

REMARKS OF MR. MARRINER S. ECCLES, GOVERNOR OF THE FEDERAL RESERVE BOARD, AT A MEETING OF THE FEDERAL RESERVE BOARD WITH REPRESENTATIVES OF THE INDUSTRIAL ADVISORY COMMITTEES IN WASHINGTON ON DECEMBER 18, 1934

There are many who feel that the making of direct loans to industry does not belong in the Federal reserve banks. There are others who feel that the Federal Reserve System can perform a useful function in this undertaking, but whatever the opinions may be with reference to the problem, Congress decided that issue last session and delegated the responsibility to the Federal Reserve System of making such loans. The Industrial Advisory Committees have been chosen to undertake this important responsibility, and are in a position which requires the patriotic giving of their time, effort and thought without compensation in this emergency. Their efforts in this connection are greatly appreciated by the Board. The results up to the present time are indicative of the fine work the committees have done in their respective communities, and while the results are disappointing to some it is not the fault of the Industrial Advisory Committees or of the Federal reserve banks.

It is a difficult thing to create credit where there is no basis for credit. It is perfectly natural after four or five years of the most devastating depression this country has ever seen that there would be many businesses in a state of financial collapse, which would immediately grasp at every effort of the Government toward

providing credit, which explains the deluge of applications that has come to the Industrial Advisory Committees. It is felt that while the field for credit of this kind is much more limited than many people thought prior to the passage of the legislation, there has been much more good accomplished than is indicated by the actual volume of loans approved. The program of direct lending has caused the banks to give more consideration to credits than they would have been inclined to give in the past. It has also tended to relieve the pressure being exerted for the liquidation of outstanding credits, so that it is difficult to measure the amount of total credit that has been carried that otherwise would have been retired, or the amount of new credit that the banks have extended which possibly would not have been extended had it not been for this legislation. There have been a number of cases where the committees have done very valuable work in advising companies with reference to changes they could make in management and policy.

All that the committees can do is to do the best they can and attempt to develop as many loans in the respective communities as it is possible to develop, being as liberal in their interpretation of eligible credit as it is possible to be. Inasmuch as the country is in a condition of general business depression, an improvement in business volume, prices and profits over a period of time can be expected, the banks can be more liberal in the extension of credit than they could be if the country was at the peak of prosperity facing the

credit dangers inherent in a period of deflation. It would be better to err on the side of liberality in the present situation than on the side of conservatism. While the banks do not want to incur losses knowingly, it is not expected that no losses will result. The Federal Reserve System should be prepared to show that their policy has been liberal, that the borrower has been given the benefit of the doubt, and that the Federal reserve banks have been willing to assume every reasonable risk.

Most individual banks cannot take any substantial losses without becoming insolvent and the earnings of the banks are so low at the present time that they are not in a position to take losses, whereas the Federal reserve banks can, without disaster, assume a greater risk than the private bank. If losses do develop they are socialized, and do not tend to destroy the banking system as do the losses in individual banks which cause the banks to close.

Bankers have a three fold duty. They must safeguard the funds of their depositors, and they must safeguard the principal and earn dividends for their stockholders. They are charged in a very large measure with a more important responsibility than either of the above, that of creating and extinguishing that part of the country's money supply represented by checking accounts. This last duty to the community at large is often overlooked. A contraction of loans and investments which may be desirable on individual grounds, may be undesirable from the viewpoint of the country as a whole for the reason

that a contraction of loans involves also a contraction of deposit money or deposit currency. In the process of liquidation from 1929 to 1933 approximately one-third of the total deposits of the country was so extinguished. The process of recovery requires that a substantial part of this lost deposit currency be replaced. This can be done if the banking system as a whole will expand its loans and investments. In the event that the banking system fails to do this the Government is then forced to supply the deficiency. That can be supplied through Government financing and budgetary deficits, the banks constantly increasing their investments in Government bonds. If the banks fail to take Government bonds, and fail to increase loans and investments, the deficiency must be supplied either through the Federal Reserve System buying such bonds as are required, the creation of a central bank upon the failure of the Federal reserve banks to take the bonds, or the issuance of currency by the Government. The desirable way is to do it through the private banking system to the greatest extent possible, but it cannot be done and it will not be done if the bankers feel that the banks are unsound unless they are liquid. We found in the depression that there is no such thing as liquidity except in the case of paper which can be converted into currency through rediscounting with the Federal reserve banks, and what appeared to be a sound bond with an \$85,000,000,000 national income appeared to be perfectly unsound with a \$50,000,000,000 income.

Bankers have insisted, and there can be no question of their

sincerity, that they are willing and anxious to make good commercial loans. But that is not enough. We must frankly face the fact that the supply of such loans is not sufficient both to offset the liquidation of old loans and to bring about the requisite expansion of total assets and deposits. Even in 1929 commercial loans eligible for re-discounting at the Federal reserve banks comprised only 12.7% of the member banks' total earning assets. At the present they are less than 8%. Bankers cannot confine themselves to such loans and still supply an adequate amount of deposit currency. In other words, if the bankers of this country are to perform their money supplying functions satisfactorily they must be prepared to increase their earning assets other than commercial loans. It is true that the banks have increased their holdings of Government securities by approximately five billion dollars, however, even with this increase the contraction of all loans and investments has been about \$18,000,000,000 since 1929. I should, however, like to see banks increase their holdings of other investments, sound real estate mortgage loans and local loans of good security but with a maturity much longer than six months.

I would not make the suggestion if I thought that it would prove detrimental to the interests of the depositors or stockholders of banks. I appreciate thoroughly the harrowing nature of the bankers' experiences with frozen assets in the past. It is possible, however, that wrong lessons are being drawn from our 1929 to 1933 banking experiences. Superficially, the trouble may have appeared

to have been lack of sufficient liquidity. But no banking system can be both liquid enough to pay off any substantial amount of its deposits at a moment's notice and at the same time serve the country by providing the amount of money necessary for business stability. Fundamentally, the real trouble lay in the circumstances that gave rise to the need of great liquidity. These circumstances are now happily past and hence the need of great liquidity is obviated. The insurance of bank deposits is designed to protect the banks from runs. Banks may lose deposits to other banks, but as a system they are going to gain rather than lose deposits. We have the will and, we believe, possess the power to prevent the recurrence of widespread liquidation and the collapse of values that have characterized recent years.

If we can get the private credit system to function in the field of mortgage loans, we will go a long way toward causing the private banking structure to occupy the place that it was designed to occupy. If the banks fail to do that, then it becomes inevitable that the Government must continue in the field of providing private credit as they have been doing in the past. If this tendency is not stopped, it will only be a short time before we have socialized and nationalized the credit structure of America. And this is a significant and dangerous trend that many bankers are entirely unaware of. The administration cannot be blamed for that development because the political pressure and circumstances that have developed have forced the administration into the credit field on an unprecedented

scale and it becomes the duty of all of us to try to divert so far as we possibly can into private channels the credit functions. With between \$13,000,000,000 and \$15,000,000,000 of time deposits in the banks, there should be no hesitancy on the part of the banks to enter the mortgage field. Either that should occur or time deposits should be divorced from commercial deposits so that time deposits can be used in the field in which they were designed to be used.

The Board appreciates the time that you have given to come to Washington to discuss the problems pertaining to industrial loans and the interest that you have shown and the cooperation that you have given. The Board pledges its support to the Industrial Advisory Committees in their work.