LETTER OF HON. ROBERT L. OWEN
TO
FEDERAL RESERVE BOARD
MAY 14, 1920

To lower the interest rates as a means of helping to
RESTORE LIBERTY BONDS TO PAR

UNITED STATES SENATE,
May 14, 1920.

Hon. W. P. G. HARDING,
Governor Federal Reserve Board, Washington, D. C.

MY DEAR GOVERNOR: I thank you for your letter of May 3, answering my letter of April 27, in which I urged the Federal Reserve Board to lower the interest rates of the reserve banks as a means of helping to restore Liberty bonds to par.

The Secretary of the Treasury and every agency of the Government, including the reserve banks and the member banks, cooperated in a strenuous drive to induce the American people to buy Liberty bonds. The people were told to buy the bonds until it hurt. They sold their property, they borrowed money, they mortgaged their homes to buy these bonds on the assurance of the Secretary of the Treasury that there was no better security, and they had a right to believe that these bonds would be maintained at par. But, my dear Governor, if you permit these high rates of interest, of which I have justly complained, the inevitable consequence will be that these Government bonds must go still lower than they are now instead of reacting to par.

The violent fluctuating high interest rates on the New York Stock Exchange which go from 8 to 30 per cent, advertised throughout the country in every important paper in the land, together with the high interest rates of the Federal reserve banks to member banks at 6 and 7 per cent, and the consequent higher commercial rates daily advertised in the public press of 8, 9, and 10 per cent, not to mention commissions on the side and discounts, are jointly impairing confidence and creating an atmosphere of suspicion, distrust, and widespread talk of pending industrial depression and industrial panic.

I have insisted that the powers of the Government should be exercised through the office of the Federal Reserve Board, the Federal reserve banks, and the Comptroller of the Currency to remove these causes, which, if persisted in, may cause a serious industrial depression and make Liberty bonds go still lower.

The claim of the New York Stock Exchange that these high and violently fluctuating interest rates on call loans are necessary for the purpose of preventing speculation is indefensible, because it does not prevent speculation. The professional operator immediately speculates in a bear market, which inevitably must follow these artificial high interest rates. The

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speculator can afford to pay high interest rates, but legitimate business can not. Moreover, the employment of bank credits for speculation can be prevented by harmless methods: First, by the banks refusing new loans for speculative purposes; second, by requiring gradual liquidation of old loans employed in speculation; and, third, by raising the margin on speculative loans.

The remedies I suggest are harmless to the general public. The remedy employed of high interest rates on call loans running up to 30 per cent is destructive of public confidence and threatens industrial depression.

When the Reserve Board raises the rate to 6 and 7 per cent it has the effect not of stopping the speculator but of stopping legitimate business, and putting the brakes on manufacture, commerce, agriculture, on production, and distribution.

You quite misunderstand the point when you speak of my contention that the Liberty bond market recently fell because the Federal Reserve Board raised the rate of interest, which you think is disproved by the fact that the bonds fell in April, 1919, to 95 before the Federal Reserve Board raised the rate of interest. My contention is that the high rates of interest on the stock exchange, and the high rates charged by member banks on commercial loans based in part on the high rates of the reserve banks, are all factors producing this result, and when the Reserve Board recently raised the rate these bonds went down much lower than they had been before, and they must go lower still if the board persist in this policy. What I contend is that the Federal Reserve Board in raising these rates, and thus adopting the unwise policy of the stock exchange, is depreciating the market value of all securities, including Government bonds.

I understand the reserve board desires to deflate credit by raising the rates of interest. Assuredly raising the rates of interest will deflate credits, even the credits of the United States, of which I complain, but I am anxious the reserve board shall only deflate those credits that require deflation and not deflate credits of the Government and of legitimate productive business, which ought not to be deflated.

The United States was compelled to expand its credits, and issued $26,000,000,000 of war bonds. The war resulted in an increase of $20,000,000,000 of bank deposits, a total increase of expanded credits of $46,000,000,000. No substantial part of these credits should be deflated at this time. The only deflation of credit justified is the deflation of credits employed in speculative loans on investment securities, on real estate, and on commodities for hoarding by profiteers.

My dear governor, it seems to me that there is some serious misconception existing in the country with regard to what is inflation and what is not inflation. I am certainly opposed to inflation, but I am strongly in favor of the extension of business, increasing production, and improving distribution by extending credits on a stable low-interest rate.

The expansion of credit for such purposes is justified, but, of course, the expansion of credit beyond the available resources, even for the most important of purposes, is not justified. The Bank of England, conducted by the wisest merchants in the world, has not hesitated to extend credits for productive purposes even when the gold reserve was thereby seriously diminished. As you very well know, they went to a very low gold reserve during the war without ever denying credits to their business men who were engaged in legitimate industry. The London merchants had $3\frac{1}{2}$ per cent acceptance rates all during the war, when the British Government paid 5 per cent.

If the people are frightened by the talk of industrial depression, by high interest rates, it has the effect of preventing production and putting the brakes on manufacture and on our entire industrial life.

I do not agree with Secretary Leffingwell that the present depression in Liberty bonds is due to the owners of Liberty bonds spending the bonds recklessly as spendthrifts. People who bought Liberty bonds do not deserve such a classification, although, of course, some individuals out of a very great number are spendthrifts. But the spendthrift quickly parts with his bonds to other people. The spendthrift theory does not explain the terrible depreciation.

If money was cheap and credits were available at low rates, it is perfectly obvious that these bonds would go to par, and just in degree that the banks of the country raise the rates to very high artificial figures to that degree the Liberty bonds and Victory bonds will assuredly fall in market value.

You advise me that the Liberty bonds "can not be brought back to par by artificial methods." They can be depressed by universal high rates of interest artificially fixed by the banks, and that is precisely what has happened and to which I earnestly object.

I do not say that the Federal reserve banks can restore these bonds to par by lending a part of their resources on these bonds at a low figure. What I do say is that the value of these bonds is depressed by the action of the Government in countenancing the scandalous interest rates on the New York Stock Exchange, the unreasonable interest rates by the member banks of the country, and the unfair interest rates by the reserve banks to the member banks.

You very justly say, my dear governor:

"There is a world-wide demand for capital, and the demand for bank credit in this country in agricultural, commercial, and industrial purposes is heavier than has ever been known before; investment demands for new construction, for the maintenance and equipment of railroads, and for the financing of our foreign trade are very great."

Are these just demands to be met by denying the credits, or are they to be repressed by raising the rates to prohibitive points, and thus retard enterprise and production, the employment of labor and capital in creating commodities?

You say the reserve banks would have been "overwhelmed with applications for loans" on Government securities if the reserve banks had continued to offer a low discount rate on paper secured by Government obligation.

I am not advocating the reserve banks lending beyond their resources at any rates or on any securities. I am protesting against the reserve banks setting a bad example to the country by raising the rates of interest on legitimate business engaged in production and distribution. I am objecting, my dear governor, to the Reserve Board taking advantage of this condition

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and raising these rates merely because the demand is urgent, when the proper function of the Federal reserve bank is to stabilize the interest rate, keep it at a reasonably low figure, and set a wise and just example to the member banks.

The member banks pay from 2 to 4 per cent for deposits and normally let their money out at from 5 to 7 per cent, with a margin of about 3 per cent. The reserve banks pay no interest on deposits, and 3 per cent is a rate high enough to enable them to make all the money they are entitled to make out of the public. On a 4 per cent rate the Federal Reserve Bank of New York last year made 110 per cent, and I suppose on a 6 and 7 per cent rate they will make this year about 160 per cent. This is precisely what I am objecting to. The Federal reserve banks should not be put in the attitude of profiteering or of setting the example of profiteering to member banks. The powers of the Government are not being properly exerted to stop the scandalous rates of interest on the New York Stock Exchange.

I was advised that six months ago the New York banks had nineteen hundred million dollars loaned on investment securities and the commerce of the country was suffering for credit. I believe with the board, that these credits on investment securities and speculative loans should be diverted, as far as practicable, to productive purposes, but to raise the rates to 6 and 7 per cent upon all banks alike does not accomplish this end. It merely penalizes all business of every kind and character, regardless of whether they are using their credits for speculative or productive purposes.

What I earnestly desire to call to the attention of the board is that credits ought to be extended at a low rate to the extent of the capacity of the reserve banks for productive purposes; that member banks should be urged to do the same thing, and that the powers of the Government should be exerted against the excessive, violently fluctuating rates on the New York Stock Exchange.

Hoping that the suggestions which I have the honor to make may be of some service to the deliberations of the board and to the country, I remain,

Very respectfully, yours,

ROBT. L. OWEN.

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