By Dr. Miller

Readjustment of industry, business and finance to a peace basis was the economic problem with which the sudden termination of hostilities a year ago confronted the United States. On the whole, the close of the year 1919 shows considerable progress toward the solution of the problem; indeed, in some important respects the year has shown the problem to be less difficult than was originally expected.

The year has been one of great activity in industry, little embarrassment having been experienced by the so-called war industries in making the shift to peace-time conditions. Unemployment, which was widely dreaded a year ago as likely to be the most troublesome feature of the readjustment process, has found its natural economic corrective in the active demand for products in practically every field of industry. There has, in consequence, been a scarcity of labor in many lines of industry throughout the larger part of the year, particularly of unskilled or common labor, with wages ruling high and going higher. Judged by most of the accepted criteria of business, the year has been a successful one, and from the point of view of earnings, a satisfactory one.

There is, nevertheless, some apprehension expressed as to the future. Conditions are not yet regarded as stabilized upon a a secure foundation.

The one important particular in which no readjustment is shown for the year 1919, is the price situation. Rectification of the price situation was widely believed a year ago to be the necessary forerunner of any real and lasting return to normal and stable conditions.

This view is still widely entertained; indeed, recent events have confirmed many in the opinion that the crux of America's after-war problem is the readjustment of prices. Prices are still upon what must be regarded as a war level, with a tendency to rise rather than to fall. Latterly, the most serious aspect of the price situation has been the aggravated cost of living condition. It has become the subject of widespread complaint. There is little reason to doubt that the irritation caused by the rising cost of living is the source of much of the acute industrial and social unrest which is being experienced in the United States.

Were it not for this factor of the situation it is probable that less anxiety would be felt in business circles over the high level of prices than a year ago, and there would be less impatience for quick and large results. For it is getting to be more generally appreciated that rectification of the price situation, and, in general, a return to stable financial conditions is going to be a matter of years instead of as was first expected, a matter of months. Those who took a sanguine view of the price outlook a year ago, and who expected an early drop of prices, believed that high prices were due simply to transitory conditions, and the acute demands for goods occasioned by the war -- otherwise stated, to disturbed conditions of production and shortages of supply, both of which conditions were expected to find swift correction in the course of the year 1919.

The fact that prices have not declined during the past year but, on the contrary, have risen, is leading to a considerable revision of American views of the fundamental factors in the price situation.

It is now getting to be more generally appreciated, and more frequently admitted, however grudgingly by some, that the main factor in putting up and keeping up prices to their existing unprecedented levels in the United States, has been the expanded state of banking credit. That prices may be expected to continue high until the volume of credit and currency is materially reduced, or production is greatly increased, is coming to be the view of thoughtful students of post-war conditions. That both of these processes are likely at best to be slow, seems fairly certain. With labor fully employed, as it is, increase of production in any large way could come only through increased efficiency of labor. As regards the volume of credit, reduction might result either from the liquidation which would follow a let-down of business and industrial activity, or from increased saving and investment on the part of those classes in the community which have been the main beneficiaries of high and rising prices. But there is little prospect of any of these things occurring so long as the present reign of extravagant living and spending continues. The fact, however, that prices for the most part have risen during the year 1919, and the prospect that they will continue to rise until the expansion of credit is brought under effective control, makes the immediate problem of credit control, in the United States not that of contracting credit but that of regulating its growth so as to prevent a further rise of prices and a further aggravation of cost of living conditions.

Even thus the problem of credit control in the United States will have its sufficient difficulties, especially in view of the undoubted large drafts that will be made upon the credit resources of the country in financial support of Europe's needs.

Growing discontent with rising prices, and public recognition of the dependence of prices on credit, however, will not much longer sanction an attitude of hesitation on the part of the agencies of banking control in the United States. Credit must be controlled in order that prices may be controlled. This is the legacy of 1919 to 1920. The still undetermined question is the method of control which will be best adapted to American conditions, especially in view of the existing unprecedented and complex situation.

The data assembled in the following table show the major changes in the banking situation of the United States since the beginning of the European war. The table shows under the heading of "Deposits" the increase which has taken place in the volume of credit extended by the banks (national and state banks and trust companies) and, under the headings "Loans and Discounts" and "Investments", the operations against which the newly created credit was extended. The dates selected are (1) the eve of the beginning of the European war; (2) the eve of the entry of the United States into the war; (3) the armistice; and (4) the most recent date for which data are available:

Date	'Gross Deposits'	Loans and Discounts	Investments
	(In millions of dollars)		
June, 1914	16,264	12,259	3,560
March, 1917	24,863	17,020	4,955
November 1, 1918	28,862	19,792	8,909
October, 1919	33,159	22,275	9,751

The above figures, which disclose an expansion of bank credit since June 1914, of over one-hundred per cent show that the expansion of banking credit did not come to a stop with the armistice. Expansion has continued at an alarming rate since then. Between the dates of November 1, 1918 and October 1919, 4,297 millions of dollars of new credit have been created; loans increased 2,483 millions of dollars; and investments 842 millions of dollars. This compares with an increase of 3,999 millions of dollars of new banking credit in the shape of deposits between the dates of March 1917 and November 1, 1918. Similar comparison for the item "Loans and Discounts" shows that between the same two dates there was an increase of 2,772 millions of dollars, and for the item "Investments" for the same dates, an increase of 3,954 millions - or 79.8 per cent. For the whole period, March 1917 to October 1919, 8,296 millions of dollars of new banking credit had been created, most of which is undoubtedly to be attributed to the exigencies of government financing.

It will be noted that the most striking rate of increase is found in the item "Investments" between the dates March 1917 and November 1918. This was the period when the Government's great bond-issuing operations were at their height: the banks were under pressure to make heavy investments of their credit in subscribing for government loans; they were also extending credit accommodation on liberal terms to their customers for the like purpose. This was also the period when the total currency in circulation was increasing most rapidly - the increase between March 1917 and November 1918 amounting to over 1,250 millions of dollars.

It has recently been estimated that the banks of the country hold among their investments over four billions of dollars of government war securities (Liberty bonds, Victory notes or Certificates of Indebtedness) and, among their loans and discounts, two and a half billions or more representing loans made to customers secured by government obligations and made, presumably, for the most part, in aid of customers' subscriptions to government loans. Altogether then, it appears that the banks are carrying, directly or indirectly, between six and seven billions of government war obligations against which has been extended newly created credit in the form of deposits or currency.

This newly created credit, like the new currency, constitutes an addition to the supply of the country's purchasing media. It is for all practical purposes to be regarded as money. It is acceptable as means of purchase and payment. It acts on prices substantially the same as money. And it is thus that the matter of prices becomes a matter of credit, and credit control a matter of urgency.

That the great expansion of credit which has occurred in the United States has been profitable to the banks, and that they may not be expected to pursue a policy of conserving the use of credit except as they are put under pressure to do so, is a fair deduction from a recent statement of the enormous increase in the earnings of the national banks during the past five years, the increase from July 1, 1914, to July 1, 1919, amounting to over 90 millions of dollars yearly, and being greater than for the entire forty-year period prior to July 1, 1914.

Borrowers, because of the elevation of prices to the extent of one hundred per cent or more, in the past five years, are now obliged to borrow two dollars to handle the same amount of physical turn-over in their businesses that formerly required but one dollar. The cost of credit in handling a given volume of production, physically measured, is, therefore, a much larger item than it was formerly. What is cost to the borrower is gain to the lender. Money lending has consequently been a profitable traffic even when all that the traffic would stand has not been charged, particularly as the banks in order to supply the increased credit are not obliged to incur commensurate increase of expense.

Under the Federal Reserve System, the banks are indeed in an unique and favored position. There is no hard and fast limit upon the amount of credit or currency which they can supply to their customers. The limitation upon their loaning and earning power which was imposed upon the national banks before the advent of the Federal Reserve System in the shape of the requirement that the banks must maintain actual minimum cash reserves, has given way under the Federal Reserve System to the easy requirement of a reserve balance maintained with the Federal Reserve Bank. This balance is only partly a balance created by actual deposit of cash; for the rest it is a book-keeping balance built up and maintained through borrowing from the Federal Reserve Bank. A bank that wishes to enlarge its lending power, has, therefore, only to borrow from its Federal Reserve Bank to build up its reserve balance to the requisite extent. Borrowing reserve credit from the reserve bank at rates fixed artificially low for the purposes of accommodating the financial program of the Treasury, the process of satisfying the American appetite for credit, has, therefore, been simple and easy and highly profitable to the banks.

The extent to which the resources of the Federal Reserve System have been drawn upon is revealed in a comparison of its discounts and advances, which amounted to 100 millions just before the United States entered the war in April 1917, and to over 2,700 millions at the end of November of this year.

That the reserve system was able to respond to the heavy demands of its member banks for advances was due to the enormous increase in its gold reserve. Between the dates given above, the gold holdings of the Federal Reserve System rose from 943 millions to 2,093 millions. The twelve Federal Reserve Banks now hold over two-thirds of the total estimated monetary gold stock of the United States, and the country's gold holdings, it will be remembered, were enriched to the extent of over 950 millions of dollars by the heavy inflow of gold to the United States from Europe in the years 1915 and 1916. It has been the concentration of this gold in the Federal Reserve Banks, added to the gold otherwise drawn from the channels of circulation, that has made it possible for the Federal Reserve Banks to expand their credit to the vast extent they have since the United States' entry into the war without bringing down their reserve percentage to a point calculated to excite apprehension. The reserve percentage of the twelve Federal Reserve Banks against combined deposit and note liabilities stands a little above forty-five per cent toward the close of the year 1919, as compared with fifty per cent at the close of the year 1918, and eighty-five per cent at the beginning of the war in April 1917.

The embargo on gold exports which was lifted June 10th of this year, has thus far cost the United States 292 millions of exported gold, But this loss has been off-set to the extent of fifty per cent or more, by 135 millions of gold held abroad and acquired from Germany, and small imports constantly trickling into the country. It is notable that neither the lifting of the gold embargo nor the enormous expansion of bank credit which has occurred in the last two and a half years, has resulted in any real impairment of the gold basis of the American credit structure, judged by the standards of five years, or more, ago.

Indeed, it appears that the gold cover held against our greatly increased volume of bank liabilities owing to the public is today considerably in excess of what is was just before the outbreak of the war in June 1914. As nearly as the matter can be computed, there are held in the banking reserve of the United States (and this means, except as to an almost negligible percentage, in the reserves of the Federal Reserve Banks,) about seven dollars of gold against each one hundred dollars of the total outstanding volume of Bank deposits (exclusive of Federal Reserve Bank deposits) and Federal Reserve Notes in circulation, whereas 4.8 dollars were so held in 1914. Bank liabilities, as a whole, are therefore about fifty per cent better covered in gold than was the case some five years ago. In a technical sense, therefore, the American reserve position is still altogether satisfactory, thanks to the large accessions to our gold holdings brought early in the war, and since then concentrated in the Federal Reserve Banks. Indeed, much of the gold thus acquired and brought under banking control might be parted with without any serious impairment of our necessary reserve strength.

The apprehension recently expressed in some quarters because of the decline of the reserve percentage of the Federal Reserve System since the armistice from fifty per cent to forty-five per cent, is not justified by any impending or threatening inadequacy of our gold reserve. Strongly entrenched as the United States is by reason of the creditor position the country has attained to in the past four years, there is little likelihood of serious impairment of our gold reserve through external drain. There will probably be little or no occasion, therefore, for the Federal Reserve Banks in the near future, to shape their discount policy for the purpose of protecting their reserves. It is, indeed, their very secure position in this respect that may prove a source of embarrassment to them in undertaking a to set up an effective control of credit by making it difficult for them in the face of relatively high reserves to initiate and pursue a discount policy for the purpose of restraining the continued growth of the volume of banking credit and the uninterrupted use of the resources of the Federal Reserve System for this purpose.

With the Treasury frequently in the market during the year 1919, as a large borrower, and with the prospect that the financial situation of the Government will, for a considerable time, necessitate heavy borrowing from the banks, there has been a natural reluctance on the part of the Federal Reserve System to advance discount rates. The favorite form of borrowing from Federal Reserve Banks during the past two years and a half has been member banks' bills payable collateralled by government securities, especially the short-dated Certificates of Indebtedness. Out of a total of 2,710 millions of bills held on November 28,1919, 1,736 millions consisted of what has come to be known in American banking as "war loan" paper; that is, bills collateralled by government securities. Preferential rates were established by the reserve banks upon this class of paper as against ordinary commercial paper, early in the war, and until very recently this paper also enjoyed a substantial differential under the rate borne by the government security by which it was collateralled.

This policy which was adopted at the beginning of the war for the purpose particularly of stimulating subscriptions to the government's short dated securities has been proving itself a questionable expedient in recent months. So long as the government maintained a pretty effective control over new security issues through its Capital Issues Committee, and over production through the War Industries Board, and so long as general conditions gave little incentive to speculation and to speculative business enterprise, little harm followed perhaps from rates that were purposely fixed at a low level in order to stimulate interest in government finance and in war production. But the situation has materially changed and there has been much evidence in recent months that the facilities of the Federal Reserve System which the Federal Reserve Act tried carefully to protect from being employed for speculative uses have been drawn in increasing volume into the field of speculation in stocks, land and commodities by reason of the easy access given to Federal Reserve Bank facilities, in aid of government financing.

As a first step in the correction of this condition, reserve bank rates on war loan paper have recently been advanced to a parity with rates borne by Treasury Certificates, the differential which was formerly maintained between them being entirely removed. At the same time a policy of "direct action" so-called, is being advocated by those who doubt the efficacy of credit control by rates under present anomalous conditions, and who also fear the effect of any radical departure with respect to discount rates on the Treasury's position, so long as it continues to be a large borrower. By direct action in present circumstances is meant a supervisory restriction of the use of credit particularly for speculative purposes through close contact and cooperation of leading member banks with the policies and purposes of their Federal Reserve Banks. This method of control is now being applied, and the experiment will be watched with interest.

It is possible that direct action of the sort indicated above may succeed as a method of controlling the excessive use of credit for stock speculation. In the opinion of many, however, the existing credit situation in the United States which calls for correction is not alone the excessive use of credit in speculation, but the excessive use of credit in ordinary trade and industry. The inflations produced by the war have given a speculative tinge to much ordinary business and industrial enterprise. Those who take this view of the credit situation hold that the proper and primary method of control is through discount rates, and they believe that the credit situation will not be brought under effective control in the United States until ways are devised here of making reserve bank rates "effective" in the sense which is well understood in Europe, particularly in England where the discount rate has long been successfully employed as an instrument of credit control and regulation. It is probable that if the banking situation in the United States were not as closely tied up as it still is, unfortunately, with the Treasury situation, the year 1920 would see important steps taken by the Federal Reserve System toward the development of a technique of control through rates. In defect of any considerable or important action along this line, there is likely to be experimentation with direct action as a method of control, for the credit situation can not any longer be left to take its own course with the many incentives that post-bellum conditions are giving to the exploitation of bank credit by financiers and traders and promoters of the inflationist type.

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