day until the price approaches the level of that of 1926; and then we are going to feed those securities back into the market. My judgment is that if the bankers and business men knew that that was going to be the policy of the Federal reserve system, the anounced policy, it would restore confidence immediately and I think that the small merchant in my town and in everybody else's town, knowing that that was the policy of the system, would immediately buy stock from the wholesaler and the wheels of business would turn, and I do not think that anything else except some policy of that kind is going to stop this decline. Now, I wish you would just comment on that.

Governor HARRISON. I am glad that you have particularized the discussion in that way, because I stated that I would elaborate on some particular period as a basis of fair discussion, but I find that it is difficult to go over past periods without provoking misunderstanding. The point I wish to bring out to the committee is that what we wanted to do was often interrupted by factors beyond our control, and therefore no mandate to the system to raise the price level would by itself have been effectual.

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Now, as to the particular problem, we have bought since the crash in the stock market approximately $800,000,000 to $850,000,000 of additional Government securities. There were periods when that procedure was checked or slowed up by various factors which if I attempt to elaborate now would provoke another discussion. There came a time, however, when after all the huge withdrawals of currency for hoarding purposes, and after the withdrawals of gold for purposes of paying foreign deposits, we had in the system a relatively small proportion of free gold as distinguished from our real excess gold reserve. That was due to a technicality of the act. I think it was a technicality of the act—others think that it is a fundamentally sound provision in the act. At any rate, because of that provision, whether a technical one or a wise fundamental one, there came a time after these other events when you would not have wanted us to buy too large an amount of Government securities lest we risk not our excess gold reserve, but our so-called free gold which is much less than the excess gold reserve. Even so, with that limitation and with the risk that the system's gold possibly would have been pinched between withdrawals of domestic deposits and withdrawals of gold from without, we have made fairly substantial purchases—between $800,000,000 and $850,000,000 of governments—since the fall of 1929. In addition to that, while I would have liked to proceed further and faster last year, I was adverse to doing so till we had the protection of the Glass-Steagall bill.

Now, as soon as we got that protection, the system agreed upon the purchase of Government securities at the rate of $25,000,000 a week, which has proceeded now for seven weeks. I may say we should have gone faster; others may say we should not have bought them at all. There is no field of human interest that I know of which is so subject to emotional debate as this one of economics and finance and while I myself am perhaps more sympathetic with speedier action, I understand the views of others who think we might have gone a little slower; $25,000,000 a week is not a small amount, especially when we have to realize the technique of the operation.

Mr. GOLDSBOROUGH. I merely used $25,000,000 a day as a matter of illustration.

Governor HARRISON. Yes, I understand; but I am trying to give you the position we are in. We bought that $25,000,000 a week for seven weeks. Perhaps we could have gone a little faster without clogging the banks by giving them too much excess reserve. If you give them too much excess reserve when they lack confidence it is just like flooding the carbureter of an automobile. It is a very difficult balance of judgment to say how fast you should go or how slowly. It is hard to say in advance which ones are right. We can only judge that in the future. But one of the most important elements of success is confidence. With a let up in the hoarding of currency and gold exports, together with the great work of the Reconstruction Finance Corporation in helping to stop bank failures, and banker's mind is now a lot easier about his own position.

Mr. GOLDSBOROUGH. Do you think so? Have you gone out and talked with bankers?

Governor HARRISON. I think they are a great deal easier. Their attitude toward making loans and investments is noticeably more liberal. Because of our purchases of securities, and as a result of the return flow of currency you will find that the discounts in the system

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have gone down from $850,000,000 at the end of June to about $625,000,000 now. That does not sound like much, but in our experience in the Federal reserve system such a reduction in discounts or borrowings from the reserve banks operates as a real relaxation in the attitude of lending banks. We hope to get discounts down further. Now, the question is, how much further we should go. Let us suppose we should go *x*-hundred millions further. The specific question you asked me was whether we should announce that we had determined to go *x*-hundred millions——

Mr. GOLDSBOROUGH (interrupting). No; not whether you had determined to go so many millions further, but that you had announced a policy after the passage of this bill that you were going to raise the price level to a certain point and you were going to continue to buy till that was done. That is a very different proposition.

Governor HARRISON. Yes; I think so. I think it is a very much more difficult proposition because I do not think there is any one power or authority in the world that can say they are going to raise the price level. There are so many factors to be taken into consideration; unless you have control of all of them (even human psychology), you can not be assured you can raise it.

Mr. STRONG. You say that because of your action things are easing up. About a week ago a banker whom I do not know personally but I think he has got a good deal of information, came down from New York and said that things in New York were worse than they have been.

Governor HARRISON. What was he talking about?

Mr. STRONG. The minds of the bankers in New York, and the stock market has continued to sag since. That does not show that your action is helping conditions up there much.

Governor HARRISON. Put it this way Congressman: It is hard to appraise different individuals' minds; but during the last quarter of 1931 bank credit was declining in the country about 24 per cent per annum.

Mr. GOLDSBOROUGH. Bank deposits were decreasing about $25,000,000 a week, were they not?

Governor HARRISON. I think you will find they were going down even faster than that. The total volume of bank deposits in the last quarter of 1931 was declining at the rate of approximately 24 per cent per annum. In the first quarter of 1932 that decline was pretty nearly at the same rate, possibly slightly less for the country as a whole. In the last three or four weeks the decline in bank deposits has levelled out so that it is almost flat now, and while it is difficult to particularize, when I said conditions were easing so far as loans and investment policies are concerned, I meant they were no longer getting worse and were just about holding their own. They can not go up until they stop the decline. With that checking in the decline of the credits——

Mr. GOLDSBOROUGH. You think that is due to increased confidence, do you not?

Governor HARRISON. I think it is.

Mr. GOLDSBOROUGH. My proposition is to help that.

Governor HARRISON. I have not one objective in mind that is different from that in the minds of every one of you. I think there never was a time when conditions deserved a more frank discussion of ways and means. The difficulty is that when you get in a hole

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like this, so many minds feel so differently it is hard to get concerted action; and who may be wrong and who may be right is a matter of real debate. But having in mind the objective you have in mind, I think the Federal reserve has directed its policy just about as it would have done even if it had had a mandate from you.

Mr. STRONG. Nobody knows when you are going to change that policy?

Governor HARRISON. We are going pretty fast in the open-market purchase of Government securities. I think, on the other hand, there is a great part of the public who think we have gone too fast.

Mr. STRONG. Who are they?

Governor HARRISON. When I say "public" I mean depositors—foreign depositors were alarmed when we spoke of buying securities, because it looked to them as if we were going to start a currency inflation, which was not true.

Mr. GOLDSBOROUGH. Take this particular bill: If you will allow me to interrupt you, it not only directs the Federal reserve system to raise the price to the level existing before the present deflation, but it directs the Federal reserve system to stabilize after reaching that point and then in section 2 it gives the system the additional power, in case they do not have, for instance, sufficient Government securities to feed out into the market themselves to issue debentures to further stabilize. Nobody can call that an inflationary measure—nobody who understands it, it seems to me. It is certainly not the intention.

Governor HARRISON. I think all this discussion of the word "inflation" is very unfortunate, because it has so many different connotations. For instance, in Europe—and that is what caused a good deal of our trouble when we had the reaction against the dollar last fall, and when we had the reaction against the dollar in January—it was because of certain articles appearing in French and other European press, charging us with embarking upon a period of "inflation." I wish somebody had told us how we could have done it even if we had wanted it at that time. The talk about inflation at that time when business was suffering worse than it had ever suffered in any comparable period and when commodity prices had gone down and down, and when wages had been cut markedly, and security values were off nearly 75 per cent—the talk about inflation shows that those who use the word do not understand the conditions in this country.

Mr. STRONG. When they should use it? Are you going to take their advice, and advice of people who do not know one thing about it?

Governor HARRISON. No; we have not taken their advice.

Mr. STRONG. I can not understand why when price levels are the lowest in history, I could excite anybody to talk about inflation?

Governor HARRISON. I would like to discuss that. A minute ago when I used the word—when I said that the use of the word "inflation" is unfortunate I meant it.

Mr. GOLDSBOROUGH. Right at that point, there is one thing, it has been suggested that it would be very helpful in the matter of stabilization (after we get back on a normal basis) if the reserves of the member banks were raised and lowered automatically with the raising and lowering of the price level. Have you heard any discussion of that kind?

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Governor HARRISON. No, sir; I have not. That is a thing I would like to think over a little before I made any comment on it. I mean that I do not think at this time any of us should discard anything right "off the bat" if there is a possible means of working out a solution. Off-hand, I do not react very favorably, but I would like to think it over before commenting on it.

Mr. GOLDSBOROUGH. In the discussion of this committee and the Congress there has been one thing uniformly held, and that is that the raising of the general commodity price level is essential. I do not refer to speculation in secutities at all, because I think if you are going to regulate Wall Street we have to do it by different legislation. I do not think that ought to be injected into the fiscal system that is created for the purpose of protecting the business interest of all the people.

When we were discussing the Reconstruction Finance Corporation bill before this committee we endeavored to find out whether the Federal reserve system thought that it would result in a raise of the price level. It was suggested that the measure would restore confidence and in that way it would put business to work and that that would have a healthful effect on the price level. The word "psychology" was used very many times, I think tremendously overworked both in that discussion and the Glass-Steagall discussion. Now, we can not tell what would happen if those measures had not passed. In my opinion we would have been in a worse condition than we are in now; but as far as the country is concerned they can not see that either one of those measures has had any effect at all because price levels have not been raised and business conditions have not improved.

So I believe that it is the very definite feeling of this committee—a very definite feeling of the Members of the House—that we should pass some legislation which would raise the price level. If you want to call it "inflation" it does not make any difference to me except for the effect it might have on somebody else. Now, if this bill we have before us would result in raising the price level I believe we are going to report it out. If it will not, then I do not believe we will report it out. If it will not, we would like to know from you, an acknowledged expert, and other experts, what can be done to raise the price level. We think—that is, I think and I believe—that this committee is close enough together to each one of us to know the attitude of every other pretty well; and I think and have not the slightest doubt in the world about it, that if the Federal Reserve Board should announce the policy that they were going into the market and buy a certain number of securities each day or week as the case might be untill a certain price level was reached, and that after that they were going to stabilize the level, it would restore the confidence of the country almost like magic, and that within ninety days the country would understand that the difficulty had been passed, and that we were on the way to rebuilding the country economically.

Now, that is my opinion and I believe that is the opinion of the committee.

Mr. STRONG. That is mine.

Mr. BUSBY. I feel the same way about the matter as far as I can see.

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Mr. STRONG. But there has got to be a determined policy and not just vacillating, changing course, influenced by those who deal in money as a business.

Governor HARRISON. I hesitate to differ with you, but——

Mr. GOLDSBOROUGH. We want you to differ with us if you actually think differently.

Governor HARRISON. Frankly, there are two ways of expressing the policy. First, that the Federal reserve banks are going into the market to buy government securities in such amounts and at such speed as will restore the price level to a certain point. That I understand, was one suggestion you made. I think to make a statement of that character to the public and to the world would be one of the most unfortunate things the system could do, because primarily they would not be able to deliver all by themselves.

Mr. GOLDSBOROUGH. Would they have to deliver by themselves if they were able by proclaiming that policy to make the public understand they were going to carry it out? Would not that so restore the confidence of the bankers and business men of the country that they would have all the help they need?

Governor HARRISON. Perhaps. And on the other hand if we made that statement of policy and you and all of your friends bought wheat or cotton or something else on the expectation that that is what would happen——

Mr. GOLDSBOROUGH. Then it would happen?

Governor HARRISON. It might not. We might have any number of different events that would defeat the operation so far as the Federal Reserve Bank is concerned.

Mr. GOLDSBOROUGH. What would they be?

Governor HARRISON. First, you might discourage the foreign investors in securities to a point where they might rightly or wrongly thing we were going off the gold standard and invite inflation that would ruin us. The effect of that might be such a rapid withdrawal of deposits that are already in banks in this country for foreign account or in the sale of such a volume of securities owned by foreigners and converted into dollars and taken out in the form of gold (I am just mentioning possibilities now) that we might be forced to change our policy within two or three weeks as a result of the very announcement we made.

The second thing that might happen is this: We might, from a factor that is quite beyond our control, have a revival of fear of depositors in banks resulting in withdrawals of currency at such a rate—I do not mean it would necessarily result from the announcement of the policy, but from something else that might happen that would start a withdrawal of deposits—that we might be forced to change our policy.

Another thing that might happen is: If we announce we are going to get to the 1926 price level, and if we put out credit as fast as we could in the form that you have suggested, and if banks for one reason or another did not move as fast in the utilization of the credit as we would like them to do; and if those who anticipate the increase in the price level to the price you want start buying securities and commodities, and then there is a let-up in the increase of prices, the first ones who thought of it would be the first ones to sell. They would say, "Now is the time for us to get out; the price has gone up half way and it can not go the rest." Then we might be forced to reverse our

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policy which would then put them in a position to say, that we had violated the law or our announced policy. Ther mere increase in the volume of Federal reserve credit can not all by itself and it never has all by itself been successful in raising the price level of commodities or general price levels.

Mr. GOLDSBOROUGH. The question is whether or not a policy of that kind would restore confidence. That is the question.

Mr. STRONG. If everybody thought the announced policy of restoring the price level could not be brought about, I would agree with you, but if the Federal Reserve Board agreed to buy Government securities and redeem the rediscount rate. It seems to me that would bring confidence, and that everybody who wants to buy anything would say "Now is the time to buy it."

Governor HARRISON. There are a great many people who would construe that as inflation, who are scared to death of inflation and who act accordingly.

Mr. STRONG. Who are those people? That is what I want to know. Are they international bankers?

Governor HARRISON. Not merely international bankers. You have a great many of them in this country and some of them are in the Congress.

Mr. GOLDSBOROUGH. When we were called in conference to pass the Reconstruction Finance Corporation bill and especially the Glass-Steagall bill, the statement was made that certain nations were planning a raid upon our gold and the passage of the legislation would prevent it. We passed that legislation upon that theory that it would prevent it. Now, it seems that that legislation can not prevent it.

Mr. BUSBY. Being the banker that you are, you are of the opinion that it is largely within the province of the banking set up—I mean all types of banks—to control and regulate the credit of the nation for business?

Governor HARRISON. I think it is within the province of the whole banking system, as you say.

Mr. BUSBY. All types of banks?

Governor HARRISON. To influence. They themselves can not really control it, Mr. Congressman, for the reason there are a number of banks in this position, who would like to make loans but can not get borrowers to come to them. I know a number of banks that have gone out and solicited loans, but business men would say, "I am sorry; under these conditions I can not afford to borrow."

Mr. BUSBY. What I was coming to was not the question of policy of individual banks, but as to whom the country should look for the responsibility of supplying credit for business; and if that credit is not supplied, at whose door the complaint should be laid when we meet a financial catastrophe such as we are now confronted with?

Governor HARRISON. Well, of course, we start out with the hypothesis that the banks plus the Federal reserve system——

Mr. BUSBY. I am not talking about the Federal reserve system. Is it not the fact that the banking set-ups of all types in this country have arrogated to themselves, and worthily so in many instances, the business of dictating the credit policy that shall be in operation in business throughout the country?

Governor HARRISON. Well, I think that negatively that is inevitably true because if a banker is running his institution properly——

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Mr. Busby (interposing). I am talking about all of them. You will get to the individual, but I am speaking of the general spirit of banks back of them operating as credit vendors.

Governor Harrison. I think that the capacity to do what you mention is in the banks, but I do not say that the failure to do it is the fault of the bankers necessarily, for the reason that conditions in a given community or among the customers of a given bank may be such as not to warrant them safely to make the loans.

Mr. Busby. You are getting back to the individual. I am staying on the field of credit which comes to the bank to supply business with that type of exchange that enables commerce to carry on. What part do you regard the Federal reserve system as playing in that field of credit-furnishing or supplying?

Governor Harrison. Our part, I think, is pretty clear in my mind. It is about this: That in periods of unusual expansion in the volume of credit at a rate faster than the normal growth, say 4 per cent per annum, an expansion that may be caused by overproduction or speculation in real estate, or speculation in commodities or speculation in securities, it is incumbent upon the reserve system to use its influence toward restraint and we do that in two ways. First, through our open markets, and second through our discount rate.

That in itself is not necessarily controlling. All I can say is that it is an influence in the direction of restraint. On the other hand, in a period of depression, business inactivity, decline of prices, decline of wages, when you have a contraction of credit much faster than even the contraction in the business activity that is in existence at the time, I think it is the business of the Federal reserve system both in the open market and through the use of its credit facilities to use its influence to expand credit.

How do we do that? Through the purchase of government securities and an easing of the discount rate.

Mr. Busby. Do you regard the Federal reserve system as being charged with the responsibility, regardless of the attitude of the other banking set-ups that may have some influence on the question?

Governor Harrison. Yes, I do.

Mr. Busby. Now, you spoke of lack of confidence of bankers a while ago. In your answers to Mr. Goldsborough and Mr. Strong a few minutes ago when you said it would be dangerous for you to announce a policy, have you not disclosed an absolute lack of confidence in the ability of the Federal reserve system to do the very thing that you say it is the duty of the system to do?

Governor Harrison. No, I do not quite agree with that because I say our duty is to do what we can through those two instruments only toward accomplishing what you want. Where I differ with you is only in the conclusion. I am not as certain as you are that the use of those two influences will do what you think they will. We go a long way together, but I fear I differ with you at the final point, as to what we have the power to accomplish.

Mr. Busby. You have described to us how the doing of those things would tend to effect the thing we have in mind, and I understood you to say to Congressman Goldsborough a while ago that the reason the Federal reserve system did not do those things was because it was afraid to try?

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Governor HARRISON. Oh, no.

Mr. BUSBY. And that certain foreign interests might get the wrong impression and that securities held by foreign investors might be sold and a general stampede might be occasioned if the Federal reserve system tried to do the things it is set up to try to do?

Governor HARRISON. No. You misunderstood me.

Mr. BUSBY. I got the conclusion that the Federal reserve as now operated was more completely enveloped in a lack of confidence of itself than any of these individual entities that are dependent on it for their preservation. That is the impression I get from your explanation to Congressman Goldsborough as to why you did not do these things that tend to help our situation.

Governor HARRISON. No; I want to make it very clear to you and also for the purpose of the record that when I made that statement I was answering a question of the chairman as to whether I thought that if we announced a definite policy that we were going to the 1926 price level, it would or would not be helpful and I made the comment merely that I did not believe that we could necessarily accomplish that. And you asked me why? In saying why, I said any number of various things might happen to prevent it, and one of the things I said might happen was that people might misunderstand it and through their actions defeat our efforts.

Mr. BUSBY. When you said "might happen," I think you are afraid to try to do the things the system was set up to accomplish because you are afraid it "might happen"?

Governor HARRISON. That is where I think we again differ. We are doing the things you want us to do; but the only place I differ with you is that I do not want to make a statement that we are going to attain a certain price level or that we are going to buy even a certain amount of governments because conditions may arise to make it unwise or impossible for us to proceed further.

Mr. BUSBY. If I understand, the Federal reserve wants to keep itself in that equivocal position where it can back up at any time it wants to do so and "face about" before anybody knows it has done that sort of thing in order to save itself from these fears you express, which of course is a lack of confidence in its ability to perform fully?

Governor HARRISON. No, Mr. Congressman, I think you would not want us to tell you even to-day that we were going out to buy X-hundred millions of dollars——

Mr. GOLDSBOROUGH. Nobody has suggested that to you, and you still recur to it.

Governor HARRISON. Then, I will put it the other way. I think it is not possible for us, with any degree of certainty, to make a statement that we are going to pursue a policy that will reach the 1926 price level.

Mr. GOLDSBOROUGH. Suppose we tell you in legislation what to do. Do you think the Federal reserve system would act in good faith with us in trying to do what the Congress wants you to do?

Governor HARRISON. I do not think there is any question about it.

Mr. GOLDSBOROUGH. And do you not think that one of the reasons why they did not do a good many things differently is because they could not take on themselves the responsibility where they would guarantee results?

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Governor HARRISON. No. Take this present period. Let us be frank about it. Since the decline in the stock market in October, 1929, what has happened? The day after the stock market broke, when I knew, and all of us in the reserve bank in New York knew, there was going to be a huge calling of brokers loans, and saw that the inevitable result of that would be a complete breakdown in New York unless the banks in New York were prepared to take over a part of those loans—on that day or in the period of a very few days the loans made for the account of others than banks decreased more than $1,400,000,000 and loans made by New York banks for account of their out of town correspondents went down $800,000,000. That meant a reduction of $2,200,000,000 within a very few days. No market could stand that unless the banks in New York were prepared to step in and take over some of the burden—I just want to show you as a practical case how we operate—that would have been impossible for the New York banks to do unless they were prepared to borrow huge amounts of money from Federal reserve banks at a time of panic in the security market.

Quite naturally, individual institutions might have been reluctant to take over those loans at the risk of having to borrow such huge sums from us.

Mr. BUSBY. When the securities were going down as they could anticipate?

Governor HARRISON. Yes. There was only one thing we could do, and that was for the Federal Reserve Bank of New York to go into the market and buy huge amounts of Government securities on that very morning.

I had to do it without even the opportunity, except over the telephone, to consult but a few of my directors, which I did at 3 o'clock in the morning; and I had to do so without the approval of the Federal Reserve Board, who frankly said that I should have got their approval first; but I say that if we had not bought over $100,000,000 of securities in those two days we might have had a real catastrophe.

Mr. BUSBY. But you had a bad picture to start from, did you not?

Governor HARRISON. Yes, sir.

Mr. BUSBY. If I remember rightly, the loans for the account of others stood at about 56 per cent and the loans for banks out of town stood about 28 per cent and the loans by New York banks were practically 14 or 15 per cent?

Governor HARRISON. Yes; all during that period.

Mr. BUSBY. And the banks of New York had not entered into the picture?

Governor HARRISON. That is true.

Mr. BUSBY. Consequently, when the loans for account of others were unloaded in order to take care of New York dealers, the New York banks had to cooperate with your bank and step into the breach because there was no responsibility on small loans for the account of others?

Mr. HARRISON. Now, Mr. Congressman, you asked me at the beginning whether I minded being interrupted. If you will let me, I would like to finish this one statement.

You are asking me, Mr. Congressman, or rather stating that you thought we had been inspired by lack of confidence in our hesitancy in going ahead during this period I explained that, when I made that statement, it was only one of the circumstances that might interrupt

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the policy, or make the policy ineffective. Now, I can tell you what actually did happen. We began two days after the first big crash and bought over $100,000,000 of Government securities. Following that——

Mr. STRONG. What was the reaction?

Mr. HARRISON. From the end of October, 1929, until the middle of 1931, we bought over $600,000,000——

Mr. GOLDSBOROUGH. 1930 or 1931?

Mr. HARRISON. This was from the end of October until the middle of 1931, we bought over $600,000,000 of securities. In this same period, we gained over $600,000,000 of gold. In the same period, we reduced our discount rate from 6 per cent to 1½ per cent. We did everything we could in that period, through the instruments that we had, to accomplish what you wanted us to accomplish, to check the decline that looked to be inevitable in business and in prices; and by prices, I mean commodity prices, and I am not talking about security prices.

Now, the only question that I can see that you have got in mind is whether we should have proceeded faster or not. There was never a factor of the operations of the system about which there was so much difference of opinion as the open market operations. That is a very difficult instrumentality to use; there are a great many ramifications to the effect of it, and the effect of it is very difficult sometimes to anticipate.

The result of that is, and I admit it, that as long as we have an open market policy conference, which is composed of 12 different individuals from 12 different parts of the country, even though we get agreement as to the policy, it sometimes takes time. The result, again, is that we sometimes have gone slower in our policy than some of the rest of us might like to go. The corollary to it is that, having embarked upon a program and the conditions that we desire to accomplish having been accomplished, and the necessity for going into reverse having arisen, we are sometimes too slow in going into reverse, and that I am frank to say, is an unfortunate incident to a banking system which, however wisely conceived, must operate through 12 different reserve banks, subject to the approval of the Federal reserve board.

Mr. STRONG. Is that the result of a lack of policy?

Mr. HARRISON. No; you can not say it is a lack of policy. We used every power that we had in the reserve banks.

Now, the policy is there. You and I may differ as to the operation of the policy; but I am referring to the Congressman's statement about our having failed to act because we were afraid of what might happen. I think we did act; I think we acted very vigorously; and in this case, we acted more vigorously than perhaps——

Mr. BUSBY. Since you are referring to what I said—you are referring to another time—I am talking about the present conditions and what they might be now, and that is why you expressed fear and mentioned things that you feared might happen. I can see that the reason for the Federal Reserve Board not taking any initiative, because it fears those things you enumerated; and, consequently, we are drifting along now. I am not thinking about what happened back at the time when the stock market crash set in. You might have had a spirit of confidence then that you have since lost; but what I am getting at now is, that this Federal Reserve Board was enveloped in a field of fear now.

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Mr. HARRISON. No; I do not think so, Mr. Congressman.

Mr. BUSBY. If not, why, since the 3d day of February down to the 30th day of March, have the total reserve bank credits shrunk up $211,000,000, notwithstanding the Glass-Steagall Act; and why is it that since a little over a month ago, or the 24th of February, when the currency outstanding was $5,562,000,000, and on March 31 it was $5,549,000,000, a shrinkage of over $100,000,000 in the currency in circulation—why the Glass-Steagall bill does not apply and have a better effect on the currency and the credit situation of the country, than disclosed by the actual figures? That is what I am getting at.

Mr. HARRISON. That is a very fair question. First, on the shrinkage of the Federal reserve credit, we have bought, since the passage of the Glass-Steagall bill, $245,000,000 of Government securities, and——

Mr. BUSBY. On that point, you have had a shrinkage of credit of $211,000,000 since March 3, which is 56 days. If you bought those governments from member banks that owed you and canceled their indebtedness on your books, you explained a while ago that that would not help anything, because it is not putting out any new credit, but it is merely taking their assets over and canceling the claims against them. Now, that is practically the extent of your operations up to now, is it not?

Mr. HARRISON. Yes; through the fact that we bought all of these governments, plus the return of over $200,000,000 of currency, and plus some imports of gold. All of those factors have resulted in a reduction——

Mr. BUSBY. Increases the loans in your portfolio, but they have not increased the credit in the country. There has been, so far as the printed side of the ledger is concerned, a drying up of outstanding credit to the extent of your purchases.

Mr. HARRISON. Mr. Congressman, I think it is very very misleading to imply that Federal reserve credit has gone down because of our purchases. Is it not rather that a return flow of $200,000,000 of currency has accounted for a reduction in the Federal reserve credit, without any pressure at all on our part?

Mr. BUSBY. The figures do not show that you returned currency for your purchases. It could not have happened that way, because the outstanding Federal reserve notes are less now than they were back in the time I mentioned, and the total currency circulation is some $106,000,000 less than it was even the 24th of February, when the Glass-Steagall bill became effective. You do not understand the theory of the Glass-Steagall bill as it was claimed it would apply to business, when the highest governmental authorities in the Treasury came before us and described the beautiful picture of how things would be helped if they were accorded this legislation. We find that the reverse has actually taken place. What I am concerned with is the practical, not the theory.

Mr. HARRISON. I would like to confine myself just to that problem, because it is the problem we all have now. First, the return flow of currency, the reduction of the circulation, is precisely the same thing, in its effect upon the reserves, as if we bought Government securities in that amount; because if you got a $100 bill in your pocket, you do not want it for circulation, you turn it in to a bank, and that creates a deposit; the bank takes it to the Federal reserve bank, which creates a reserve deposit of $100; which may be used to retire discounts or as a

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base for new credit. That is inevitable; and it is just the same as if we bought $100 of Government securities.

So that, when you want to bring out the true position of what has happened, so far as its effect upon the credit structure is concerned, you should add to the amount of our purchases the amount of the return flow of currency which has not struck anything out of the credit picture, at all, because it has come out of hoarded money, and money that is not needed.

Now, the next point is: Supposing we have, as we have had, $800,000,000, or $850,000,000, of discounts, and suppose we wanted to build up reserve credit as fast as we could, and suppose we buy $500,000,000 of Government securities and put that money in action, and somehow or other it mills around and circulates until it gets to some bank that has got a debt to pay off, and it pays it off—that represents no increase in reserve credit. But that we can not avoid.

It simply illustrates limitation upon our effectiveness in raising the price level. We can not, of ourselves, control the total amount of Federal reserve credit, because when we try to put it out it may come back in two ways: Through the repayment of discounts at the rate of $200,000,000 since the 1st of March, or through the liquidation of our bill portfolio. So that so far the program of purchases has not actually increased the total amount of Federal reserve credit, but I do not say it has not been helpful, because I do——

Mr. GOLDSBOROUGH. The only intimation that we could get from your testimony is that it has been extremely helpful, because, instead of a downward trend, we have reached a level, so your testimony, as I understand it, is that, in your judgment, it has been helpful.

Mr. HARRISON. Now, I think we were wise, through the months of September, October, and November, and even December, in not pursuing a vigorous policy of Government purchases, Mr. Congressman, for three reasons: First, because of the fact that we were having a raid on our gold from abroad; second, currency was going up at a terrific rate—both of those things would have offset anything we could have done by purchasing governments; and the third reason was, and it is a practical reason, that because of the technical limitations in the law we did not have enough free gold to justify our doing it.

Now, we can use Government securities as collateral for Federal reserve notes, and that releases gold for use. As soon as the Glass-Steagall bill was enacted, we had a meeting and determined upon the program to purchase $25,000,000 a week, which we have been doing for seven weeks. Some people think that is not fast enough, and others perhaps think it is going just about right. Others think that perhaps it was a little too fast. I, personally, in the latter part of the period certainly, put muself in the first class. I think it was not quite fast enough.

We have since had another meeting, I think you will now see that the program has been very much stimulated, both in amount and in rate.

Mr. GOLDSBOROUGH. Why do you feel, as the Chair understands you do—and this is a specific, sincere question that should not be discussed lightly—that you should not make a statement as to what you decided upon at this meeting of what you are going to do? I am not insisting upon your making a statement; but why do you think it would hurt the country?

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Mr. Harrison. Because, as a practical matter, today, I as an individual would not be free to make the statement. Secondly, as to the wisdom of making it even if I were free to do so, I think that the most that the country should expect of the reserve system, in the best interests of the country—is to show, through its actions, that it has embarked on a program.

Mr. Strong. But the public has no confidence, and does not know when you are going to change. If you announced a policy, it would have confidence.

Mr. Harrison. The system is announcing a policy through action. There are two policies you might conceivably announce by a statement, one that you have not got in mind being a statement of amount.

Mr. Goldsborough. No; we do not suggest that, because nobody knows, as I see it, how great the purchase would have to be to reach a certain point; and this committee makes no suggestion of that kind.

Mr. Harrison. I think this, we all agree, we should not announce; because, obviously, if we did announce the amount and our objective were accomplished before that amount were reached a lot of people would say: "Why did you not go the full way?" They would think that would be a breach of good faith with the country.

Now, the next policy that we might announce, and the one you suggest, is that the Federal reserve system is to pursue a policy which will accomplish certain results and——

Mr. Goldsborough. Raise the price level to a certain given point?

Mr. Harrison. And the suggestion in this case is to raise the price level to the price level of 1926, say. It was mentioned by Congressman Busby that I said that our reason for not adopting a policy was the fact that certain events might transpire which would defeat the policy. There was not a fear on my part that they would happen, nor did they deter the adoption of a policy, but the possibility of their happening and the fact they they might defeat the policy which we had announced, was a good reason not to make the announcement.

Mr. Strong. I can not understand why, if he announced a policy that would be circulated throughout the country, that it would help you, rather than taking a vascillating policy of "We do not know what we are going to do."

Mr. Goldsborough. Governor Harrison, if you think that the mere fact that the board's action will of itself be all that the country should require, why would not that of itself have this evil effect which you are afraid that an announced policy would have? If the country is going to know, even though you do not announce a policy that you propose to go into the market and stay in the market until the price level is raised, why would not that cause the withdrawal of these foreign deposits that you are talking about, or that you spoke about a few moments ago? In other words, we can not understand, if your policy is going to be effective, both advantageously and detrimentally, why it will have any worse effect detrimentally to announce it than not to announce it.

Mr. Harrison. Well, I admit there is a real basis for a difference of opinion. My own judgment is that it is unwise to announce it, because I think there are so many possibilities of our not being able to accomplish it, and there are so many possible intervening factors which might defeat it.

Mr. Goldsborough. As far as this committee is concerned, I believe that we feel that the factor that you mentioned, which would

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be viewed by the country as of the greatest significance, would be the withdrawal of the foreign deposits. Now, I would like to discuss that with you a few minutes.

The only country that is on the gold standard now, with the exception of the United States, is France, is it not?

Mr. Harrison. No; there are a few others.

Mr. Goldsborough. They are not strong anough to be effective?

Mr. Harrison. Switzerland and Holland——

Mr. Busby. Their financial agents have the power to issue notes against the central bank, which takes them practically off of it.

Mr. Harrison. But the fact is, they are on the gold standard.

Mr. Goldsborough. Where would these deposits go? We are on a gold standard and certainly no one who has any financial information is afraid we are going to get into trouble. So where would these large deposits, which are evidently held by people who know what is going on—where would they go, if they went out of this country?

Mr. Harrison. They would go back home. That is what happens to them.

Mr. Goldsborough. To what country, for instance? England is not on the gold standard, so why would they withdraw the deposits from a country that they think may go off the gold standard and put them in a country that has gone off of the gold standard?

Mr. Harrison. As long as you mention that point, which was purely a hypothetical one, I have no thought that we are going off of the gold standard, regardless of any of these open market policies, or regardless of this bill.

Mr. Goldsborough. Why should these depositors think so any more than you think so?

Mr. Harrison. All I can say in regard to that is this: Mr. Congressman, every time there has been a mention of the possibility of inflation in America, there has been a substantial raid on the dollar. Now, that is more than a coincidence.

You and I may differ as to whether they are wise in taking their dollars home or not, but it is a matter of fact and a matter of record.

Mr. Goldsborough. I know it; and there was a little checking up of the stock market when the reconstruction finance bill was talked about, the Glass-Steagall bill, but they did not amount to anything.

Mr. Harrison. I think in this discussion we have been overly exercised over the position of foreign deposits.

Mr. Goldsborough. You certainly did make a statement along that line.

Mr. Harrison. I am sorry if it was interpreted that way, and am certainly sorry if those statements have given any erroneous impression to some of you. I did not mention any one of those possibilities as an expression of my opinion as to what I thought would happen. I merely mentioned them, as I have repeated once or twice already, as an explanation of the various reasons that might make it difficult for us to consummate a program that you would have us announce. Not that I believe that any one of them would happen, but they are among the possible reasons why we could not accomplish what we had announced that we would accomplish.

Mr. Goldsborough. Governor Harrison, at a time like this, when business is going to pieces every day, when your acquaintances and mine and everybody else's around the room are losing their business morale, do you think that we ought to be influenced by a mere possi-

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bility in passing legislation which would, in all probability, if it is sympathetically administered, result in raising the price level and curing these certain conditions?

Mr. HARRISON. Mr. Congressman, I think the difference between you and me is not in what we are actually doing. So far as I am in position to direct our policies, and I am only one of a number, of course, I want to accomplish what you want to accomplish. I would not want, however, to be the one to say whether it should be the price level of 1926 or some other figure that we should reach, because I am not wise enough to know what should be the figure; but I do agree with you that, so far as it is within the power of the Federal reserve system to give a basis for the expansion of credit which will act as a stimulus to business and prices, we should employ those powers. I think we are employing them now in the only way that I think that we could possibly employ them. The difference between us is, first, as to the rate of employment, and all men might differ on that. You might be right and we might be right. The second point of difference, as I see it, is whether we should announce, or the system should announce, that it is going to adopt a policy that will do certain things, things which we can not be certain will be accomplished. I agree we should operate in the open market, but I do not want to be the one to prognosticate that the effect of those operations will be what you want.

Mr. GOLDSBOROUGH. What is your objection, if you have one, to a legislative direction to the Federal reserve system to raise the price level as is contemplated by section 1 of this bill?

Mr. HARRISON. Well, I think my real objection to it is this: That I am not at all certain that we could accomplish it, even if you direct us to do it, first; and, secondly, I do not know that it would be wise for Congress to say to all of the people in the country: "The commodity price level will be raised to the level of 1926," unless it is in the power of Congress, or the reserve system, or somebody, to keep it there. What would happen? Supposing we announced a policy like that and people had faith in it, both the legitimate investors and the speculators, and supposing they invest in some commodity which immediately has the effect of putting it up; the minute those commodities get to or appraoch the limits which you have fixed, all of those people, speculators and others, will say: "Well, I guess now is the time for me to get out," and you immediately have a tremendous pressure of selling on the price level, which will force us to begin all over again with much smaller resources to work with.

Mr. GOLDSBOROUGH. You understand it is the index number we want to raise, do you not, and not the possibility of increasing the price of any given commodity?

Mr. HARRISON. There is another real difficulty in it, too, as I see it, and that is the difficulty that we have——

Mr. GOLDSBOROUGH. These index numbers are published every week?

Mr. HARRISON. Yes; but supposing the index number gets up to the point you fixed, everybody that has got any commodities in the index will be inclined to sell.

Mr. STRONG. Why should they when we stabilized there?

Mr. HARRISON. Because they bought it with the view to selling it when it did get there.

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Mr. Strong. Then you admit that the psychology that would go out through the country, if you make a definite declaration, would help you get there?

Mr. Harrison. But even should you get there, what would you do? It is inevitable that you would feel a wholesale liquidation by people who bought expecting or hoping that you would accomplish your objective.

Mr. Goldsborough. We are not trying to regulate the law of supply and demand. Anyone who knows enough to go into the market knows what we are after is to raise the general commodity price level, as indicated, for instance, by the Bureau of Labor Statistics. That is what we are trying to do. We are not saying that we can raise and stabilize the price of cotton or wheat or any other commodity. Our idea is that, if the general commodity level is raised, that it would inevitably react on all business.

Mr. Harrison. Suppose we had this law in effect back in 1928 and 1929. What was happening in that period——

Mr. Busby. I believe you would get along better with us if you would keep off of that period. We are trying to deal with the present situation, Governor, instead of going back and mulling over the very unpleasant, abnormal, condition that pictures itself out of joint economically and involves——

Mr. Goldsborough. We think that the Federal reserve system could do now what it could not do during the spring and summer, for instance, of 1929, when everybody was crazy over the stock market.

Mr. Harrison. Well, I will apply what I want to say as to the present period——

Mr. Busby. I have no direction, except that——

Mr. Harrison. I think you are wise, because that earlier period is so controversial. Suppose, however, you have a period when the commodity price level is below the figure fixed by Congress, or announced by the Federal Reserve Board to be the objective——

Mr. Goldsborough. Governor Harrison, can you stay with us this afternoon?

Mr. Harrison. I will be glad to.

Mr. Goldsborough. I am going to suggest that the committee adjourn until 2 o'clock p. m.

Mr. Harrison. That will be very satisfactory to me, sir.

(Thereupon, a recess was taken until 2 o'clock p. m. of the same day.)

AFTERNOON SESSION

(The committee met, pursuant to recess, at 2 o'clock p. m.)

Mr. Goldsborough. Governor Harrison, do you believe that a rise in price level is absolutely essential?

Mr. Harrison. I think this, Mr. Congressman: That either the price level must go up or else there must be a readjustment of fixed charges of various kinds, including many debts of the country, involving in many cases a readjustment through the bankruptcy courts; because debts contracted at much higher price levels find themselves very much prejudiced by the present price levels. Many people who have contracted debts at higher price levels are not in position, at the present price level, to earn enough to pay the fixed charges of all kinds, debts, rents, wages, and all of the other things that go to make up their expense accounts.

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I, myself, feel that we must all contemplate that the correction will come more largely through an increase, or should come more largely through an increase in prices, than through the readjustment of fixed charges, because that would be a most unfortunate thing to contemplate. That being true, I think it is right for all of us, however else we may differ as to the mechanics or means, to do what we can properly to strengthen and enhance the prices of commodities and goods throughout the country and the world.

I admit that it is not very difficult, over a period, to see a close relationship between the volume of credit and the price level, but I do not admit that credit is the only factor. That being true, I think it is a dangerous thing to put into the law, or for the reserve system to make a statement of a policy which contemplates or presupposes that, by their powers to influence the volume of credit, they can necessarily correct the price level. There are so many things, so many factors which I tried to outline this morning which may operate to defeat it.

We know that the breakdown of the markets for goods throughout the world has had one of the most important bearings upon the decline in prices. The market for our surplus products has been severely curtailed abroad.

We know, from experience, that however much credit there may in the country, a bumper crop of wheat or cotton may very seriously affect the prices of those particular commodities that go to make up the general index. We know that new inventions, new machinery, new processes, even new substitutes for the materials we have now, seriously affect the price levels. We know that panics, and fear, the unreasoning fear of holders or owners or producers of goods often itself makes for a decline in prices quite apart from the volume of credit.

That being so, I just wonder whether it is wise to let the country think that, through the use of the Federal reserve machinery, it is possible to do a thing that is influenced by so many other factors than credit alone. I do not mean by that, however, that we should not, in these circumstances, use our powers, so far as we have got them, to influence the volume of credit, hoping that it, in turn, will influence the price levels. I believe it will have some effect.

Now, how far that may be offset by other factors, no man is wise enough to tell.

Mr. Goldsborough. Now, as I understand it, you agree with us that the price level has to be raised, if the country's economic conditions are going to improve?

Mr. Harrison. I agree with that.

Mr. Goldsborough. We agree on that; and you stated this morning, I believe, that the Federal reserve system was actually using, as a means to endeavor to raise the price level, the purchasing of Government securities?

Mr. Harrison. That is right, as an intermediate step. Of course, our purchasing of securities, itself, does not increase the amount of outside bank credit which in turn affects the price level. In other words, all we do is to give a basis for credit through which the other banks may make loans and investments, which would have an influence on the price level.

Mr. Goldsborough. Well, of course, that would be so, even if this bill was adopted and even though the Federal reserve system

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announced the policy which we were discussing this morning; the intermediate steps would still be the same.

Mr. HARRISON. Yes; I think that is true.

Mr. GOLDSBOROUGH. So that, where we appear to differ in our view of what can be done is in two ways, as I see it: First, that you do not lay as much emphasis on the purchase of securities as you feel the committee does?

Mr. HARRISON. I think that is right.

Mr. GOLDSBOROUGH. That is one thing, and the second thing is that you think it would be a mistake to announce a policy, even though it were the policy of the board?

Mr. HARRISON. Yes; that is my position.

Mr. GOLDSBOROUGH. Those two things now, as I see them—I hope I have stated them fairly—that is our line of demarkation?

Mr. HARRISON. Yes.

Mr. GOLDSBOROUGH. Probably there has been some misunderstanding about whether we really do differ on the first point. For instance, I realize that what is known as the business cycle is the result of psychological factors, that prices go up a little, and people begin to get careless in their business methods, and instead of working they begin to speculate until the thing topples over on itself and goes down, and then spiritual forces begin to operate, people go to church more, think more about the primary factors of life, and that continues for a while and then the other operation begins.

Now, of course, those factors, being exclusively spiritual factors, are some of the most powerful that can influence the very thing that we are now attempting to analyze and discuss—that is my opinion but I think also that when people are thinking normally, on the grand average, that the effect of money, the supply of money and its degree of circulation, has a tremendous effect upon normal conditions. So that my feeling is that one of the things we ought to try is to restore confidence, and get the public in a more normal mental attitude, and I think that if the Federal Reserve Board would announce its policy, it would have a tremendous effect, for several reasons:

First, of course, the great mass of people do not understand anything about the operations of the Federal reserve system; and, secondly, there has come a feeling of great doubt in the minds of the public as to just what the attitude of the Federal reserve system is. Now, I am sure that statement is correct.

The first period of great doubt was created when the deflation of 1920 occurred. Since that time and up until the present time, there has never been an interval, for instance, when a farmer felt that he not only had been treated badly in 1920, but had been treated badly ever since. So that I think there is great uncertainty in the minds of the public as to what the aims of the Federal reserve system are; and therefore, I feel it would have a magical effect if the Federal reserve system would announce a policy.

Now, then, after the price level is raised, I think a legislative direction to the board to stabilize the price level would be tremendously helpful to the system; nad I believe that, measurably, a realization of that stabilization would very greatly help to solve most of the problems that the Federal reserve system is confronted with.

So that it does seem to me that, when we take away all the extraneous matters, that there is very little difference between your point of

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view and the point of view of the committee. You appeared to agree with the objects and purposes that are in the minds of the committee, but you do not agree entirely with the manner in which those purposes can be attained.

Mr. Harrison. I think that is a fair summary of our relative positions.

Taking the bill, specifically, I question, first, the wisdom of any one group of men attempting to state to what point the price level should be restored, because I do not think any of us is wise enough to say now what would be the proper price level in future circumstances.

The second thing which you mentioned over which we differed is that, even if you should determine upon such a point, I do not believe that the reserve system alone, through its indirect influence on the volume of bank credit, which in turn has an influence on the price level, would be certain to accomplish the result, in view of the possibility of so many other factors in the situation such as those I just mentioned a moment ago. Therefore, if Congress should instruct us to go to a certain point with the price level, with the machinery of influencing only the volume of credit, we run a risk and a real risk of failure to attain the objective which Congress has specified.

If we should fail, as I think it is not at all impossible, by our efforts alone, then the people who would have acted on the assumption that we had the power that Congress had directed us to use, would very properly feel so resentful that it is a question whether the effect on the usefulnesss of the system would not be worse than if you do not specify any particular objective.

It is for the same reason that I fear that it is always difficult, if not unwise, for the reserve system in advance to say what its policies are going to be, because there are so many situations which develop which may force us to change our policy perhaps overnight.

Mr. Goldsborough. You understand how difficult it makes it for business, do you not?

Mr. Harrison. Yes; I agree to that. Now, as I was saying, suppose a case, which is not at all an improbable or unlikely case, the price level is going down, and the Federal reserve system begins to buy Government securities, hoping to check the decline, and that inspires a measure of confidence, and a speculation is revived in securities, which may in turn consume so much credit as to require our sales of Governments. There was that difficulty in 1928 and 1929, when the commodity price level was going down, and when, if we had had this mandate from Congress, the only thing that we could do if commodity prices were our sole guide, would have been to buy Government securities. But at that very time and coincident with it, there was such a tremendous consumption and use of credit for speculative purposes that we were between the devil and the deep blue sea—should we buy more Governments, in order to stabilize the commodity price levels, which were going down, or should we sell Governments, as Congressman Strong indicated we did not do fast enough, in order to prevent such a rapid rise in the volume of credit for speculative purposes.

Mr. Goldsborough. The committee understood you to indicate this morning that precautions had been taken to prevent, as far as the stock market was concerned, that thing from occurring again——

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Mr. Harrison. Through the use of non-banking credits, but you still might have the case in the future where the credit that we put out is being used by the banks——

Mr. Goldsborough. That is true.

Mr. Harrison. For speculative purposes.

Mr. Goldsborough. But there is an effort now being made in the Glass bill over in the Senate to correct that situation. We are not discussing here legislation for the control of the New York stock exchange at all. That question as we conceive it is entirely a separate problem that will have to be solved by different legislation. What we are interested in is whether or not, under the present conditions at this time, the Federal reserve system has sufficient resources to raise the price level now.

I am informed that there is available about $3,900,000,000 of gold, which would enable the Federal reserve system to issue nearly $10,000,000,000 in Federal reserve notes. Now, in my judgment, if you use the experience and ability that the Federal reserve system has, you could raise the price level anywhere you wanted to. That is my judgment.

Mr. Harrison. Well, in one way, I would like to say I agree with you that we did have that power, because I would like to see the price level increased. On the other hand, what is the danger, if we have got the power? Suppose you give us this mandate to raise the price level to point X, whatever that point is, and we use the only instrumentality that we have, which is the purchase of governments, and suppose that gives a large quantity of excess reserves to the banks and they expand their loans and investments and prices go up, nothing else interferes and the price level gets to point X that you have designated, then you always run the real risk that, having gotten to the point that has been designated, either one of two things will happen: Either those people who have contemplated the success of the program and have bought commodities would unload and thus run the price level down again and force us to begin all over again with much reduced resources, because our resources would have been used in getting to point X or else——

Mr. Goldsborough. You would not use a great percentage of them?

Mr. Harrison. That depends on all of those extraneous factors.

Mr. Goldsborough. You have not forgotten the speech you made in January, have you?

Mr. Harrison. That is the only speech I have ever made since I have been in my present position.

Then you run a second danger, too, Mr. Congressman, that if by a strange coincidence of circumstances we accomplish what you want us to accomplish, the great majority of people in the country say: "That is bully; that is wonderful. The Federal reserve system has done a great job. We are all right in line. Now, let us raise the price level to X plus 2."

Mr. Goldsborough. Of course, there is a danger there.

Mr. Harrison. There is no limit to where they may ask us to go.

Mr. Goldsborough. There is danger in anything, friendship, love, childbirth and everything else, but that does not deter you from trying to correct the evils.

Mr. Harrison. That is right, but try to correct them, if possible, without the dangers. That is my text, and that is what we are try-

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ing to do, I think. I do not think we would act any differently from the way we are acting to-day, even if you had this bill law; and the advantage of it is that no one can be critical of Congress or the Federal reserve system, no one can be deceived, no one can be subject to the losses which would result, if they acted upon that hope and then found that it was not realized, through no fault of ours, at all.

I would much prefer to operate the system with a view to maintaining the stability of prices and business, as far as it is in our power to do it, without either any promise on our part that we would accomplish a certain result, or without any direction from Congress that we must accomplish a certain result; because I do not believe that credit alone is an inexorable control of the price level.

Mr. GOLDSBOROUGH. And I do not either.

Mr. HARRISON. I go very far in saying that I think the relation of prices to credit is pretty close, and I believe that we should always act on that assumption; but if other factors come in that defeat our objectives, it is unfortunate, it is unhappy for all of us, but at least no one has been deceived or cheated, and we would not then have failed to carry out the mandate that you gave us. I do not see how we can do differently from what we are doing, even if you put your bill in the statutes.

Mr. GOLDSBOROUGH. Now, you say you are doing at this partiular time—you may be doing all that should be done now, of course, but it has not been disclosed to this committee what you are doing, or commencing to do right at this time.

Mr. HARRISON. Well, I am sorry I am not really in position to speak for the system or disclose it. If you would excuse me, I would rather not.

Mr. GOLDSBOROUGH. I am not asking you to.

Mr. HARRISON. I have no authority to do it.

Mr. GOLDSBOROUGH. We will not ask you to do it.

Mr. HARRISON. I did say, under the pressure of cross-examination this morning, that——

Mr. GOLDSBOROUGH. I am sorry that occurred.

Mr. HARRISON. I have no real objection to it. Some of my associates may think there has been a breach of confidence but I do not think so, really. First, we have been buying Government securities at the rate of $25,000,000 a week for seven weeks; and, secondly, a great many of us feel now that that is not rapid enough; and that we are embarking upon a more substantial program. But more than that, I would rather not say, and even that much perhaps I am not authorized to say.

Mr. GOLDSBOROUGH. Of course, and I can understand that, Governor. The members of this subcommittee know that they have, certainly, for a year past, urged the Federal reserve system to not wait until it was too late to adopt this vigorous policy, not to wait until the liquidation took place.

Mr. HARRISON. You would have had my support.

Mr. GOLDSBOROUGH. We know that.

Mr. HARRISON. In fact, one of the provisions in the Glass-Steagall bill was recommended by the unanimous vote of the governors' conference at least a year and a half ago.

Mr. GOLDSBOROUGH. But we certainly did not get support from the Federal Reserve Board. Now, then, when we went along with

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measures which they have told us would relieve the business situation, and which we did not believe in as furnishing ultimate relief, we are justified, at some time, in reaching the conclusion that we knew something about it ourselves.

Mr. HARRISON. Yes.

Mr. GOLDSBOROUGH. And that is the conclusion we reach.

Mr. HARRISON. Of course.

Mr. GOLDSBOROUGH. And I say that with great respect. I say that with respect to everybody; but we think that the Federal reserve system, the Federal Reserve Board should have been able to know, at least a year ago, that these various measures should have been passed, and that the Federal reserve system should adopt a policy which would prevent largely the bankruptcy of the country and the tremendous distress.

Mr. HARRISON. Of course, Mr. Congressman, the implication of that statement is that we did not do very much. As a matter of fact, you know, if you look at the records, a great deal was done from the end of 1929 until the present time. As I explained this morning, in that period, we bought well over $800,000,000 of securities and——

Mr. GOLDSBOROUGH. Governor Harrison, I happen to know something about that. I went downtown and talked to the members of the board the last part of 1929, and as you say they acquired blocks of Government securities, and for the first two or there months in 1930 it looked as if the country was going to get back into a normal condition, and then something changed the policy, with the present result.

Mr. HARRISON. Well, there were a number of factors that made us change, especially in view of the fact that we did not have at that time the Glass-Steagall bill.

Mr. GOLDSBOROUGH. You could have gotten it. I mean there were plenty of us up here that knew that we ought to have a policy that would allow Federal reserve notes to be issued for Government bonds, but at that time this committee could not have gotten this bill out with the opposition of the Federal reserve system, because there was not sufficient pressure at that time, and the country did not understand the situation well enough to enable us to legislate, without the support of the Federal reserve system.

Mr. HARRISON. Mr. Chairman, I wonder if it would be agreeable to the committee to let me make a statement on the fundamentals of the use of Government securities as collateral for Federal reserve notes because I think that is important not only now but in view of the 1-year limitation in the Glass-Steagall bill. It will not take me a minute.

Mr. GOLDSBOROUGH. I want you to make it; and I want you to also notice that, in the bill that I introduced on January 19, H. R. 8026 and which I took to the Secretary of the Treasury and the Governor of the Federal Reserve Board, and every member of the Federal Reserve Board, and almost prayed to them about it—there is no 1-year limitation. I think the 1-year limitation was wrong, but the majority of the committee did not agree with me.

Mr. HARRISON. There is a great deal of misunderstanding as to the effect of that provision of the Glass-Steagall bill, which authorizes us to put up Government securities as collateral for Federal reserve notes. You hear all sorts of talk of inflation of the currency, Government bond-secured currency, and the abuse of the privilege of

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issuing notes. As a matter of fact there are approximately 30 central banks in the world of considerable size, and of those 30, 6 of the principal ones in Europe have no collateral whatever for their note issues—they are obligations of the banks, and they have a certain percentage of gold reserve, and in some cases they are a first and prior lien on all of the assets of the bank. The danger against the inflation of the currency is avoided by the gold reserve required and the power to use the discount rate. Of the other banks which require some collateral to be pledged against the notes, there are only three in the world outside of the Federal reserve system which have not been authorized to pledge Government bonds, and the great majority——

Mr. GOLDSBOROUGH. You might mention those three, if you will.

Mr. HARRISON. The Reichsbank, the Austrian National Bank, and the National Bank of Hungary. All of the others authorize their notes to be secured by Government bonds, and always, of course, with a certain percentage of gold; and some of those authorize the pledging not only of bonds of their own Governments, but of foreign governments as well. So that we did nothing at all unusual, nothing unwise, nothing in effect inflationary in authorizing the Federal reserve notes to be collateralled by Government bonds.

I think that, were it not for the fact that the Federal reserve note is, technically or nominally, the obligation of the Government of the United States, but issuable only through the Federal reserve bank, there would have been no occasion to require the pledging of specific collateral, because a Federal reserve note is a first and prior lien on all of our assets, anyway, and because we have to maintain a 40 per cent gold reserve.

But being an obligation of the United States Government, once it is issued, it becomes technically a liability of the Government, against which there must be an offsetting asset; and how is that provided for? They place in each Federal reserve bank a Federal reserve agent who is the representative of the Government in the bank. When we get a note from a Federal reserve agent, to issue to one of our member banks, we pledge with the Federal reserve agent some offsetting collateral to balance the Treasury's books.

Now, if that was the purpose, and I think myself it was the purpose of the collateral provision (there are many people that differ with me), there is no better collateral to protect the Government for its liability than its own obligations.

So far as the dangers of inflation are concerned, it is really little different, whatever the character of the collateral. The way currency has been inflated on the government's own obligations in the past, in other countries, is through having the government itself pay its own debts by use of the printing press, issuing currency collateralled by its own promise to pay, just like our old greenbacks. If a government, in a period of war, or for some other reason, finds that it can not balance the budget, or does not want to balance the budget, and wants to pay its bills by the issue of currency, and starts the printing press going, then you have got real inflation of the currency secured by government obligations, the worst form of currency obligation; but when the currency is not issuable by the government, or not printable by the government to be used by itself to pay its own debts and thus to avoid taxation, there is not any danger of an infla-

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tion of the currency, so long as it is in substance a bank obligation, so long as it is collateralled by all of the assets of the bank, and so long as it has a 40 per cent gold reserve.

I mention that now because, at the end of the time, at the expiration of the year, when the Glass-Steagall bill matures, I think it may be very important to have some understanding of the fundamentals, in order that it will be recognized not as an emergency provision, but as a perfectly natural orthodox principle of central banking.

Mr. Goldsborough. Governor Harrison, I think it would be well to say, that in the discussion of the Glass-Steagall bill, that the majority of us were opposed to the 1-year limitation. Our understanding was, however, that it would not pass the Senate without that 1-year limitation.

Mr. Harrison. I do not want the committee to think, or the country to think, that whatever we have done in invoking section 3 of the Glass-Steagall bill, that we have started on a ruinous inflation of the currency. We have done nothing but what is the normal, proper thing for a central bank to do.

There is one more thing: This morning, when we got into the discussion of the dangers of the withdrawal of foreign funds, in the event the foreigners think we are inflating, I want to explain, in the light of what I have just said, that the word "inflation" has so many different connotations that it is a dangerous word to use. In Europe, inflation is thought of as inflation of the currency in the form that I just mentioned, the use of the printing presses by a Government to pay its debts.

Mr. Goldsborough. Is not that your understanding of it, also?

Mr. Harrison. That is an inflation of the currency, yes; but what has happened in this country is that we have had one of the most severe deflations in bank credit; that is, the loans and investments made by commercial and private banks of the country. It is a very different thing to stop the decline in the volume of bank credit, which is forcing farther and farther the liquidation of goods and securities, on the one hand, and to bolster up credit through appropriate means, always subjected to control, so as to give the volume of credit the proper relationship to what the price level should be. That I do not call inflation.

No steps have been taken yet, and I hope none will be taken, having anything to do with the inflation of the currency. All through the period of 1928 and 1929, when we had one of the most speculative inflations we have ever had, the volume of currency went down, and the inflation was financed by the use of bank credit, or rather the credit of other lenders, and by the increased velocity with which that credit was used.

So that our problem, I think, is not to worry about the stability of currency, which I believe to be absolutely sound and secure, but rather to do all that we can to restore a normal volume of credit, so that you will avoid any further unnecessary liquidation of goods and securities at ruinous values. When you have done that, you may be able to bolster up the volume of credit, so far as it is within the power of any of us properly to do so, so that you may expect a revival of business, a demand for goods, and the enhancement of values that goes along with it.

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Mr. GOLDSBOROUGH. Do you think it would be wise to have a stabilization direction such as will use all available means to maintain such a wholesale commodity level of prices—I am not referring to any attempt to raise the level, but to attempt to stabilize any level that may be reached—to use all available means to maintain such a wholesale commodity level of prices? Do you think that is an assumption that the Federal reserve system can perform impossibilities?

Mr. HARRISON. I think that the implications in it would not be as serious as they are in the bill as now drafted, Mr. Congressman.

Mr. GOLDSBOROUGH. You mean in raising the price level?

Mr. HARRISON. Yes; on the other hand, I would not want to have it implied that Congress thought the present level of prices was the correct one.

Mr. GOLDSBOROUGH. No; but what I had in mind was this: This bill is drafted as an emergency bill, and also as permanent legislation. Now, of course, I understand what you object to, the emergency features of the bill, but what I am directing your attention to now is the provision in lines 9, 10, and 11 of the first page, which provide that the Federal reserve system shall use all available means to maintain such wholesale commodity level of prices.

Mr. HARRISON. Well, there is one real difficulty, if you will let me go into it, because as operating officers of the Federal reserve branches, we have faced it several times, and may have to face it again. You would, by that legislation, require us to direct our policy solely to the wholesale commodity price index, and we have found by experience that many times the commodity price index was going down, when the general price level, for instance, was going up.

Mr. GOLDSBOROUGH. What is that?

Mr. HARRISON. That the wholesale commodity index is going down, and the general price level is going up.

Mr. GOLDSBOROUGH. The bill has not been perfected, but the reference would be made in this to the wholesale commodity price level, and there would not be anything put in the bill which would direct you to try to control the stock market.

Mr. HARRISON. No; but the general price level, as compiled by most of the economists and statisticians, include, in appropriate weights, wholesale prices, rents, wages, security prices, and so forth.

Mr. BUSBY. That is the Snyder index you refer to?

Mr. HARRISON. Yes.

Mr. BUSBY. As an illustration.

Mr. HARRISON. Yes, and during many periods we found in the past that while wholesale prices were going down, real estate, rents, and other prices were going up relatively so fast as to bring the whole index upward. Then we are stumped as to what to do, especially if, in the process—and you have had cases of that kind—the volume of bank credit is going up, and the wholesale commodity price indexes are going down. Now, what are you going to do in a case like that, when bank credit goes up faster and faster because of a speculation in real estate, or securities, or something else, and when it is using up more credit than the country can afford even though commodity prices may be going down? That is what has happened before. That is the only way, partly——

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Mr. Busby. Nothing of that kind ever happened so seriously as the fall in the commodity index prices that we are experiencing now?

Mr. Harrison. Again, that is one of the most——

Mr. Busby. If you will permit me to interrupt a minute, the policy of the Federal Reserve Board is going to do more to pass the payment of the bonus bill, to put the currency in the field, blindly, or some other way, than any other thing that can be done to present the cause of the bonus claimants. I am telling you that. Of course, your careful policy may be the very means of Congress passing out some other kind of a command to the Treasury to do something to take the place of the inactivity of the Federal Reserve Board. I am just giving you that and the sentiment in the House, and they have practically argued the bonus bill through and sold it to the members, who do not have one particle of concern about the payment of the bonus to the soldiers, but they are demanding, and are going to drive through the Congress, legislation which will put currency in the field, so that business can have an opportunity to have it in the future.

These careful policies do not appeal to people who are hungry, when the policies are not getting anybody anywhere.

Mr. Harrison. I agree with you that the passage of the bonus bill—without my commenting on the merits of the veterans needs, but solely from an economic standpoint—the passage of the bonus bill would probably do more to defeat what you and this committee have in mind than any other one thing Congress can do.

Mr. Busby. I do not want to express an opinion, but my conclusion is that the orderly thing to be done is, for the Federal Reserve Board to cooperate with Congress, and launch out and shake off some of its fears about what might happen to it, and try to restore the commodity prices back to the point where the commodities can be sold, do something towards liquidating the debts that the people have made at higher prices, which debts always remain fixed——

Mr. Goldsborough. And the interest rates.

Mr. Busby. Everything incident to debts.

Mr. Harrison. I think that the views of the Federal Reserve Bank of New York, including myself and the directors, are definite that we should do all that we can within our powers now to correct the conditions that are becoming more and more pitiful. I think we are doing it to the limit of our powers though your statement implies, I think, that in your judgment we are just too cautious and too slow.

Mr. Busby. You may be doing it, but I want to say that the country does not know anything about your intention, and you are not making any impression on the country.

Mr. Harrison. Well, I think it is gradually seeping through to the country.

Mr. Busby. I do not know whether you know it or not, but about one-fourth of the homes in my State have been sold for taxes during the present month.

Mr. Goldsborough. How many were there?

Mr. Busby. Sixty thousand homes, 7,000,000 acres of land, one-fourth of all of the property, because the people can not pay taxes; and when people get in that kind of condition, they can not long enough to listen to fine-spun theories of fears that might arise, in the event you took some step forward.

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Mr. HARRISON. Of course, you know, Mr. Congressman, that up until the end of February we did not have capacity to do what you wanted us to do. Now, then, if you have any criticism of us, I think it is since the 1st of March——

Mr. GOLDSBOROUGH. I do not think that is hardly fair, Governor, for this reason: That the Federal Reserve Board were urged to help Congress pass such legislation long before last February. As a matter of fact, there is the bill I introduced in January, H. R. 8026, the bill which I think you are talking about——

Mr. HARRISON. I do not think you would ever have had any resistance from me on that bill, if I correctly remember which bill it is.

Mr. GOLDSBOROUGH. I do not either. I want you to understand that I am not talking about you.

Mr. BUSBY. If I gather the meaning of what you said a minute ago, it is that the Federal Reserve Board does not see the necessity for additional legislation at the present time. I do not ask you to speak for the board.

Mr. HARRISON. No; I would rather not.

Mr. BUSBY. I would rather not put the question that way, but you discussed the point.

Mr. HARRISON. I do not think there is any necessity for further legislation at the present time, if we could assume that the provisions of the Glass-Steagall bill are permanent, rather than limited to one year. That is unavoidably a restraining influence, certainly, on some of the managers of the system——

Mr. BUSBY. If you drive right up to the time when you need it, when you need any extension, Congress will be in session next year, and we have never had any trouble getting an extension on matters where it appeared to the country that it was necessary for Congress to extend them.

In the Federal Reserve Bulletin for March, page 143, you deal with the amount of gold in hand; there is a calculation that comes to this conclusion:

> On the basis of these excess reserves, the Federal reserve bank could issue $3,500,000,000 of credit if the demand were for currency and $4,000,000,000 if it were for deposits and the reserve banks.

I call attention to that because it does not appear that the Federal Reserve Board regards our position in reference to the gold standard as being at all precautious.

Mr. HARRISON. I have no tears about the gold standard.

Mr. BUSBY. Now, in your speech before the New York Bankers Association——

Mr. HARRISON. I think it was a pretty good speech, considering it was prepared in about 10 minutes.

Mr. BUSBY. I am referring or quoting from the National City Bank letter for February, in which this statement begins:

> If the United States desires to experiment with the allurements of inflation, it would not be necessary to go off of the gold standard to do so. In an address to the New York State Bankers Association during the past month, Governor Harrison, of the New York Federal Reserve Bank, stated that the gold reserves of the country would permit an expansion of some $3,500,000,000 in reserve bank credit before reducing the reserve percentage below the legal minimum. Such expansion would increase the loanable funds of the member banks by as much as $35,000,000,000. Evidently, the United States is under no credit pressure traceable to the gold standard.

Did you express that sentiment in your speech?

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Mr. HARRISON. Obviously they have paraphrased what I said.

Mr. BUSBY. I will continue with the quotation:

In regard to the sufficiency of tne gold reserves against the demands for export, and our increased currency withdrawals within the country, the present calculation reveals a surplus above the legal minimum sufficient to provide for, either, first, a loss of approximately $1,400,000,000 through exports (referring to gold); or, second, an increase of $3,500,000,000 in domestic currency requirements. In the event of a simultaneous demand for gold and currency, the reserve banks, after a loss of $500,000,000 in gold, could still provide for $2,200,000,000 in additional currency, and after a loss of $1,000,000,000 in gold, for an additional $1,000,000,000 in currency. In addition to this, the gold reserves could be further augmented somewhat by substituting Federal reserve notes, requiring only 40 per cent gold backing, for gold certificates in circulation requiring 100 per cent gold backing.

Mr. GOLDSBOROUGH. That was before the Glass-Steagall bill was passed?

Mr. HARRISON. Yes.

Mr. BUSBY. Yes.

As a final emergency measure, the Reserve bank could, under the law and upon the payment of certain penalties, permit their gold reserves to fall temporarily below the normal required minimum.

As suggested by Mr. Goldsborough, this was all before the enactment of the Glass-Steagall bill, which became effective February 24, as that, substantially, your view of the soundness of our economic situation at that time?

Mr. HARRISON. Mr. Congressman, all of that which you have read was not a quotation of my remarks, at all; it is their own comment. I think, however, that what they say there is substantially correct.

Mr. BUSBY. What I wanted to direct the attention of the committee to was that practically that same calculation is made by the Federal Reserve Board in its official bulletin of March, 1932. Now, with all of that sound situation and condition existing in this country, and the Federal Reserve Board taking such hesitant uncertain or undeclared attitudes toward tackling the economic depression with which we are overwhelmed, I can not understand the reason for the timidity, unless the Federal Reserve Board lacks confidence, just as the small banker lacks confidence in himself.

Mr. HARRISON. Well, I do not think that we are lacking in confidence, and I do not think there is anything in our program that would support that statement. I think we are going ahead. There may be——

Mr. BUSBY. I can not understand, is all I am saying.

Mr. HARRISON. There may be a difference of opinion both within and without the system as to how fast we should go ahead.

Mr. BUSBY. Let me interrupt. I think that the conditions ought to determine how fast you could go ahead. The depression, the situation with which the country is confronted, and people out of employment and others losing their homes by the thousands, because of the depression, ought to demand the most speedy type of action on the part of the agencies of the Government to relieve that condition.

Mr. HARRISON. Well, I think we are giving you that.

Mr. BUSBY. Within safe limits, you mean?

Mr. HARRISON. No; I think we are giving you that. I am handicapped by not being able to say at what rate to-day——

Mr. BUSBY. Well, I can appreciate that.

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Mr. HARRISON. But you have got to remember one other thing, Mr. Congressman. There is always difficulty about the mechanics and the speed with which we operate. First of all, it is not always easy, over a certain number of days, to buy as many Government securities as you might want. They are most popular investments and they are sometimes hard to get, and without completely disorganizing the market you sometimes can not purchase them as rapidly as you want them.

There is another reason why you may not be able to go as fast as you might like to go, and that is this: That you run the risk, if you go too fast, of flooding the market or the banks with excess reserves faster than they can use them, or faster than is wise for them to use them. The proper and orderly operation of the open market, I think, is to create a volume of excess reserves gradually, gradually increasing them, and keeping it up constantly, and not have periods when you have got excess reserves one week and none another week.

Now, there have been periods when that has been one of the defects in our operation, that the excess reserves have not been persistent enough over a long enough period; but I admit that you should have them at a time like this, and I admit that that is the objective of the system. You have always got the problem of not going so fast that you do not make for the proper distribution of credit, once you put it out.

Now, almost all the Government securities that are bought have to be bought in New York, whether they are bought for the Kansas City Reserve Bank or the San Francisco Reserve Bank——

Mr. BUSBY. I can appreciate that.

Mr. HARRISON. And we have got to buy at a rate which will give the New York banks the excess reserves which, through the ordinary and appropriate channels, will necessarily get out to the rest of the country.

We have already, as I said, bought approximately, in the $25,000,000 a week program, about $170,000,000 of Governments. In that period, the discounts, that is, the borrowings from the reserve banks, have gone down $200,000,000 partly, because our operations were supplemented by the return flow of currency and some gold. Practically all of those discounts have been retired by banks outside of New York and Chicago.

Thus, while we put the funds in New York in the first place, through the operations of the Treasury and the Reconstruction Finance those funds are redistributed all over the country, but you can not go too fast because you may clog the machine.

Mr. BUSBY. Do you regard the Federal reserve system as having done what it reasonably and properly ought to have done since 1929, to take care of the financial situation in the country? We are coming down to actual fruits of efforts. That is what I am trying to get at.

Governor HARRISON. I think with possible exceptions as to some timing and some speed, the operations of the reserve system in that period, especially considering the limitations of the law and the difficulty we had with foreign withdrawals and the hoarding of currency, were possibly as effective as we could have made them. Looking back I think there are some things I would have done differently, but on the whole I think the system has functioned fairly effectively in that period.

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Mr. BUSBY. As well as you could expect it to do?

Governor HARRISON. Without the advantages of retrospect.

Mr. BUSBY. It certainly has not been very effective in taking care of the financial situation in the country for the last three years if it has been worked at its best, according to my notion.

Governor HARRISON. That may be true if you assume that all the business depression and all the decline of prices and all unemployment could have been corrected solely by credit, which I do not think is the case.

Mr. BUSBY. I asked one other witness this question: Do you regard this system as being necessary in a financial way, to go through periods I mentioned, cycles of expansion followed by periods of deflation such as this that we are now experiencing? Do you regard that as being necessarily a permanent thing that we must look for and that we must expect? What I am referring to is the fundamentals involved in our system of national financing.

Governor HARRISON. Well, I think that you have got to expect certain swings in both business and prices that no mechanism or organization can level out completely.

Mr. BUSBY. I know, but under our present set-ups do you regard the deplorable condition into which we have gone financially as being a necessary incident to our system or set-ups that we can reasonably expect under the workings of that system from time to time?

Governor HARRISON. I think even if you had the advantage of looking backwards, and even if we had all the power that you in your liberality might have been willing to give us, most of what has happened could not have been prevented by the Federal reserve system or the banks, because there are so many other elements that have made for this depression that I do not think it is a fair charge to put the onus of all that has happened upon the handlers of credit.

Mr. BUSBY. I concede that, and I agree with you, and for that reason it seems to me that a fundamental change in the measuring of the dollar should be studied and put into operation by law so as to make the commodities that are used in commerce and trade, the price of which should be determined by their utility, the supply and demand as is determined by the Bureau of Labor Statistics—make that the basis of value and have your arrangement of gold or the yard stick to measure the exchange in relation to the commodity values.

Governor HARRISON. You are referring in that statement, I think, are you not, to the third paragraph of the pending bill?

Mr. BUSBY. Well, that is more fully set out in the third paragraph of this bill than in the other provisions, yes; but not as fully set out as in other bills introduced by Mr. Goldsborough and as outlined by some of the leading economists that have been before us.

Governor HARRISON. I am afraid, Mr. Congressman, that while I will go a long way with you in our efforts to influence prices through appropriate action of the Reserve System relating to the price and volume of credit, I think I would not agree at all in the wisdom of a law which provided for a varying gold content in the dollar. I think the dangers of that are immeasureable, and any law which provides for a change in that content may work untold injuries, not only upon us domestically, but in our foreign trade as well.

Mr. BUSBY. Well, I would like for you to explain that; but I do not want us to get into that subject now. I am so positive in my

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views to the contrary of what you state, and I know the reasons for them that I would be peculiarly interested in knowing on what you base that conclusion?

Governor HARRISON. Perhaps it would be agreeable to you to let me write a memorandum for the record at this point, because it is a very contentious point, and it is one that requires more careful handling than I am prepared to give in oral testimony now. I would like to put it in a memorandum for the committee.

Mr. BUSBY. Well, I would not want you to go into it now unless some of the other members do, because I would not want you to go into it unless I had the opportunity to question you about some of your statements.

Governor HARRISON. Well, I will just summarize my views now.

Mr. BUSBY. That is perfectly all right. Now, this is the other phase, with all the millions of people who are unemployed, who have been sold out so far as their tangible properties are concerned—turned out on the streets and who have no better future in sight than the present existence. Do you have any thought or suggestion as to legislation or the handling of bank credits or the revising of our currency basis that will keep our Nation from having to go through this situation at recurrent intervals of every few years?

Governor HARRISON. I think the more liberal powers that you can give to the system in its open market operations, especially without limitations as to time, the more effective it will be toward accomplishing what you have in mind. I do not think that there is any amendment to the Federal reserve act other than that, as to making the Glass-Steagall bill permanent, that I want to suggest at this time to accomplish what you have in mind, because so far as our influence on credit is concerned I think we have adequate powers now.

There are such things that relate primarily to the banking system such as branch banking, of which I am quite in favor, which I think will do a great deal to take care of small banks and eliminate failures.

Mr. STRONG. It will eliminate the small banks all right.

Governor HARRISON. And provide means of getting funds out into the country to the small unit banks in the country which you can not get there now. I think that is legislation that would be very helpful.

Mr. STRONG. Did you ever know a branch banking system to get any money out through the unit banks?

Governor HARRISON. Oh, yes.

Mr. STRONG. It does not do it in Canada.

Governor HARRISON. The smaller the area the better it will work.

Mr. GOLDSBOROUGH. In Canada where they have those branch banks, the people have to take their shoes off to get into the bank to borrow money. Do you know what the condition is up there? They are slaves. The average poor borrower is just a slave. You do not want any such condition in this country do you?

Mr. BUSBY. I would like to say this in deference to Governor Harrison's views, and I think he is more liberal than the average banker. This is my own statement. The people who hope to use some portion of this country for their own happiness and enjoyment find it practically impossible to do so with the bankers in the position they occupy with regard to money and credit, refusing all of these wails and appeals and ragged tramps and millions of hungry people—that does not appeal to them. It might appeal to them, they might

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pity them, but their system does not contemplate any sort of contact with that kind of individual if there is no credit in it that can be sold for a profit. They have no patience with the proposal that would take the class I have into consideration. That is my conception. You are the most liberal one I have seen, I believe.

Governor HARRISON. It is most difficult, Mr. Congressman, for the Federal reserve system (and I think it would be a mistake if it were possible) to exercise such direct control over each of these individual private banks in the country as to tell them what loans they should or should not make. I do not think any one group is wise enough to do that.

Mr. GOLDSBOROUGH. But you seem to take the view, and I don't say this as an unfriendly criticism of you and you know it, that you want to be allowed to use your unregulated judgment about a thing that affects the daily lives of 120,000,000 people without the slightest restraining influence. That is the way we see it.

Governor HARRISON. Let us reduce it to a practical case. I do not see what we could or should be doing differently from what we are doing to-day, even if you should pass this bill. I am looking for light and help.

Mr. GOLDSBOROUGH. That may be true, but there was a witness here the other day that testified, and he was a very responsible man, that he went to John Skelton Williams (Comptroller of the Currency) in February, 1920, and asked him when they were going to start to deflate, and that Mr. Williams, with tears in his eyes, said they were going to begin on May 20 to deflate. Mr. Williams told him that he had said to the board, "you will burst a great many country banks"; and that he was answered "it does not make a damned bit of difference, there are too many of them already." That he stated to the board further, "you are going to ruin a lot of farmers throughout this country." His answer was, "well, they have made so much money they won't work, let them bust." That is the testimony before this committee, and as far as I am concerned I believe every word of it, because they did start on May 20, 1920, to deflate and they destroyed the agricultural sections of this country by raising the rediscount rate. And yet, after that tremendous power was misused as it always is misused when too much is lodged anywhere, whenever anybody connected with the Federal reserve system comes before this committee they object to any sort of direction as to how they shall operate the system.

Governor HARRISON. Well, suppose we had had that direction in May, 1920, when the wholesale commodity price index of the Bureau of Labor Statistics, using the 1919 figure as 100, was 122, which was 22 per cent up.

Mr. GOLDSBOROUGH. Suppose it was?

Governor HARRISON. If we had had this mandate to maintain the stability of that index we would have had to try to deflate because the index had gone up so rapidly.

Mr. STRONG. But suppose you had had it in 1928, you would not have permitted so much inflation. Suppose you had had it in this last decline, you would not have had so much inflation. It is the inflation rather than the deflation which caused the damage.

Governor HARRISON. It is very difficult for any banking system to prevent a deflation such as we had in 1920 after you have had such an expansion for war purposes.

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Mr. Goldsborough. Economists that I think were splendidly equipped and the business men that I think are splendidly equipped and humanitarians thought the price level, having existed for several years on that particular plane, should be maintained there.

Governor Harrison. But it did not.

Mr. Goldsborough. Of course it did not, and the reason that it did not was because the Federal reserve system would not let it do it.

Mr. Strong. They do as they please.

Governor Harrison. The index went up from 100 the last quarter of 1919 to 120 the middle of 1920, within six months.

Mr. Strong. That 100 was the level before the war, and we had been through the war before that.

Governor Harrison. This 100 was in 1919, Mr. Congressman.

Mr. Strong. I thought you were comparing——

Governor Harrison (interrupting). No, sir; I said the basis of 100 was for the last quarter of 1919. The wholesale commodity price level, compiled by the Bureau of Labor Statistics, went up 20 per cent in those six months. From the last quarter of 1919 to the middle of 1920, it went up 22 points. I think that if we had had this bill in effect then we would have had to do just what you are now criticizing us for doing.

Mr. Strong. But they shot us down when the price level began to decline, instead of bringing us down easily, they just simply cut the ropes and let them fall.

Mr. Busby. It is said that when Horace Greely went to California to write up the big trees, somebody wanted to show him a bigger tree, and he said "This is big enough; the boys back home won't believe this." When you go back to the peak in 1919 for your illustration, could you jump back and show a sufficient burst of prices to give us another shock? Why do you not take from 1921 and discuss why the commodity price level was practically consistent up until 1929?

Governor Harrison. Well, we had a period of relative quiet and peace throughout the world. We operated the Federal reserve system with a view, so far as we had power, to stimulating business and prices when they got a little low and to restraining them when they began to consume too much credit. But it is very much more difficult now.

Mr. Busby. In 1926 when it began to go down you stimulated it a little, and later when it began to go higher you retarded it?

Governor Harrison. We tried to, but that was one of our diffities. The critics of the Federal reserve system point to 1927 as the cause of all our later troubles.

Mr. Busby. I remember when you were in a row with Mitchell and all those fellows.

Governor Harrison. I do not think they were right.

Mr. Busby. I did not think they were right either. I thought you ought to have stood by your guns.

Governor Harrison. No; I think we are talking about different things. I was talking about 1927, not 1929.

Mr. Busby. That is when they began to criticize you.

Governor Harrison. In 1927 business was going down and prices were going down. We were threatened with gold imports from all over the world. Business was suffering abroad; purchasing power abroad was declining. We bought about $250,000,000 worth of Government securities. We did everything we could to stimulate

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distribution of capital through foreign loans to markets abroad, to enable them to buy our surplus products. We had to stop, because when we got to $250,000,000, we saw that credit was getting unduly active and running the risk of inflation. As a matter of fact it is charged that that activity in 1927 was what started the inflation in 1928 and 1929. I do not agree with that. I think we might have been a little quicker in raising our discount rate at the end of 1927 instead of waiting until January, 1928, but that again is another question of judgment which is easier to pass upon in retrospect.

Mr. Busby. With the possibility of issuing three and one-half billions of currency you do not show an activity of more than seven or eight hundred million dollars of purchases of governments, it appears to me that you have not turned the rudder far enough, but you have just quit and let the ship drift, and then it got up headway in going down to destruction.

Governor Harrison. I think since October, 1929, we have bought more Government securities than we have ever bought in any one operation before.

Mr. Strong. Because you had a worse condition.

Governor Harrison. Yes; but it shows that open market operations alone are not sufficient to turn the tide against such forces. That is one reason why I think that any legislation that we must always maintain that price level regardless of everything that happens, is erroneous in its premise. I agree that we ought to do all that we can, and I think that by and large we have all tried to do all we could. We may not have done it perfectly, as we look back. We might not have done it at the right time, but it is so much easier to look back than to look forward.

Mr. Strong. I am not criticizing you for not doing what you now think you should have done.

Governor Harrison. Getting back to the present situation, what should we do?

Mr. Goldsborough. This move to purchase on the part of the Federal reserve system had not started seriously until this legislation was begun, until the time came that it was perfectly apparent legislation of this kind was going to be considered by Congress. What reason have we to suppose that after the probability of this legislation has subsided, you are still going into the open market and purchase in order to raise the price level? What reason have we for supposing that it will not immediately stop?

Governor Harrison. I do not think that is a fair assumption.

Let us sit down now to see what we can do. We have increased our Government securities from $147,000,000 in 1929 to pretty mear a billion dollars now. That may not be enough, but there has never been an operation as big as that in this country, or in any other country. In addition to that for the better part of that period when the price level was going down we imported $600,000,000 of gold, but even with the very rapid reduction in discount down to 1½ per cent in rate, the lowest ever known in banking history, the forces of credit ease were not enough to stop this economic depression. Now, I remind you, you might say that during 1931 we should have continued more rapidly than we did, but there were a lot of events that happened that forestalled us. First, there was the breakdown in Austria through the failure of the credit anstolt; that spread to

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Hungary, and eventually to Germany, and finally England had to go off the gold standard. Immediately after that we had a raid on the gold dollar. In a very few weeks we lost $700,000,000 in gold, the largest amount ever lost by any country in such a short time. At the same time we had currency being hoarded at the rate of a billion dollars a year, and our available free gold being diminished very rapidly to a point where, in my judgment, at the end of 1931 it would have been unwise to buy Government securities so long as we had the provision in the law that limited the free gold to a very small per cent of our real excess reserves.

I have been in favor of some relaxation in that limitation for a long time. Whose fault it is that we did not get the relaxing legislation before is not important. As soon as we got it we had an open market policy meeting and we started to buy Governments. You and I may differ as to whether that program begun the 2d of March was rapid enough or was not rapid enough. In retrospect I think I would have liked to go faster.

Mr. GOLDSBOROUGH. Do you really mean that, because if you are going to testify in retrospect then you mean you would have liked to have it go faster.

Governor HARRISON. I would have liked it faster; yes.

Now, as I mentioned it to you, the program is being speeded up both in rate and amount. After all, these are matters about which judgments always differ. They are very emotional matters. These financial questions are not an exact science, and whether the rate should be one rate or another is not the judgment of one man, but a combination of judgments. As I explained it this morning to get a combination of judgments, especially when the men come from 12 different sections of the country, is sometimes a slow process; not that they necessarily feel differently, but it takes time. Another danger of the procedure is that once you get the program started you sometimes have the same difficulty in reversing it promptly. But on the whole, considering the limitations and the difficulties, I think the open market program and policy for the last two years has been about as effective as we could have made it.

Mr. BUSBY. I will say again that you have the same cautiousness that all the other bankers have. I think if you knew where the Congress and the country through the Congress wants you to direct your efforts when you have reached that point and passed it, reverse those efforts and direct them back—if there is any efficacy in the advantages given to the several types of powers exercised by the Federal Reserve Board, they ought to be just as good and useful in one way as another. The 1920 act of the board shows that they can reverse the machinery and deflate without any ceremony, and if they had used the same tactics in inflating that they did in deflating in 1920, it is my opinion they would have no trouble in getting the ship started in the right direction, regardless of the adverse winds and waves.

Governor HARRISON. I do not think that is quite so, Mr. Congressman, for this reason. In 1920 you had the apex of an inflation that followed an arbitrary expansion of credit for war purposes all over the world.

Mr. BUSBY. You mean in 1920?

Governor HARRISON. In 1920, and prices went to unknown heights everywhere. Now, to say that the Federal reserve system broke that

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price level is, I think, not a fair statement of facts, because some time before this May 1 date to which the chairman refers you had the great crash in Japan of the silk industry. That is the first place the inflation started to break. It was inevitable that it should break sometime just as the speculative inflation in securities did in 1929. I think it was our duty to use our efforts to check that inflation in both periods.

Mr. Busby. Do you not think when the action of the Federal Reserve Board was such that it refused loans on Government securities to banks, rediscounts on loans made on Government securities, that that was a rather drastic move?

Governor Harrison. I did not know that that was done.

Mr. Busby. I went back and read the record of the thing. You think that would have been very drastic action if they had taken that course, do you not?

Governor Harrison. I personally never believed, either in a period of inflation or deflation, in what is called direct action. I think for a central bank to say that they have reached a point where they will not lend any credit at any price is wrong. I think the proper control is to apply the discount rate and to keep on applying it, but not to refuse credit at any price. To say we will not lend credit at any price on Government or any other collaterals, in my judgment is wholly erroneous principle of central banking.

Mr. Busby. But you regard the Federal reserve system as an agency of the Government for service to the people, do you not?

Governor Harrison. I would like to read a little statement that is in that paper that the chairman has. Sometime before Governor Strong died, he wrote out a little statement that was always in his desk, and has always been in my desk ever since then. I believe it spells out the real functions of the reserve bank:

> To the governor of this bank: Never forget that it was created to serve the employer and the working man, the producer and the consumer, the importer and the exporter, the debtor and the creditor, all in the interest of the country as a whole.

I believe that is our function. The difficulty is determining at what point you should lend your influence in favor of one or the other of those conflicting interests.

Mr. Busby. I will say that unless you have a point to which you hope to arrive and stabilize your financial status, that you will always be drifting from one port to another, and that seems to be the thing that the Federal Reserve Board wants us to do, not give them any chart or direction but let them drift and let them determine what ought to be the credit policy and the ups and downs of the country without any direction.

Governor Harrison. What would you do now under this proposed legislation? The bill that I see before me is a little different from the one I had at first. It says:

> The Federal Reserve Board and the Federal-reserve banks are hereby authorized and directed to take all available steps to raise the present deflated wholesale-commodity level of prices as speedily as possible to the level existing before the present deflation.

Mr. Busby. I would like to answer that. I would write in the words "1926 commodity-price levels," because at that point you balanced practically all of the debt obligations, private and public, that were in existence in this country and those debt obligations have

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been estimated by leading economists, one of which was Doctor Pearson, at Cornell, to be between $200,000,000,000 and $203,000,-000,000, while the assets of the country were $362,000,000,000, or 44 per cent more than the debts. Now the wealth of this country has changed tremendously. Those debts still stand at $203,000,000,000 until they have reached 83 per cent of the national wealth and any adjustment that you make that lowers the standard of living and the cost of reproducing the tangible property such as houses, railroads, and improvements of all kinds, any lowering in that will settle us into a permanent condition of bankruptcy, because the debts, you remember, do not reduce. Therefore I would go back to the 1926 level, and I would direct the Federal Reserve Board to stabilize prices at that point in relation to the wholesale commodity index number as ascertained by the Bureau of Labor Statistics.

Now, these things are dependable. They are not such things as you gentlemen that direct these mysterious things like the Federal Reserve Board are continually subjected to. If you continue your 1926 level, knowing your compass is directed to this 1926 level, you can come back to that point and stay by it; otherwise, the things that shift us from one way to the other will keep us an inefficient people; whereas, we ought to be a happy and contented people. That is my personal view.

Governor HARRISON. That is very clear but I forsee this difficulty: First, you feel that the 1926 price level might be the right price level. There are probably great differences of opinion as to what it should be. Let us assume that that would be desirable. Then the next question is if you were running the Federal reserve system what would you do to-day differently from what we are doing? Because after all, I am looking for the same solution you are looking for, looking for light. There has never been a time when the problem was more difficult and when there were more differences of opinion.

Mr. GOLDSBOROUGH. In the first place, we do not know what you are doing and you say you are under an obligation not to tell us. And the second proposition is this: it is a good deal like a child that misbehaves and misbehaves and misbehaves and the time comes for the child to be corrected, and he says, "If you do not lick me this time, I will never do it again." When we have been working on this thing for years and years and years, still we see the same policy as far as we can tell, pursued by the Federal reserve system, we feel that it is necessary to have some direction; not because we lack confidence in the character of the Federal reserve system, but we feel that the point of view of those in control of the Federal reserve is the point of view of the banker and not the great masses of the people which the Federal reserve was created to serve—and, of course, when I said the masses of the people I meant that to include the bankers. That is what I have in mind.

Governor HARRISON. It is almost inevitable that the Federal reserve system or any central bank will always have to be going contrary to what the banks are doing. When they are inflating we have to put pressure on them, and when they are deflating we have to boost them up. I think that is what we should do.

Now, I ask what we should do differently from what we are doing, and I ask that not facetiously. It is true, I have not said the rate at which we were buying Government securities, but I said that we had

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been buying at the rate of $25,000,000 a week since the passage of the Glass-Steagall bill, and we have increased the amount of our purchases very substantially. The point I think you should realize is that we appreciate the difficulties just as you have outlined them; and secondly, we appreciate that we should do what we can to correct them. Third, while we are trying to do what we can to correct them, we have full realization of our limitations to do what you want us to, order us to accomplish. But I do not mean by that that we should not exercise our powers the best we can. I think we are exercising those powers. I hope our program will work. I believe it will work.

The difficulty with the situation as I see it is this: Not that we are not exercising our powers, but what is going to be the effect of them after we use them? Clearly, as I explained this morning about buying securities, that operation alone accomplishes nothing because it gives excess reserves to the member banks, which is no better than gold locked up in the Federal reserve banks. That excess reserve that we give them, before it becomes useful in expanding the credit structure, must be used. It is impossible to be used for expanding credit where it is used for paying off debts of a bank. That does not change the volume of Federal reserve credit at all, but does relieve the bank under pressure, which tends to make it more liberal.

If a bank that is not in debt has an excess of reserve it still may not use it—I do not think it is the function of the Federal reserve system to tell it how it must use it or how it is to invest that money. But I believe that over a period of time the pressure of excess reserves has a tendency to work, and that credit will expand upon the basis of it. I hope that is what will happen. But at best it is a slow process which I do not see how we, in the reserve system, can speed up.

Now, you can not expect the bankers, whether rightly or wrongly, whether you criticize them or not—they are charged with the responsibility of administering the affairs of banks, protecting the depositors and shareholders as best they can, to use that excess reserve unless they have reasonable confidence in the loans they make or in the general situation. They are not going to make loans on commodities if they think those commodities are going down. They are not going to buy bonds if they think they are going down. They are not going into the bond market at all if you have legislation pending in Congress that makes for the unbalancing of the Budget or if you are making arrangements to pay Government expenses by borrowing. While this is a little bit out of my bailiwick it is a very definite problem with the banks. It is going to have a very definite effect on this program. I think if we have to face an unbalanced Budget and a soldiers' bonus it is going to make it difficult to work this program, because the banks will not have the necessary confidence to go ahead. I mention that because it does weight on the problem which we are discussing.

There have been very definite steps taken to create the confidence needed—and we need both confidence and credit. We are willing to give them the credit, but we have all got to give them the confidence which they, in a large measure, lack—many of them.

The first thing to do is to stop bank failures, which naturally terrifies a banker more than anything else. He does not know when it may spread to his own shop. The second thing is to stop the hoarding of currency.

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You gentlemen have already taken steps to accomplish those objectives. I think the Glass-Steagall bill and the Reconstruction Finance Corporation have been very effective in stopping bank failures. We have seen that hoarding, which was going on at an appreciable rate, has been checked.

The principal remaining thing that is going to encourage the bankers of the country to go ahead is largely what you gentlemen may determine as to the question of this Budget. But I do not think it is up to us in the Federal reserve system to wait for that. We are not waiting for that.

Mr. STRONG. We passed a bill through the House to balance the Budget.

Governor HARRISON. Yes; but the bonus bill to which the Congressman just referred would probably upset that.

Mr. BUSBY. That is not going to cost us anything.

Governor HARRISON. I am laboring under the disadvantage of not having read the bill. Let us forget the individual factors. Many of the factors causing lack of confidence have been eliminated. Recently, the rate of decline in bank credit which had been proceeding very rapidly, at the rate of 24 per cent per annum, has slowed up until now it is levelled out and is just about even. That is not so much, but it is an encouraging index, and if we can give the banks sufficient reserve credit plus confidence to go ahead, which we are trying to do, then I think we are doing all that you want us to do.

Mr. STRONG. Yes; but we do not know how far you are going.

Governor HARRISON. But you would not want me to say?

Mr. STRONG. Oh, yes I would.

Governor HARRISON. But I do not know how far we may need to go.

Mr. STRONG. That is what I want you to do. That is why we are trying to pass this bill. That is the trouble now—nobody knows whether you are going to buy another $25,000,000 next week, or whether you are going to quit.

Governor HARRISON. You would not have us commit the system publicly——

Mr. STRONG. I would have you say you are going along till you start this price level upward.

Governor HARRISON. But your bill says more than that; it not only says start it upward but hold it up till we get back to the 1926 level.

Mr. GOLDSBOROUGH. The bill does not say that.

Governor HARRISON. I beg your pardon.

Mr. BUSBY. That is what I said.

Mr. GOLDSBOROUGH. Let us take this as a practical situation. You are not going into the market but for just one purpose and that is the raising of the price level.

Governor HARRISON. Yes; our primary object is the raising of the volume of credit.

Mr. GOLDSBOROUGH. The purpose of your going into the market to buy Government securities is to raise the price level, either directly or indirectly?

Governor HARRISON. Yes, sir.

Mr. GOLDSBOROUGH. All right. Now, then you are assuming that what you do will be effective, that you will be able to raise the price level?

Governor HARRISON. I hope and expect that will be true.

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Mr. GOLDSBOROUGH. You hope and expect that will be true. In other words, as a matter of fact you have got the power to raise the price level, but where are you going to stop it after you start to raise it?

Governor HARRISON. That will be determined again by a lot of factors.

Mr. GOLDSBOROUGH. Of course, but if you can raise it, if you can do it, do you not think it is a good deal better for the country as represented by the Congress to tell you where to stop than it is to take the risk of your consulting with individuals who have selfish motives to subserve and with the inevitable subconscious reactions? I am terribly sincere about this thing.

Governor HARRISON. I know you are, and so am I, Mr. Congressman. I do not know whether you and I, or any one of us here is qualified to say what that point should be.

Mr. GOLDSBOROUGH. Just here Governor Harrison, I am sure that nobody could say the level which is the average from the first of July, 1921, to the first of July, 1929, which is within one-tenth of 1 per cent of the 1926 level, is unfair to either debtor or creditor. It is so near exact that it could not be considered unjust. Now then, if it could not be considered unjust why not take that as a point and begin there, and then have no trouble in the future? Of course, it may not be the exact adjustment between debtor and creditor but it will be substantially just, evidently so.

Governor HARRISON. Let us admit that that is just and that we start in—and here is where I need help because it is a practical question—to buy Government securities and bank credit begins to go up, the price level begins to go up and then goes up a little more; and then you suddenly have people to saying: "This looks pretty good; we are going to use credit now to borrow from the banks to buy securities," and you find your security values go up far more rapidly than commodity prices. That is important to us only in so far as the rise is being financed by bank credit. As you will remember in 1929 bank credit was going up so fast that we had to put on the brakes. Should we at that point continue to purchase Government securities in spite of the tremendous waste of credit in speculation? Should we continue to buy in such a situation as that? Or should we sell securities and raise rates in order to conserve——

Mr. BUSBY. That is where you use your discount rate—18 or 20 per cent would do the work, and if you want to run this ship straight, put on enough pressure on your rudder and run it straight; and when you need it straightened up, straighten it up instead of toddling along with this bunch of bankers we are trying to tease out of the hole now with this seductive, oily method we are applying and they will not come out yet.

Mr. GOLDSBOROUGH. The difficulty about your argument is that you go back every time to the fact that the whole country is under the control of the New York stock market. I do not agree with you.

Governor HARRISON. I do not agree with that either.

Mr. GOLDSBOROUGH. I think we ought to have other legislation to control the stock market.

Governor HARRISON. Yes, but the reserve system has its responsibility to use its influence on the total volume of credit, and if it is going up too rapidly and at a rate quite disproportionate to normal growth of 4 per cent a year, we have to use our influence to check it,

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no matter whether that credit is used for the purchase of commodities or securities, or real estate, or what not.

Mr. GOLDSBOROUGH. Your rediscount rate would enter there, would it not?

Governor HARRISON. Not if you are buying governments. We do two things to control an inflation of credit; we decrease the supply and increase the rate. Buying governments and increasing the rate are inconsistent operations.

Mr. STRONG. Why not look at the commodity price level and not look at the stock market?

Governor HARRISON. A moment ago you gave me the devil bcause we did not sell securities fast enough in 1928 when bank credit and securities were going up; but when the commodity price level was going down.

Mr. STRONG. After the armistice you let the price level go up to 246, and then you let us stay there and toboggan downhill and you cut the rope and let us fall. You might have let us slide downhill and put a little sand on the track by buying some bonds.

Governor HARRISON. I agree with you that firmer brakes should have been put on in 1929; a lot of us felt that way. But I do not agree with you that because we failed to do that we should never have put on the brakes at all.

Mr. STRONG. No, I am only objecting because you did not put the brakes on soon enough, and when you got us up to the top of the hill you cut them off and let us go down to a bad fall. I thought you ought to buy some Government securities there and soften the fall.

Governor HARRISON. You know it is an interesting thing to look at that chart. While commodity prices began to decline in May, 1920, the Federal Reserve credit continued to expand for six months longer, or until December, 1920.

Mr. STRONG. That is true, but when you get along down in here the summer of 1920 if you had begun to buy securities, we would not have hit the bottom.

Governor HARRISON. I think probably we should have done that, and if we knew what we now know we most likely would have done it.

Mr. STRONG. The only controversy I have with you is that which I had with Governor Strong. He admitted he had been stabilizing the market for several years by the use of the open market and rediscount rate; but he said, "Do not tell us to do it. We are going along all right." We did not tell him and he did go along all right till 1929 but if in 1926 we had passed this bill, you probably would not have tumbled so much after 1929. The bankers went to the Federal Reserve Board and said something in their ears, and they took their eyes off of commodity price levels and got them on to the stock market.

Governor HARRISON. There has never been a more active use of the open market or the discount rate than in the last three years.

Mr. STRONG. I understand you tried to use the system, but you did it in a lackadaisical way.

Governor HARRISON. That was not entirely our fault.

Mr. STRONG. I do not blame you, but I blame the system.

Mr. GOLDSBOROUGH. Have you ever, in spite of the fact that all we can get from the Federal reserve system is that they have been compelled to devote their activities to trying to control prices on the New York Stock Exchange have you ever heard of any body con-

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nected with the Federal reserve system coming down here to help us get legislation through to control, the New York Stock Exchange?

Mr. STRONG. No.

Mr. GOLDSBOROUGH. Have they not been down here opposing such action?

Mr. STRONG. When I got back last fall, I was out at somebody's reception at the Mayflower, and I met one of the great advocates of branch banking that used to be on this committee, and he said to me: "We tried your scheme out on the stock market." I said, "For God's sake, why didn't you try it on the commodity market?"

Governor HARRISON. We could not buy Government securities with a view to boosting up commodity prices in 1928 and 1929 because the funds would have been diverted inevitably to the stock market.

Mr. STRONG. You did it in 1920. You came out in our country and said "You must not lend money to people to buy automobiles; you must not rediscount paper to buy automobiles." That is what you did in 1920 when you were going down hill, but you did not do that in the case of the stock market in 1928 and 1929?

Governor HARRISON. I think that was a great mistake if they did that in 1920.

Mr. STRONG. I wish you would think the same thing about the stock market.

Governor HARRISON. I do. I think it is a great mistake for any central banking system to attempt to tell people of the country just how they should use their credit. I think when credit is going up too fast in proportion to normal uses, it is incumbent upon the central bank to put the brakes on. We heard all during 1929 that it was a great mistake to raise the discount rate to 6 per cent because that would have had a deterrent effect on business. I think it would have been a God-send if we had done it, because business itself was going along pretty well at that time—faster than it could have gone for a period anyway. I dislike to argue with you this way, because it appears to you that I differ with you more than I do. I am for control but not for having the reserve banks or the Reserve Board by direct action tell bankers what loan or loans they shall or shall not make. I am in favor of the open market to the limit and the discount rate to the limit, and believe that in that way—especially now that we have minimized the possibility of the other than bank loans for stock exchange purposes—you have the best method of controlling excessive uses of credit.

Mr. STRONG. I am positive that you are in sympathy with this situation and I get my knowledge from the time I went up to New York to get Governor Strong to help me write a bill for stabilizing the purchasing price of money. I met you then and talked it over. I am confident your sympathy is in favor of so using the open market operations. The only thing, you are inclined to say "don't tell us to do it; let us do it of our own volition," and I am afraid somebody else is whispering in your ear when to do it and when not to do it. I do not want to be discourteous or anything of the kind.

Governor HARRISON. There probably never has been a central bank that has done so many unpopular things in its own community as the New York Federal Reserve Bank.

Mr. STRONG. I do not think you could satisfy those bankers in New York, anyway. Since the Glass-Steagall bill was passed the

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Federal reserve banks have purchased $245,000,000 of Government securities and then later you say you commenced to buy $25,000,000 a week for seven weeks, which would be $175,000,000. Where is the difference between the $175,000,000 and the $245,000,000?

Governor HARRISON. You will have to look at our statement on Friday.

Mr. STRONG. Can you not tell what that difference is?

Governor HARRISON. I was referring to two different things. I was referring to what was bought under a certain program at $25,000,000 a week.

Mr. STRONG. That was during the last seven weeks?

Governor HARRISON. Yes.

Mr. STRONG. Then you said you had bought $245,000,000 since the passage of the Glass-Steagall bill, which was $70,000,000 more than the $175,000,000?

Governor HARRISON. We have bought more since that last statement.

Mr. BUSBY. I am impressed with one thing. You always refer to the stock market in connection with the Federal reserve system. There ought to be some study made so as to take the operations of the stock market or the weight of its operations off of the Federal ieserve system, so that the Federal reserve system could supply credts to and serve the rest of the country and not have to devote most of its time to the New York and other big stock exchanges. I am not proposing any special plan for legislation, but it does seem to me until we can divorce the Federal reserve system from the New York Stock Exchange it is going to be difficult for it to function for the benefit of the people. I am not saying that in a reflecting manner, but as my impression of a serious situation.

Governor HARRISON. The difficulty is this: That every bank that does any business opens its doors and receives deposits and gets a lot of funds. As a rule the funds which it receives on deposit are in excess of the commercial demands of its own community. The various 30,000 banks we once had all over the country (now around 20,000) employed a large part of their funds in commercial loans to their customers. Then they employed any excess funds over what they had for their commercial customers in loans to other customers whose only credit was some security, bonds or stocks. You and I may have a doctor's bill to pay and we go to our bank and our credit is not too good. We have no satisfactory credit, except the obligations of American industrial concerns. We put up that as collateral to secure a note. As a result of that practice you have in the banking system of the country a large per cent of customers loans predicated upon stocks or bonds. It is not right to assume that all those loans are speculative loans. It is not possible for us in the Federal reserve system to determine which are legitimate and which are speculative.

Mr. BUSBY. I can see that you can not regulate the operations of the New York Stock Exchange.

Governor HARRISON. The result is that when we see the volume of credit going up too fast, whether it is for investments in stocks, bonds, or commodities, we have to put on the brakes. We have never in New York tried to tell the banks in which category of loans they must contract, or how they must control their loans; but we have tried to use the open market and rediscount rate as an effective re-

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straint on a too rapid expansion of credit. And I believe over a period of years—after all we are quite young as a system—the best way to accomplish this is prompt use of the rediscount rate, regardless of where the credit is going; and by the supplemental use of open market operations.

There has been a difference of opinion in the system. There were differences of opinion in 1929. We think we were right. The Federal Reserve Board think they were right. No one knows now whether it would have been better to increase our rediscount rate higher than we did. I personally believe it would have been better. I can not but believe that the pressure of the discount rate upon rediscounts that were forced into the Federal reserve banks by sales of government securities would have been effective.

I would like to say here what I have said before other committees, that I still believe it is essential at some time and in an appropriate way to make sure that all commercial banks of the country are members of the Federal reserve system so that open market and discount rate pressure will impinge on all banks and not just a part of them.

Mr. Busby. If you want my opinion, I think we are getting too well machinized and too well organized in the banks and stores and everything else for an individual to have any sort of chance in the scheme of things in our country; and the more you get it aligned with organizations, the heavier will be the fall as we are experiencing now when the whole organization falls, because you have not those sustaining independent units to carry on. I think that is one mistake of the comptroller and every big banker that comes in here. They want to put the credit of the country in the hands of a few dependable people because the few people out here in the hamlets and small towns that organize their banks are not dependable, and these people out here are not willing to risk them with their own affairs.

Governor Harrison. Of course there would be no greater concentration of power in the world than in the Federal reserve system if this bill were enacted into law, and were we given the power to do what you are directing.

Mr. Goldsborough. No; I do not understand what you mean. All we are directing you to do under this bill is to raise the price level to a certain point and then maintain it. The purpose is to do justice to everybody, human justice; and God in Heaven knows that we have not got it now.

A young man who bought a farm a few years ago for $5,000 and put a mortgage of $2,500 on it, might be the most honest and most dependable and most industrious young man in the United States; and yet, he is broke now. He can not help it, and he can not understand why it is. He is completely demoralized. His morale is gone. It is through no fault of his, but through the fault of our fiscal system.

Governor Harrison. If there is any way we can correct that——

Mr. Goldsborough. I say all that this bill does is to ask that the board use all the powers it can to maintain justice. That is all. That is everything there is in the bill.

Governor Harrison. Of course it is hard to defend one's own position but I think we are doing all we can do.

Mr. Goldsborough. Governor Harrison, I do not say that to-day, the 13th day of April, 1932, you are not; but I do say this emphati-

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cally, that there have been thousands of bankruptcies and thousands of suicides because this policy which you may have adopted to-day was not adopted before, and this committee, to my certain knowledge, has been urging this thing for months and months and months. We urged it long before we had the meeting on October 6 with the President when this Reconstruction Finance Corporation matter was brought up. It was said there that the Reconstruction Corporation would not do it. The governor of the Federal Reserve Board was at the meeting and now for a member of the Federal reserve system to come before this committee and say: Don't pass this legislation because to-day we are doing the best we can is not very convincing, do you know?

Governor HARRISON. I am giving you my best judgment as to what I think is the right position on this bill, and if we differ I am sorry; but I do think this: That perhaps we do not differ at all as to procedure. The thing we differ on is what you outlined as you began the afternoon session that is the wisdom of putting into the law a mandate on the reserve system to restore a certain price level as it existed at a certain date, whatever date that is, when the reserve system is only one factor in attaining the objective which you want us to accomplish.

Mr. GOLDSBOROUGH. You said a few moments ago—if you desire to modify your statement you may do so, as a great many of mine have to be modified—if I understood it, that the purpose of the Federal reserve system in going into the open market was to raise the price level and you believe they could do it.

Governor HARRISON. That I hoped and expected that we would. But as to how far up the price level will go through the use of credit alone nobody here could tell. You know as well as I know that the price level is determined not entirely at all by the volume of credit in this country. It is determined certainly, in part, by the volume of production in relation to the volume of consumption. Many of the commodities in the price level which you are making the index are world commodities that are influenced by all sorts of world conditions wholly beyond any influence of the Federal reserve system.

Mr. GOLDSBOROUGH. I know, but if the quantity theory of money is sound, then the open market operations, while it may not act as rapidly in one case as in another case, is bound to be effective, it seems to me.

Mr. STRONG. With the use of the rediscount rate.

Mr. GOLDSBOROUGH. Oh, yes.

Governor HARRISON. I think it is very apt to be effective, provided we do not have droughts, and provided we do not have wars, and provided we do not have complete stoppage of our foreign markets, which after all determine the price of many of our commodities. I do not remember the exact terms of your original bill, Congressman Strong, but it was not, as I remember it, so specific as this. I think there is a real danger in making it too specific because the implication is that Congress is sure that we can accomplish the objective, and I am not so sure as that.

Mr. STRONG. When I was up in New York with Governor Strong and he finally agreed to let Mr. Burgess and Doctor Commons get together and see if they could prepare a bill, they prepared a bill and he corrected it and I corrected it, and finally he had it over at

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Atlantic City and sent for me and he and I went over the bill. The language of that bill is Governor Strong's language—nearly every word of it. That was the bill wherein he provided for a study of the Federal reserve system. We have all realized since that some of the officers of the system required more information about the system and the use of the powers Congress had given them. He was so positive that that bill ought to be accepted by the Federal Reserve Board that he arranged a meeting here in Washington, and I and the chairman of this committee attended that meeting. It began in the morning—I can tell you the exact date because it is the date of my first speech on the subject. I came down to the House and made my speech and went back and spent the afternoon with the board and Governor Strong. At that conference Governor Strong's statement was the same as yours is now. He had been doing a very good job of stabilization with the open market and rediscount rates. Of course, he said as you have said, that "if there were a war or something very unusual should happen it might not be so successful," but under ordinary conditions it would be. Now, you are proceeding upon that theory. We could not get the Federal Reserve Board to look with favor upon the bill. They took the same position you do—"Do not direct us to do anything; let us do it; we know how now and we are going to do it."

Governor Harrison. As I remember the terms of that bill I do not think I was opposed to it, Mr. Congressman.

Mr. Strong. I do not think you were.

Governor Harrison. What I think the difficulty is in this particular bill is the specificness with which the object is defined, and the implication that the Federal reserve system has the power to attain that objective and to feel the responsibility for failure to attain that objective.

Mr. Strong. The Federal Board was going along very well in 1926 to 1929, and we failed to pass the bill. The reason we failed to pass it was because the dollar was on speaking terms with everybody, and now it has got so high that everybody wants to get it down.

Now, we have this bill and its purpose is to make the price level of commodities go back to the place where the producer can sell what he has and pay his debts. The purpose of the present situation is to force the farmer to pay his debts with 30-cent wheat, it would compel every man to pay his debts at the depreciated commodity price level. Consequently we put into this bill that if you can go back to conditions in 1926 and stabilize there, we think you ought to do so.

Now, what I am getting at is this: You take the position now that all things being equal, no wars or famines or anything like that, you could stabilize pretty well by use of the open market and the discount rate. Simply because you have not done so from 1929 to this date we feel certainly the time has come when the Federal Reserve Board should be given directions by Congress to so use its powers. Congress built this system. The members of the Federal reserve system did not build it. We placed these powers in your hands. Certainly we made a mistake when we did not direct your use of them. We did not. We feel they have not been properly used. Banks have been wrecked, business houses have been wrecked; factories have closed down; people are out of work, and everything financially is in chaos. Now, we feel you all have had plenty of time to wander around, and

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you ought to now use the powers Congress has given you to stabilize the purchasing price of the dollar. But as you said the Federal Reserve Board did not agree with you in 1929, and members of the Federal Reserve Board did not agree with Governor Strong in 1920. The first time I had very much conversation with him was at dinner downstairs. He was telling me how he believed in this thing and how it could be done, but that they ought not be bound down too close. I said to him, "Where were you in 1920?" He hesitated a little bit, and he said, "In Washington." I said, "Were you with the Federal Reserve Board?" He looked me in the eye and said, "Mr. Strong, I was; and with all the power I possessed I tried to prevent that resolution." I said, "Governor, if this bill which I propose had been on the statute books then you could have pointed to it and told those gentlemen not to pass that deflation resolution because it would be against the law."

That is the first time I got him interested in helping to suggest wording for a bill. He was afraid of this jealousy of the Federal Reserve Board. He was afraid if he helped me to prepare a bill he would destroy his standing with the Federal reserve system. Several weeks after the bill was introduced we had expected that when Governor Young came before the committee he would say something in favor of the bill. He came and stood at the head of this table, and Mr. Wingo asked him his position on the bill, and he said, "We are opposed to it." Then you come along now and tell us that in 1929 the board did not agree with you; that you were right and they were wrong. Now, it seems to us that after this experience in history we ought to have reached the time when we should do that which we should have done when we passed the law—"direct the Federal Reserve Board how to use the powers we have given them." We have given them the powers to regulate the volume of money in circulation among the people of the United States. We have given them the power to regulate the cost of it by the rediscount rates; we have given them the greatest powers ever given to any group of men except in matters of life and death and liberty. Now, after all this experience we still believe that we ought to direct the policy to which such powers should be used. You are pulled here and yon by one group of bankers or another; or, at least, they try to influence you. Now, we say, "Do not look at the stock market, but look at the index of commodity prices and let that be your guide," you will have something to go by. If you take the guide of what you think is best to-day, to-morrow, and the next day, you have no objective, you get nowhere. So we believe that you should try to use these powers to stabilize money to commodity prices. I can not see any harm that could come about through doing that. I do not see why we should not try it. I do not see what worse could happen than has happened since 1929.

Now, what I want to know is, what do you think would be wrong in passing a bill simply directing the use of the powers we have given you toward stabilizing the purchasing power of our dollar.

Governor Harrison. Suppose we had had the bill two or three years back?

Mr. Strong. Yes.

Governor Harrison. And the stock market had broken as it did? And then the commodity price level began to fall off, do you think

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it would have been possible for us through the use of the open market to stop that decline in commodity price level?

Mr. STRONG. I think before it got too high you could have stopped it, and I think when it broke you should have come out with a prompt policy to purchase securities, right along and decrease the discount rate.

Mr. GOLDSBOROUGH. Governor Harrison, you remember the first of 1930 it seemed that the market was rising and we were getting back to normal conditions, till after the market operations stopped?

Now, you say you are going into the open market and buy $25,-000,000 a week, and how long you are going to continue you say you do not know. I imagine you do not know what position you are going to take. Therefore, I think we should direct that you continue trying till the better price level is reached, otherwise you being one of several, your associates might say: "Now, we have bought enough of these bonds." Whenever you quit buying these bonds the price level is going to sag.

Governor HARRISON. Of course, you are assuming that we have unlimited power to do it, but in face of world conditions it might be impossible to get up to that level of 1926. We can use our credit, but we can not be sure of the effect on the price level. You would not have us go ahead indefinitely diluting our gold reserve if the only result of it was clogging up the banks with excess reserves which the banks would not use. It is perhaps less difficult to control an inflation than a deflation, because you can not make people buy goods if they do not want to, no matter how much credit you give them.

Mr. STRONG. Especially if they have not the money?

Governor HARRISON. We can give it to the banks, but we can not be sure as to how far they will have confidence to use it.

Mr. STRONG. If we have come to the point where the banks are not going to function and use the facilities we have given them and help business of the United States, it is about time the Government of the United States should take over that system. I do not believe in that, but if the bankers of the United States are in such frame of mind—now that Congress has passed the Reconstruction Finance Corporation and the Glass-Steagall bill—that they are saying, "we can borrow this money and lend it to business to go ahead but we won't do it," it is about time the Government took over the system.

I have always been an earnest friend and supporter of the Federal reserve system. I believe it protected our dollar in the World War and made it the best dollar in the world. But I am fast getting to the point where I think the bankers of the United States have too much to do with the Federal reserve system. I commence to doubt whether or not the Government should put into the hands of men who deal in money, for profit, the facilities to regulate the volume and price of the money to the people and I wonder if the bankers are not too close to the Federal reserve system; and if we should not put business men on that system instead of bankers.

Governor HARRISON. I think it is very necessary for the record here first to show that we deny the challenge that we are influenced by the banking group of New York. I do not think we are. I will tell you the reason why——

Mr. STRONG. What influenced you when you said you differed with your associates in 1929 and they overrode you?

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Governor HARRISON. The Federal Reserve Board overrode us. There are only three directors of the Federal Reserve Board that are bankers. That is the class A directors.

Mr. STRONG. Those are the fellows who run the banks?

Governor HARRISON. No; they are not the ones that run the banks.

Mr. STRONG. The others are class B and class C directors?

Governor HARRISON. Class B directors are the ones who represent business and class C are appointed by the Federal Reserve Board to represent the public at large. There has never been a time when I think the policies of the Federal Reserve Bank of New York have been dictated by the banking community as distinguished from our board of directors. And I do not think there is any way you can get confirmation of that any better than by talking to the directors themselves or to the New York banking community.

And if the time ever comes when Washington or New York or any other place justly feels that the New York Reserve Bank is controlled by the banking community rather than by our interpretation of the best interests of the country, I do not want to be in the bank.

Mr. STRONG. I was directing my criticism not to your bank, but I am talking about the system. Do you remember that during Mr. P. G. Harding's administration they came down to us and got us to put in a step-rate proposition?

Governor HARRISON. Yes.

Mr. STRONG. And they told us they wanted to control the banks in New York City, and they did not put it into effect in New York but put it in effect out in Kansas?

Governor HARRISON. I think it was a mistake.

Mr. STRONG. It was a mistake. The more I discuss this proposed legislation with bankers and business men the more faith I have in it, the more I believe when we give the Federal reserve system these great powers we should have given them some direction for their use, and I believe now that we have given them a pretty fair trial and they have not been any use to the country except when Governor Strong used them for stabilization. I feel that we should pass this law.

Now, we have gone just about as far on deflation as this country can go, and I want to say to you, from conferences which I have had with other Congressmen, the point is about reached where the people are going to have some inflation. They have been deflated till they are about ruined. We are going to have some inflation or we are going to have some very drastic legislation, and I think this is about as wise a thing as we could do; to direct the Federal reserve system to use the powers they have to influence some inflation and then give us stabilization of commodity prices through a dollar of stable purchasing power.

Governor HARRISON. I do not believe there is anybody in this room more sympathetic with your desire than I am to correct conditions that have become intolerable throughout the country and the world. There has never been a time when we have had an economic crisis that affects a greater number of people or as great a number as this one does, or which has resulted in a greater number of unemployed that this one has resulted in. I do not think there is any better task that the Congress of the United States or the people could put themselves to than to remedy that situation.

I do not think there was ever a time when it was more necessary for the bankers and members of the Federal reserve system to exert

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every influence to solve this problem. I hope and pray we may find some way that will do it. I believe as far as we are able to do it we are now aiming in the right direction.

It is my desire to be just as helpful and cooperative in attaining what you are trying to attain as I can be, Mr. Congressman. My judgment is not just a stubborn resistance to being told to do something. If I thought that was the way to do it I would be for it and for it a thousand per cent.

Mr. STRONG. I have got so much confidence in you that I am willing to give you a direction to back you up.

Governor HARRISON. My only question is whether or not you can do it in some fashion——

Mr. STRONG. I believe in your heart you can do it, you are trying it now?

Governor HARRISON. I hope it will be successful. I think if there should be any legislation on this subject, the more general and less specific the better, because otherwise the people will have given us a mandate which may never be carried out, through nobody's fault.

Mr. STRONG. That might be, but I do not think any bill we have ever had here has been given any more critical study than the one that Governor Strong wrote, and I believe he is the world's best expert. He changed every little word, here and there, and yet when we came to the Federal Reserve Board after an all-day conference, they came to this committee and said, "We are opposed to it." When we asked them why, they said, "Well, because we do not know whether we can do these things or not; and we ought not to be dictated to." It is the same old excuse and it does seem to me it is pretty nearly worn out.

Governor HARRISON. And I am just as anxious as you or some of the members mentioned here to do what we can through appropriate and wise channels rather than through unwise and uncontrolled channels.

Mr. STRONG. I want to say to you that I know of no man in the United States that I have more confidence in as the head of the New York Reserve Bank than yourself, but unfortunately there are not enough of you to fill all offices in the Federal reserve system.

Governor HARRISON. I appreciate that, but I do not think it is quite deserved.

Mr. STRONG. I want to ask you one other question: Have the governors of the Federal reserve banks availed themselves of the Glass-Steagall bill by purchasing government bonds rediscounting their eligible paper and trying to relieve the situation or have they simply used it in their banking business in purchasing sufficient bonds to cover their commercial paper? Do you think they have really tried to bring about some inflation through the facilities afforded by the Glass-Steagall bill?

Governor HARRISON. I think every dollar of bonds we have bought since the passage of the Glass-Steagall bill has been under the assurance of that bill that we can use government securities as collateral to notes if we have to use them. The fact that we have not had to use them does not mean that we have not realized that when necessary we can use them.

Mr. GOLDSBOROUGH. I believe that one of the reasons why this subcommittee is thoroughly convinced it is on the right track is

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because of what you have told us to-day, that the Federal reserve system is doing the thing we have been trying to get them to do for a long, long time. I think one other reason is because we prophesied to them what was going to happen to the country if they did not adopt the policy which you indicate they have. I am like Mr. Strong; how it can possibly injure the operations of the system or how it can possibly affect detrimentally the confidence of the country for the people to know you have a specific direction to use your powers to do a thing—whether it can always be done 100 per cent perfectly or not, is another question—we do not see. My opinion is that your views and ours are really not so far apart. I may be entirely wrong about that. I am not attemping to speak for you. That is my own opinion.

Governor HARRISON. I do not think they are far apart. Yet, there is one thing that worries me, and that is this: In that bill as drafted the commodity price index is made the sole guide of the Federal reserve system policy, and if the price level should continue to go down we would have to buy Government securities regardless of whatever else may happen.

There is one other hestitation I have about the bill. In a period such as we had this fall when England went off the gold standard, banks were failing right and left, currency was being withdrawn from the banks, and gold was being exported very rapidly. It would have been a very unwise and dangerous thing for the Federal reserve system to continue to dissipate its credit in the purchase of Government securities at such a time and yet in that situation last fall we would have had to do it had this bill been law for the price index was going down.

Mr. GOLDSBOROUGH. Yes, but you would not have had that situation if we had had this direction to stabilize. If you had had this direction to stabilize instead of thinking about what some individuals might think of your policy to-morrow—if you had had this as your North Star and had this as your policy and discussed your work in reference to this policy and pointed to it all the time, you would never get in a position such as you were in as you indicate last fall.

Governor Harrison. Do you think that is true when you consider that that situation last fall was the result of a combination of world conditions which was overwhelming?

Mr. GOLDSBOROUGH. World conditions, Governor Harrison! If we had had a definite policy of stabilization in this country world conditions, in my judgment would never have become anything like as drastic and serious as they were. We are absolutely at this time in a position, not only because of our present gold reserve but because of our tremendous productive capacity over and above what our people can use, to control the fiscal policy of the world. There is no doubt about that.

Governor HARRISON. We no doubt have great influence. But for instance, back in 1926 and 1927, when there was a tendency for business to "slough" off, and commodity prices were declining we were easing our policy considerably for two reasons: We wanted to give what stimulus we could to business activity and prices here; and furthermore, we wanted to facilitate business activity and the export of capital to markets abroad, which had been gutted of capital as a result of the war and whose purchasing power for our goods was severly

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curtailed because of lack of capital. That policy worked pretty well for a while. A great many New York bankers are now being criticised because they issued foreign loans. I think at that time it was the right policy even though certain individual loans may not have been wise ones.

Governor HARRISON. I do not quite know whether I have given you the views that you expected or wanted as to the different provisions of the bill. I want to conclude as I began, that I think this problem is the most important before the country. I think that the more people study it earnestly and sincerely as your committee is doing, the more chances we have of a solution. I have great sympathy with the fundamental principles which you have in mind but differ fairly vigorously I think as to the weight which you put upon our powers of accomplishing those objectives.

I think, as I said to Congressman Strong, that if there should be any legislation along the lines of your bill that it would be to the best interests of the country, quite apart from the Federal reserve banks and managers of Federal reserve banks, that there be no such definite mandate as to virtually make it impossible for us to conduct the operations of the reserve system soundly except as it happens to be consistent with the commodity price level. You know if you will look back over the records of the years, there are various times where the commodity price level has not responded to the volume of credit. All that I want, admitting sympathy with your object, is to be sure if possible that there is no legislation which assumes too much or puts upon the reserve system an impossible burden, the failure to carry out which not only casts discredit and reflection upon the system but ultimately does more harm than good.

Mr. GOLDSBOROUGH. The difficulty is that the Federal reserve system resists anything except a status quo in spite of all this condition.

Governor HARRISON. I do not know what the rest of the system feels about it. My own principal criticism of the bill is the one I just gave you. I think it assumes powers for the Federal reserve system that it does not have.

Mr. STRONG. What harm would it do to assume that?

Mr. GOLDSBOROUGH. Could you have any higher function than to try to work economic justice between debtor and creditor?

Governor HARRISON. I think as far as I am concerned that will always be its objective.

Mr. BUSBY. I would just like to quote about eight lines of verse from Whittier as a motto for the Federal Reserve Board:

> Life is a leaf of paper white
> Whereon each one of us may write
> His word or two, and then comes night.

I apply that to the do-nothing policy of the Federal Reserve Board.

Governor HARRISON. I have failed indeed if I have failed to convince you that we are exercising our powers to the limit.

Mr. GOLDSBOROUGH. I do not think Mr. Busby meant the slightest reflection on the Federal reserve system but this secretive policy. I admit that a frank exposition of what you are going to do might do harm for a little while, but nothing could sooner restore confidence of the people in the Federal reserve system and nothing could make it easier for the policies of the Federal reserve system than to give out

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openly and frankly what it is going to do. Nobody knows to-day what the Federal reserve system is going to do to-morrow.

Mr. Strong. There are some that know.

Governor Harrison. I hope it will be possible for me to go over the record. If you will permit me to insert a few charts it might be helpful. I am sorry as I conclude that I did not pursue my original intention of referring to each of the last four periods just as a factual statement of what we did do and what we did not do, because I think it would be helpful.

Mr. Strong. Put that in the record.

Governor Harrison. If you do not object to my preparing a memorandum on that and putting it at the end or at some point in my statement I shall do so. It is just a factual statement and not argumentative.

Mr. Strong. That is what you have done in the past here.

Governor Harrison. Yes, sir. I would like to take it up in four different periods, from 1922 to 1927, inclusive; then from 1928 to 1929, inclusive; the end of 1929 to the middle of 1931, and then from 1931 to the present.

Mr. Goldsborough. I think that has more merit to it than demerit. I do not believe that this Committee or the House or the country will be benefitted by special pleading of the Federal reserve system as to what it has done for the country in the past. I do not believe that will help any. I have no doubt—in fact I am sure after what you have said that you did go out into the market when the market burst in 1929 and tried to stabilize it; but that does not solve this problem one way or the other.

Governor Harrison. I would like to follow that up and show month by month what was done during the several different periods.

Mr. Goldsborough. Without objection, it will be permitted.

(Thereupon, at 5 o'clock p. m. the committee adjourned until 10.30 o'clock Thursday morning, April 14, 1932.)

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STABILIZATION OF COMMODITY PRICES

THURSDAY, APRIL 14, 1932

House of Representatives,
Subcommittee on Banking and Currency,
Washington, D. C.

The subcommittee met, pursuant to adjournment, at 10.30 o'clock a. m., in the committee room, Capitol Building, Hon. T. Alan Goldsborough, presiding.

Present: Messrs. Goldsborough (chairman), Busby, Prall, Strong, and Beedy.

The Chairman. The subcommittee will please come to order. To-day we will hear from Mr. Eugene Meyer, the governor of the Federal Reserve Board.

STATEMENT OF HON. EUGENE MEYER, GOVERNOR OF THE FEDERAL RESERVE BOARD

The Chairman. Governor Meyer, will you state your connections for the purposes of the record?

Governor Meyer. Governor of the Federal Reserve Board and also chairman of the board of directors of the Reconstruction Finance Corporation.

Mr. Goldsborough. You have read H. R. 10517, have you?

Governor Meyer. Yes, Mr. Chairman.

Mr. Goldsborough. Now Governor, I think when you appeared before the committee before, you completed your statement and then the subcommittee or any member as the case might be, might ask you such questions as they thought should be asked, and, if you so desire, this hearing will so proceed.

Governor Meyer. That would please me very much, Mr. Chairman.

I had the opportunity, Mr. Chairman, of reading a part of the record of the hearings conducted by the committee which has been put into print.

Mr. Goldsborough. That was up to the time Governor Harrison appeared before the committee yesterday?

Governor Meyer. I think so. The subject is such a large one and I have been so occupied with my various administrative duties—and it has been necessary also for me to be present at hearings before other committees—that, if I have not a prepared statement to give you in the beginning, I hope you will understand that it was not that I did not want to take the time to make a careful and formal record of my views, but rather that I have not had the opportunity.

Mr. Goldsborough. If at the conclusion of your statement, Governor, you should like to correct the record before it is printed, we shall be very happy to give you the opportunity?

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Governor MEYER. I thank you, and possibly to add to it if I may?

Mr. GOLDSBOROUGH. Yes.

Governor MEYER. Anything that occurs to me?

Mr. GOLDSBOROUGH. Yes, sir.

Governor MEYER. The whole question is one that has been so much under discussion in the press at home and abroad that it is hard in any limited period to attempt to do justice to it. I appreciate the fact that the members of the subcommittee are approaching the problem in a serious and earnest way, and are anxious to make a contribution of importance to the public interest. I have every sympathy with your general purpose. If I see difficulties which perhaps you do not quite visualize, it is perhaps due to my somewhat intimate experience with the administrative side of this sort of work and to my contact and experience with other factors which I think affect the practicability of accomplishing your purpose entirely by the means here suggested of control over the volume of credit or currency.

Stability as I see it is affected in an important way by the volume of currency, including both credit and currency in this general concept. I do not feel, however, that it is the only factor, and I have in mind that any instrument such as the volume of credit, if used in accomplishing or attempting to accomplish such a purpose, has to be considered in relation to a great many other important factors in the situation. For example, I do not think anybody can say right now how much currency is actually hoarded. We use estimated figures to indicate that amount, but in view of the large number of banks that have been closed within the last two years, and the consequent greater use of cash in business, in small amounts in each case, perhaps, but in a large aggregate amount, it is impossible to determine or even to estimate how much of the so-called hoarded currency is not really hoarded but is made necessary by bank closings.

Then, too, with the change in the banking situation, there has been in the past year and a half or two years a considerable decline in the number of small accounts that are paid by checks on account of charges imposed by banks, and that may have been a factor affecting the volume of required currency. Of course, offsetting that is the fact that under normal conditions with the diminished volume of business and the lower price level, it takes less money in circulation to transact business. I mention this merely because it brings out some of the difficulties with which anyone charged with responsibility for regulating the volume of currency would have to contend.

I regard the efficiency of the banking structure as an important element in achieving stability in the price level, and in using for that purpose, to the extent it can be used, the regulation of the volume of currency and credit.

I had the privilege of appearing here, not before this subcommittee, but before the whole Committee on Banking and Currency, as far back as in January of 1923, when I said after a study of the banking structure of the country——

Mr. GOLDSBOROUGH. On what bill was that?

Mr. MEYER. It was in connection with a bill on rural credits which resulted, I think, in the establishment of the Federal intermediate credit banks. After analyzing the banking structure in 1923, as a result of a study of the 4,300 banks to which the War Finance Corpo-

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ration had made loans in the 1921–22 period, I called attention of this committee to the banking structure of the country as a primary element in our economic and financial structure. May I just quote from that hearing for a moment, dating back as it does over nine years ago, because I think it is of interest at this particular time? I said then:

There are necessarily many difficulties involved in our dual system of banking. We have a State banking system, a national banking system, and a Federal reserve system, the latter having a membership derived from both the State and the national systems. The State banking departments supervise the State banks, and the Comptroller of the Currency supervises the national banks, while the Federal reserve system has a supervision of its own for the member banks, and there has been at times some disposition to competition between the State and the national banking systems.

The State banking laws frequently permit practices which national banks can not legally engage in. This is creating competition between the two systems which can not be regarded as wholesome and may lead to the gradual weakening of both. The question of branch banking is one that is causing considerable discussion at the present time.

Some of the States permit branch banking on an unlimited scale. As a result, agitation is now going on for an amendment to the national banking act to put national banks on a par with State banks in that respect. I do not propose to discuss the subject of branch banking here. Branch banking may be good or it may be bad. It may be good if carried on in a limited way and bad if permitted on an extensive scale. But, whether it is good or whether it is bad, branch banking should be considered on its merits and should not be the product of competition in the endeavor to expand either the State or the national banking organizations. The competition that exists at the present time between State and national banks can not fail to remind one of the competition that prevailed a generation ago among the various States seeking to become domiciles for corporations—a competition that was based upon the laxity of the laws governing incorporation. Nothing could be more disastrous than competition between the State and national banking groups based upon competition in laxity.

I am mentioning this question of the banking structure, Mr. Chairman, particularly at this time because you contemplate using the influence of the Federal reserve system on the volume of credit as a means of affecting the volume of business and the price level. It seems to me that the instrument through which the volume of credit functions is a vital factor in the efficiency with which the Federal reserve system can function, and that instrument is the banking system.

In the hearings which we had a few days ago before the Glass committee with regard to amendments to the Federal reserve act, the board, through me, presented its views in favor of a unified national banking system, and I was rather interested that members of the committee did not seem to be opposed to that thought. On the contrary, Senator Glass and others said that if it could be brought about constitutionally they would be in favor of it. The board, in expressing its support of a unified banking system, did so unanimously. I merely call that to your attention at this time because I think that it is a vital factor in what you have in mind in achieving a greater stability for business. I think it can not be denied that an efficiently organized and properly supervised banking structure is vital to the control of inflation and deflation of credit, and efforts to stabilize without fundamental improvement in the banking structure seem to me not to pay sufficient attention to the agency through which sound principles can be put into practice.

In the report which we, as a unanimous board, presented to the Banking and Currency Committee of the Senate there was also incorporated a recommendation for a new method of calculating

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bank reserves. I quite appreciate that such an important matter as a new method of calculating reserves is one that ought to be given careful study and thorough investigation; but we had in the Federal reserve system a committee working about 18 months studying this question of reserves and they made a report to which I think sufficient attention has not been given by the Congress. It was the result of a very careful study, and while it may possibly have some weaknesses, we have the assurance from the men who have been studying it in a conscientious way that they tested it over a considerable period of past years. I think this proposal would be an important factor in achieving stability and preventing undue speculative expansion of credit and its contraction, from which we are now suffering. This system of reserves would tend to safeguard the banking structure by increasing the reserve requirements in a time of expansion and decreasing them at a time of credit contraction, and would, I believe, assist in the achievement of the more stable conditions which you in this committee are contemplating to a greater extent than this bill which deals only with the control of the volume of currency and credit.

I do not know if this committee is familiar with that report on bank reserves, but, in a word, it abolishes the difference between time and demand deposits so far as their classification for purposes of reserves is concerned, and I think in that respect the recommendation is wise, because the low 3 per cent reserve on time deposits has been an inducement for banks and for depositors to build up to an undue degree time deposits which carry a higher interest rate and a lower reserve. This has induced banks to invest in slower assets in order to get the larger yield necessary to make a profit on the higher rates of interest paid.

Now, the proposed revision of reserve requirements provides for a uniform minimum of 5 per cent on net deposits, both demand and time, and reserves above the 5 per cent minimum are based on the velocity of turnover. In a true savings deposit there would not be any turnover; therefore, on that business there would be a 5 per cent reserve. Under this proposal, when business expands, and more checks are drawn and the turnover of deposits is greater, as is the case in an inflationary period, a greater reserve would be required based upon the velocity of these deposits.

Mr. Goldsborough. That is in the member banks?

Governor Meyer. That is in the member banks. It would also, owing to the fact that larger reserves were required, result in the banks expecting larger average deposits in those accounts that turned over more rapidly, which is proper.

Those are the principal features. The other things are that it allows the banks to count as reserves, up to a certain percentage, their cash in vault. This provision applies to all banks, but country banks are the ones that more frequently need to keep cash in their vaults because they are not so readily accessible to the reserve banks, and to that extent it would benefit the country banks.

There are a few cases where perhaps it would increase the required reserves of individual banks, but as a whole the principle applied would expand the reserves in relation to the expansion of business and particularly would do so in speculative periods, like 1928 and 1929. It would also make call loans made by others than banks result in

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increased reserve requirements because checks still have to be drawn to make settlements.

Our committee felt that the additional reserves required at the time when loans for account of others reached such large proportions, would have exerted a strong influence to check the inflationary and speculative movement long before the time when it came to a head.

Mr. GOLDSBOROUGH. That is exceedingly interesting. Will you explain?

Governor MEYER. I think it is an important factor in the whole situation, and I would be very glad to furnish this committee copies of the report which was made by the committee on reserves. We have some copies of it here with us. It is quite comprehensive and I think it is important for this committee that the question of bank reserves should be thoroughly understood.

Mr. GOLDSBOROUGH. What I had in mind right at that point was just how the expansion of the reserves would restrain loans for account of others?

Governor MEYER. What I intended to say was that even loans for account of others, which, of course, would not be reflected in deposits, therefore not under present law in additional reserves, would still be reflected in the velocity of the turnover which under the proposed splan would require an increase in the reserve. The studies of the committee on the velocity of the turnover in relation to loans for account of others indicate that a very substantial increase in the reserves would have been made necessary, entirely apart from increased deposits, because the requirement would be 5 per cent on the deposit with the balance related to the turnover. That turnover is there whether the loans are made for account of banks or for account of others.

Now, on the broader subject, it is true, of course, that the volume of money and credit in circulation is an important factor in the price level, but some of the other things that seem to me to be vital in connection with a study of the problem are conditions which I believe it is difficult for the Federal Reserve Board, or any other human agency that exists or that could be called into existence, to control.

If we look back at the history of the last 10 or 12 years with the abnormal conditions at home and abroad in production and consumption, at the currency standards in various countries, at the political as well as the financial relations within and between nations, we can see factors which it seems to me, while subject to influence, nevertheless can not be definitely controlled by any one country or by any one group of men or any institution in any one country. I am one of those who agrees that the United States, with its large population, with its great productive and consuming capacity, is the greatest single economic factor in the economic world. There are nevertheless many others, and the changing conditions in many of our relations, both national and international, are striking, whether we analyze them by a chronological process or whether we analyze them in view of the fluctuation of price, or of the volume of business or of international financial movements. Everywhere we have difficulties to meet and adjustments to make, dependent on the behavior of human beings in large groups; and if we go back to the 1921 situation for a moment, where we had what looked at that time like a most acute depression we find that we came out of that depression

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through a series of constructive developments in world relations, particularly with respect to our own country.

We came out of the war and the temporary postwar inflation, first and foremost, as the one country where the world felt that its capital invested or its money deposited was safer than in any other country. That led to a tremendous movement of liquid capital and investment money toward the United States, which resulted in a tremendous amount of gold being imported into the country, representing foreign bank balances and individual deposits and investments. That happened to combine with rather extraordinarily favorable conditions at home from the point of view of the possibility of money affecting industry, and the particular feature to which I want to call your attention in that connection is expressed in this diagram.

This is a graphic representation of the per capita value of building permits of 50 cities. From 1913 when business was slow there accumulated during the war period of 1917–18 until 1922 a deficiency in the construction of housing and other plants such as office buildings, which left a very large construction program necessary and sound. As soon as the money market began to ease after the 1919–1921 tight-money period, money began to flow into residential building—both apartments and private dwellings—and into business office construction all over the c untry. I am sure from your study of economics that you know that there is no single activity which produces a greater employment of labor and a greater purchase of material than the building industry. It employs labor at good wages—gives it buying power. It puts traffic on the railroads and expands the employment of labor and material there, and finds its way more thoroughly into the general volume of business activity, I think from my observation over 35 years, than any other one activity.

When this activity began, we began to have an improvement in our general level of prosperity, because like many other good things, it began on a sound basis to fill a legitimate need. Population had increased and housing and business plant had not. Therefore, a need existed. The business began by filling a legitimate need, with the demand large and the profits substantial, but it developed more and more, and cumulatively on a geometric ratio, into a tremendous speculative activity.

In this period a very important financial development occurred which was the means by which the construction activity passed from the legitimate stage into the speculative stage and to some extent, the dangerous stage. That was the development of a new channel to large amounts of capital through the real-estate bond market. Real-estate bonds had been known previously on a small scale, locally. But in this period of rapid development and profitable activity there was found a way to large amounts of the savings of the country, through the real-estate bond market, on a scale which had never existed before.

That led to two things: To some extent, to speculative building where the business was carried on for the profit of the people who were doing it rather than to meet a legitimate need; and to overbuilding in certain localities.

Now, it is generally assumed I think, from the present condition of the real-estate and construction industries that there is no building

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need to be filled at present. There is, but with the breakdown due to over-speculative building in certain areas in the recent past and the consequent injury to banking, the credit of the construction industry is greatly impaired. So that to-day, when we find that we have the lowest building volume that we have ever seen in peace times we also find, I think, one of the most significant factors in the present depression and deflation of price levels.

These things I mention because I think they are so large in their importance that they balk us in achieving results which, under more normal conditions, might be possible. I had a feeling last year, when an easy money market prevailed for several months, that there might be an opportunity for stimulating a little greater activity in housing development in localities where there was a need for housing. In some places there might be more activity even now, if money were available in the mortgage market on an adequate scale.

As you know, cotton or wheat have a world market, and if there is surplus anywhere there is a surplus everywhere; but housing is different, and even last year there was considerable housing construction done in suburbs of large cities where new highways and automobiles and buses are taking people out of the crowded sections into the suburbs. That is a possibility that I think will be developed in the future, and I think that there is a long time trend in that direction where you will see results when conditions are a little more stabilized. But I also think that the recent overexpansion in building is one of the major factors in the present economic depression.

Abroad last year we saw a major financial crisis in two of the four great economic powers of the world. The German situation first came to a critical climax, following difficulties in the Balkan States and in Austria and Hungary. At the end of a long period of reparations payments and heavy borrowings, the German situation came to a standstill, resulting in the so-called standstill agreement. I know it might be argued that if the price level had been maintained perhaps that would not have happened, but I doubt very much whether the maintenance of any price level could have prevented what happened in Germany where there was borrowing on short-time obligations to pay debts which could not be liquidated in any short period of time.

The English situation followed not long afterwards, and if you analyze that situation you will find that the English had large amounts of foreign deposits payable on demand, and that they had been making large amounts of loans abroad on less liquid and longer terms, so that when the strain was put upon them through withdrawal of their short-time obligations they were unable in the circumstances to continue to meet their payments on a gold basis. There has always been a difference of opinion with regard to the English situation. The pound had been maintained close to the gold basis during the war through artificial methods, largely by borrowing in this country and the sale of investments. In February, 1920, I remember that the pound got down to $3.18 at the low point. That resulted in wage increases in England which could not be sustained, I think, after the English had restabilized at the old gold basis. They were unable to modify the wage scale and they became unable to compete with other countries where labor was cheaper, or where plants were more efficient. The result was that the whole economic basis on which pre-war England had been developed was undermined in an important respect.

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Developments during the war also changed the world market situation. I recently looked up what happened in the textile industry in the Far East during the years of the war and immediately afterwards. Spindles in India and Japan and China grew from 10,415,000, in 1915, to 18,161,000, in 1922, and looms in about the same proportion. In other words, in the war period, when England's capacity for export production was interrupted, other countries which previously had depended on England or other European countries for supplies were forced to build up a production which continued to exist after the war. As a result Lancashire has been enormously handicapped by these developments in other countries to meet the demands which formerly had been supplied by England.

England's banking power, which was based on the fact that the pound was the almost universal medium of exchange in trade relations with foreign countries in pre-war days, became less dominant after the war. Less banking went to England and more came to this and other countries. The American interest in foreign trade went up by large amounts. Substantially, in that period when all Europe was engaged in war, America was called upon to take the place of many countries which were put out of the business of supplying industrial markets, and these figures indicate some of the fundamental changes that occurred in world economic relations which can not be ignored when you approach the problem of how to achieve stability. I will give you the figures: From 1913 to 1929, the share of the American market in goods imported into South America grew in Argentina from 15 per cent of the total to 26 per cent. In Brazil, from 16 per cent to 30 per cent; in Chile from 17 per cent to 32 per cent; in Columbia from 27 per cent to 46 per cent; in Peru from 29 to 42 per cent; and in Venezuela, from 39 to 55 per cent.

In Asia, Africa, and the Oceanic Islands, our share in goods imported into British India grew from 3 per cent to 7 per cent; into China, from 6 per cent to 18 per cent; into Japan, from 17 per cent to 30 per cent; into Australia, from 14 per cent to 25 per cent; into New Zealand from 10 per cent to 19 per cent; into South Africa, from 10 to 19 per cent.

That means that the United States developed the capacity to supply the needs of a market which was temporarily deprived of its normal sources of supplies, and after that productive capacity had been duplicated in the United States it came into competition with the other productive capacities. Certainly maladjustments in business conditions and competitive conditions and price levels must flow from such a major development as that.

Let me just say that, in the light of these major difficulties in the European economic structure, which were inherent in the situation as a result of the war, we have had to struggle in the world with maladjustments proceeding from the passions of war which did not end with the so-called peace; and national animosities as well as international economic and financial instability have been vital factors in our home situation.

I think that it was the large construction needed in the United States, which was in good condition, that enabled us, in spite of the disturbed conditions of the world to develop what appeared to be an independent prosperity which we were able to maintain for a period of years.

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Total building contracts rose from $2,756,000,000 in 1921 to $6,381,000,000 in 1926, went down to $3,093,000,000 in 1931, and are on a still lower level at present. With the revival in building and the resultant activity that flowed into all the channels of trade, the purchasing power of the United States developed in a large way. But at the same time, with the tremendous expansion in the volume of industry, American industry, with more highly developed mechanization and larger production units, was able to make goods at low prices and to invade foreign industrial markets with manufactured goods, so that for a while it looked as though something impossible was going on and could go on. It went on longer than seemed possible. What I mean is that we were a large creditor annually in the world's balance of trade through exports of raw materials and manufactured goods, and at the same time we were collecting interest on debts and investments on a large scale.

It is interesting at this point to call to your attention that, in the period from 1922 up to the present moment there has been no great expansion of exports of crude materials, including raw materials and foodstuffs. From $1,447,000,000 in 1922, the export of crude materials reached a peak in 1925 of $1,740,000,000, and then declined. Exports of manufactured goods rose from $2,318,000,000 in 1922 to $3,745,000,000 in 1929. I think that that is a measure of the ability of the American manufacturer to sell in world markets at a competitive price, which is interesting and important; but, at the same time, it seems to me to be extremely difficult for foreign countries to buy raw materials to compete with an industrial country which can expand its market for manufactured goods on a competitive price level notwithstanding high labor costs. That is what the United States achieved for a certain period and to a certain extent for the first time in the world's economic history.

Mr. GOLDSBOROUGH. You are not making a very good Republican high tariff speech this morning.

Governor MEYER. Mr. Chairman, I am not making any tariff speech.

Mr. STRONG. I might interject that the Democrats made a stronger tariff argument when they brought in their bill and did not change the tariff rates.

Governor MEYER. I believe in the tariff for protection of American industry and agriculture. I think it is more important to protect the domestic market than it is to invade foreign markets; but what I want to say is that, during this extraordinary period, we appeared to be able to do both. And it is not possible to do both. I think the future may show that the United States can not continue to operate on the basis of exporting raw materials and manufactured goods at the same time, in the volume that prevailed in that period.

Mr. GOLDSBOROUGH. All political economy teaches that, does it not?

Governor MEYER. Yes. But it went on for so long it appeared to be possible.

Mr. GOLDSBOROUGH. That is the way the world over, is it not?

Governor MEYER. To some extent. Of course, there were so many apparently constructive developments in this period from 1922 to 1929 that the world was lulled into a sense of security. There were periods of acute and critical difficulties like the invasion of the Ruhr in 1923, and the debacle of the mark; there was the degeneration of the

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franc and its final stabilization; but, in spite of the several critical periods that menaced the last decade, there was a gradual improvement in European international relations due to the stabilization of of currency, which was helped enormously by the loans we made. There appeared to be a prospect of being able to go on and continue with a condition in the field of international finance that now is obviously impossible; there is, for example, no possibility, in my opinion, of Germany paying continuously for a long period of years the great annual sums contemplated in the Young plan in 1930. But the improved tendency and the satisfied feeling at times that we were on a sound basis gave confidence to people everywhere that a condition which was fundamentally unsound in major respects could be continued.

I particularly feel that such matters as this great invasion of the world's industrial markets by our manufacturing industries are important to consider in connection with stabilization, because for such a long period it looked as though something impossible was possible. We all criticize the other fellow, but we were all subject to the same delusions and mistakes in those periods, because they were worldwide. It is well to look backward with a broad point of view.

Speculation in stocks of course was reprehensible. Foreign loans were made on a scale that should never have been made. Real-estate was speculative to a degree. There were other speculative activities of great proportions and great unsoundness, and international relations were just as far from sound as many of the other activities of human beings.

I am just mentioning, gentlemen, a few things that seem to me to be important in the picture. If it were possible to take your resolution and put it into effect and accomplish the result you have in mind—I would like to say absolutely this is the thing for you to do and I will do my best to help to carry out every purpose, or if I can not somebody else should be put in my place who can. But this bill contemplates, it seems to me, that a small group of men will understand things in the future that men nowhere understood within the last 10 years.

I felt in 1928 that the indications were that the expansion of credit had gone to a dangerous extent. In talking it over I found that a lot of people did not agree with me. Some of them were very wise, too. But they said business is good and we can't stop good business. In a time like this, of acute depression in prices, there is not a man who has any decency who would not want to see the price level rise if a sound method were available to raise it from the present level.

In times of good business and overexpansion, let me tell you it is very hard to get people to agree that things are overexpanded, and it is often hard for men, even if they feel it, to have the courage to say that it is the time to put on the brakes.

Mr. Strong. That is the reason we want the law that we are proposing to pass.

Governor Meyer. You can not accomplish it by law because it is a matter of judgment. You can not supply judgment by law.

Mr. Strong. If you adopt a measure that indicates what should be done?

Governor Meyer. I do not think that there is now or ever has been any failure on the part of the people in positions of responsibility to endeavor to avoid unsound inflation.

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I just want to try to give you a little picture of the problem we have. Take the problem of cotton which is one of the world's great commodities. It is more than just a matter of so many million bales of cotton at so much a pound. I have always considered that cotton is one of the great key commodities not only of this country but of the world. In 1921 we had a large surplus of cotton. We had bad international currency conditions. The export trade went down and the price of cotton dropped to 10 cents. In the War Finance Corporation, if you will remember, we negotiated some large loans to cooperatives and exporters and cotton started up quite promptly. But let us take a few individual commodities, because your price level, is, after all, a total of individual commodities. This very last year, the present cotton year, in spite of a reduction of acreage and a substantial reduction in the use of fertilizer, the yield per acre, due to climatic conditions, or Providence if you like, and absence of boll weevil and frost, was almost 200 pounds, compared with 150 pounds the year before, and was the highest yield since 1914, which was before the boll weevil swept over the Cotton Belt. A rise of 50 pounds per acre is a 33 per cent factor in the output of cotton. If the cotton yield last year had been what it was the year before, instead of nearly 200 pounds per acre, you would have had 12,750,000 bales of cotton instead of 17,000,000 bales, and you would have had an entirely different price level for cotton in the absence of 4,250,000 bales. Cotton perhaps would have stayed around the 10-cent level if it had not been for the abnormal yields last year.

If you take a commodity like cotton, it is not only of importance in terms of so many million bales, but it is a vital factor in 13 States. It affects the buying power of the people of those States, and it is a vital factor to the industries of the North which sell to the South, and I fail to see how it is possible to avoid price level factors of major importance entering into the situation where you have such violent fluctuations in world production.

Now, let us take the 1921 yield per acre of 125 pounds, and the last year's yield of 200 pounds. Let us say it is produced on 40,000,000 acres, using round figures. On the same acreage, the difference between the 1921 yield and the 1931 yield would be 6,000,000 bales.

We have another vital agricultural industry, and that is the beef cattle industry. We had a good deal to do with that in the War Finance Corporation. We loaned about $90,000,000 on cattle and sheep. During the war the sheep population had gone down 25 per cent and the cattle population had gone up 25 per cent. The result was that when we came into a stabilized period of normal conditions the beef cattle industry was reduced through attrition, a long period of droughts and low production, and so forth, till the beef cattle population which in 1921 was 45,000,000 dropped to 35,000,000; it may be a little higher than that at this time.

The sheep population which had gone down to about 36,000,000 head in the war period has gone up as high as 54,000,000. But the beef cattle industry, I would say, is in a sound statistical position, and as soon as a turn comes in the general situation I look for an important revival and improvement.

I think it is worth while to note perhaps for the record this chart which shows the awarding of building contracts and how it developed in 1921 and 1922 from small proportions to this large expanded area of large proportions when it was being overdone.

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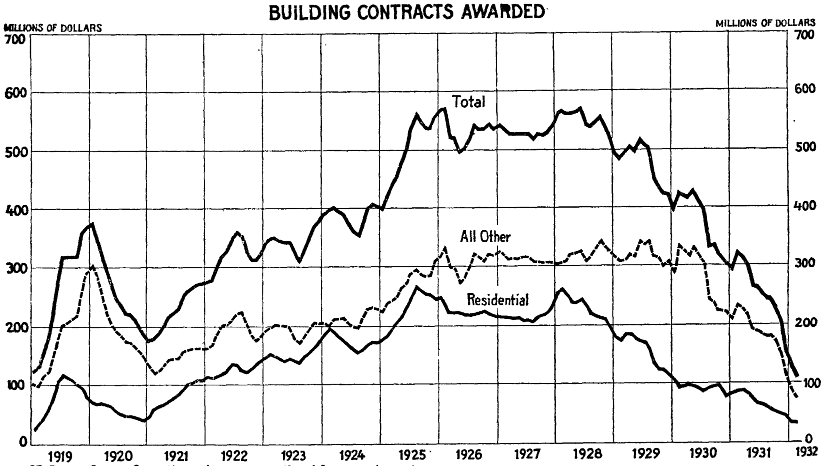
Mr. GOLDSBOROUGH. Without objection, please insert that at this point.

(There was no objection. The chart referred to is as follows:)

BUILDING CONTRACTS AWARDED

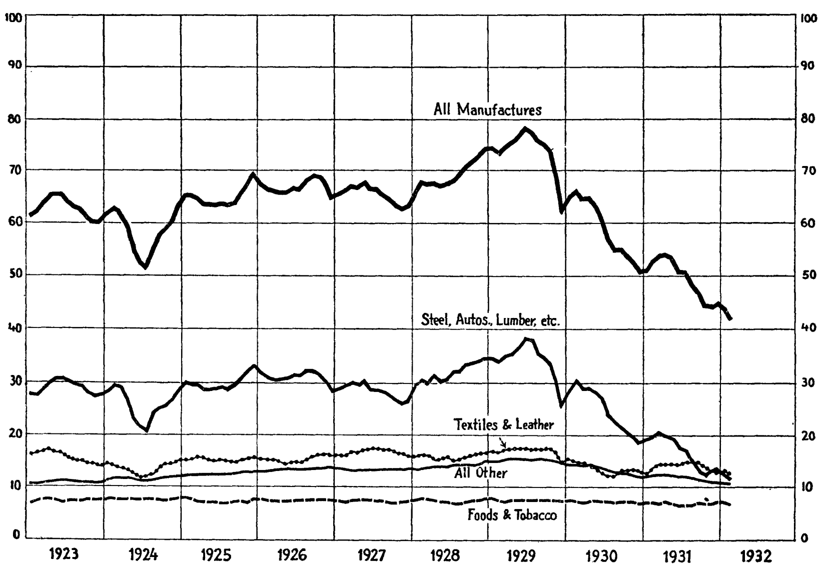


37 Eastern States - 3 month moving average, adjusted for seasonal variation.

The chart on the volume of manufacturing production shows some interesting figures. It shows how closely some of the manufacturing curves follow a normal trend and where the troubles of the inflation and deflation periods manifest themselves in the volume of manu-

VOLUME OF MANUFACTURING PRODUCTION

DAILY AVERAGE AGGREGATES IN F. R. BOARD INDEX, ADJUSTED FOR SEASONAL VARIATION



facturing production; and it is in these construction industries and in the industries whose buying power is tied to the construction industry that you see the greatest expansion in good times and the greatest contraction in bad times. In part, to a large extent, contraction in these industries is what causes bad times.

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As you know, Mr. Chairman, I have been in the Federal Reserve System only a year and a half. Naturally I was an interested observer from the outside prior to that; but the last year and a half probably has been the most difficult period from a banking point of view certainly in the history of the system and perhaps in the history of the country; although in the past there have been other difficult periods. But again, out of this experience I feel, as I felt after the 1921–22 experience and study, that a sound banking system is an essential precedent to any attempt to moderate these peaks and depressions, whether you pass resolutions or not, or whether the board or the Federal reserve banks be rightminded in their purpose or intelligent in their efforts. The committee here supported me in 1921 when I recommended the revival of the War Finance Corporation as a method of adjustment in our economic machinery, and we made a large number of loans principally to nonmember country banks, although there were some member banks; and I think the corporation was very helpful in easing the situation and in relaxing the forced contraction that was going on—a contraction forced by fear and other things. The work of the corporation, combined with the gold imports which followed about that time, and with the need for construction which had developed, enabled us to achieve a quick come-back.

I came here some weeks ago and asked you to authorize, and you did, a reconstruction finance agency, and amendments to the Federal reserve act, and I want to say at this time that I think the results have been good—not as immediate, perhaps, as might be hoped by some, but you can not just pull a financial lever, whether it be in the Federal reserve system to ease credit or increase the volume of Federal reserve credit, or loans in the Reconstruction Finance Corporation to make loans to country banks, which feel easier with the corporation than they felt with their correspondents, and immediately engender confidence and a more open mind to do business. There is always a lag, and it takes time for money to produce its effects on business. I used to study that particular aspect quite closely many years ago, and I found that when money became easy and available on mortgages it would ordinarily reflect itself in construction activities about six months later. You could see that under normal conditions when money became tight and unavailable in the mortgage market, in the days before the real-estate bond market, it would show up about six months later in business. There is a lag between the entry of money into circulation in the banks and its effectiveness in stimulating business in ways that are obvious to ovservers of business.

The first thing to do is to exert every effort to arrest adverse tendencies, and if you can hold the line, you can turn it eventually.

There is a time element and there is a lag, and I am hopeful that we are now at the point where we are going to be able to hold the line. That does not mean that banks will not close, because occasionally there will be banks that will close because of events that are in the past, but I think the banks that have reopened—opened within the past six weeks—have had larger aggregate resources than the banks that closed in that period.

Mr. STRONG. That is, it takes a little more time from the time the corn is put into the hopper till the time it begins to come out?

Governor MEYER. I think that is a pretty good way to put it. I was somewhat surprised and pleased over the speed with which we

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were able to organize the Reconstruction Finance Corporation. We were able to organize it and put it into operation rapidly, so that loans have been made up to date to 1,392 banks.

Mr. GOLDSBOROUGH. Most of them are in small towns, are they not?

Governor MEYER. Ninety-two per cent of the banks to which loans have been authorized are located in towns of less than 100,000 people and 76 per cent in towns of less than 10,000 people. There are some loans all over the country in virtually every State, I think. Every day a considerable number of small banks receive loans and more of them are applying for money to be used not only to pay off indebtedness that presses on them but also to meet their other requirements. I do not like to prophesy and I do not like to promise, but I am hopeful, with all the various things that are being done, and while we are not going to be able to make good the irrecoverable losses that have already occurred, or which may develop from time to time in the future, that with your help we have made a contribution of real importance.

Governor Harrison told you yesterday, as you probably already knew, that the Federal reserve system has been expanding credit in the banks through purchases of United States Government securities. There has been about $250,000,000 of hoarded currency returned as nearly as we can make out up to date, allowing for seasonal adjustments. That has been fairly steady except for one period where there was a little flare during the period around April 1 on account of tax assessments. It looked as though currency was not returning but that apparently was in connection with tax matters; there were some withdrawals all over the country in almost every district. The handling of our volume of currency has got to be considered with respect not only to our domestic conditions but also with respect to international conditions as between our country and our money market, our investment market, our exchange market, and the rest of the world, and in relation to what is going on between other countries. Sometimes it might seem logical to pursue a certain policy, if we could consider it from a purely national point of view, but we might be hampered in achieving success, if such a policy were carried out, by conditions with which we have very little to do and over which we have no control.

Mr. GOLDSBOROUGH. Right at this point, I hope that you and other members of the Federal reserve system will understand that this proposed legislation is not intended as a personal criticism. I think I can add here that when the Reconstruction Finance Corporation bill was being discussed and I was on the floor, I was aksed the direct question whether I believed the act would be administered in the public interest. My answer was that I absolutely believed it would be administered in a patriotic American way and that one of my reasons for saying so was because of your connection with it.

Governor MEYER. I appreciate that.

Mr. GOLDSBOROUGH. That is a matter of record. You understand that is how we feel. Have you finished your statement?

Governor MEYER. I would like to finish by saying that I am in hearty sympathy with the general results that you have in mind, Mr. Chairman and members of the committee and that I find that other members of the Federal Reserve Board and the governors of the Federal reserve banks, with whom we had a meeting this week,

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are all earnestly disposed to search out how each and every one can contribute to the improvement of the situation.

You must remember that, when you talk of this operation as sufficient to control a price level at any particular point, you are thinking in terms of a price level which was established by the greatest building activity in the history of the country. I may be that it is the right price level, but it was a price level established with a very extraordinary background of building activity. The justice of it or the ability to restore it I am not discussing here because frankly I do not know the future of price levels.

Mr. GOLDSBOROUGH. There is not any specific price level mentioned in the particular bill under discussion?

Governor MEYER. No, not in the bill; but I have seen the 1926 price level mentioned as the ideal, and it may be that it is. It may be the price level to which the world will return, and it may not. I would not profess to know. But if you get the ideal of a fixed price level which you can control by adjusting the volume of money upward or downward as prices move up or down on the average from that price level, you are immediately confronted with the fact we saw so clearly in the war, that to fix a price, whether you do it directly or indirectly, is very difficult unless you control production.

Mr. GOLDSBOROUGH. Well, we can not do that.

Governor MEYER. No; but it is necessary before you can level prices.

Mr. GOLDSBOROUGH. There would be 784 commodities affected?

Governor MEYER. Yes. In times like these we all say we want stability, which means return to normal conditions; and that is the desire of everybody. There is no creditor class and no debtor class that has not got the same interest, because the creditor class has losses which far outrun any possible gain in buying power arising out of conditions of this kind. There is nobody that stands to profit or benefit from this situation; and in my opinion, therefore, the desire for a stabilized condition, by which we mean a return to more normal prices, is the desire of everyone. But to assume from that that it is a permanent, universal animating motive of human beings in the long run I think is dangerous, because what does every manufacturer in this country do to his price? He tries to make lower costs and lower prices. Every farmer is trying to produce his products more cheaply in order to make more money, but actually if enough do it more cheaply it brings the price down. What did the United States do to the European grain producer when we opened up the fertile fields of the Mississippi Valley? Were we for stabilization? We were for producing grain cheaper and selling it cheaper. What happened when the Canadian wheat fields were opened? We were interested then in stabilization and they were interested in invading what had always been our market.

Now, there was Russia which by revolution was taken out of the economic circle of nations. She always had been a large producer of wheat in pre-war days—a large exporter. Canada came in and supplied that demand when Russia was not able to supply it, and one of the things to-day that the world price of wheat is suffering from is the reentry of Russia into the world market.

Mr. GOLDSBOROUGH. You are segregating the items, instead of developing in your own mind the picture of the price level?

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Governor MEYER. Well, I have them both in mind, Mr. Chairman, but I am choosing wheat and cotton and all those things, because they are big factors, after all. You can take from the 784 commodities, as provided by the bill, a large number of commodities, and they do not have the weight that a few of them have; and when you take cotton and grain and wheat, you have the biggest factor in world economics to-day.

Mr. GOLDSBOROUGH. Yes; and they are the very heaviest weighted in the index numbers, too.

Now, Mr. Busby, have you any questions?

Mr. BUSBY. I want to ask some rather general questions as to the testimony relating to these specific commodities to which you have addressed yourself.

I would like to ask to what you regard our currency related, or on what value do you base our currency? Is it your view of the philosophy of our exchange system, that our currency should be based on credit, or should it be based on wealth, or should it be based on gold? If none of these things, what is your notion of the tangible value expressed by the currency used for exchange purposes?

Governor MEYER. The law provides the method of issuing currency and——

Mr. BUSBY. I understand that, but that does not answer my question. I am talking about the philosophy back of the situation, disregarding the statute which fixes the standard of the dollar. I might make myself plain by calling your attention to the fact that, in all of your discussions about the things which have had to do with our domestic economical welfare, you have coupled your premise to Europe and foreign conditions.

Governor MEYER. I did not intend to do that. I did not think I was doing that. I am giving it some weight, because it affects our domestic situation.

Mr. BUSBY. To use one of your expressions, that the domestic welfare is tied with the international credit welfare——

Governor MEYER. No; I did not say that.

Mr. BUSBY. You did not say that? I do not mean to say that you said that, but do you regard domestic welfare as being tied and intermingled with international credit and the welfare of other nations, as it relates to their dealing in credit in this country?

Governor MEYER. I do, in some areas and markets. If you take, for instance, cotton, in which your State is largely interested, roughly 50 per cent is for export, and the condition of the purchasing nations—their buying power and currency conditions—are economic factors in the market for cotton.

Mr. BUSBY. I think we had better go back to the first question: What should determine the value of credit as it is available through the banking circles of this country? Should it be the wealth backing up the things that credit represents? Should it be some ephermeal notion that we call "confidence" in a vague sort of way? On what would you base the development of credit that is used for normal purposes, or in bringing it to the use of business and commerce in this country, not in foreign countries?

Governor MEYER. The Federal reserve system is based on the theory of commercial transactions as the basis of credit, of course.

Mr. BUSBY. What value do you regard money as being based on—on gold that is represented by the statutory requirements or on com-

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modities that are represented in possibly 60 per cent of your Federal reserve note issues? And if not on those, on what would we base the value of money?

Governor MEYER. Money has been the standard of value and the medium of exchange, both, of course, as you know as well as I; but when it comes to the exchange of goods and commodities you get back to the fact that really the bank check is the medium of exchange for the greater part of business; and for that reason I go back to what I said in the beginning, that a sound banking system, with the check, which is the real money of business, as currency, is the vital factor in the purposes I think the committee has in mind.

Mr. BUSBY. There are two objects, as I understand it, that we have in mind at the present time: One object is to revive values in commodities, to make them come back somewhat in relation to our outstanding debts, so that we can sell things that we work and produce, and discharge the obligations we have assumed, and which we could at that time reasonably believe were in proper ratio to the commodity values as they stood then. Now, that is the first idea.

You have suggested 1926 as having been mentioned by some one as being the fair level to which we should return. I do not know what you say about it being the fair level.

Governor MEYER. I would not say anything about it, because I do not know.

Mr. BUSBY. Would you mention any other point?

Governor MEYER. No, I would not know how. I would like to bring about an improvement in the present levels.

Mr. BUSBY. How far would you carry that improvement; how far would you continue the work to carry that improvement?

Governor MEYER. I think it would depend a great deal on conditions. That gets down to another thing that is of vital importance, and when you discuss these very fundamental questions, you hear a great deal about the quantity of money, or the quantity of Federal reserve credit. The quantitative theory is, of course, the basis of most of our discussions and the discussions of people who are interested in restoring things by that machinery, whereas I feel that more thought has to be given to the quality of the credit. If the amount of building that had been done in the United States had been done on a sound credit basis, instead of an unsound credit basis, the picture of the financial condition of the building industry and the present depression, I believe, would have an entirely different aspect.

Now, it is not only the quantity that has to be thought of, it is the quality, and it is a warning to the banking authorities when they see obviously dangerous speculative activities in larger areas.

Would not you, for instance, looking backward, feel that the Florida land speculation was, in itself, a warning of something wrong in the credit situation of the country?

Mr. BUSBY. Looking forward and backward both, I feel that it was. It never cost me even a 2-cent postage stamp. I want to tell you why, and give you my idea, and then I can question you.

Governor MEYER. I would be glad to hear it.

Mr. BUSBY. These gentlemen who happen to be in the Treasury—and I am not speaking of you, but of the gentlemen who deal with the financing in a broad sort of way, relate your testimony to credit,

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almost wholly. Credits are a substantial thing, in my mind, only as related to the true values, and that is one trouble with the Florida boom; and we have no system that is accepted by responsible persons like yourself, and the others whose business it is to deal with this particular thing, of determining the value of these commodities or credits in relation to them; but the system has a drifting attitude, without an objective to be attained, or likely to be reached, or any purpose in maintaining the situation, unless, forsooth, some peculiar notion should get into the majority of the managers that that situation was right.

Now, money and currency and credit can be related properly only to value, is my notion; and we have the Bureau of Labor Statistics which are accepted in this country, and throughout the world, as being wholly and fairly determinative of commodity values. It is my idea that our currency and our credit and the quality of our currency and our credit, since you have used the term, should be related to those true commodity values. Certainly they are determined by the utility and the law of supply and demand, which you have so forcibly pointed out; but those values are something tangible and definite; and currency and credit and faith in business, to my mind, could measure itself, if it knew by what measure it could determine its worth.

I can not see, in the attitude of you bankers who come here, any disposition to direct the ship of finance to any point, any definite point. You may tell us what way you think you ought to go for a time, but we do not know how long you are going to go that way. If we give you the center of gravity of values, which is the wholesale commodity index price, any farmer in the country could calculate his propositions and his contracts in relation to that, and if we tell you to take that center of gravity of prices to a certain point, if it be the 1926 price, your only objection is that we might not be able to do it with the machinery that we have; and if we did it, we might not be able to hold it with the machinery that we have; and every time the subject is mentioned, we are thrown into the interlacing situation with the conditions of other countries, and an examination of our connection with the credits of other countries.

Some of the best authorities that we have, hold that we have, perhaps, at least $28,500,000,000 investment in credit, while foreign countries have invested $7,500,000,000 in this country, leaving us a net outlay, war debts and all, of about $21,500,000,000, and hold that the defaulted bonds and spurious issues of their countries—they got credit and property out of this country amounting to about $4,000,000,000, already defaulted, and that there is $11,000,000,000 of war debts, making a total of about $15,000,000,000 marked off, and that is the argument, as I understand it, of most of those who are in high financial positions, leaving a net amount, possibly, of $6,000,000,000 or $7,000,000,000 of all credits we have extended in all of our experience with foreign countries, that we can hope to collect.

There is always the same picture of the bankers connecting us with the welfare of nations in the other parts of the world.

Governor Meyer. I was discussing that in terms of the buying power for our exports, and I was not discussing it with the view to any interest we would have in the foreign countries, except so far as the conditions in those countries, politically or financially, would

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affect our export commodities; and you know it is important not only from the point of view of the quantity of exports, but also of the timing.

I have occasionally called the attention of the committee here, in years gone by, to the fact that when conditions are normal, exchange is stabilized on some basis or other and that the cotton crop used to be sold, to the extent of 80 per cent of the annual exports, in the months of September to January. At the present I would say that probably the foreigners buying cotton would buy only about one-twelfth monthly. That leaves a large carrying problem for the producers and the banks that finance the producers. That is why we think that the change in the time element is one of the results of disturbed foreign conditions, and that is why there is a larger visible supply, really greater than it ought to be, because of the disturbed condition of the whole scheme of distribution, and the change in the time element. We think the timing apparatus on an automobile is very important, to get our spark plugs coming in at the right time. If they come in at the wrong time, you have a great deal of trouble. It is just as bad for the cotton market, when its timing gets out of order, because it affects the price and slows up the market.

People do not think very much of the time element.

Mr. BUSBY. That is a fine illustration, but I would not follow it to any extent, not that it is mysterious, but because it does not bear a great deal of logic, in my mind, just to speak to the point on the subject, without criticizing you.

Governor MEYER. I am sure we want to be frank. I welcome criticism and new ideas, and I am anxious to learn.

Mr. BUSBY. Now, what ideas or plans do you have for financing these foreign exports, or getting the pay back to the American exporter? Would you do it with advancing more credit, or would you get more gold from the foreign peoples, or would you exchange it for goods? These are all practical things, as we understand, but that timing business and all——

Governor MEYER. I can not undertake to endeavor to solve the problems of the breadkown in international trade.

Mr. BUSBY. Well, we can not sell commodities abroad unless they can pay for them back home, can we?

Governor MEYER. The change in the time element—that compels us at home to make some readjustment in our financial machinery to carry the commodities for a longer period. If the exports of cotton were to be 6,000,000 bales in the year, it would be a very different thing if 80 per cent, or 5,000,000 bales, were exported in the first four months of the year instead of being spread evenly over the year.

Mr. BUSBY. If they can not pay for it at any time, you can not export it.

Governor MEYER. They would pay gradually; and, of course, if they did not pay for it at any time, they could buy; that is all there is to it.

Mr. BUSBY. That is most of the trouble now, instead of the time element.

Governor MEYER. It is both, because, after all, we are exporting millions of bales of cotton, and we exported in the current cotton year considerably more than we did a year ago, although conditions are worse.

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Mr. Busby. Is not it a fact that the foreign countries that have somewhat depreciated currencies, as it is rated, currency exchange, in selling commodities here, get their money back home and exchange it for considerably more money in their own money, and thereby undersell the American trader who seeks to go into his own market.

Governor Meyer. Let us take the cotton textile industry, for instance, and let us take the processes——

Mr. Busby. I know as much about cotton, of course, as anybody else, but you keep talking about it because you think I don't know anything but cotton.

Governor Meyer. No, but that is one of the most important industries in this country.

Mr. Busby. I might add that in 1929 the exports of cotton were $920,000,000, before we passed the last tariff act. I happen to know that, but I also know this: That the buying power is broken down abroad, notwithstanding we have given them some $15,000,000 of American credit.

Governor Meyer. I am not favoring credit to foreigners, Mr. Busby, if that is what you have in mind.

Mr. Busby. No; but we have talked about it all of the time.

Governor Meyer. No; we have just discussed the effect of those conditions on our trade. What does the manufacturer in England do? He buys future cotton, to be delivered in three months, or six months, and under normal conditions he transports it and manufactures it and sells it to China, or somewhere else, and gives them six months in which to pay for it. Now, that business is done on a manufacturing basis, or on a fairly competitive basis; but in the last few weeks, the pound has fluctuated from $3.25 up to $3.80, which is about 15 or 20 per cent. Well, where the manufacturers have to overcome fluctuations of that magnitude and have no basis on which to make their calculations, because it is uncertain, it hampers business.

Mr. Busby. I tried to get over this idea, that the credit set-up at the present time, being based on practically nothing but what the world has recently been pleased to call confidence, that is as unsubstantial as the fabric of dreams, just as you pointed out, and nobody knows how to make contracts——

Governor Meyer. That is the trouble.

Mr. Busby. And if the currency and credit were based on the true values and stabilized values, commodity values, taking the quantity of commodities, like the 784 used by the Bureau of Labor Statistics—if those values remained reasonably constant and unvarying, and if that currency was measured in relation to the values of that currency, we would not have this condition you have pointed out, and we could not have that condition that you have pointed out; but in answer to that part of your statement, I say to you that there is practically no commodity of importance in the world but what has fallen tremendously in value, as measured by the gold currency dollar, and it is not the fault of the commodities, and it is not the fault of the people that millions of them are walking the streets, having been sold out and separated from the last vestige of tangible property, while we talk about theories and the fine-spun notions of what somebody might do that would upset the apple cart; while we find ourselves saying, if you will, the private and public debt and measuring them by the present national wealth, which is in a condition of bankruptcy, and we are

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still spinning fine theories about credits and the lack of confidence and all of those things. We have the largest part of the gold in the world, and it is the measure of values at the present time, under our standard set up by statute. It has been suggested that no minimum gold requirement should be set up in the statutes of the countries of the world that are on the gold basis, and——

Governor MEYER. No minimum what?

Mr. BUSBY. Requirement.

Governor MEYER. You mean as reserves?

Mr. BUSBY. As reserves. What would you have to say on that?

Governor MEYER. Well, the Federal Reserve Board, under the present law, can suspend the reserve requirement.

Mr. BUSBY. It has not done it, though.

Governor MEYER. There has been no need to do it.

Mr. BUSBY. Do you believe that the United States and France can continue to gather in the monetary gold supply of the world and ever have anything like a uniform gold currency range throughout the world?

Governor MEYER. It is only a few years ago that the French had a minimum amount of gold, and they would not have had it if the people had been able to get it out; and now, by a change of circumstances, the gold has moved to France.

Mr. BUSBY. Most of that change was brought about by stabilizing her franc at 3.9175 cents per franc, instead of 19.3 cents, and she was able to cancel 80 per cent of her debts, and that is the trouble in this country to-day.

If we could cancel 80 per cent of our debts, private and public, we would have no trouble in getting along, but the debts are what is the burden on the people of the country, and the fixed charges.

Governor MEYER. Yes; there is no doubt about that.

Mr. BUSBY. Every country in the world except the United States has so manipulated its currency within the last 15 years as to cancel all the way from a total of its international debts, such as Russia did up to a large portion, such as has been done by England in going off the gold standard recently. Is not that a fact?

Governor MEYER. Germany is struggling to maintain her currency at the present time.

Mr. BUSBY. She has already, at one time, canceled her domestic and internal debts.

Governor MEYER. Yes; but they are making, as the result of that experience, which you regard as a happy experience——

Mr. BUSBY. No; I do not. I beg your pardon.

Governor MEYER. Which their people regarded as the most wretched experience in the history of the world—they are making a tremendous struggle now to maintain their currency, and avoid another experience of a kind which they abhor.

Mr. BUSBY. I do not regard that as a happy experience, and I have spoken in the House many times and have never intimated any such thing.

Governor MEYER. I misunderstood, then.

Mr. BUSBY. I have not come to that conclusion, nor have I suggested anything of the kind; but I am speaking now dealing with the subject of a fair deal to the American debtor in the scheme of things under which we try to carry on business and to live and get a liveli-

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hood, and not be forced out into the cold, homeless, and without the hope of obtaining employment under our system.

That is why I allude to those things.

Governor MEYER. I think we are all symphathetic to that point of view. I have just answered that Germany abhorred the thought of the degeneration of her currency.

Mr. BUSBY. I should say so. They were all wiped out.

Mr. GOLDSBOROUGH. Governor Meyer, as far as I know, the feeling of the subcommittee is that, as nearly as they have been able to ascertain up to this time, the 1926 level represents a fair situation as to debtor and creditor. There has certainly been no disposition on the part of any member of the subcommittee, or Mr. Busby, to create a situation that would be unfair to the creditor.

Now, if 1926 is not right, we would like to have all the assistance we can get to fix the point which is fair and would allow people to get from under their burdens, and to resume their normal positions as economic units. That is our position.

Governor MEYER. That is a fair enough position, Mr. Chairman.

Mr. GOLDSBOROUGH. Governor Meyer, we would like to adjourn until 2 o'clock, and we would like to hear you again, as there are a few questions we would like to ask you.

Governor MEYER. I will be very glad to come back.

(Thereupon a recess was taken in the hearing until 2 o'clock p. m. of the same day.)

AFTERNOON SESSION

Mr. GOLDSBOROUGH. Gentlemen, the subcommittee will come to order. Mr. Busby, you may proceed.

Mr. BUSBY. Governor Meyer, as you very well know, the object of our activity is to try to discover some remedy for the present very unsatisfactory financial condition in which the people of our country find themselves, and also, if possible, to discover some fundamental method or set-up whereby we can prevent a recurrence of this very unsatisfactory condition.

I am sure you are as familiar as almost anyone else with the suffering and distress that is in existence from one end of our land to the other. To my mind it is very clear that there is a breakdown, because of the nature of the set-up of the currency and credit system of the country; and I might add that, if we remain on the present currency and credit set-up, I see no way of preventing the thing from recurring at shorter intervals in the future as in the past to a like deplorable financial condition. It is not necessary, under our set-up, to recur to similar periods of depression as this, and I wish you would give us any light that you may have regarding the subject of securing stabilization that will prevent it.

Governor MEYER. I am not, Mr. Congressman, a believer in the idea that you really want to achieve a static position, in all respects, economically speaking. No matter how much a steady condition appeals to anyone as an ideal, I think when you get down to it, any business man will try to go ahead, and want to go ahead in the world. You want your boy to go ahead. We have internal competition and instability of economic factors between each part of the country, in a way, as well as international competition and the instability of economic factors: For instance, take Texas and Oklahoma, which are

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big cotton-producing States. If you will go back 30 or 40 years you will find that the proportion of cotton grown in the West has increased enormously and has taken away the market for a lot of the cotton grown in the Carolinas and Georgia.

That does not alter the fact that relative stability is desirable, and limits to the area of fluctuation are desirable. Therefore, I do not think that you and I differ, and I only make the distinction because I do not believe the human race wants a static position, and I do not think that any human being——

Mr. BUSBY. Do you think it wants a recurring condition like the one we are now unhappily passing through?

Governor MEYER. I certainly do not.

Mr. BUSBY. Well, now, what does your very far-reaching knowledge of the handling of domestic and international credit to-day, and banking problems, point out to you as a way to prevent us from recurring to this condition. I think it is worthy of us making almost any sacrifice in throwing away some fetish, such as the ancient idea of banking that we are still playing to, in order to prevent this condition recurring. This is a real problem with me, and I do not believe in theories. If we can lay aside theories, we can get to something substantial.

Governor MEYER. I am entirely sympathetic to your point of view. Now, if you ask me what I consider the most important factor in achieving relative stability, which is what you and I both think is possible——

Mr. BUSBY. Surely.

Governor MEYER. We do not think absolute stability is possible, but relative stability with the elimination of the inflation and speculation that we have discussed. I regard the reorganization of the banking situation as most important, in view of the concentration of reserve bank activities and——

Mr. BUSBY. You mentioned the reorganization of the banking system of the country as being fundamental in your idea.

Governor MEYER. I think it is one of the most important factors.

Mr. BUSBY. Are you of the opinion that the comptroller's notions of branch banking within trade areas is the proper set-up?

Governor MEYER. Would you mind letting me tell you what I think?

Mr. BUSBY. Yes; but I do not want to take up too much time with that phase of it.

Governor MEYER. I do not believe that you will get the kind of banking that shows stability, relative stability, except through a unified banking system; that is, if you put increased supervision and control on national banks, organized under national charters, you may have them withdrawing from the national banking system, as they frequently do, or as it is frequently threatened that they will do when legislation is passed to insure the proper banking safeguards is under consideration. You are being asked here, year after year, to modify the national banking laws, because some State legislation has been passed which enlarges the function of strictly commercial banks, and all other kinds of banks. You can not make real progress in banking uniformity under such conditions.

You can have a national banking system that is truly national in effect, as well as in name.

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The national banking system now comprises only a small part of the total banking resources, and is really not entitled to the name "national banking system," because it is not national.

Mr. BUSBY. Well, now, I do not care to pursue that issue any further.

Governor MEYER. You asked me what I think is the important thing, but when it comes to what kind of banking system you ought to have, I think you can very much better determine what the system should be—whether it should be a State-wide branch banking system, or a system without any branch banks, or with regional banks, or other kinds of banks—when you have a system that permits a proper definition of the functions of commercial banks, in the first place, and adequate laws, regulations, and supervision in the second place.

Mr. BUSBY. Whatever the banking system may be, its primary function is to sell banking credits to people who want those credits——

Governor MEYER. It ought to be.

Mr. BUSBY. In order to transact business.

Governor MEYER. It ought to be.

Mr. BUSBY. Those credits ought, primarily, to be related to values, ought they not, in order to have proper security for them?

Governor MEYER. Yes. Of course, as related to that——

Mr. BUSBY. Now, I do not know what your observation has been, but I have never seen any section of the country where banks have failed very extensively but what in that particular section values fell prior to the time the banks started failing. Take that whole section of the Northwest from 1921 to 1929, and even Georgia, Florida, and South Carolina territory, after the boom, and so on.

Now, I might add to that the entire country, the entire United States, where we have had in the last 10 or 11 years losses of more than 6,000 banks and where the national wealth undoubtedly has depreciated $100,000,000,000 to $150,000,000,000; and whereas in measuring values by the scheme or set-up of currency we used, the annual actual income that the people have been accustomed to receiving has dried up at the rate of more than $3,000,000,000 a month, or $750,000,000 a week, compared with 1928 and 1929, do you not think there is something wrong besides the bank credits?

Governor MEYER. Well, you asked me what steps I would suggest that seemed important to my mind as a way of improving the situation, and I was frank to tell you; that is all.

I think if you place commercial banking under national charter and national supervision and have the functions of banking defined and restricted within proper limits, you will begin to avoid a great many of the maladjustments and difficulties due to the excessive use of credit and the subsequent reactions of disastrous character, such as those from which we are suffering. I do not mean to say the present situation is exclusively the result of any one thing, but bad banking is certainly a factor that has contributed to the situation and rendered much more acute a situation which probably would have reacted in a milder degree.

Mr. BUSBY. I notice that Mr. Whitney is reported to have stated before a Senate committee investigating the New York stock market, that the securities listed on the New York Stock Exchange lost more than $6,000,000,000 in value in the last two weeks.

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Governor MEYER. You mean in price?

Mr. BUSBY. I mean in price, yes; I do not say in value, because I want to use that in another way in a moment. Would you attribute that to a lack of proper financing through banking credit, or through a fundamental weakness in the currency set-up, which holds and prevents an ability to contract through our banking credit and currency set-up, in order to use it?

Governor MEYER. I do not know whether I would attribute it to any specific thing. I think there are probably things that were not mentioned at the hearing that might have had something to do with it.

Mr. BUSBY. Now, it is my opinion that the currency and banking set-up with which we have been afflicted throughout our national systems—that they will not stand great use in peace or war time, without getting out of joint and being followed by a financial crisis, such as we are now experiencing.

What is your suggestion along that line?

Is it your suggestion that the system is working all right if there is no special use of it out of the ordinary, but if it is used in peace or war time to any great extent, then it shows its efficiency following any extraordinary use?

Governor MEYER. I am in sympathy with some of the criticism of the existing banking system. I do not think you could tell how the system would work, though, until you have a truly national banking system, with its functions restricted to commercial banking and activities of a character that properly can be added to the function of receiving deposits and making loans, for the most part for commercial purposes and business purposes, and avoid the undue use of the volume of credit for speculative purposes. Speculation goes on in business at times as much as it does in securities, or otherwise.

It is very hard to draw a line of demarcation between one part of business and call it legitimate, and another part and call it speculative; because in speculative times, there is a stimulation of legitimate business into speculative activity. You can not entirely separate legitimate business and speculative business during an inflation.

Mr. BUSBY. Well, in 1838 there began a very serious money and credit panic, and there was no war on at that time, and had not been, except the political wars such as we experience always in America. In 1860 the banking and credit structure, with the national bank set-up being tried out for the first time, caused a period of great use of banking and credit systems. Following that, we had a time similar to this. Within the 1890's we had another period of depression, and nothing was said about any war. Then, in 1921, those who had no better excuse to offer said it was the result of the war, and I hear many people in this present time, 1932, saying that we are just now adjusting ourselves after the war, as the result of the destruction of property by the war. What would you have to suggest with regard to those effects, and what caused them? What I am trying to do is to get at the fundamentals that are involved in our set-up, and the manifest necessity to change from it so as to secure such light as we can in looking forward to a proper move in making that change.

Governor MEYER. There are certain periods of great activity in the growth of a youthful nation. When this country was expanding to the west, new lands were being brought into cultivation, railroads were being built, construction activities were being stimulated, and

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with the successful results and profitable rewards for people engaging in these enterprises, there was, of course, a tendency for speculation to develop.

Mr. Busby. What do you regard——

Excuse me. Go ahead.

Governor Meyer. An economically youthful country, with a rapidly growing population, is likely to have periods of extreme activity and of speculation at the end of it, and reactions and depressions after that.

I think that now we are more matured and our population is more settled and will increase less rapidly, with the restrictions on immigration, and the reduced birth rate, I think that is one of the important fundamental factors in the situation.

Mr. Busby. Will that stabilize our commodities, though?

Governor Meyer. No, it will not; but I will say this, that those violent movements, which are the characteristics of rapid growth, and the interruption in that growth, on account of overdoing the rate of growth, economically, in proportion to the fundamental stability of the country, ought to be now more susceptible of control in the direction of relative stability.

But I think that what we have talked about as normal, in the United States in the past has been a rate of growth of population and of industrial and agricultural production—a rate of about 3 per cent per annum, compounded. Now, that is what we have called in the past normalcy in the United States.

I doubt very much if that is going to be the normal measure of progress in the future, because the population is not increasing as rapidly as it did before.

Mr. Busby. I have examined, for 100 years, the question of the normalcy of 3 per cent increase in business, in the growth of population, and in the gold production, and I find that each one of them is about as variable as you could imagine, and that you must take a period of 30 to 40 years in order to get anything like a substantial rule on your 3 per cent increase in commercial development.

Governor Meyer. Well, I think it is more general than you refer to. You can see an increase of about 3 per cent in the cotton production of the United States up to 1914.

Mr. Busby. Why do you regard it as being necessary for the United States to relate its money to the value of gold?

Governor Meyer. Why do I regard it as necessary?

Mr. Busby. Yes.

Governor Meyer. The law states it.

Mr. Busby. I am not talking about the law. We are figuring on changing the law.

Governor Meyer. I see.

Mr. Busby. Because the law, or something, has caused too much suffering and privation and inequality in the money, when we are supposed to have an equal chance in the game of commerce, to obtain a livelihood, and the other things necessary for us to have, if we are going to live here.

Governor Meyer. You want to ask me why the gold standard is the standard for the country? You know that, I am sure, fully as well as I do.

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Mr. BUSBY. I asked you this:

Why do you regard it as being necessary to relate the money of our country to the value of gold, independent of the statute to which you have recurred—the commodity value of gold?

Governor MEYER. I suppose the justification for making gold the basis of the standard of value is the fact that it is one commodity which has been accepted by more people in the world as the basis or standard of value than anything else. Gold can be used anywhere in the world for the purpose of exchange. It is a standard of value more than any other commodity.

Mr. BUSBY. But it happens that only about four countries in the world to-day can claim to be on the gold standard, and you have got 45 countries in the world which, through their exchange rates, have their currency related to gold, when they have not got the gold.

Governor MEYER. But you can go with an ounce of gold into any one of those 45 countries, and you can get a corresponding amount of whatever money they have in exchange for the gold; but you can not take what they have as money and come into a gold standard country and in every case get gold for it. In other words, gold, as far as I can see, is the standard of value for the greater part of the world, even in countries where they have not the gold standard, and the reason for that is that it is apparently more suitable for the purpose of a standard of value and a medium of exchange than any other product which has been heretofore used in human experience for those purposes.

I do not think that the value of gold has been made by its use as a medium of exchange.

Mr. BUSBY. You do not?

Governor MEYER. No; I think it is the standard of value and the medium of exchange because it is universally accepted as such, even in countries where they do not have the gold standard.

Mr. BUSBY. The universality of it——

Governor MEYER. I think you can go to a native in the heart of Africa and, if you have gold in the form of gold dust, can get what you want.

Mr. BUSBY. That might be true with the existing statute but——

Governor MEYER. They do not know anything about the statute in the jungles of Africa.

Mr. BUSBY. It is my information that about $1 out of every $14 mined is used commercially, and the other $13 are taken care of by the statute, which declares that the forty-five, plus, grains of fine gold shall be the unit of value here; and because the United States and and France have maintained that kind of statute, gold is acceptable in these other places that you mentioned.

Governor MEYER. I can not quite agree with that. Gold has always had a purchasing value——

Mr. BUSBY. That is what I am talking about.

Governor MEYER. Going back to Biblical days, you will find it was good then. If you were to go back to prehistoric days, and you could find out what happened then, you would probably find that it was always acceptable as having a value in a small, compressed form, and I do not——

Mr. BUSBY. I concede all of that; and the world has been in trouble with gold as the measure of value ever since the days you mentioned.

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Do you not think that 784 commodities, associated together like the strands of a rope, when some go up and some down, and some in and some out, and yet all of them go along in a reasonably straight line, dependable year in and year out, because humanity has to acquire these commodities in utility, in order to exist, when taken together and their composite value determined in a scientific way, such as by the Bureau of Labor Statistics, would be a better value to which we should relate the currency, than one commodity, gold, simply because gold, out of habit, has been accepted throughout the world?

Governor MEYER. Mr. Busby, I have this feeling about that: I think it is easy to see the evils we know, but it is difficult to see the difficulties of a different standard that we might adopt.

Of course, we all know that the gold standard has weaknesses, and I believe that any standard would have weakness, because——

Mr. BUSBY. Do you not think that gold and the gold standard can be manipulated so as to cause an apparent scarcity of gold and thereby a raise in the gold dollar, much easier than the prices of all commodities could be manipulated and thereby swing our currency out of relation, such as we find it now, to the true values?

Governor MEYER. I do not really think that the gold supply of the world is subject to manipulation. I think there is a fair amount of gold scattered around over the world.

Mr. BUSBY. The Federal Reserve Board, of which you are governor, makes a calculation in its March number, where it discloses that our country has sufficient gold to issue $3,500,000,000 of additional Federal reserve notes, and yet retain the 40 per cent basis for the currency; and I think it is common knowledge that France needs $1,100,000,000 of gold, and has practically $3,000,000,000.

Now, if the currencies of the world are going to be based on gold, does not it seem to you that the United States and France have gotten things a little bit out of balance by acquiring this gold that each one does not need and will not use?

Governor MEYER. How did the gold go to the United States and France?

Mr. BUSBY. I know how it got here, because we were a creditor nation, and they owed us, and we continued to get it here.

Governor MEYER. We became the recipient of the bank balances of the central banks and private banks of foreign countries. The gold which came over here in periods when we had an inordinately large supply of the world's gold was largely gold deposited here for foreign account. While it was called our gold, it was not our gold, because there was a demand liability against it. If we had used that gold as if it were our gold——

Mr. BUSBY. I am not talking about that.

Governor MEYER. If we had used this gold as if it were our gold, and absorbed it into our credit structure, we would have been in a very difficult position when the gold was demanded.

Mr. BUSBY. I admit that, but I am talking about something else.

Governor MEYER. This inordinate amount of gold over here was not our gold.

Mr. BUSBY. I am talking about the inordinate amount that is here now, when we roughly need about $2,500,000,000 less than that with which to stabilize our currency, and we have got roughly

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$4,350,000,000, in rough figures. We have got more than $1,300,-000,000, according to your bulletin——

Governor MEYER. Surplus reserves.

Mr. BUSBY. Yes; surplus reserves.

Governor MEYER. Yes; and the required reserves——

Mr. GOLDSBOROUGH. You still maintain a 40 per cent reserve?

Governor MEYER. Yes.

Mr. BUSBY. Well, what I am getting at is this:

Gold has gotten into the hands of two nations, with 162,000,000 people, to the extent of practically 70 per cent of all of the gold in the world, and the other 45 nations are having to use makeshifts and get along without this gold, this very desirable gold standard of monetary set-up.

Do you regard that as being a desirable situation?

Governor MEYER. I do not think you can consider it from the point of view of desirability, because it was not a desire on our part that brought it about. Other people's desires brought it about more than ours.

Mr. BUSBY. That is what I am getting at, the weakness of the set-up, because we can not control our own situation.

Governor MEYER. I think we could have a little more than we did.

Mr. BUSBY. With the international working of credit, so much so that those foreign credits controlled our domestic supply of bank credits and finances, and threw us entirely out of line——

Governor MEYER. I am not quite in accord with that opinion. I think we could have controlled it more than we did, and I think that was one of the mistakes in the banking administration. The gold exchange standard, which seemed to be a practicable and feasible thing, was built up in this period through which we have just passed, in the 1920's, and then suddenly came along Germany and France and their needs, and there was built up the idea that deposits in foreign countries, invested in bills or securities or anything else, was the equivalent of gold in the vaults of the central banks.

Mr. BUSBY. That was for the small countries.

Governor MEYER. Well, the big ones, too. There were huge deposits built up here one way or another, and they were counted as equivalent to gold reserves by the foreign central banks, until they were waked up by the German and English incidents, and found that maybe they were and maybe they were not.

Mr. BUSBY. Well, now, there have been built up credits in the nations using the gold-reserve basis, or a supposedly additional amount of $2,000,000,000 of gold, which was really an exchange against the countries that had sufficient reserves of gold in the central banks? That was the practical effect at that time, was it not? When they woke up to this, and that gold prop was taken out from under the inflation of gold itself, then there was a shrinkage not only of the $2,000,000,000, or 19 per cent of the world's gold supply, and that acted naturally to bring about this catastrophe, but the shrinkage of credit also, that was based on that fixation—was not that a part of the world catastrophe?

Governor MEYER. Yes; I think that is true.

I think it was unfortunate that the gold exchange standard permitted pyramiding of reserves and caused a good deal of inflation

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during the 1920 period—I mean 1920 to 1930. That is what you are indicating?

Mr. BUSBY. Yes.

Governor MEYER. I quite agree with you, but I think that should have been avoided. I do not say that we want to establish control over foreign bank deposits in the United States down to a fine point, but I do think that it is a matter in which the public interest and public policy should determine the hospitality which our banking structure should afford to foreign banks desiring to deposit.

Mr. BUSBY. That seems to be agreeable to everybody.

Governor MEYER. The attitude generally seemed to be one of welcoming indefinitely the deposits that foreign banks and bankers built up here.

Mr. BUSBY. What I am coming to as my last question is, that if we should base our currency and use gold as we have used it, as the yardstick to make our international exchanges, and in some way to limit the amount of our currency by that yardstick measure, and applying the true values, and those true values determined by commodities as we now determine them through the Bureau of Labor Statistics—would not that be a safer plan than one working alone on gold, on the assumption that gold exists, which we have just discussed?

Governor MEYER. Well, I say this to you, Mr. Congressman: I am not prepared to answer that, because I do not feel as though I have any definite views as to whether or not the commodity base for money is workable and practicable, and I have not been able to figure it out to its ultimate conclusion. I can see the weaknesses of one system. I can see the weaknesses of the maladjustment in our economic structure, many of which are attributable to other things than the gold standard; and I can also say that I can not see where some weakness would develop under a new system, and I do not believe you or anybody else can, but a whole lot of these maladjustments come from neither one standard nor another, but from the conduct and behavior of people; and sometimes a large number of people, en masse, get optimistic together, and overdo things; then they get pessimistic and overdo things on the other side.

I think that all you can safely do is to try to restrain and limit the extremities of the expansion and contraction of credit by the mechanism of the banking systems, both in the commercial banks and in the Federal reserve system, and I come back to the thought that no better thing can be done for better behavior of our economic mechanism than establishing a sound banking system, which I say can only be arrived at by a national or unified banking system.

Mr. BUSBY. In all of your statements, I gather that your view is that credits should be the basis of our activities, and that those credits are based largely on—I do not want to say manipulations, but actions in banking circles, and pressures of different types, like discounts and interest, and buying Government securities, and so on, which system is as dependable as any we can get; but my idea is, if you turn around and relate the flow of those two values, which are commodities that are usable, and the price is determined according to the supply and demand for those commodities, you would have a more substantial thing than the ephemeral things you speak of as credit, which depend on the humor or disposition or attitude of somebody, independent of the things themselves.

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Governor MEYER. I accept your statement on behalf of yourself, but I must protest against your interpretation of my views, because what I want to say is that the banking and credit structure should serve in the accommodation of business.

Mr. GOLDSBOROUGH. Mr. Prall, you were engaged this morning, and have not had the benefit of Governor Meyer's extremely interesting statement, but you may have some questions that you would like to ask.

Mr. PRALL. I would like to ask Mr. Meyer one question: Assuming that 784 commodities make the standard of value, could the producers of those commodities, by any form of combination, raise the prices to any extent that they might produce fictitious values?

Governor MEYER. Mr. Congressman, I do not want to appear unwilling to answer that, but I can not say that I consider myself an expert on the commodity index basis for currency or the medium or standard of exchange. I would like to have more time to study it. In fact, I have been terribly busy with a lot of administrative questions, and I had to ask the indulgence of the committee in postponing my appearance, and I do not feel that I can properly answer your question with the background of study and thought that I think you are entitled to have, if I make any answer to you at all.

Mr. PRALL. Well, the question was brought up here as to the control of gold, how it might be manipulated, and I wondered if there would be any change in that situation if the producers of these commodities could, by any combination, bring about a similar situation.

Governor MEYER. You mean by——

Mr. PRALL. By rigging the values.

Governor MEYER. I should not think anybody could rig 780 commodities, or 680, or any such number of commodities. I would not think so. I do not see how it would be possible to do it. Of course, if you are speaking of the value of commodities in terms of some other value, you mean some other measure of value, or some standard of value.

Mr. PRALL. That is all.

Mr. GOLDSBOROUGH. Mr. Strong?

Mr. STRONG. Governor Meyer, I noticed you used the language of the statute, "accommodation of business." That is what the language of the statute is in regard to the use of the rediscount privilege, that it shall be used for the accommodation of business and commerce. In the original act, instead of that language was the word that it should be used for the stabilization of the price level. That language went out in conference and the language "for the accommodation of business and commerce" inserted instead. In my original bill, five or six years ago, I used the words of the original language of the bill, stating that the powers of the Federal reserve system should be used for the stabilization of the price level, and ever since then I have been using the words "for the stabilization of the purchasing power of the dollar," which, of course, you know, means the same thing, but I used this language in order to get rid of the charge of price fixing, which I do not think can be done or should be done in this country. My idea is that the law of supply and demand is a very safe law, upon which we can base most of our activities in commerce and business. If that is true, the regulation of the supply and demand

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of money largely tends to fix its price, and its price is what it is worth in commodities in general. Therefore, it seems to me with the powers we have given the Federal Reserve Board, to regulate the volume of money and largely the price of money through the rediscount privileges, the Federal Reserve Board could regulate the volume or supply and demand of money; and it is on that basis that I have, for the past five or six years, advocated that the Federal Reserve Board should use its powers to stabilize the purchasing power of money, regulating its powers through the amount of speculation.

Now, Governor Strong of the Federal Reserve Board intimated to me and this committee that he had used those powers in open-market operations to buy and sell bonds on the rediscount rate quite successfully for the past two or three years, or up until the time of his death, and he had several others with him, among whom was Governor Harrison, who was here yesterday, who frankly admitted that he believed in and was sympathetic with this theory, and he thought the Federal reserve ought to operate along this line, but he objected to us directing the Federal Reserve Board to do so.

I would like to ask you what objection you see in Congress asking the Federal Reserve Board to use its powers for such stabilization? Why should not the Congress, having given these powers to the Federal reserve system, direct the use of them?

Governor Meyer. Well, I think the authorization of powers which Congress obviously intends to be used to accomplish the purpose within the limits of possibility should be used; but when you give directions to a body to accomplish a result, and give them the means, and make it more or less mandatory that they shall accomplish the result, which depends on a good many conditions, then you are raising a difficult question. I think probably Governor Harrison intended to convey the idea that you were charging the system with the responsibility for the results as well as for the discharge of a function.

I think the Federal reserve system has always endeavored to do just exactly what we are talking about, or what you are talking about, within the limits of possibility; but, for instance, let us say that in 1921 and 1922 there were operations conducted with the view of increasing the outstanding supply of credit and stimulating its use, and you come into such a situation as I showed you prevailed at that time, with the boom in the building of houses and partments and office buildings, plants, and everything else, that money would be immediately effective in stimulating industry in an extraordinary way. The same amount of money put out in the market to-day under present greatly changed conditions would have different effects, in my opinion.

Mr. Strong. Well, I grant you that.

Governor Meyer. I think that is what Governor Harrison had in mind.

Mr. Strong. And I realize that perhaps you said the market operations and rediscount privileges would not, under our conditions, bring about stabilization. I can realize that.

Governor Meyer. Especially if the overuse and overexpansion in the period has led to expensive speculative actions, which cause reactions of a deplorable character.

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Mr. STRONG. Of course, my answer to that would be that we did not sell bonds and reduce the amount of money in circulation and put up the discount rate enough to stop that expensive speculation.

Governor MEYER. That gets down to a very fine point; and of course you know it is not only a question of the quantity of bank credit that is available, but also of the velocity of the turnover of that same volume, and the use that is made of it. In other words, you get down to the factor of human judgment. Credit policy does not operate instantaneously, and the effect of an increase in volume of credit to-day does not appear to-day or to-morrow, but after a period of time. A considerable time must elapse before any kind of financial work has its effect.

Now, then, there comes in the element of human judgment, in deciding how much to do, and how far to go, and how fast to keep it up, when to stop, and when to reverse.

Mr. STRONG. But you gentlemen have a pretty good idea now, after these years of operations, of about where to stop, and about when to stop, to reach a certain conclusion, a certain objective point.

Governor MEYER. I would like to feel that you are right on that. But I would hesitate to agree with you that any of us has infallible judgment.

Mr. STRONG. You know I have a great deal of confidence in your judgment, and I have always felt that way, ever since our experience in the War Finance Corporation; but I do think, in the operation and use of these powers of the Federal reserve system, which we have used now for these years, that we could give—that in giving any direction, we should give them a measure to follow. For instance, I think, if we should direct them to use their powers toward stabilization of the purchasing power of money, which was the language worked out by Governor Strong, and then say to them to accept as the measure of value of the purchasing power of the dollar the index numbers set up by the Bureau of Labor Statistics, with the large number of commodities that are used in arriving at the index number, that would be a pretty good measure to direct the Reserve Board or system to follow.

Now, as to how long they should proceed, and when they should stop, will be a matter of judgment, which I am willing to trust you on; but it does seem to me that there ought to be some measure of value that they should be directed to follow.

Now, I want to ask you this question: The Reconstruction Finance Corporation and the Glass-Steagall bill have for their purposes the enlargement of the credit structure, so as to bring more credit into use, and in a manner an inflation, or what probably you might term a reflation of the deflation; is not that as practical a thing as if we directed you to use the powers to stabilize the purchasing power of money?

If money was unstable, credit was unstable and the country was paralyzed; because of such condition we come to the Congress, and as the result of an Executive proposal, we passed the Reconstruction Finance bill and the Glass-Steagall bill, and that was done for the purpose of trying to improve the price level, was it not?

Governor MEYER. As I said this morning, there is the time element, which it is very difficult to regulate. I think those measures have certainly tended to improve the situation, yes; and I think it would

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have been worse than it is, if they had not been passed. There has not been any definite upward trend, but I think it has slowed up the decline, and I do not think——

Mr. STRONG. Governor Harrison told us yesterday that for the first time in a number of months the decline of bank credits had been brought to a halt.

Governor MEYER. Yes; I think that is significant.

Mr. STRONG. And bringing them to a halt is probably pretty good evidence that they are liable to turn upward.

Governor MEYER. They have to stop going down before they begin going up.

Mr. STRONG. Now, he also told us that they were buying $25,000,000 of bonds each week.

Governor MEYER. Yes; that is published weekly.

Mr. STRONG. That is continuing now, and has stopped the lowering of credit, bank credit. If that condition keeps up, and you keep on buying $25,000,000 a week, a turn will probably come, will it not?

Governor MEYER. You are getting me in the position of prophesying. I hope you are right. I personally am in favor of a little stronger policy than you are.

Mr. STRONG. Well, fine. I hope your desire prevails.

Governor MEYER. But you see there are several things that enter into the situation in making a program—what it a suitable amount, whether it is better to keep purchasing moderate amounts over a long period, or to do it all in a short time in larger amounts, in addition to which you have to take into account——

Mr. STRONG. The use of it?

Governor MEYER. Yes, the use of it. And furthermore, we have been getting a return flow of currency from hoards since the beginning of February, amounting to about $250,000,000, and aside from a little interruption on April 1 on account of tax assessments, and the flow has continued now for a good many weeks. If the expansion of the program of Government bond purchases, which was referred to by Governor Harrison here yesterday, is continued and the hoarded currency continues to come in, I think we can look forward to improved conditions. But we still have lots of problems; the period is difficult in many, many directions, and I wish as much as you do that I knew a simple formula of turning a simple trick that would change economic conditions all over the world.

Mr. STRONG. If you continue to play your cards as you are doing right now the change will come.

Governor MEYER. Well, sir, I am hopeful that the change will come at home and abroad.

Mr. STRONG. Along that line, Governor, you might not want to answer this question, but in a speech last night Governor Smith made a proposal that for every hundred million dollars in trade between foreign countries and the United States we remit or credit that country with $25,000,000 on account of their debt to us. Do you think that is a good proposition? Do you think that would stimulate trade?

Governor MEYER. The people who can pay debts are paying them. The people who can buy goods are buying them. I do not know exactly whose debts should be cancelled for this purpose and whose goods should be sold. Would you want to be chairman of a committee

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when somebody's debts are canceled to say whose goods should be sold for that purpose?

Mr. STRONG. No, I do not think I would.

Governor MEYER. It is one thing to generalize and another thing to get down to business.

Mr. STRONG. And when you have given this bonus or this money that was loaned to Europe and that is exhausted, then what would you do? Lend them some more money so as to give them some more opportunity to have the amount remitted to them?

Governor MEYER. I did not hear the governor's speech. He may have some good ideas.

Mr. STRONG. I would like to ask you what, if you know, caused the recession in bank credits during January? Why did they go down?

Governor MEYER. They were going down before that, and it was a continuation of a movement that was in progress and had not been checked. Bank closings in January aggregated 342 in number, and that was not only an intrinsic factor but an important psychological factor. Beginning in February bank closings which were heavy in the beginning of the month slowed up and at the end of the month they were very much smaller. I think in the month of March the resources of banks that opened were as great as those of banks that were closed. I do not mean to say that there will not be more bank failures; but any way they have been less, and January was a bad month from that point of view.

Mr. STRONG. Then if we had commenced along in October and November and bought Government securities, would not we have been apt to have checked those failures that happened in January and prevented the recession in bank credits?

Governor MEYER. There were so many other complications, Mr. Strong; beginning with the suspension of gold payments in England, you have had a series of events which were very complicated. Within a few weeks after September 21, $750,000,000 was withdrawn by foreign countries from their balances here and taken in the form of gold. No country in the history of the world has ever been able to stand that kind of drain of gold. It is true that during that period we also imported some gold but in view of the large drafts on this country by foreigners, chiefly due to repatriation of foreign central bank reserves and, I believe, even some remittances by Americans out of the country from fright, purchase of securities by the reserve banks at that time were impracticable. We could not undertake anything of that character in October without increasing the loss of gold. That is my opinion. You will remember at that time we had to raise the discount rate from 1½ to 2½ and 3½ per cent. Purchases at that time would not have had a stabilizing effect. They would have tended to neutralize the effect of the advances in the discount rate, which was an important intrinsic and also an important psychological factor at that time.

Mr. STRONG. If Congress should see fit to pass a bill of this kind directing the Federal Reserve Board to use the powers we have given it toward the end that we should have as near as possible the stabilization as to purchasing power of money, what harm could you see coming from it?

Governor MEYER. It is a fact that we understand that it is our duty to prevent inflation to the extent that it is feasible, and to stop the deflationary forces as far as possible through our machinery.

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Mr. Strong. You would go along as you are doing now, would you?

Governor Meyer. I do not think we can do anything more than we are doing, if you mean that.

Mr. Strong. That is what I mean.

Governor Meyer. On the other hand, I do not think you would like to be ordered to run a race of 100 yards in 10 seconds.

Mr. Strong. Well, I never ran that far within that time.

Governor Meyer. I know you do not expect impossibilities to be achieved; but I think in setting certain standards you ought to set standards that are practicable, and what you have in mind is that we should be charged with doing what we are doing now to the extent that it is possible. I do not like either by definite or implied authorization or direction to lead people to believe that a thing can be done if it can not be done under any and all circumstances, even though it may be within our power to work in that direction.

Mr. Strong. I would like to ask another thing. Congress is being asked to pay off in advance the certificates we issued to service men of this country due in 1945. It is being urged that we can do that by issuing paper money based upon what gold is now in the Treasury. I wish you could give us your opinion about that. It is a matter that is very perplexing to Members of Congress who would like to pay the certificates if they could.

Governor Meyer. I suppose there is a committee studying that, Mr. Congressman.

Mr. Strong. I know, but you know about the gold in the Treasury and what it could do, and I think your opinion would be very valuable if you care to give it to us.

Governor Meyer. As an offhand opinion, I feel that the balancing of the Budget is becoming a fundamentally important factor in rebuilding confidence in business. I should be reluctant to see a very heavy expenditure which could not be paid for out of taxation at this time. But I really have not been giving that particular question special thought, although I have seen it mentioned in the papers. I think the balancing of the Budget has become one of the most important things for this country.

Mr. Strong. That is to protect our credit at home and abroad?

Governor Meyer. Yes. And I think inflationary devices which might be assumed to be beneficial are dangerous, because they might have a very different effect from what is expected.

Mr. Strong. Can you tell us how much gold there is in the Treasury which would be free to be used in guaranteeing such currency?

Governor Meyer. I am told that it is $20,000,000.

Mr. Goldenweiser. That is not including the reserves of the reserve banks.

Mr. Strong. Well then, with that situation would you care to say what perhaps would happen if we should issue $2,500,000,000 worth of paper money?

Governor Meyer. I think that it would be most unfortunate from the point of view of the masses of the people of this country.

Mr. Strong. Would it be liable to hurt our credit in foreign countries?

Governor Meyer. Not only in foreign countries but at home.

Mr. Strong. You really think it would be an unwise thing to do then?

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Governor MEYER. I do.

Mr. GOLDSBOROUGH. Governor Meyer, in various discussions of this proposed legislation it has been spoken of as an inflationary measure?

Governor MEYER. This bill?

Mr. GOLDSBOROUGH. Yes; I have seen it spoken of as an inflationary measure.

Governor MEYER. Well, you know that is a word that is pulled on everybody. If it is pulled on us, Mr. Chairman, why——

Mr. GOLDSBOROUGH. It is intended as a reflection on the propriety of the proposed legislation. Section 31, which is the first section of the bill—I think you have it right there, have you not, in front of you?

Governor MEYER. No; this is not that.

Mr. GOLDSBOROUGH. The first section of the bill directs the Federal Reserve Board and the Federal reserve banks to take all available steps to raise the present wholesale commodity level of prices as speedily as possible to the level existing before the present deflation and afterwards to use all available means to maintain such wholesale commodity price level. If you will turn to section 2, which reads:

> If, in carrying out the purposes of the preceding section, the Federal Reserve Board and/or the Federal reserve banks, in selling securities, should exhaust the supply, the Federal Reserve Board is authorized and directed to issue new debentures.

The obvious purpose of section 2 is to assist the Federal reserve system if it should run out of bonds through the process of feeding them back into the market, and provides for an issue of debentures in order to prevent the price level from going above the pre-deflation price level. I direct your attention to that because I think it is important for the Congress and the country to know that this is not intended to be an inflationary measure. It is intended to be a stabilizing measure, and that the measure has no more interest in raising the price level than it has to keep the price level from going beyond a proper and legitimate point. Now, if I may for just a moment, I want to read from a speech that I made just 10 years ago, on May 23, 1922, in the House of Representatives, on a bill providing for stabilization:

> I firmly believe that the purchasing power of money can be stabilized. I believe that the solution when we have it will be found to be simple, and I trust that that solution will soon be embodied in legislation. I never want to see agricultural and industrial enterprises struggling in the agony of a long period of falling prices or to see the young, active, bright business man, naturally uninformed as to political science, feel that he is rising to prosperity on the tide of rising prices only to find his business bankrupt and his hopes blasted in the inevitable crisis just beyond the peak.

I read this to accentuate the fact that this committee and I personally are not interested in inflation but simply in an endavor to create a fair and proper relation—reestablish a fair and proper relationship between debtor and creditor, and after that relationship is reestablished to make it impossible, because of these stabilizing influences, for business to expand in an unhealthy manner. Now, that is the purpose of the proposed legislation. This morning in a very full and interesting statement you called the committee's attention to the fact that other influences other than quantity of money and credit

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and its velocity operated on price levels, and you undertook and did very clearly state what some of those influences were. Now, the reason I am making this statement is because I want you to comment upon it. This subcommittee, I think, fully realizes the validity of influences which you mentioned. They realize fully that under uncertain conditions it would take more activity on the part of the Federal reserve system in the matter, for instance, of purchasing securities, than it would at another time in order to achieve the same result. But I believe that the subcommittee feels that under anything like ordinary conditions, with the enormous credit facilities of the Federal reserve system that by applying its powers courageously enough and strongly enough the result can be achieved. A man may be steering his ship and because of conditions of wind and tide it may be more difficult for him to reach a given point than it would be under other conditions, but if he puts enough pressure on the rudder he can reach his port in safety.

This subcommittee does not think that if the Congress directs the Federal reserve system to stabilize at a given point that the Federal reserve system could keep always the level at that point; but it believes it could measureably do that; and it also believes that if the price level could be measureably stabilized that business would be accommodated, and that a great many of these evils and difficulties which you speak of would be obviated. We feel that if stabilization were made the North Star of the Federal reserve system that you would then have the power to prevent these periods of inflation as well as periods of deflation from going beyond and getting out of hand, and that is the theory I am sure upon which the subcommittee is considering this bill.

Governor MEYER. You understand, Mr. Congressman, that the open market committee which deals with open market operations is composed of the governors of the 12 banks.

Mr. GOLDSBOROUGH. If they will not act, you have the power to change to another committee?

Governor MEYER. The Federal Reserve Board can only approve or disapprove the open market policies and operations proposed by the banks.

Mr. GOLDSBOROUGH. The Federal reserve banks are authorized to do the same thing?

Governor MEYER. Yes; but in talking of the board I want you to understand that it is not a central bank.

Mr. GOLDSBOROUGH. If you have any suggestion to make and could put in this bill in order to give you power——

Governor MEYER (interposing). You would find that that would be opening a very interesting subject, which was discussed when the bill was passed, and you would not think it advisable for a member of the board to come up here and urge that the powers which now reside in the banks should be transferred to the board, would you?

Mr. GOLDSBOROUGH. I do not know. As a matter of fact, if we pass legislation we use this language: "Federal Reserve Board and Federal reserve banks." We have the idea that there would be a spirit of cooperation and that would accomplish the purpose.

Governor MEYER. When we get to talking about these things we sometimes forget that the organization of the system was determined after the most careful study by committees of Congress. There are

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some powers reserved to the board and some to the banks, and some lodged in the banks with the approval of the board.

Mr. GOLDSBOROUGH. It was suggested to the committee yesterday by Governor Harrison that this legislation was unnecessary because the system was now doing exactly the thing which was contemplated by the legislation.

Governor MEYER. When was this?

Mr. GOLDSBOROUGH. This was yesterday.

Governor MEYER. Oh, yes. Well, I think that is the purpose.

Mr. GOLDSBOROUGH. And we asked Governor Harrison when it began, and he said it began yesterday.

Governor MEYER. I think he was misunderstood if that is what he appeared to say. I think it has always been the object since I have been on the board to work in the direction you are talking about; but it has been a struggle against conditions at home and abroad and, as far as the particular present movement, buying Government securities, is concerned, it was started some weeks ago—seven weeks ago.

Mr. GOLDSBOROUGH. But he said the policy had changed in the last day or so.

Governor MEYER. As a result of a conference called a week or 10 days ago. Naturally, the governors have to come from all over the United States—some of them are several days' distant—and it takes them quite a little while to gather for a meeting. It was a question at the time—seven weeks ago—as to what should be the rate at which Government securities should be purchased.

Mr. GOLDSBOROUGH. Do you object to saying what the rate is now?

Governor MEYER. There is not any fixed rate, Mr. Congressman; it is movable and changeable. I do not have charge of the open market operations, as you know.

Mr. GOLDSBOROUGH. Now Governor Meyer, in this time of absolute economic destitution, do you not believe it would be a tremendously helpful thing if the Federal reserve system could declare a policy, if they could undertake to say that they were going to pursue a definite policy in the purchase of Government securities till a certain goal is reached? I talk to the bankers in my district and they say, "Oh, yes; we know they have been buying $25,000,000 of Government securities a week for the last few weeks, but they may start selling them next week; and, therefore, we do not know what to do."

Governor MEYER. I do not think they believe that. To reverse a policy and start to doing it the other way next week has never been done.

Mr. GOLDSBOROUGH. But the system does reverse its policies?

Governor MEYER. Yes; with change of conditions, but not with just a whimsical this-week or next-week attitude. That is out of the question; at least, as far as I know.

Mr. GOLDSBOROUGH. Now then suppose this bill were passed, this section 1 and section 2. I will leave out of consideration section 3 for the time being, and the responsible officials of the Federal reserve system should say to the press, "We have been directed by Congress to raise the price level to a certain point, and we are going into the open market and buy Government securities at the rate of, we will say, $25,000,000 a day, every business day, till that point is reached."

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Do you not believe that that would have almost a magical effect in restoring confidence and would cause hoarded money to be withdrawn and the money put in circulation and cause the retailer to buy from the wholesaler and the wholesaler from the manufacturer and the manufacturer from the raw producer and put people to work?

Governor MEYER. I am doubtful of the advantage and expediency of talk in connection with those matters, because the matters speak for themselves.

Mr. GOLDSBOROUGH. No; you do not understand me. I mean it to say and do it, both.

Governor MEYER. A great many things happen to interrupt and make changes necessary. I think you asked that question of Governor Harrison. I read it in the paper. I do not think I would express it differently from his view. I think you would tie their hands. It takes flexibility out of the program. I think flexibility is vital and you know just as well as I do that conditions change from time to time, and if you announce a program like that you deprive yourself of flexibility which you ought to retain. I would not consider that a good or helpful thing to do.

Mr. GOLDSBOROUGH. You do not think it would restore confidence almost immediately?

Governor MEYER. No; I would not think so. I would not consider it advisable.

Mr. GOLDSBOROUGH. Here is a question, Mr. Strong suggested, and I think it is a good one. I do not know whether you care to answer it or not. The question is whether you feel that the Federal Reserve Board should have charge of the open market operations?

Governor MEYER. I do not, to tell you the truth. But you know better than I that the functions of the board and the banks have been defined after very careful consideration and investigation at the time of the passage of the act, and at various sessions of the Congress since then. I do not think it would be sound to transfer those powers. On the other hand, you have to realize that with the advantage of decentralization of powers you get some slowness in the working of the machinery. The whole banking system is based on the idea of decentralization of power. It has been the historic policy of the people of the United States not to allow too great centralization of power, particularly in banking. I agree with that policy; but you can not expect the same quick action and the same prompt decisions from a decentralized power that you would from a central bank, as conducted in European financial centers, where the board of directors of one bank directs the operations. In the interest of efficiency and wise administration there is, of course, a constant drift toward centralization of power. In the wise checks placed upon centralized power which are fundamental in our Constitution, we do do not permit the centralization of power—and I do not think as a whole we are wrong in that, though sometimes it costs time and inefficiency as well as delay. We have to stick to good principles, even though we have to pay for them at times.

Mr. GOLDSBOROUGH. I gather from what you have stated to-day several times that you feel we should have a central banking system, unified banking system?

Governor MEYER. I am not talking about a central banking system; I am saying that banks of deposit all over the United States

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should be federally chartered; now part are so chartered and part are chartered by the State. You could make it any kind of system you want. You could make it unit banking or state-wide banking. If the Federal Government were supervising and organizing the banking of the country, so far as commercial banking was concerned, it could determine what kind of banking system you should have. As it is now, it is determined by the Federal Government and 48 States, each determining for itself what it wants to have.

Mr. GOLDSBOROUGH. Governor Meyer, this bill probably amended in certain ways, is going to be considered in executive session by the subcommittee and acted upon, and also acted upon by the full committee. It makes no difference what our report is the full committee will take its action on that report.

Now, we are extremely anxious in writing the mechanics of the bill if we decide to report it, to make it as effective as possible, and we would like to have the benefit of any suggestions you can give us?

Governor MEYER. If I can think of any suggestions by way of modification or amendment or otherwise I will communicate with you, Mr. Congressman, I do not like to offer off-hand suggestions for legislation.

Mr. GOLDSBOROUGH. Yes. The other day—I do not know who it was—showed me a typewritten statement about that long [indicating] which involved a change in the reserves of member banks, which changes depended upon the change in the deposits' condition and the rapidity of circulation?

Governor MEYER. That is the report I gave you this morning.

Mr. GOLDSBOROUGH. And it might be in carrying out the purpose of this legislation a section of that kind would be very helpful.

Governor MEYER. I told you this morning, Mr. Chairman, that I thought serious consideration of that report would be worth while as one of the things to help achieve what you have in mind, stability; because if it should work as it is expected and intended, it would have the value of checking undue expansion and undue contraction automatically in so far as it can be done through monetary means. An automatic device working in the right direction will be helpful in not having to depend entirely on the exercise of human judgment.

Mr. GOLDSBOROUGH. That is what we think—to give some direction to the Federal Reserve Board which we feel would be helpful. Have you any plan which you would prefer to this, assuming that Congress is going to adopt or attempt to adopt a stabilization plan? Have you anything in mind which you prefer to this?

Governor MEYER. Well, only the things about which I spoke this morning, Mr. Congressman—a better banking structure, an improved method of reserves and better banking supervision, examinations, which could be accomplished with a unified system and better men in public service.

Mr. BUSBY. You are introducing more uncertainty to our already uncertain status.

Mr. GOLDSBOROUGH. In closing, I would like to say this: That we do not have in mind that any human institution can act perfectly, and we realize fully that you will have the difficulties that you have spoken of and possibly difficulties that you have not thought of and can not vixualize at this time. There are spiritual difficulties always to confront, because human selfishness is operating all the time and

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we are confronted with that. But this is one thing we hope may assist in restraining human selfishness and promote justice as between different classes of society. That is the purpose of it, and we believe also that any legislation that is passed will be sympathetically administered by those in charge of it. There is just one question that has been suggested to me. Has it been necessary to invoke the more liberal rediscount powers of the Glass-Steagall bill yet?

Governor MEYER. You mean section 10a and 10b. There have been a few applications under 10-b. In most cases banks that would have borrowed under 10-b are using the Reconstruction Finance Corporation. There have been a few cases where loans have been obtained under 10-b, but not many.

I thank you very much for your courtesy to me here.

Mr. GOLDSBOROUGH. We appreciate very much your kindness in this discussion, which has been very interesting, and I think it will be of help to us.

Governor MEYER. I am afraid I have not been able to contribute as much as I would like to contribute.

STATEMENT OF E. A. GOLDENWEISER, DIRECTOR OF DIVISION OF RESEARCH AND STATISTICS, FEDERAL RESERVE BOARD

Mr. GOLDSBOROUGH. The subcommittee understands that you are on the staff of the Federal Reserve Board, and do not care to discuss its policies, and we think that is proper. We will direct our discussion only to factual matters for that reason. I, as one member of the subcommittee, would like to have explained the plan for changing the method of reserves for member banks.

Mr. GOLDENWEISER. I shall be very glad to give you some explanation of it. I was a member of the committee and have some familiarity with it.

The question of member bank reserves has been one receiving study in the Federal reserve system for a number of years, and there was a large amount of accumulated experience on it. Our committee, after working on it for three months, found there were essentially three features in it. The member banks, as you know, must hold all their legal reserves as balances on deposit with the Federal reserve banks, and they must have 3 per cent on time deposits anywhere in the United States, and 7, 10, and 13 per cent on demand deposits, depending on whether the bank is located in a country district or in a reserve city, or in one of the two central reserve cities, New York and Chicago. This system has been in operation for a number of years, and it has not worked satisfactorily. The main point in which it has not been satisfactory are that, in the first place, the 3 per cent reserve on time deposits has encouraged a large amount of transfers from demand deposits to time deposits, because it is advantageous to banks to have as large a part of their deposits on time as possible, since the reserves are smaller.

As Governor Meyer pointed out this morning, this has resulted in a competition for time deposits and increasing rates paid on time deposits, with the consequence that the banks were obliged to seek more and more profitable investments, and an increasing yield almost invariably carries an increased risk, so that the risk of the banking business increased. That was one factor in the situation—the

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evasion of reserve requirements through the increased classification of deposits which were in fact subject to demand, as time deposits. It made it possible for bank credits to grow without corresponding growth in reserve requirements.

The other bad feature of existing reserve requirements was that it was inequitably distributed between the member banks. These inequalities grew up; they were not anticipated but experience has demonstrated them. There were primarily two of them. One of them arose from the fact that cash in vault did not count as reserves which resulted in a discrimination in favor of the banks located in a city where there is a Federal reserve bank or branch, because they could get along with a very small amount of cash since they could get cash at any time by messenger from the reserve bank; while the country banks where it took a day or two to get cash had to have a much larger amount of cash in vault in order to meet emergencies. Since this cash did not count as reserve, the consequence was that the actual reserve burden on the country banks was much greater than it was on the city banks, and that was not anticipated when in 1917 the law was passed which prescribed that nothing but balances in reserve banks should count as reserves it was assumed then that about 5 per cent would be kept in cash; and since this amount was not going to be changed it might as well be left out of the law. As a matter of fact, the amount has diminished tremendously, from about 5 per cent to about 2 per cent, and that decrease has not been equitably distributed. It has been a decrease in the Federal reserve cities where they have the facilities of Federal reserve banks, and not in the country banks. There has been as much as five or six hundred million dollars decrease in reserves as a result of diminishing the cash, and it has worked inequitably.

The other feature that has made our reserves work inequitably has been the method by which banks figure their net deposits against which they have to have reserved. They are permitted to deduct checks in process of collection and balances held with other banks only from amounts that other banks hold with them. As the law says it, they can only deduct "due from's" from "due to's." The banks in the cities carry large balances for country correspondents and have plenty of "due to's" from which to deduct their "due from's." Country banks, on the hand, had balances with the city banks which they had to have as a matter of operation; but they had nothing from which to deduct their balances because no other banks deposited money with them. As a consequence that also worked against the country banks.

Now, these were the two principal features of inequality. In addition to that, and that is much more important, the part is that reserve requirements did not change with the conditions of business. Instead of increasing when business increased, they were likely to diminish when business increased, and instead of declining when business became slack they were likely to increase when business became slack. The reason for that was partly technical, because when business was slack the country banks would send their deposits to the city banks which would mean there would be a duplication of deposits, the deposit with the country bank by the customer and with the city bank by the country bank; and the latter reserve was in the 13 per cent class. So that while business would go down the volume

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of reserves would go up. When business would become more active, and interest rates would rise, some of the country banks would withdraw some of these deposits to use at home or to place in the market, the duplication would be eliminated, and reserve requirements would decline.

To sum up, the existing law on reserves is susceptible of evasion, it works inequitably as between banks, and works contrary to the trend of business conditions and to Federal reserve credit policy.

We thought, therefore, that it would be wise to modify existing reserve requirements, and after a great deal of figuring we found that one of the real difficulties of the situation was that it applied to regions; that is, to banks in central reserve cities, in reserve cities, and to country banks; whereas there were great differences between banks in the same city. There are banks in New York City that do a country bank business and banks in the country that do more of a city business. The best way to do was to find a way by which each bank could be judged by its own business, and, even further than that, by which each account could be judged by its own behavior. If a bank has a savings account that does not turn over once a year—it does not require a great deal of reserve. On the other hand, if it is a deposit that is utilized all the time and circulates all the time, then it should carry a higher reserve. We worked out a plan by which we do away with the classification of cities, do away with the classification of deposits, make provision for counting cash in vault to avoid one of the difficulties I mentioned, and also equalize the matter of deductions. After brushing all these technical difficulties out of the way, we come out with total net deposits all of which carry a 5 per cent reserve plus 50 per cent reserve on the average daily turn-over of the deposits.

I would like to show you a chart that shows you how these reserve requirements would have worked, compared with how existing requirements have worked since 1924. The solid line shows how present reserve requirements have worked, and the broken line shows how our proposed requirement would have worked. You can see that during the period of very rapid expansion, the actual reserve requirements were going down, not very rapidly, but going down. The proposal which we had would have made them go up.

Mr. GOLDSBOROUGH. It would have had a stabilizing effect?

Mr. GOLDENWEISER. Yes; as the boom developed it would have constantly made the banks have to borrow more from the Federal Reserve and give the Federal Reserve that much better control over the situation. There was about $400,000,000 more than they would have had to borrow, and it would have fallen exactly on the banks which needed to be controlled, because it was the banks which had the largest amount of speculative activity and brokers' accounts, which turned over several times a day. They are the ones that would have been hit by it. The little country banks would not have been hit. In 1920 and 1921 when most of the speculation was commodity speculation it would have been a different set of banks. This chart does not carry it back that far. You will notice that our depression started at the end of 1929 and continued through 1930 and 1931. You will notice that the existing reserve requirements stay up and show relatively little change till the very last period. During the last period, with a decline of deposits that is absolutely unprecedented in

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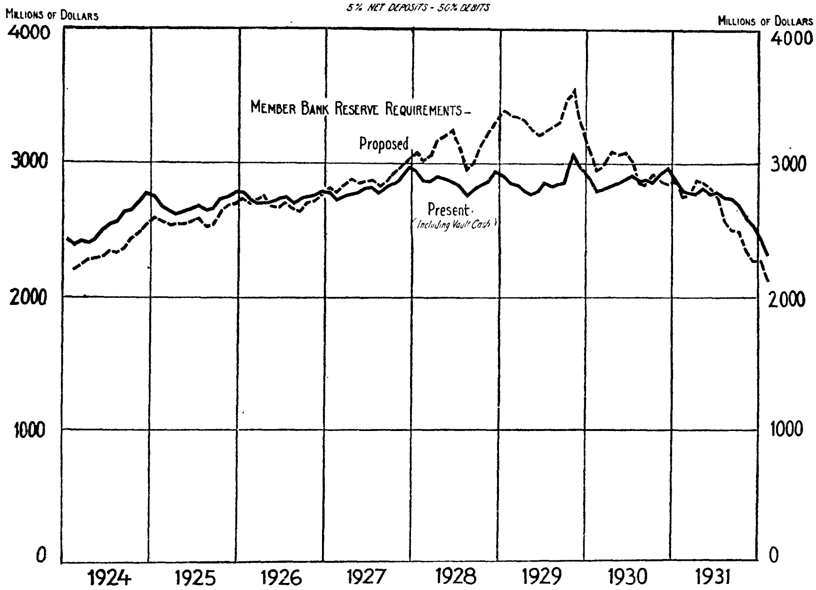
history, the reserve requirement finally did go down. But they stayed up with business going down and prices going down for a long period of time. Whereas, the other plan would have given you a decreasing reserve requirement. In other words, it would have been equivalent to purchase of that much Government security right straight through this period; so that at the present time we would have about $200,-000,000 less resources than under existing law.

It is a system by which reserves are distributed more equitably among the banks, and under which they increase when business is expanding and decrease when there is a depression. It would be a helpful device.

MEMBER BANK RESERVE REQUIREMENTS UNDER DEBIT FORMULA

5% NET DEPOSITS - 50% DEBITS



Mr. Goldsborough. Did you reduce this thing to a formal piece of legislation?

Mr. Goldenweiser. In this report which was given to you, there was a proposal of the committee on the last page, but I would like to add that after this report was published we have given this matter a good deal of additional study and amended the proposal in some particulars. The amended proposal was included in the report which the Federal Reserve Board made to the Senate Committee on Banking and Currency; and if you want to consider the legislation I suggest that you take this latest version rather than the other one, because there are some important amendments which have developed.

Mr. Goldsborough. On yesterday Governor Harrison explained to us something that had been done, some practice that had been adopted in an attempt to control credits used for stock-market speculation, and frankly I did not catch—I am sure I did not catch exactly what he meant. Do you know what he had reference to?

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Mr. GOLDENWEISER. I believe what you are referring to is a rule adopted by the New York Clearing House. The rule adopted by the New York Clearing House that no member of the clearing house can place loans in the market for account of outside corporations. In other words, those loans for account of others which went to such enormous extent in 1929, are now outlawed by a rule of the clearing house.

Mr. STRONG. That is, banks out in Iowa and Kansas could not send their reserves in here?

Mr. GOLDENWEISER. No, it does not apply to banks. If a big corporation should decide because the call rate happened to be 6 or 7 or 8 per cent to say: "There is no use in keeping our money on deposit in the bank at the small interest rate we get; let's put it in the call market." Those loans were an evil in 1929 because they got in without being under control of the reserve banks. They did not increase deposits and did not increase bank loans.

Mr. STRONG. Do you not think that rule ought to be abolished to prevent banks from other States sending in deposits?

Mr. GOLDENWEISER. I prefer not to discuss things that might be proposed, but I might add that there is an amendment in the Glass bill which makes this rule of the New York Clearing House a part of the permanent law.

Mr. GOLDSBOROUGH. Is that just banks?

Mr. GOLDENWEISER. No. I mean it refers to nonbanking lenders.

Mr. GOLDSBOROUGH. Since the passage of the Glass-Steagall bill, how much reserve have you?

Mr. GOLDENWEISER. Free gold on the lastest date which I have, which was April 12, was $323,000,000.

Mr. GOLDSBOROUGH. $323,000,000?

Mr. GOLDENWEISER. Yes, sir.

Mr. GOLDSBOROUGH. How much reserve?

Mr. GOLDENWEISER. We have excess reserves of a billion and a half.

Mr. GOLDSBOROUGH. That makes a total of how much?

Mr. GOLDENWEISER. One includes the other; $1,500,000,000 is the full amount we have.

Mr. GOLDSBOROUGH. Now, how much does it take to maintain your full 40 per cent reserve, which you have a right to waive, if you see fit?

Mr. GOLDENWEISER. I have not the figures here, but about a billion dollars is what we need for reserve against notes, and about seven hundred millions against deposits; so that we have about a billion seven hundred million that is required, and the other is excess reserves.

Mr. GOLDSBOROUGH. About how many gold certificates are there out that you could use for reserves if you wanted to?

Mr. GOLDENWEISER. About $800,000,000 in gold certificates.

Mr. GOLDSBOROUGH. How much is that in all?

Mr. GOLDENWEISER. You can add to your $1,500,000,000 about 60 per cent of the gold certificates we call in, because we would have to put out notes against them. So you can add 60 per cent of $500,000,000. That is about $300,000,000. The actual and potential excess reserves amount to about $1,800,000,000.

Mr. STRONG. I understood you to say the gold to be used to put back of the certificates for the service men would be about $20,000,000.

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Mr. GOLDENWEISER. The question, as I understood it, was how much gold the Treasury had?

Mr. STRONG. Oh, yes.

Mr. GOLDENWEISER. I think I overstated it then. The rest is either in the Federal reserve system or impounded 100 per cent against gold certificates.

Mr. STRONG. There is approximately $1,800,000,000 of reserves, including gold certificates and excess reserves?

Mr. GOLDENWEISER. Yes, sir.

Mr. STRONG. This is excess reserves?

Mr. GOLDENWEISER. Yes, sir.

Mr. STRONG. The Federal reserve system has a right to dispense with reserves, if it sees fit?

Mr. GOLDENWEISER. Yes.

Mr. STRONG. How much is that?

Mr. GOLDENWEISER. How much is the reserve we have?

Mr. STRONG. Yes.

Mr. GOLDENWEISER. About $1,700,000,000.

Mr. STRONG. That is about $3,500,000,000?

Mr. GOLDENWEISER. Yes; I should think so.

Mr. STRONG. So that it is possible in case it became necessary for that $3,500,000,000 to be used as a 40 per cent basis for the issuance of Federal reserve notes?

Mr. GOLDENWEISER. Yes; if we suspend—not only suspended but did away with all reserve requirements.

Mr. STRONG. Which you have a right to do?

Mr. GOLDENWEISER. The Federal Reserve Board has a right to do it; but has to charge an enhanced rate. It is not a painless process. It would make money very expensive. On that basis you could issue close to $9,000,000,000, but once reserve requirements are removed they cease to be a contention and there would really be no limit to the notes the Federal reserve banks could issue.

Mr. STRONG. In Federal reserve notes if you had to?

Mr. GOLDENWEISER. Yes, sir.

Mr. BUSBY. In your official bulletin for March, on page 143 of that bulletin, you go into the figures that Mr. Goldsborough was striking at in his questions?

Mr. GOLDENWEISER. Yes, sir.

Mr. BUSBY. In a rather careful way?

Mr. GLODENWEISER. Yes, sir. We did discuss that in connection with the passage of the Glass-Steagall bill.

Mr. BUSBY. If the chairman does not have any objection, I would like to read the full working out of the facts as relate to that question.

Mr. GOLDSBOROUGH. All right.

Mr. BUSBY. From that bulletin I read as follows:

On February 24, for instance, reserves of the Federal reserve banks were $3,140,000,000. Federal reserve notes in actual circulation were $2,643,000,000, and deposits $1,973,000,000. The 35 per cent reserve against deposits would be $691,000,000 which would have absorbed all of the $102,000,000 in reserves other than gold and in addition $489,000,000 of the gold.

Mr. GOLDENWEISER. That is right.

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Mr. BUSBY (reading):

And the 40 per cent reserve against Federal reserve notes would be $1,057,000,000, so that the total reserve requirements would be—

As I understand for all outstanding Federal reserve notes——

Mr. GOLDENWEISER. And deposits.

Mr. BUSBY. And deposits on hand with the Federal reserve banks—"a total of $1,748,000,000; and excess reserves," which I understand to be gold that would not be employed if the Glass-Steagall bill were put into operation, the amount of $1,392,000,000?

Mr. GOLDENWEISER. Yes. That has gone up since then to $1,500,000,000.

Mr. BUSBY. That amount of gold has increased since this bulletin was published to $1,500,000,000?

Mr. GOLDENWEISER. Yes, sir.

Mr. BUSBY. Of course that would increase your ability to increase currency against your added amount of gold?

Mr. GOLDENWEISER. Yes, sir.

Mr. BUSBY. Your bulletin continues:

On the basis of these excess reserves the Federal reserve banks could issue $3,500,000,000 of credit, if the demand were for currency, and $4,000,000,000 if it were for deposits at the reserve banks.

That is right. Now, with the increase of gold you mentioned, these figures would be increased somewhat?

Mr. GOLDENWEISER. Increased somewhat.

Mr. BUSBY. So that, to my mind, is a suggestion that with your present set-up, present gold holdings, if you put into operation the Glass-Steagall bill, you could issue and give to the country safely $3,500,000,000 additional currency in the form of Federal reserve notes?

Mr. GOLDSBOROUGH. In addition to that, if you reduce the reserve requirement, by reducing the requirement below 40 per cent, in proportion as you reduce the requirement below 40 per cent you could continue to increase your Federal reserve issues till you could reach a maximum of something like $9,000,000,000?

Mr. GOLDENWEISER. Nine billions, or any other amount. There would be no limit. I would like to make just one comment on this; that is, that the Federal reserve banks can issue Federal reserve notes only to the extent that the notes are required by the business of the country. Federal reserve banks have no channel for issuing notes just on the basis of their reserves without some asset coming in. They can issue Federal reserve notes if business increases, and if people want more Federal reserve notes, they can obtain them. The Federal reserve banks, owing to these reserves, are in position to meet the demand. They have no way however, not even through open market purchases, to issue currency, unless there is a demand from the outside. I would like to elaborate that. Assuming the Federal reserve buys $100,000,000 Government securities and thereby places $100,000,000 at the disposal of some member banks. Those banks, if they owe money to the Federal reserve, will use that to pay it up; if they do not owe it, and if no one else owes it so that it does not get around and pay off indebtedness to the reserve bank, it is added to the reserve of the member banks, and then they have that much excess reserve; that is all the Federal reserve can accomplish;

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and then the member bank can, because of its excess reserve condition, go out into the open market and make loans; that is another step. At no stage in the proceeding can the Federal reserve bank issue Federal reserve notes. Practically the only way it can issue Federal reserve notes is, if there is a demand for them, because of increased pay rolls, because business is bigger, or in retail trade, or in hoarding.

Mr. GOLDSBOROUGH. You have been buying $25,000,000 Government securities for several weeks?

Mr. GOLDENWEISER. Yes, sir:

Mr. GOLDSBOROUGH. How do you do that?

Mr. GOLDENWEISER. The mechanics of it are very simple, for the New York bank where the principal market is, buys those securities and pays for them with a cashier's check on the Federal reserve bank.

Mr. GOLDSBOROUGH. I probably misunderstood you. I understood you to say they could not even buy unless there was some demand for Federal reserve notes?

Mr. GOLDENWEISER. No, they can buy but they do not pay for them with Federal reserve notes, unless the demand is for Federal reserve notes.

I would like to get that point clear. The Federal reserve bank has no way or means of issuing so-called Federal reserve notes unless there is a demand for them. They buy the Government securities on their own initiative.

Mr. GOLDSBOROUGH. Suppose they buy it on their own initiative. Can they not pay for it with Federal reserve notes on which they put up Government bonds as security under the Glass-Steagall Act?

Mr. GOLDENWEISER. They can under the law; but the point is that when a dealer has ten million dollars worth of securities and sells them to the Federal reserve bank he does not want Federal reserve notes. What he wants is credit on their books; and suppose they give him Federal reserve notes for them, which would be an awful nuisance and practically would not be done—but suppose they do, he would take these notes immediately to the bank and deposit them and that bank would find it had more cash than it required, and immediately would redeposit them in the Federal reserve bank. That is why I say that they can not issue notes unless there is a demand for them because they immediately come back.

Since I am here, I would like to call your attention to this one chart and I would like to incorporate it in the record, because it brings out a point that might be useful to you. This line shows the total amount of deposits in the banks. This other line shows how many times in the year a deposit is utilized. When it is down here it means that the deposit is used at the rate of twenty times a year, or at the rate of about 18 days to a turnover. The thing I want to show you in it is that the deposits in these banks stayed fairly steady in 1928 and 1929. They increased in 1930 notwithstanding the depression. They did not begin to diminish till the latter part of 1931; while the turnover began to go down very clearly at the peak in 1929—went down from fifty-five or fifty-four times a year to twenty times a year. And while at this level they still had the same amount of deposits, their actual buying activity—the amount of business they did had been cut more than in two. This is the item of velocity which enters into the situation and the one over which there is much less direct control than there is over the volume.

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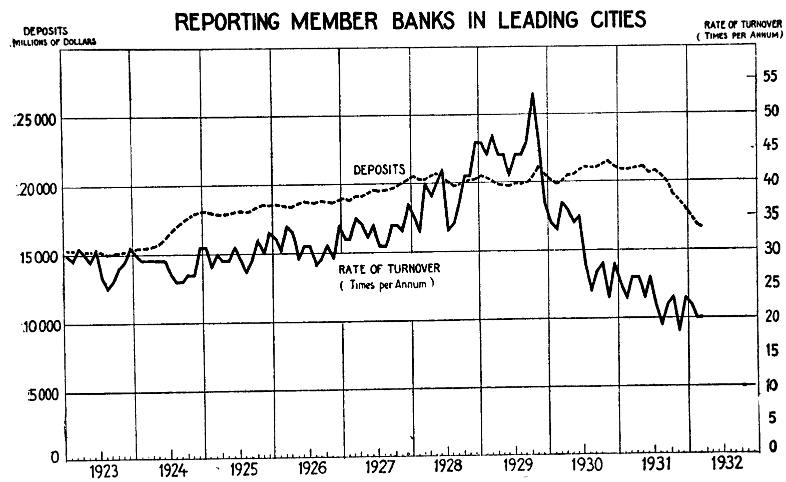
Mr. BUSBY. It is my recollection that for New York City the velocity of deposits was tremendously out of proportion in 1929 to the velocity of deposits in the rest of the country.

Mr. GOLDENWEISER. Yes, sir. You are quite correct about that. Here is a chart for New York, where it is up as high as 110 in 1929, and is now down to 33. In the country as a whole outside of New York it went up to 25 and is now down to 13. It is perfectly true that the great growth in velocity was in the speculative market. It is also true that there has been a cutting in two of the velocity outside the speculative market.

Mr. BUSBY. Outside the city of New York all along from 1923 to 1932 there is no great variation except in 1929 it is a little higher?

Mr. GOLDENWEISER. That is a little higher.

Mr. BUSBY. Would that include the Chicago section as well as San Francisco?



Mr. GOLDENWEISER. It includes all the leading cities, but not the country banks. We have not the information for country banks. This is for the leading city banks.

Mr. BUSBY. Have you any information whether or not the two large cities mentioned, San Francisco and Chicago, would not also increase the velocity of turnover to bank credits as shown by your chart for banks outside of New York City?

Mr. GOLDENWEISER. Yes, sir; they would.

Mr. BUSBY. That might account in some degree for the shooting up in velocity as shown on your chart there for the year 1929?

Mr. GOLDENWEISER. Yes, sir. It is a factor.

Mr. BUSBY. I would like very much to see those three charts placed in the record.

Mr. GOLDSBOROUGH. Without objection, they will be placed in the record at this point.

(The charts referred to are as follows:)

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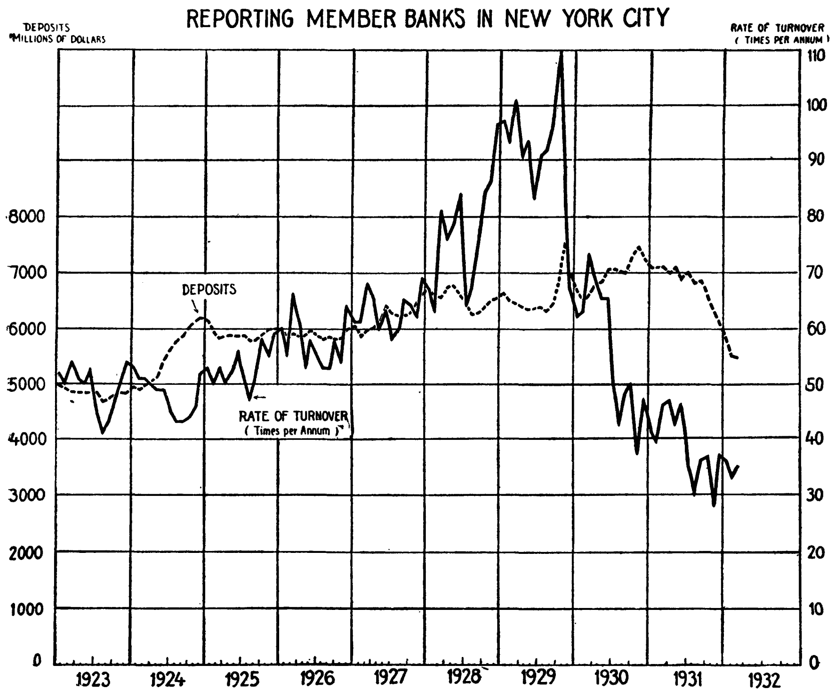

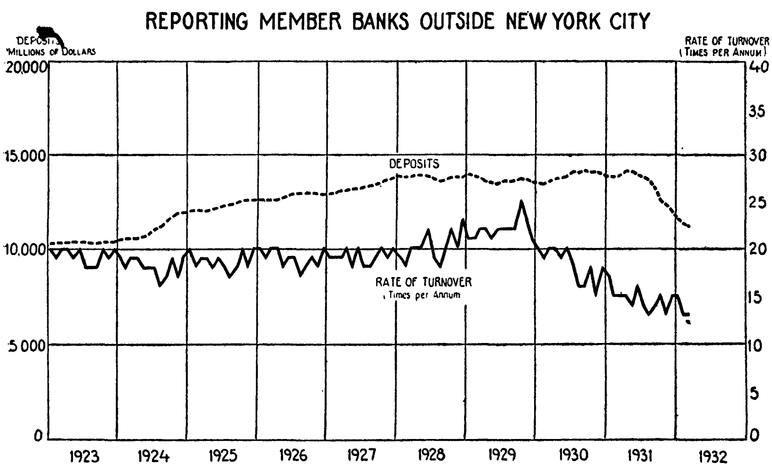

(Thereupon the subcommittee adjourned.)

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