December 20, 1933.

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PROFESSOR SPRAGUE'S CRITICISM OF FEDERAL RESERVE BOARD

Answers.

Professor Sprague, in Article #4 published in the New York Times of December 8th, stated among other things:

> "Heavy responsibility rests upon those conducting the Federal Reserve System for failure to effect needed restraint during the two years preceding the collapse of 1929."

> In another place in this article, he criticises those economists who preached the New Era as being in part responsible for the collapse of 1929.

In this connection, the following statement of facts may be found interesting:

-I-

The Board gave very serious consideration in 1928 to its responsibility and duty with regard to the control of speculation in securities, based materially on brokers' loans, and early in March requested Professor Sprague, as an economist, to come to Washington and advise the Board as to whether, in his opinion, discount rates should be increased and Government securities sold to check this speculative movement.

In response to this request, Professor Sprague came before the Board, or certain members of the Board, on March 7, 1928. He was present for about two days, and received an expert fee for his advice.

He advised members of the Board not to increase discount rates, nor to sell Government securities, stating that he was perfectly satisfied with what the Board was doing, and that by slow, constant pressure, it was doing all that could be done.

Later, on that day, Professor Sprague appeared before the Senate Banking and Currency Committee and discussed the whole subject of brokers' loans. He told the Committee that these loans could be controlled by increasing discount rates, and selling Government securities, but that such a course would have a reaction on commercial loans, and if persisted in would be more severe on legitimate business than on brokers loans.

He further made the surprising statement that brokers loans are a minor evil, and their expansion is a matter of secondary significance; that it is not too high a price to pay for the strengthening of the gold standard on the other side, and for stimulation of our export trade.

Sc. bk. 179, p. 15.
At (54) (55) (62).

Such was the advice Professor Sprague gave to the Board on March 7, 1928.

-II-

In startling contrast to this advice, Proffessor Sprague published an article in The Annalist of April 20, 1928, - only 6 weeks later - in which he took the position that brokers' loans were dangerous and that the Federal reserve banks were considerably responsible for the situation. He advised sharp and drastic action to correct the situation in the security market, and stated that even if such drastic measures should precipitate a spectacular collapse in the security market, the consequences might well prove far less damaging than those which may be anticipated if the market continues in its present mood until it collapses from its own weakness and excess.

In this article he further stated that if, in the latter part of February or early in March, the reserve banks had sold rapidly 100 or even 200 millions of Governments, an immediate advance in call money to 6% might have been brought about; that an abrupt advance of this extent would have exerted a far greater influence upon the speculative temper of the community than the gradual advance that has been experienced.

He also stated that an advance in the discount rate to 4½% in March might further have been advisable as a means of emphasizing the policy of effective control.

He further stated that had measures along these lines been followed, it is reasonable to believe that the situation would now be far more satisfactory from every standpoint.

Comparing brokers loans and security prices on the above date, April 20, 1928, with the date March 7, 1928, on which Professor Sprague gave the above advice to the Federal Reserve Board, we find that brokers' loans had increased, taking 1926 as 100, from 136.1 on or about March 7, to 152.0 on or about April 20, while security prices had increased from 135.8 on March 7, to 145.3 on or about April 20, 1928.

These advances were relatively slight as compared with the very great increase which occurred later.

In other words, Professor Sprague, on April 20, 1928, criticized the Board for not having done the very things he advised them not to do on March 7, 1928, - just 6 weeks before!

-III-

Professor Sprague, in the above article in the New York Times, also criticized those economists who endorsed the New Era, so-called, and stated that they were in part responsible for the crash of 1929.

He does not disclose the fact that he was one of those economists.

On may 29, 1929, Professor Sprague published an article in "Trust Companies" taking the position that the discount rate should be increased to 6%, and used the following significant language:

> "Now you may say that a 6% rate would create a panic. Those who think that must believe that the security prices are too high. Well I do not know that they are too high; in fact, I rather doubt if they are, and so I do not anticipate that there would be a panic."

Sc. bk. 193, p. 31.

On the date this article was published, May 29, 1929, security prices had increased from 145.3 on or about April 20, 1928, to 180.2 on May 29, 1929.

On April 20, 1928, he pointed out the danger of the security market collapsing from its own weakness and excess, and yet, after the startling increase up to May 29, 1929, he expresses the opinion that he doubts whether security prices are too high.

-IV-

To sum up:

Professor Sprague, on March 7, 1928, advised against increasing discount rates, and against sale of Government securities.

On April 20, 1928, he had shifted his ground, and advocated both an increase in discount rates and sales of Government securities, criticizing the Board for not having done this in March.

On April 20, 1928, he advocated sharp and drastic action to control brokers' loans, and stated that even if it caused a spectacular collapse in the security market, it would be no worse than the collapse which may be anticipated if the market continues in its present mood until it collapses from its own weakness and excess.

On May 20, 1929, he makes the inconsistent statement that he does not know that security prices are too high; that, in fact, he rather doubts whether they are too high.

-V-

The above would seem to show that any responsibility upon the Federal Reserve Board for, to quote Professor Sprague's words, - "failure to effect needed restraint during the two years preceding the collapse of 1929", must be shared in material measure by Professor Sprague himself.

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