OPENING REMARKS OF GOVERNOR HARDING AT THE CONFERENCE WITH THE FEDERAL RESERVE BOARD OF THE FEDERAL ADVISORY COUNCIL AND THE CLASS "A" DIRECTORS OF THE FEDERAL RESERVE BANKS, TUESDAY, MAY 18, 1920.

Gentlemen, the Board desires me to welcome you to Washington and to express its appreciation of your consideration in leaving your business and coming here to this conference.

We have been very judiciously advised from time to time by the Federal Advisory Council, which body has always held its four statutory meetings a year, and at times its executive committee has come on by request for a special meeting; but the present situation is such that we felt it would be helpful if we could have with us not only the Advisory Council but also the Class"A"Directors of the Federal Reserve Banks. We should have liked to have had all of the Directors, but we could not ask them all to come to Washington at one time, for it is necessary that a quorum of directors be left at home to attend to the business of the Federal Reserve Banks.

The Class"A"Directors are the banker members of the Boards of Directors of Federal Reserve Banks. They have a dual relationship. They are not only directors and, as a rule, very influential directors of Federal Reserve Banks, but they are officials of member banks and thus they see both sides of the picture. So it seems to be peculiarly appropriate, at a time when there is a banking situation to discuss, to have bankers here to discuss it.

As you are busy men it will be our purpose to detain you for as short a time as possible, and if it is agreeable to the members of the Conference, we will try to finish our discussion by half past 1 or 2 o'clock so that you can then be free to take afternoon trains home, if you wish, or to devote your time, if you stay in Washington, to such other engagements as you may have.

Of course, we all realize that the credit position is extended and very considerably extended. There is no occasion, though, to be unduly disturbed over the situation. We want to look at the facts as they are and not deceive ourselves in any particular. Having diagnosed the case, then we want to determine what is the proper policy to pursue. We have had an analysis made of the general banking credit expansion in this country, and without going into details I am going to save time by stating the result.

After allowing for the normal credit expansion in a growing country, we find that since the 30th of June, 1914, the expansion of bank credit in this country has amounted to about eleven billion dollars. At the same time the expansion in the volume of currency in circulation, deducting from our starting point the currency held in the Treasury, and deducting from the present figures the amount held in the Treasury and in the Federal Reserve Banks, has been about one billion, nine hundred million dollars. When we remember that during the last three years the Government has floated twenty six billion dollars of securities to take care of its own war requirements, and to enable it to make advances to governments associated with us in the war, this expansion of bank credit does not seem to be excessive or disturbing, when looked at purely from the standpoint of war necessity; but the situation that we want to discuss particularly today, and which seems to be disquieting, is the expansion that has taken place in the last twelve or fourteen months. From the 1st of April, 1919, to the 1st of April, 1920, the expansion of bank credit was about 25 per cent. This has been in spite of the very large reduction of the amount of Government obligations outstanding. The reduction in Government obligations has all been absorbed by commercial credits, with the net result of expansion of bank credits of about 25 per cent. During the same time there has been an advance in commodity prices of about 25 per cent. This has been accompanied by a decrease in production of essential articles.

Assuming for the year 1918 an index number of 100 in each of ten principal articles of everyday use and necessity--not necessarily production figures, but distribution and consumption figures, such commodities as grain, live stock, wool, copper, cotton, petroleum, pig iron, steel bars--putting all them at 100 for the year 1918 we get an index number for the year 1919, on the average of the ten commodities, of 89.07. While these figures cannot be accepted as indicating a positive decline in production, they do indicate a decided trend in that direction, a certain trend toward a reduction in the distribution of those products, so to all intents and purposes we may assume that there was a decline in essential production during the year 1919 of about 10 per cent. At the same time credit has expanded 25 per cent.

It is this tendency of production to decline, particularly in some essential lines, which constitutes a very unsatisfactory element in the present outlook. It is evident that the country cannot continue to advance prices and wages, to curtail production, to expand credits and to attempt to enrich itself by non-productive and uneconomic operations without fostering discontent and radicalism, and that such a course, if persisted in, will eventually bring on a real crisis.

There is a word-wide lack of capital, and with calls upon the investment market which cannot be met there is an unprecedented demand for bank credits. The fact must be recognized that however desirable on general principles continued expansion of trade and industry may be, such developments must accommodate themselves to the actual supply of capital and credit available.

Official bank rates now in force in the leading countries are higher than at any time during the present century, except during the war panic week at the beginning of August 1914. Only within the last few weeks the official rate in Italy has been raised from 5 to 5-1/2, the Bank of France rate from 5-1/2 to 6, and the Bank of England rate from 6 to 7 per cent.

Every effort should be made to stimulate necessary production, especially of food products, and to avoid waste. Planting operations in many sections have been delayed because of adverse weather conditions, and should there be an inadequate yield of crops this year the necessity for conservation and conservatism will be accentuated. War waste and war financing result inevitably in diminished supplies of goods, and increased volume of credits.

Now I assume, looking at the matter from the standpoint of the economist that the trouble with the general situation throughout the world, and in this country, is the disruption of the proper proportion or relationship between the volume of credit and the volume of goods. Whenever that phenomenon occurs, there are two remedies which suggest themselves: first a reduction in the volume of credit, credit contraction. That is a drastic remedy, it is unpleasant medicine, but it may be necessary at times to take medicine of that kind. The other and better method is to restore the proper equilibrium by building up production, in other words, letting the country catch up with itself. We can approximate this result in two ways. We can restrict credit and expand production, letting the expansion of production proceed at a greater rate than the restriction of credit, and we are then working along in the right direction. This is our essential problem today, the formulation of some constructive policy to be adopted by the Federal Reserve Banks which will build up essential production and at the same time preserve the solvency of other concerns which may not be essential per se, but which are highly essential as part of the general situation, because there is no chain which is stronger than its weakest link.

Now, there is undoubtedly, however, a spirit of extravagance in this country which must be curbed. There are some indications that the people are waking up to what the consequences will be if this wild orgy of extravagance and waste should be continued indefinitely. It may be that some real personal sacrifices must be made for the general economic good. But it is very clear that if we find it impossible under the present circumstances to increase the volume of production of the most essential articles, the only thing for us to do is to reduce consumption of those articles.

Now, we might as well look at the situation as it is. A prudent man never lives for the day alone. He always looks to the morrow and the months to come. What is the situation in regard to the output of the mines and of the farms in particular? What has been done to get normal output and production at the present time and to provide proper means of distribution of the output in order that there may be no acute shortage in the fundamental necessities of life next Winter? In this connection, I might call attention to one circumstance which has caused a good deal of uneasiness. It may not prove as bad upon analysis as it appears at first blush, but I refer to the lack of liquidation which we have experienced during the early months of the present year. We all know that normally, after the fall trade is over and the crops have been harvested and distributed, there is a marked easing of money accompanied by the liquidation of debts. This occurs usually in January and February and up to the middle of March of each year. Liquidation of this kind is entirely natural and is necessary in order that the banks may strengthen their resources in order to meet the demands which will be made upon them later on in the year as the crops are in the process of making or harvesting. This year we have had no such liquidation. Commercial loans have expanded steadily, and while there has been some reduction up to the last week or so in loans secured by Government obligations, it is noticeable in the last few days that those loans have increased. It would appear that this means an anticipation on the part of the American people for their requirements for bank credit which they usually make later on in the year. We may well inquire that as we have had this demand at a time when we ought to have had liquidation, what is our situation going to be in the later months, when we are going to have the demands which we have been accustomed to having? Now, I hope that the answer to this is -- and if this is correct it is the reassuring feature of the situation -- that the demands which have been made in the past few months, when we should have had liquidation, are due, at least in part, to the fact that essential commodities have been held back by lack of transportation facilities. Then our problem is directed to opening up the transportation facilities in order that these goods may flow to market. This done, we will get some liquidation which ought to be sufficient to offset the demands which will be made upon the banks for essential purposes later on in the year.

But we have figures to show that the extravagant spirit has not yet been checked. There are some indications that the peak has been reached and that people are coming to a more realizing sense of the situation and that they will pursue a sounder and a saner course. There ought to be a recrudescence of our old war-time spirit, of doing something that is worth while, and we should get down to work and solid business. There should be a general spirit of cooperation on the part of the Federal Reserve Banks, the member banks, the non-member banks and the public to work out a policy which will result in greater production, less unnecessary consumption and greater economy; all unnecessary borrowings for the purpose of pleasure and luxury should be restricted as far as possible and the liquidation of long-standing, non-essential loans should proceed.

We should be careful, however, not to overdo this matter of liquidation, because too drastic a policy of deflation, which might result in crowding to the wall and throwing into bankruptcy legitimate enterprises, however unessential their operations may be, would have a tremendously bad effect and would defeat the purpose of the very policy which we are trying to have established. There must always be a wise and discriminating judgment used.

A sensible and gradual liquidation will result in permanent improvement, as we all know, but any attempt at radical or drastic deflation merely for the sake of deflation will result in very serious consequences, and such a policy should be avoided.

It will be helpful for us to discuss and to understand the parts which must be played by the Federal Reserve Board, the Federal Reserve Banks and the member and the nonmember banks in solving the financial and economic problems that confront us.

Our problems are inter-related, but they are distinctive. The Federal Reserve Board is a governmental body, sitting here in Washington. It does not come, except indirectly, in contact with the member banks, and it can not be expected to have any intimate knowledge of the details of your business. And, it ought not to attempt to interfere with the details of your business. The function of the Federal Reserve Board, is to deal with general conditions and principles and to keep away from the mass of details which it is impossible for any Board sitting here in Washington to digest.

The Federal Reserve Banks do come in direct relationship and contact with their member banks. They have an intimate knowledge of the credit policy and of the borrowings of the member banks; they are kept fully informed from day to day of the change of position of the member banks, and through their contact with the Federal Reserve Board, as the coordinating and supervising body, they keep informed as to the Board's general policy, and they transmit to the Board such specific and general information as may be of assistance in determining these policies. But the primary banking business of this country is transacted by the member and the nonmember banks. Those are the banks which come in contact with the public; which are the custodians of the funds of the public, put with them on deposit, and they are the media through which commercial loans are made.

We have heard a great deal about the necessity of discriminating between an essential and a less-essential and a non-essential loan. The discount operations of the Federal Reserve Banks and their powers to make investments are all clearly defined in Sections 13 and 14 of the Federal Reserve Act. Those sections are permissive and not mandatory. A Federal Reserve Bank is not required to make any particular loan nor any particular investment. The Federal Reserve Board may define eligible paper, but all rulings and regulations of the Board must be in strict conformity with the terms of the Federal Reserve Act. The Federal Reserve Board has no legislative powers whatever. It can merely interpret by regulation or rule, the enactment of Congress.

Now, without discussing any power that the Federal Reserve Board may have to define essential and non-essential loans, I wish to point out that Section 13 provides, in a general way, that any paper maturing within the prescribed time, the proceeds of which have been used, or are to be used, for commercial, industrial or agricultural purposes, is eligible. There is no specific condition imposed as to whether or not, in the judgment of any man or body of men, any particular loan is an essential loan, for the well being of the community or the country at large.

The Board has reached the conclusion that there is no occasion now, whatever may be necessary later on, for it to attempt, by any general rule of a country-wide application, to define essential and non-essential paper. You remember the difficulties that were experienced in making such a definition during the war, when we had the War Trade Board, the War Industries Board, the Capital Issues Committee, and other temporary Boards here passing upon all these matters. At that time the problem was simpler than it would be now, because there was a general underlying principle that anything essential must be something that was necessary or contributory to the conduct of the war. Now we have no war. The temporary boards have all dissolved and gone. The Federal Reserve Board is not a temporary board. It is a permanent organization and it must conduct its business in strict accordance with the terms of the Federal Reserve Act. Therefore, I think we are all agreed that there is no occasion at the present time, if ever, for the Federal Reserve Board to attempt to define, by regulation of country-wide application, what is an essential and what is a non-essential loan. A Federal Reserve Bank is in much better position to undertake this than is the Federal Reserve Board. But even here there are difficulties in the way. Some of the Federal Reserve Districts cover very large areas. A rule adopted by one Federal Reserve Bank may not be susceptible of adaptation in another Federal Reserve District, because what seems to be essential or necessary in one place may not be in another. While there is no particular objection to a Federal Reserve Bank, in the wisdom of its Directors, undertaking, to make a general discrimination between loans plainly unnecessary, plainly non-essential, and those which are less essential or more essential, it seems to the Board that that whole question of discrimination might very properly be left for solution at the source, as a matter between the individual banker and his own customer, because the individual banker, particularly at times like the present, has a very close, confidential relationship with a borrowing customer. They can talk matters over with the utmost frankness. The individual banker is in position to give advice. He can accustom his customer to come to him, in advance of seeking a loan, or of making any commitment involved, to discuss the situation with him before the commitment is made. The individual banker in many cases - - of course this may not be possible in the larger cities - - but the great mass of banks all over the country that do mostly a local business can very largely anticipate the legitimate and necessary credit demands.

which are going to be made upon them; they can estimate the fluctuation in the volume of their deposits, and they are better qualified than any one else to give advice to a borrowing customer. They can often restrict the amount of a loan before it is made and can persuade a customer in very many cases that he really does not need the money after all. Then, again, the individual banker can determine, not so much the essential nature of a loan from an elementary standpoint, as to whether the loan is going to produce something that is absolutely needed, but he can decide better than any one else whether the loan is essential or necessary for the public good in his particular locality, not only as a means of producing something that ought to be produced, and which is needed for consumption , but as a means of preserving the solvency of his community. We all know that if the bankers in any community, large or small, were to clamp the screws on tight, they could bring disaster to the community, which might spread to other communities.

Of course, there may be cases, and there have been cases, doubtless, probably in all of the districts, where some of the banks have overdone the matter of extending credits, but there is one very encouraging feature of the present situation, and that is such cases are comparatively few. The majority of all the member banks in each of the Federal Reserve Districts are not borrowers from the Federal Reserve Bank, and the number of member banks which are borrowing from the Federal Reserve Banks in an amount exceeding their own capital stock is not large in proportion to the total membership. Every banker knows, or he ought to know, what reasonable line of credit he can get from his Federal Reserve Bank, and I want to call your attention to the power that the Directors of the Federal Reserve Banks have to limit their loans. I referred a moment ago to the fact that there is no mandatory provision in the Federal Reserve Act requiring that any particular loan be made. The nearest approach to compulsion in the matter of loans that you will find anywhere in the Act is that provision which permits and, upon the affirmative vote of five members of the Federal Reserve Board, requires a Federal Reserve Bank to rediscount for another Federal Reserve Bank. With this exception there is no other mandatory provision relating to loans in the Federal Reserve Act. While sections 13 and 14 are permissive, there is however, a strict injunction laid upon the Directors of the Federal Reserve Banks in that part of section 4 which requires the Directors of a Federal Reserve Bank, to administer its affairs without favor or discrimination for or against any member bank, and in making loans, discounts and advancements which in their opinion may be safely and reasonably made, to pay due regard to the wants and requirements of other member banks. Thus the Directors of Federal Reserve Banks are clearly within their rights when they say to any member bank, "You have gone far enough; we are familiar with your condition; you have got more than your share, and we want you to reduce; we cannot let you have any more." They must exercise their discretion as to the proper course to pursue, but they have the power, and there are many cases where the rule ought to be laid down and a member bank ought to be made to understand that it cannot use the resources of the Federal Reserve Banks for its own private advantage for profit; that it must not abuse the rediscount privileges of the Federal Reserve System.

When a banker understands, just as he did in the old days before we had the Federal Reserve Banks that there is a limit to his borrowing -- you will remember in the old days no National Bank was permitted to become indebted for borrowed money in an amount exceeding its capital stock -- when a banker realizes that if he wants to expand his business he must do it more and more out of his own resources and not lean so heavily upon the Federal Reserve Bank, When he understands what limitations and penalties may be imposed upon his borrowings, then if I know anything about the psychology of banking I know that the banker may be depended upon to use a wiser discretion in the matter of granting credit.

The recent amendment to paragraph (d), section 14, which empowers the Federal Reserve Bank, for itself, and without regard to any other Federal Reserve Bank, to establish a normal or basic line of credit upon some principle applicable to all member banks in its District alike, and to impose a graduated or penalty rate upon excessive borrowings, does not repeal, amend or modify in any particular the provisions of section 4 or section 13, and a Federal Reserve Bank is still, even though it adopts the progressive or penalty rate, entirely within its rights in declining to take undesirable paper at any rate. The progressive or penalty rate I will not discuss at this time, because we will have an open discussion a little later on and we will take it up then.

It may be argued that the volume of credit must necessarily be greater now than was the case a few years ago on account of the higher prices and higher wages which are prevailing, so that any given transaction requires a greater number of dollars to finance it than was formerly the case. That is true, but I believe that I can present figures to you that will convince you that if there could be a freer flow of goods and credit, in other words, a greater velocity in the turn over of credit, the resources of the banks of this country are abundantly ample to finance all essential enterprises and a good many of the non-essential as well. The fundamental trouble with the situation today is that there is a large volume of essential goods and commodities held back from the markets and kept out of the channels of distribution, either for speculative purposes, being held with the idea of getting higher prices later on, or where they are held back of necessity on account of lack of facilities to transport them to market. In the latter case, it is a wise and proper policy to ease the situation along, to assist the people who are thus compelled to hold and not throw any obstacles in their way, provided there is a genuine and sincere disposition to put the stuff in process of distribution as soon as transportation can be had. But in the case of the hoarder, who for selfish and profiteering purposes wishes to hold back from the mouths of hungry people essential articles of food, or from the backs of the naked essential articles of clothing, every good banker should exert every influence within his power to force people of that kind to turn loose their hoards. Here is an opportunity for wise discrimination, and this discrimination can be exercised more intelligently and effectively by the individual banker himself than by any Governmental board.

We find instances also which always occur when there is a constantly advancing tendency in the market, where merchants have stocked up. There are many cases where mercantile loans are too large and ought to be reduced. There are merchants everywhere who ought to be reasoned with and who ought to be encouraged to push their stocks out and get rid of the high priced stuff, because some of these days, it may be sooner rather than later, the reign of reason is going to be restored and the man in the street is no longer going to want to pay $25.00 to $30.00 for a silk shirt, or $20.00 for a pair of shoes or $1.00 for four pounds of sugar, and lower prices will be demanded, and trade will fall off unless lower prices prevail. It seems to me, from the standpoint of good merchandizing and good banking, that the merchants should be encouraged to reduce their stocks and not tempt the passer-by by extravagant display in the windows at high prices, which under the abnormal state of mind which has prevailed, may themselves help to sell the goods, because you all know cases where a customer would pass by with contempt a two or three dollar article and turn his attention to something at $25.00, although it may not be one whit better suited to his purposes.

In order to bring about a correct tendency and to lead to a permanent cure of our present situation, a campaign of education must be begun and continued. Here, again, there is no agency so well qualified as the banker, who receives on deposit the money of the public and makes loans to the public, to give advice, so thus there should be a concerted effort all over this country on the part of the bankers to arouse in the public a spirit of common sense. Let us take our heads out of the clouds and get down to business, and let us save, produce, and let each do his part in a constructive and productive way for the community, to add to the volume of goods and facilitate distribution, thereby doing something to cure the discrepancy, the bad relationship which has existed between the volume of goods and the volume of credit and money.

In any circumstances, you all know that the Federal Reserve Banks and the Federal Reserve Board will do their part to cooperate with the sound, sensible and reasonable member banks. In order that we may accomplish any real results and effect any permanent good, there must be cooperation on the part of the public with the banks, and on their part with the Federal Reserve Banks and the Federal Reserve Board. We must all pull together for sound, economic and financial principles. We should do all in our power, and we can do a great deal to check the false ideas which have gained circulation and inculcate in the minds of the people a sense of the importance of steady, every-day production and distribution, and to encourage the avoidance of waste and the elimination of extravagance.

I have here some charts, which will be distributed among you, which show the movement of principal asset and liability items of each Federal Reserve Bank and of the System, of the twelve banks combined. These figures are taken from July 3, 1919, to April 30, 1920. They show the gold reserves, the total cash reserves, the member banks' reserve deposits, the Federal Reserve notes in circulation, the acceptances bought, paper secured by Government war obligations, divided into the headings, secured by Liberty Bonds, secured by Victory Notes, and secured by Treasury Certificates, and the total discounted paper on hand. Then there is another table which shows the volume of bankers' acceptances purchased from other Federal Reserve Banks and the volume of bankers' acceptances sold to other Federal Reserve Banks, figures at the close of business on each Friday from July 3, 1919, to April 30, 1920.

Now, gentlemen, I declare the meeting open for general discussion.