STABILIZATION

HEARINGS

BEFORE THE

COMMITTEE ON BANKING AND CURRENCY
HOUSE OF REPRESENTATIVES

SEVENTIETH CONGRESS

FIRST SESSION

ON

H. R. 11806

(Superseding H. R. 7895, Sixty-Ninth Congress)

A BILL TO AMEND THE ACT APPROVED DECEMBER 23, 1913, KNOWN AS THE FEDERAL RESERVE ACT; TO DEFINE CERTAIN POLICIES TOWARD WHICH THE POWERS OF THE FEDERAL RESERVE SYSTEM SHALL BE DIRECTED; TO FURTHER PROMOTE THE MAINTENANCE OF A STABLE GOLD STANDARD; TO PROMOTE THE STABILITY OF COMMERCE, INDUSTRY, AGRICULTURE, AND EMPLOYMENT; TO ASSIST IN REALIZING A MORE STABLE PURCHASING POWER OF THE DOLLAR; AND FOR OTHER PURPOSES

MARCH 19, 20, 21; APRIL 30; MAY 1, 2, 3, 4, 8, 9, 15 16, 17, 18, 23, 24, 28, 29, 1928

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COMMITTEE ON BANKING AND CURRENCY

House of Representatives

SEVENTIETH CONGRESS, FIRST SESSION

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STABILIZATION

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Monday, March 19, 1928.

The committee met at 10.30 o'clock a. m., Hon. Louis T. McFadden (chairman) presiding.

The CHAIRMAN. The committee will come to order.

This is a hearing on H. R. 11806, a bill introduced by Representative Strong of Kansas, under date of March 6, 1928, proposing to amend the act approved December 23, 1913, known as the Federal reserve act; to define certain policies toward which the powers of the Federal reserve system shall be directed; to promote the maintenance of a stable gold standard; to promote the stability of commerce, industry, agriculture, and employment; to assist in realizing a more stable purchasing power of the dollar, and for other purposes.

This is really a continuance of the hearings that were consummated in the spring of 1927 on H. R. 7895.

(The bill under consideration is as follows:)

A BILL To amend the act approved December 23, 1913, known as the Federal reserve act; to define certain policies toward which the powers of the Federal reserve system shall be directed; to further promote the maintenance of a stable gold standard; to promote the stability of commerce, industry, agriculture, and employment; to assist in realizing a more stable purchasing power of the dollar, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the act approved December 23, 1913, known as the Federal reserve act, as amended, be further amended as follows: Add to section 14 the following paragraphs:

"(g) The term 'Federal reserve system,' as used in this act, shall mean the Federal Reserve Board, the Federal reserve banks, and all committees, commissions, agents, and others under their direction, supervision, or control.

"(h) The Federal reserve system shall use all the powers and authority now or hereafter possessed by it to maintain a stable gold standard; to promote the stability of commerce, industry, agriculture, and employment; and a more stable purchasing power of the dollar, so far as such purposes may be accomplished by monetary and credit policy. Relations and transactions with foreign banks shall not be inconsistent with the purposes expressed in this amendment.

"(i) Whenever any decision as to policies is made or whenever any action is taken by the Federal reserve system tending to affect the aforesaid purposes of this amendment, such decision or action and reasons therefor shall be thereafter published by the governor of the Federal Reserve Board at such time, place, and in such detail as may be deemed by him to be most effective in furthering such purposes, and at least once each year in the Annual Report of the Federal Reserve Board to the Congress."

SEC. 2. After section 28 add the following:

"SEC. 28A. The Federal Reserve Board and the Federal reserve banks are hereby authorized and directed to make and to continue investigations and studies for the guidance of the system's policies, at least to the extent and in the manner described in paragraphs 1, 2, 3, 4, and 5 of this section, and to such further extent as they may deem to be desirable; namely,

"(1) Of the manner and extent to which operations of the Federal reserve system affect (a) the volume of credit and currency, (b) the purchasing power

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of the dollar, (c) the general level of commodity prices and of other relevant prices, (d) the prices of stocks and bonds, and (e) business activity; through changes of rates of discount, purchases, and sales of securities in the open market, relation and transactions with other banks of issue, or through any other means.

"(2) Of the influence of activities of agencies of the Government of the United States or of domestic or of foreign banks not under the control or influence of the Federal reserve system, or of any other agency or agencies upon the purchasing power of the dollar; and of the influence exerted upon the policies and affairs of the member banks and of their customers by means of direct representations, by publicity, or otherwise; and of the effect of such operations as are conducted by the Federal reserve banks with foreign banks.

"(3) Of the effect upon the purchasing power of the dollar of changes in the supply of and demand for gold, either actual or prospective.

"(4) Of existing means and proposed plans, both national and international, having for their aim the stabilization of agriculture, industry, commerce, employment, and the purchasing power of money.

"(5) Of existing or proposed index numbers of prices or other measures of the purchasing power of money, which are used or might be used, singly or in combination, by the Federal reserve system as a guide in executing its policies.

"SEC. 28B. The Federal Reserve Board shall report to the Congress from time to time, and at least annually, the methods pursued and the conclusions reached, either final or otherwise, resulting from the aforesaid investigations, and any legislation which will, in its judgment, best promote the purposes of this amendment to the Federal reserve act.

"SEC. 28C. Acts and parts of acts inconsistent with the terms of this act are hereby repealed."

The CHAIRMAN. I may say at the opening of these hearings that, at the request of Representative Strong, the chairman of this committee called this meeting this morning, and prior to the calling of the meeting he sent invitations to certain people whom we desired to have heard at this hearing. Among them were Governor Benjamin Strong, of the Federal Reserve Bank, of New York; Prof. O. M. W. Sprague, of Harvard University—who, by the way, has not yet been located, he being out on a trip through the Middle West; but as soon as the invitation can be gotten to him he will be invited to appear before the committee on this subject matter; Prof. John R. Commons, of the University of Wisconsin, at Madison; and Mr. Owen D. Young, a director of the Federal Reserve Bank of New York, were also invited. An invitation was also extended to the governor of the Federal Reserve Board and members of the board to appear before the committee.

I understand that at the meeting this morning there are present Governor Strong, of the Federal Reserve Bank of New York; Governor Young, of the Federal Reserve Board; Mr. Goldenweiser, director of research, of the Federal Reserve Board; Doctor Burgess, of the Federal Reserve Bank of New York; Mr. Platt, of the Federal Reserve Board; and Prof. John R. Commons, of the University of Wisconsin. In order that we may have a record of those that are appearing, is there anyone else here that I have missed?

(There was no response.)

The CHAIRMAN. At this point I would like to read the reply which I have received to the invitation extended to Mr. Owen D. Young to be present at this hearing.

NEW YORK, *March 16, 1928.*

Hon. LOUIS T. MCFADDEN,
Chairman Committee on Banking and Currency,
House of Representatives, Washington, D. C.

DEAR MR. MCFADDEN: I regret that I am leaving New York to-night and will be absent for about five weeks, and so I can not without great personal

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inconvenience appear before the Committee on Banking and Currency at its hearings on the Strong bill next week. If this were a matter in which I had primary responsibility or had any special qualification to testify, I would not, of course, permit any question of personal convenience or business expediency to interfere with my appearance before your committee. It seems to me, however, that I am confirmed in this by an examination of your questionnaire that the matters with which you are dealing call for cooperation from the Federal Reserve Board and the executive officers of the Federal reserve banks, who are especially informed on the questions you submit and who have the direct responsibility to aid you in every way possible. Compared with them I would be only a very mediocre and incompetent witness.

In general I may say that I have read the bill carefully and see no specific objection to it as drawn except as hereinafter indicated. In so far as it directly authorizes investigation and study, it makes certain the propriety of the expenditure of money for that purpose, and is, therefore, helpful.

As to your proposed paragraph h, if I understand it correctly, it expressly imposes on the system the obligation to do that which, as a director, I have always assumed was inferentially its duty under the existing law.

In so far as paragraph (i) is concerned, I have no objection to the object which is sought of a specific statement of reasons for any action taken, but I do not quite see how the paragraph will work. One has to remember after all that the Federal reserve system is composed of a coordinating board at Washington, with specific limited powers granted to it under the law, and independent boards of directors acting for the individual banks.

Any action taken by the system to accomplish the purpose of paragraph (h) requires action by these independent groups, and I should think it would be difficult for the governor of the Federal Reserve Board to do more than state the reasons which actuated his board in its action within its own field. If the paragraph means that the Federal Reserve Board at Washington is to exercise whatever powers are necessary to accomplish paragraph (h), then you have fundamentally changed the whole theory of the system and created a central bank with headquarters in Washington governed by the Federal Reserve Board with the boards of directors of the several banks simply as advisory groups without duties or responsibilities except possibly in the detailed field of administration. If it be the purpose of paragraph (i) inferentially to strengthen the centralized control of the Federal Reserve Board, then I am opposed to it, because I believe in the independence of the several regional banks.

Yours very truly,

OWEN D. YOUNG.

STATEMENT OF HON. JAMES G. STRONG, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF KANSAS

The CHAIRMAN. Mr. Strong, do you care to make a preliminary statement?

Mr. STRONG. I think I should perhaps make some statement at the opening of the hearing.

I became very much interested in the proposition of the stability of the purchasing power of money from the fact of the great loss that comes to the Nation at large, to all business, to all labor, to all those engaged in agriculture, in fact, to all groups of citizens of this country, by reason of the inflation or deflation in the purchasing power of money; and after considerable study of the subject I introduced, on January 18, 1926, H. R. 7895, simply directing that all the powers of the Federal Reserve Board should be used to that end, using the words at that time, "the promotion of the stability of the price level," meaning, of course, by "price level" the average prices of commodities which measure the value of money.

Both in an address on the floor of the House on February 20, 1926, and at the opening and close of the hearings had upon the bill before this committee I tried to make plain that I was not seeking immediate

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action by the Congress or by the committee, but was seeking, through the introduction of the bill and the study that might follow, that the best legislation possible on the subject might be enacted into law.

The hearings on that bill continued for many weeks. They have been translated into three languages. It has been said by men who have deeply studied our financial system that they comprise the best textbook on the Federal reserve system that has been published.

During the progress of the hearings I sent out three form letters to financiers and economists throughout the United States. The first letter, I think, went only to 250, the second letter to about 2,500, and the third letter to 5,000.

At the close of those hearings I did not ask that the bill, even as amended and perfected at that time, should be reported, but stated that I would continue the study of the proposed legislation and the hearings.

As the result of the study of the replies to those form letters and of the hearings, I have continued, by every effort that I could make, to get all the information I could upon this subject, and I have become convinced that the great powers given by this Nation to the Federal reserve system should be used toward the stability of the purchasing power of money. Those powers embrace the regulation (through the purchase and sale of Government securities) of the amount of money in circulation. To a certain extent the price of money (through the regulation of discount rates) and to a large extent the influence they may exercise upon the extension and contraction of credits by banking institutions throughout the entire Nation. It is a tremendous power. No greater power was ever given by any government in the history of the world than these powers, except perhaps the power of life and death and liberty.

The Constitution directed Congress "to coin money" and to "regulate the value thereof," and while we have complied with the direction so far as "the coinage of money" is concerned, we have so far only complied with the direction to "regulate the value of money" by defining the number of grains of gold that shall constitute the dollar, without making any effort to determine and fix the value of the gold. So that direction of the Constitution has not been very well carried out, and I doubt if we ever had an opportunity to carry it out until the creation of the Federal reserve system with the great powers that have been placed in its hands. I feel, therefore, that there should be a direction that the powers of the system should be used for the promotion of the stability of the purchasing power of money, which is the purpose of the proposed legislation.

In the preparation of this bill I have proceeded carefully, as noted, because of my loyalty to the Federal reserve system. My service upon this committee during the past nine years has convinced me that the creation of the Federal reserve system, and the position it has taken in our financial system, has made for America the best financial system in the world, and I would be the last man to do anything that would injure that system. Therefore I have continued to seek every cooperation from financiers and economists, both inside and outside the Federal reserve system, to try to get every possible information that would lead to the preparation of a proper bill that would direct the powers of the Federal reserve system to be used for

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stabilization of our monetary unit and that would not interfere with or injure that great system in any way.

During the summer I made a trip to the Orient, requiring 51 days on a boat. I took with me the hearings and a great many of the letters that I had received, and tried to make a careful study of the proposition. On my return I found that Dr. J. R. Commons, of the University of Wisconsin, who had been granted a leave of absence by his university, was willing to use that vacation, or leave of absence, for the study of this subject, and that he was willing to come to Washington and make an intensive a study of the subject. I got in communication with Doctor Commons, and he expressed his willingness to come to Washington and help in every way he could. I have had the advantage of close association with him, and he and I have had many conferences with officials of the Federal reserve system, and economists both inside and outside the Federal reserve system; and as a result H. R. 11806 was prepared and introduced on March 6.

Following the introduction of the bill, with the assistance of Doctor Commons and others, I prepared a questionnaire and submitted the same to the members of the Federal reserve system who are to appear at these hearings. Not that we expect or desire them to answer the questions in detail, consecutively, but in order that they might be advised of the nature of questions we would desire them to discuss before the committee; and I should like to introduce at this time, to be placed in the record, that list of questions.

The CHAIRMAN. Without objection, that will be inserted in the record at this point.

(The questionnaire referred to is as follows:)

PROPOSED SUBJECTS OF INQUIRY OF WITNESSES

If there should occur a change in the membership of the Federal Reserve Board such that a majority wished to carry through a policy of inflation of commodity prices and if the board should change the Federal reserve agents and the class C directors of the Federal reserve banks accordingly, could the reserve system produce an inflation of the average price level of commodities in general?

What means could be used?

1. Retire gold certificates and substitute Federal reserve notes.
2. Buy securities.
3. Reduce the rates of rediscount to, say, 3 per cent or less.
4. Other methods; publicity, etc.

How high could the average price level be raised in terms of index numbers?

How rapidly could this inflation be produced?

What forces would set the limit of rapidity at which inflation could proceed? Exports of gold till the legal minimum is reached, etc.

If, on the contrary, the membership of the Federal Reserve Board, Federal reserve agents, and class C directors, wished to carry through a policy of deflation of commodity prices, what means could be used?

1. Retire Federal reserve notes and substitute gold certificates.
2. Sell securities.
3. Raise rate of discount.

Other methods; publicity, etc.

How long could the average price level be reduced in terms of index numbers?

How rapidly could the deflation be produced?

What forces would set the limit on deflation? Gold imports. To what extent could these be prevented from getting into circulation?

If the United States has about 40 per cent of the world's monetary gold, and other nations are paying us about $1,000,000,000 in gold or equivalent gold exchange per year, do these facts indicate to you any greater power of the Fed-

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eral reserve system over world prices or domestic prices than would have been the case without this control over the world's supply of and America's import of gold?

In the aid given by the reserve system to enable other countries to return to the gold standard, would the following clause in the proposed act seriously restrict your efforts, namely, "Relations and transactions with foreign banks of issue shall not be inconsistent with this amendment?"

Would the placing of responsibility for publicity of policies upon the Governor of the Federal Reserve Board interfere with or place undue limitations on the freedom of action of the Federal reserve system?

Would such responsibility enable the system to avoid misleading forecasts and thus benefit the public?

Would such publicity tend to win and hold the confidence of the public?

What is your idea of what is intended in the clauses referring to investigation (sec. 28A), and how should such investigation be conducted as to persons to be employed in statistical, economic, and advisory capacities?

What distinctions do you make between the several purposes of the bill as stated in the preamble and section b?

Stable gold standard.

Stability of commerce, industry, agriculture, and employment, and a more stable purchasing power of the dollar.

What are your objections, in general or particular, to the enactment of the bill into law at the present time?

Suggest any changes in the wording, purposes, or provisions of the bill.

Mr. STRONG. Before the final draft of the bill was prepared, I did everything that I knew how to meet the objections of the men inside of the Federal reserve system who are making a study of this question and devoting their lives to the working out and the development of the Federal reserve system, and I thought I had met their objections. I do not say that the bill had their approval, but I thought I had met their objections. I only sought to retain in the bill that direction by the Government to the Federal reserve system that the great powers they have should be used to promote stability of the purchasing power of our dollar; not that they could make an absolutely straight line that was not to be deviated from in the rise or fall of average commodity prices, but that the great powers they have should be used for the purpose of stability, to the end that violent inflations and deflations should be minimized and the country saved the great disaster that comes through violent inflations and deflations in our monetary system, and which affects so disastrously all classes of our Nation.

On last Saturday the chairman, Doctor Commons, and myself had two conference with the members of the Federal Reserve Board and system, lasting several hours. As the result of those conferences I have amendments which were suggested to the bill. They are as follows:

In the preamble of the bill, in the fourth line, strike out the word "further."

On page 2, line 5, paragraph (h), after the word "system," add the words "in addition to the purposes expressed in the title of the Federal reserve act of 1913" and strike out the word "all" in that line.

On page 2, line 7, at the beginning of the line, add the words "promote the" and change the word "maintain" to "maintenance," adding the word "of," so that it will read: "Promote the maintenance of a stable gold standard."

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On page 2, line 9, after the word "stable," add the word "average," so that it will read: "More stable average purchasing power of the dollar."

On page 4, line 8, after the word "of," add "the average of."

Mr. LUCE. The second "of," you mean?

Mr. STRONG. Yes; the second "of." That is, before the word "prices," in line 8, add the words "the average of," so that it will read: "Of existing or proposed index numbers of the average of prices."

On page 4, line 9, at the beginning of the line, add the words "of commodities" and change the word "measures" to "measurements," and after the word "the" add the word "average," so that those two lines will read: "Of existing or proposed index numbers of the average of prices of commodities or other measurements of the average purchasing power of money."

After the word "combination," on page 4, line 10, place a comma.

At the end of line 11 of page 4 change the word "policies" to "policy," strike out the period, and add "of stabilization," with a period, so that the line will read: "Federal reserve system as a guide in executing its policy of stabilization."

At the end of the bill, section 28C, add the words "except that the purposes of the act of 1913 shall remain," so that that section will read:

SEC. 28C. Acts and parts of acts inconsistent with the terms of this act are hereby repealed, except that the purposes of the act of 1913 shall remain.

Mr. KING. What is the meaning of that?

Mr. STRONG. That amendment was suggested because some of those with whom we were in conference on Saturday felt that that clause might repeal some of the powers or authorizations that they had in the act of 1913.

Mr. MACGREGOR. Well, what does it repeal, as you leave it?

Mr. STRONG. It repeals anything inconsistent with this act only.

Mr. MACGREGOR. What is inconsistent with it?

Mr. WINGO. That is always the rule, without any definition.

Mr. STRONG. I know.

Now, gentlemen, I want to say that this present revision is now the twelfth revision of the sixth revision of this bill. I only mention this for the purpose of showing to the committee that I have made every effort that I knew how to try to meet the objections and suggestions that were made by the men who are conducting this great financial system; my purpose being to direct in the bill that the powers that they have now shall be used for the purpose of promoting the stability of the purchasing power of money, and further to direct that when they shall have made a change of policy they shall, as soon as they shall believe safe and proper, and at such time and place as they shall believe desirable, advise the American public why they made such change of policy. I believe it is necessary that the people who own and run this great Nation should be taken into the confidence of the great system of finance that they have set up in this country.

Then there is directed a study by the Federal Reserve Board and the Federal reserve banks of the questions set up in the bill.

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There is one question that I want to point out, so that you will know the reason that I have for urging this investigation. The question of an index number. I was urged by various groups in the United States to adopt different index numbers to be used in measuring the purchasing power of money. Some had one index number that they thought was preferable, and others had other index numbers. Realizing that an index number is perhaps not now or never will be perfect, and realizing that my study was rather limited, I finally decided to specify that as one of the subjects that the Federal Reserve Board and governors should study and report to Congress, out of which we might be assured that we would have the information that would lead to the adoption of the best possible index number in measuring the purchasing power of money. Other questions set up in the bill are to be studied, which I think will result in a better understanding by the American people of the system of financing that we have set up, and a better solution of the problems that confront us.

Now, gentlemen, there is but one principal objection that I have received from those who are so vitally iterested in the administration of the Federal reserve system that I could not meet in this bill, and that is: They fear that the American people will not understand what is meant by the use of the powers they have given to the Federal reserve system for promotion of the stability of the purchasing power of money. To my mind—while I do not want to go into it at length—that is not to be compared with the danger that may result from a failure to use these powers for the stabilization of the purchasing power of that which the people must use in exchange among themselves for everything that they buy and sell and use, because of the doubt that may exist in the minds of the people as to whether or not the great powers that they have given this system are being properly used. I do not think that they will fail to understand a direction to be used in their interest half as much as they fear that the powers they have given the Federal reserve system may not be used in their interest.

Mr. KING. Mr. Chairman, will the gentleman yield?

Mr. STRONG. Yes.

Mr. KING. I just wanted to know how the Federal Reserve Board, or those who are administering the Federal reserve act, are going to proceed under this bill with this last section that you have put in it.

Mr. STRONG. Well, that will come up in a discussion of the bill. I am willing to admit, Brother King, that perhaps much of the language, as I was just going to state, may have to be rewritten. That was put in there because on last Saturday it was suggested that perhaps the authorization of the repeal of all acts inconsistent with the terms of this act might repeal some of the act of 1913 that was necessary to the proper performance of the duties in administering the Federal reserve system. So I made the suggestion—it has not been given a great deal of consideration. I expect it will be discussed before the committee in executive session after the hearings have been concluded.

Mr. KING. You know the King of France marched up the hill with 10,000 men, and then he marched down again.

Mr. STRONG. I know; but we want to go up cautiously, in order that we may not march down again.

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I want to state to the members of this committee that after two years of study and work on this subject, and the efforts that I have made to meet the objections of the principal financiers and economists, both inside and outside the Federal reserve system, I realize that the various amendments that have been made to this bill will have to be rewritten; but this represents finally the result of the effort to cooperate with those men who are devoting their lives to the study of this question, and I ask the assistance of my colleagues, after these hearings, in the final preparation of this bill, to the end that the purpose of directing the uses of the powers of the Federal reserve system toward the stability of money may be properly carried in the bill, and also the clauses regarding publicity and investigation of the various questions set up in the bill may be retained. And after we have done that I hope that the bill may be favorably reported.

Mr. STEVENSON. Will the gentleman permit just one question?

Mr. STRONG. Yes, sir.

Mr. STEVENSON. As I understand, the gentleman says that probably a great deal of it will have to be rewritten. Is not the very heart of this bill subdivisions (h) and (i) of the first section?

Mr. STRONG. Yes, sir.

Mr. STEVENSON. There might be a difference in phraseology there, but that is what you mean to do?

Mr. STRONG. Yes, sir.

Mr. STEVENSON. The other things are all means to that end, as I understand it?

Mr. STRONG. Yes, sir.

Mr. STEVENSON. And you expect a great deal of the other to be rewritten?

Mr. STRONG. Yes, sir. As a result of these hearings, it is thought desirable to do so.

Mr. STEVENSON. But if the bill passes, according to your ideas, it should contain the meat of subdivisions (h) and (i)?

Mr. STRONG. Yes, sir.

Mr. WINGO. In order that I may follow the discussion, I would like to ask the gentleman from Kansas about the first proposed amendment in line 5, page 2. What is that amendment that you are proposing there?

Mr. STEVENSON. Mr. Wingo was not here when you were reading those amendments.

Mr. STRONG. It is, after the word "system" on line 5, to add the the words "in addition to the purposes expressed in the title of the Federal reserve act of 1913."

Mr. WINGO. You propose, then, to amend the title of that act.

Mr. STRONG. No.

Mr. WINGO. You are going to add to it?

Mr. STRONG. No.

Mr. WINGO. Why use the words "in addition"?

Mr. STRONG. The Federal reserve system shall, in addition to those purposes, do the following——

Mr. WINGO. So you are going to amend it by adding other purposes?

Mr. STRONG. It amends the law, of course. It adds other purposes; yes.

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Mr. WINGO. Now, you propose to amend the title. What about the act? What about the purposes expressed in the act?

Mr. STRONG. I have explained, Mr. Wingo, that I am only making these suggestions as the result of the conference had with the members of the Federal reserve system on last Saturday, and for the purpose of meeting objections that were urged at that time. I realize that when we get into executive session you and other members of the committee who are familiar with this subject will help in perfecting the language.

Mr. WINGO. I want to follow you. I am not interested in the source of this amendment. I am interested in the character of it. I do not care anything about the wording of it. Do you propose simply to add to the purpose expressed in the title of the Federal reserve act and leave unchanged the purpose in the Federal reserve act, or do you propose to add some purposes to the Federal reserve act?

Mr. STRONG. I am proposing to add, certainly, to the present Federal reserve act a direction that the Federal reserve system shall use the powers that they now have, or may hereafter be possessed of, to promote the maintenance of a stable gold standard, to promote the stability of commerce, industry, agriculture, and employment, and a more stable average purchasing power of the dollar, so far as such purposes may be accomplished by monetary and credit policy. That is really what I am trying to do.

Mr. WINGO. I understand that. But you do not understand my question. I did not ask you about that. I am asking you about the mechanics of the bill. Do you propose by this bill to add to or take from any of the powers of the Federal reserve system as expressed in the act; not simply in the title?

Mr. STRONG. I do not. I only give a direction as to the use of the powers they now have.

Mr. WINGO. We are talking about purposes, not powers. Do you propose to amend any of the purposes expressed in the Federal reserve act, or do you propose to confine your additions to the purposes expressed in the title of the Federal reserve act?

Mr. STRONG. I propose to add nothing to the purposes of the Federal reserve act except a direction as to the use of the powers that they now have.

Mr. WINGO. Well, that is an addition, is it not?

Mr. STRONG. Yes, sir; a very important addition. But I hold that the first duty of a monetary system is to maintain the stability of the purchasing power of its monetary unit.

Mr. WINGO. Because the whole struggle over the Federal reserve act, the question of the distribution of powers and checks and balances is just exactly like all the powers of our Federal Government. It is a question of the use and abuse of powers or the lack of exercise of powers. That is the whole story of the Federal reserve system.

Mr. KING. I suppose the gentleman is going on the theory that they have a power which is equivalent to life and death, as he stated in his original statement; and therefore I was wondering what the purpose of extending those powers was.

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Mr. STRONG. I am not extending them.

Mr. WINGO. I want to follow you. Take the last amendment. You propose to repeal acts inconsistent with the terms of this act, except that the purposes of the act shall remain. In other words, you repeal every provision of the Federal reserve act that is inconsistent with this act except the inconsistencies that go with the purposes of the act; is that it?

Mr. STRONG. Of course, that may be your interpretation.

Mr. WINGO. I am asking this, my dear sir——

Mr. STRONG. I have said, Mr. Wingo—I do not know whether you were here or not—that that was a suggestion made last Saturday at a conference with members of the Federal reserve system, and it will be discussed in these hearings; and then, after we go into executive session, as the result of the information we get in these hearings, we will have to change that phraseology.

Mr. WINGO. I want to follow you, but I can not find out what you propose to do.

Mr. STRONG. Well, I am trying to tell you.

Mr. WINGO. You do not understand my question. Do you propose to repeal all of the provisions of the Federal reserve act that are inconsistent with this act except that provision which is inconsistent with the purposes of the act?

Mr. STRONG. Why, I certainly want to repeal anything that would interfere with carrying out the direction set up in the bill I have introduced and which these hearings are to consider.

Mr. WINGO. All right; I have got it, then.

Mr. CANFIELD. Mr. Chairman, I notice that Representative Strong said that he sent out a questionnaire to the witnesses.

Mr. STRONG. Yes, sir.

Mr. CANFIELD. I would like to suggest that he send a copy of that questionnaire to each one of the members, so that we may go over it as we go along.

Mr. STRONG. I have two copies here. I can furnish one for each side of the table.

The CHAIRMAN. Gov. Roy A. Young, of the Federal Reserve Board, is here. We would be very glad to hear Governor Young's statement at this time.

Mr. YOUNG. Mr. Chairman and gentlemen of the committee, the board, of course, has considered this bill and discussed it, and the board would like to be represented by Doctor Goldenweiser, Doctor Miller, and Mr. Wyatt if necessary. Doctor Miller is sick at the moment, but expects to be able to appear before the committee on Wednesday. I have been informed that there are some witnesses here who would like to catch a train this afternoon, and the Federal Reserve Board is quite willing that they should appear first, so that they can catch their trains.

Mr. WINGO. Governor, does the board approve this bill?

Mr. YOUNG. No; the board is opposed to the bill.

Mr. WINGO. That is what I wanted to know. I had heard many rumors that they were in favor of it.

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STATEMENT OF BENJAMIN STRONG, GOVERNOR OF THE FEDERAL REERVE BANK OF NEW YORK

The CHAIRMAN. I am going to call Governor Strong, of the Federal Reserve Bank of New York. I would like to state to the committee in that connection that Governor Strong has to make a train early this afternoon, and he has an important statement to make, and I am going to suggest that he be not interrupted until he has completed his preliminary statement, and then, if desired, that questions be propounded to him. I will say, further, that Governor Strong has come here at some personal risk, because he has just recently gotten out of a sick bed, with a slight attack of pneumonia, and we do not care to tax him beyond his strength to-day or to cause him any harm. We are always glad to have Governor Strong before this committee, because he always has something of importance to say to us, and I am sure that in whatever he may say to-day will be of interest on this particular piece of legislation.

Mr. WINGO. I suggest, Mr. Chairman, in addition to the ordinary corrections that the gentleman is permitted to make in his remarks when they are submitted to him, that he be given authority to elaborate and add anything to them that he wants to.

The CHAIRMAN. Yes. That courtesy is usually extended, and it will be in this case.

Governor Strong, the committee will be glad to hear you now.

Governor STRONG. Mr. Chairman, I should say first, and especially in view of what Governor Young has stated, that obviously I have no authority to speak for anyone but myself. That is, I have no authorization from the Federal Reserve Board or the Federal reserve system to express views other than those that I hold myself about this bill.

Certain technical questions have been raised as to the drafting of the language of the bill, and there may be some legal questions involved in the construction of this bill. I do not feel competent to discuss those, Mr. Chairman. So I hope that you will understand that I am merely discussing the language of the bill as it has been changed by the suggestions just made by Congressman Strong, without regard to questions of legality or technique.

In the hearings in 1926, when I was before the committee, you will find a rather elaborate discussion of the way I did feel about the bill then proposed, H. R. 7895, and I would like to avoid repeating, if I may, all that was stated at that time, and simply summarize to this extent that I do not believe, and have never believed, that any method of fixing the general level of commodity prices can be devised which would enable a monetary and credit policy by a bank of issue to accomplish that object. That is, the theory that the volume of credit and money in circulation alone controls the price level, I think is not altogether to be accepted. There are other theories of price changes which obviously can not be dealt with by legislation at all. You will recall that I also expressed the view that there was some danger in legislation of this character, in misinterpretation by the public, which might be led to believe that this was an effort to fix the prices of some individual commodity or group of commodities.

With that brief summary of some of the statements at the previous hearing I want to call attention to the language of this bill

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where Congressman Strong has sought to meet that objection, namely, in paragraph (h), on page 2, the bill provides that the system shall use its powers to promote stability, and so on, so far as such purposes may be accomplished by monetary and credit policy.

I personally interpret that language to be a recognition of at least one of the objections which I made to the bill in its original form, but it still leaves a certain possibility of misunderstanding by the public that this bill, instead of being a direction as to the effect of a monetary credit policy upon prices, extends far beyond that and is really an attempt to fix some stability in prices, which can not be accomplished by monetary policy alone. It does provide an explanation to those who are managing the Federal reserve system that they are not expected to do the impossible; I admit that, but I am not yet sure it will entirely obviate or avoid the possibility of some public misunderstanding of the purpose of the bill.

At the time of the hearing in 1926, you will recall that I did state that a very brief addition to the title of the bill, or the preamble, or a slight amendment to the Federal reserve act in the nature of a declaration as to the gold standard in its operation might accomplish all of the purposes as to prices which are capable of being accomplished by monetary policy and thereby avoid the difficulty of construction of language to which no one can give exact definition; that is, the meaning of the words "inflation" and "deflation" and what is a stable price level, and so on.

Apparently, that suggestion has been incorporated in the title to this act, but it is coupled with the other provision as to efforts to bring about stability by monetary policy. I would like to refer to that later, if I may, in connection with the questionnaire, but, in general, I still feel that everything important which is sought to be accomplished by this direction of the Congress, or by this definition of policy by Congress, could be well accomplished, possibly with avoiding some misuderstanding, through a scientific application of the well-known principles of the gold standard.

That is about all I had in mind to say about that specific provision of the bill.

I would like to refer to paragraph (i), an important one, as to publicity. It is a subject which has engrossed and puzzled the responsible officers of the Federal reserve banks from the very organization of the Federal reserve system.

To express exactly the way I feel about it, I would like to divide the possibilities of publicity as to policy into three methods or species of publicity. One is a statement in advance of the intention of the system as to what it shall do in the future. The second is an explanation simultaneous with the adoption of any policy of the reasons for the adoption of the policy. And the third is a subsequent exposition of why something had been done in the past.

The language of the proposed act, I think, very clearly lodges the discretion as to what shall be stated and when it shall be stated in the governor of the Federal Reserve Board, who is the responsible head of the system. The language employed, which seems to me conservative, makes feasible a procedure under which I feel that much good can be accomplished in educating the public and the Con-

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gress as to why the Federal reserve system undertakes certain policies, and at the same time escapes the danger of publicity in advance or simultaneous with the adoption of policies.

May I explain by illustration, if you please? Let us suppose that conditions arose which indicated the necessity for an advance in the discount rate of the Federal reserve banks and the procedure of the Federal Reserve Bank in New York was elaborately explained at the previous hearings—and in preparation for such an advance in the discount rate it was desirable, in order to make that rate effective when it was made, that the system should sell some of its securities.

Now, if Governor Young at the time that that action was decided upon should state to the public that the Federal reserve system proposed to sell some securities and one, two, or three months hence expected to advance the discount rate, I think it is almost inevitable that the public reaction and the effect upon public sentiment by any such announcement might make it necessary to reduce the discount rate when that time arrived, and at once the system would be charged with being disingenuous and deceiving the public; and there is great danger, not in what we do, which is known to everybody, but in the effort to explain specifically and in detail all of the reasons.

I can express that in a different way to show the practical difficulties by explaining the method by which a change of policy is decided upon in our bank. At a meeting of the directors, which occurs every week, I am asked if I have any recommendation to make as to the rate of discount.

Mr. WINGO. You make that recommendation where?

Governor STRONG. To the directors at weekly meetings.

Mr. WINGO. That is, at your own directors' meetings?

Governor STRONG. At our own directors' meetings in New York. If I recommend a change, it comes up for discussion and is very exhaustively discussed always. There are nine directors and usually five or six of the executive officers of the bank at the meeting.

Now, it well may be that there will be four, five, or six specific reasons in the minds of the directors or groups of directors or officers for making the change, and the majority of directors will vote to make a change, whereupon a report is made to the Federal Reserve Board at once of the action of the directors, and in order that this act of the bank may not be held in suspense for a long time it has usually been possible to have approval by the Federal Reserve Board the same day our directors act.

Now, if the Federal Reserve Bank of New York is to convey every shade of view of every director to the governor of the Federal Reserve Board, every motive for a change in the discount rate, as well as the objections to the change entertained by some of the directors, and then Governor Young is called upon to submit that to the eight members of the Federal Reserve Board and listen to their views in support of or in opposition to it, and finally express a composition of all these views, of all the reasons, the pros and cons, I can see it is quite impractical, quite impossible to make an honest, complete statement that will be incapable of misinterpretation by the public.

In fact, the views which we may ultimately express as to this important act may be so contrary to the views of some of the col-

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leagues in the system that they might feel called upon to express their own views for their own protection, especially at a time when a change in the discount rate is of great importance to the country.

Now, this argument applies to every effort to advise the country in advance of what the system proposes to do and, to a very slightly less degree, to any effort to advise the country simultaneously with the action, because no action by the Federal reserve system has instant effect. Any statement made at the time is a statement made in anticipation of the effect of the action anyway.

So I frankly believe that the language in this section (i) is conservative, and, if not too much is expected in the way of explanation, I believe it may be helpful in educating the public as to the policies of the Federal reserve system.

I want to point out, however, in order that you may not by the slightest degree misunderstand what I mean, a very slight change that I understand Congressman Strong has made in the language. In line 17 it reads.

Such decision or action, and reasons therefor, shall be thereafter published.

Now, originally it had the definite article (the) in front of the word "reasons," and to leave that out makes a very material alteration of the meaning of that phrase. It permits of a certain latitude in making both a comprehensive and concise statement, which would not be permitted if he was required to give all the reasons.

Mr. WINGO. In other words, you would swear the witness to tell the truth but not the whole truth?

Governor STRONG. Well, Congressman, that is one way of expressing it. I think there are occasions when a man is unable to tell the whole truth.

Mr. WINGO. I am not quarreling with you.

Governor STRONG. It is the difference between stating facts and motives. When you come to expressing motives you have difficulty enough in expressing your own, but when you engage yourself honestly and exactly to express other people's motives you are in no end of difficulty, and that is the difficulty I apprehended about a definite article.

All of section 28 (a) is addressed to a direction, or an authorization, for the Federal reserve system to conduct certain inquiries and to report the results. It is my belief that, in the main, in the general authorizations of the Federal reserve act there is probably ample authority now to conduct very extensive inquiries as to all monetary matters of that sort; but as to those matters in which we are especially interested in the Federal Reserve Bank of New York, I think some authorization of this character would give us all a sense of assurance that what we were doing in those respects is affirmatively understood by Congress and approved.

Of course, we have to recognize that the world is gradually emerging from a period of the most extraordinary disorder ever known in the history of monetary affairs. It presents many novel problems, and too much study can not be given to the subject. Certainly a voluntary expression of the desire of Congress that we should do whatever is necessary to get an adequate understanding of these problems is to our great advantage, and I believe that it would be to the

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advantage of the system if more elaborate reports were made of the result of investigations and studies of these matters.

Personally I would like to see this part of the proposed act a little bit shorter. Making it as long as it is might be a little confusing and later lead to some complaint by Congress that what was desired had not been accomplished sufficiently or promptly enough.

Mr. WINGO. Has your attorney passed upon this question? In other words, under the law now you have authority to make any investigation you think is necessary to guide you in the formulation of a policy. Now, this restricts that by undertaking to enumerate the purposes.

Governor STRONG. I do not think it does.

Mr. WINGO. So that if you have not enumerated all the purposes you want, the inclusion of these excludes all others under the familiar rule of interpretation.

Governor STRONG. The language on page 3 says "and to such further extent as they," the Federal reserve banks, "may deem to be desirable."

Mr. WINGO. But the courts have passed upon that kind of language, saying that it does not mean anything. Where you make general terms and then you follow it up with specific terms, the specific controls and nullifies the general.

Governor STRONG. I am afraid I must refer you to the alibi that I stated at first about technical and legal questions that are raised in drafting legislation. I have had no experience there.

Mr. WINGO. You started out with the idea that you thought possibly you had this power but you did not think it would hurt, and your namesake is restricting your present powers by undertaking to enumerate them.

Governor STRONG. He is doing it in very kind language. [Laughter.]

Mr. WINGO. He is. He will bury you with flowers. [Laughter.]

Governor STRONG. I do not feel competent, therefore, to make any comment on section 28(c) on the question raised by Mr. Wingo.

The CHAIRMAN. Do you care to say anything about section (b)?

Governor STRONG. Section 28(b)?

The CHAIRMAN. Yes.

Governor STRONG. Well, in passing, as to section 28(a), I merely said I thought it would be to the advantage of the system and of Congress to have a better understanding of the work we are doing in that particular line, or the best possible understanding, and that these reports would be enlightening and helpful. I base that partly, Mr. Chairman, upon my belief that these hearings have been most helpful to the Federal reserve system. I think they have led to a better understanding of what we are driving at.

Mr. STEVENSON. I think your statement before this committee on a former bill has been a very educational one. I have had a tremendous number of applications for it, and there have been a great many bankers and others interested who have expressed the idea that they knew a lot more about it after reading your statement here last year.

Governor STRONG. I enjoyed it, Congressman. I warned you that I would talk at great length if you ever got me started on the Federal reserve system.

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I hope there is no impropriety in my saying one thing about legislation of this character, which was suggested by something that one of our directors said—I think Mr. Young. This is the kind of a bill where a very slight change would alter the fundamentals of the bill to such an extent that I might alter my views very materially as to what the bill would accomplish. I do not know very much about methods of legislation, but enough to realize that a bill as introduced does not always emerge in exactly the form in which it is introduced.

I think I might summarize my general feeling about the bill by saying that the principal objections which I personally entertain are those which I first described, as to the effort toward bringing about stability by this particular mandate of Congress, and the possibilities that this bill may not be in substantially the form which it now is when it is approved.

Those are the two points on which possibly I feel justified in laying some emphasis, but I do not know whether it is proper to make that suggestion to a committee of Congress.

The CHAIRMAN. Inasmuch as I am assuming that those remarks are largely directed to the possible changes that might be made in the United States Senate, I think it is quite all right. [Laughter.]

Governor STRONG. I had not thought of that.

Now, I think it is only fair—and I am trying to give a judicial opinion, if that is possible, on such a matter—to say this: That I very firmly believe that everything sought to be accomplished by this amendment to the Federal reserve act can be accomplished, and, in fact, will be accomplished, provided you have two things. First, good management in the system, honest, intelligent management; and, second, a general restoration of the full gold standard in the world.

Mr. STRONG. Do you mean a full coverage of gold?

Governor STRONG. No; I mean the full and free payment of gold in redemption of notes circulated in the nations.

Mr. WINGO. Do I understand that that means an unrestricted flow of the free gold of the world?

Governor STRONG. Between the nations.

Mr. WINGO. I say, between the nations.

Governor STRONG. Yes.

One other thing which I think it is not fair to omit is this: That you will find, on page 183 of the hearings, Part I, 1926, a chart of prices extending from the year 1800 down to the year 1924. If you will observe, the great price distortions that occurred grew out of war in every instance; that is to say, the Napoleonic wars, the American Civil War, and this last war, were the occasions for price disturbances which in every instance gave rise to efforts to legislate exactly as Congressman Strong is now attempting; and I do not believe, and I can not think that Congressman Strong believes, that any legislation of this character, no matter how strongly it may be framed, will protect the monetary system against the strain imposed by financing a great war, and therefore I feel that there is a little exaggeration of the importance of this question because of the bitter experiences growing out of the recent war, and that if you gradually get back to the old method by redeeming our obligations in gold we shall accomplish pretty much what he wants.

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Now, Mr. Chairman, would you like to have some comments on this question——

Mr. STRONG (interposing). I was going to suggest, Governor, that owing to your limited time and our desire not to tax your strength to-day, there are many questions pertaining to this same subject, some of which you have touched upon at these previous hearings, which the committee would like some time or other to discuss with you, but at this time we are not proposing to do that, but simply want to give the members an opportunity to ask any questions of you on this particular subject.

Mr. WINGO. Would it not be better, Mr. Chairman, after we have heard from these other gentlemen, to have the governor back here some weeks later, at a time suitable to the governor, and then we will be better prepared to get his advice?

The CHAIRMAN. If that will be agreeable to the governor——

Governor STRONG (interposing). That will suit me perfectly.

The CHAIRMAN. Some time in May or June. The governor, in other words, is so engrossed in the management of this system, and particularly in connection with the banks of issue of the world, that it would be enlightening to this committee to have the benefit of his experience from the time he appeared before us last up to date; and, if it is agreeable to him, we will at some convenient time invite him to come before the committee again.

Governor STRONG. I shall be delighted.

I can, in a few words possibly, answer the first two groups of questions generally, which I believe are the ones to which Congressman Strong attaches the most importance.

Mr. STRONG. Yes. I have said to you, and to many others, that I was pretty well satisfied with the stabilization that had been made possible by the management of the Federal reserve system in the last three or four years. One thing has always worried me, and that is this: If through a political upheaval in this country the membership of the Federal Reserve Board should be so changed, and the members of that board conscientiously believe that the price level should be reduced or the price of gold raised, and the purchasing power of money raised, or vice versa, that such a board might undo all that is being now done, and a contrary policy adopted. Hence I desire that language should be written into the law to direct that the powers placed in their hands shall continue to be used toward promoting the stability of the purchasing power of our dollar.

That was the purpose of those first two questions.

Governor STRONG. On that subject the great inflation of credit which occurred in this country, and the subsequent contraction of credit, undoubtedly are attributable to the war financing. Since the system has now reached a stage of development where its operations are more normal, I do not think anyone, even the most violent critic of the system, can charge any deliberate attempt to bring about an undue expansion or contraction of the currency or credit of the country; but as to the change of management, and that is the first paragraph in the questionnaire, let me call attention to the provision of the Federal reserve act as it is now. The members of the Federal Reserve Board are appointed for terms of 10 years.

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Mr. BRAND. Would you mind if I interrupted you for a moment to ask the chairman a question? The House is meeting now; how long are you going on with this?

The CHAIRMAN. Just until Governor Strong finishes this statement.

Mr. BRAND. But Congressman Strong wants him to answer all these questions.

Mr. STRONG. No. The governor suggested that he could in a few words answer these particular questions and I made a few remarks so that he would understand what the main purpose of them was.

* * * * * * *

Governor STRONG. We were discussing the question of the change of management of the Federal reserve system. The members of the board are appointed for terms of 10 years, and unless some catastrophe happened the change of management of the system, as far as the Federal Reserve Board is concerned, would take place very slowly. With respect to the suggestion that the complexion and character of the board might be changed by appointment, and that the new board would appoint class C directors who were avowed inflationists, if you please, even that would not bring about, necessarily, any period of deliberate inflation of the currency, because there are only three class C directors in each bank, and the other six directors are elected by the member banks, three of whom are experienced bankers and three experienced business men. So that, in the 12 reserve banks, you have 36 directors appointed by the Federal Reserve Board, 36 bankers and 36 business men, and my belief is that changes of that character could be brought about only so slowly that there is very little if any danger to be apprehended on that account.

If the whole country were bent upon having some inflation of the currency, no doubt, in the face of public pressure and pressure by Congress, the system—and the Government as a whole of the Federal reserve system is not a supergovernment—might put up a fight against the country, but probably in the end it would get licked; so that, after all, the reliance against such an extraordinary occurrence has got to be public opinion.

Now, as to the internal management of the system itself and what might be done to check either an inflation or a deflation, I go back again to the operation of the gold standard. The creation of a great volume of credit, in excess of what the business of the country requires, immediately has certain reactions. Interest rates go down. You have an exodus of capital from the country and, if such a policy is so deliberate as to be generally recognized, there would be a flight of capital, and if it was a gradual policy of inflation, insidious and not readily perceived by the public, it would undoubtedly in time have some effect upon prices.

But in every case the consequence is the same; gold would leave the country, Gresham's law would operate at once, and it would be an apparently short time, particularly if the public were aware of the situation, before the reserves of the country would become so impaired that we would be facing a suspension of specie payments. I do not know of anything that would bring the country to its senses any quicker.

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The reverse of that is equally true in a period of deflation of the credit and currency of the country, if it could be brought about. There is a limitation upon what is possible, but the method would obviously be to sell all the investments of the system, and the banks would thereby be heavily in debt to the reserve banks, and then the only method would be to raise the discount rate, possibly to perilous heights, and the response to that would be an influx of gold. Reserves of member banks would build up very rapidly and the automatic check on contraction would begin to operate.

I describe this very roughly. It is not possible to mention all the circumstances that would arise under those conditions, but in either event a very large gold movement that appeared to be excessive in its effect would bring an instant response from public opinion, and I can not conceive of such a situation arising as is hypothetically indicated by these two groups of questions.

So my conclusion is that these questions are not inspired by the ordinary experience of times of peace, when these things work smoothly and naturally and, I hope, are managed by capable people, but they are really the outgrowth of experiences caused by war. These opinions are naturally based upon the extraordinary occurrences of the war and the immediately subsequent developments, and I have not the fears that would be indicated by this type of inquiry.

Mr. STRONG. Do you think it would be necessary to have a change in the majority of the 36 men managing this system in order to have a change of policy? Do you not think that perhaps a change in the dominating men in control of the system might bring about a change?

Governor STRONG. I do not think so. I think that is one of the great advantages of the regional system of banking, that it provides that democratic balance of power, where one branch is checking against the other.

My friends on the Federal Reserve Board sometimes think that the men managing the reserve banks are pretty independent in expressing their views and resisting the views of the board, and we sometimes think that the board is pretty arbitrary in dealing with us; but that is not necessarily an element of weakness in the system. That is one of its elements of strength.

Mr. WINGO. Suppose that it were an element of weakness? Where in our experience as a nation or in the experience of anybody else have we brought out a wisdom superior to that of the man experienced in the business that is affected by the controversy? What is there in our experience as a people to say that a political board sitting at Washington can tell anyone in this country how more efficienly to conduct his business?

Governor STRONG. That question is really applicable to the last few questions in this questionnaire. Again getting back to the gold standard, the gold standard is a much more automatic check upon excesses in credit and currency than is a system where gold payment, if you please, is suspended and it is left to the human judgment of men to determine how much currency shall be issued which they do not need to redeem in gold—do you see the distinction? And when you speak of a gold standard, you are speaking of something

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where the limitation upon judgment is very exact and precise and the penalty for bad judgment is immediate.

Where you are speaking of efforts simply to stabilize commerce, industry, agriculture, employment, and so on, without regard to the penalties of violation of the gold standard, you are talking about human judgment and the management of prices which I do not believe in at all. I do not think anybody should be given the power to say what the price of anything should be.

Mr. WINGO. Price fixing indirectly is just as vicious as price fixing directly.

Governor STRONG. But if your system of price fixing is that which has been tested, so far as human society goes, by operation of the automatic system of gold payment and redemption of the notes of banks of issue, I think you minimize the possibilities of bad judgment or abuse of power by a better method than any that has yet been devised.

Mr. WINGO. Here is another factor: You can not foresee all of the picture. There are never two sets of circumstances exactly alike in the handling of the credit machinery. You might have a different commodity situation and a different gold situation each time and, in the last analysis, there has got to be a judgment based upon the wisdom of experience in handling these affairs which must control, and, in addition to that, the old fact still obtains that there are certain laws of economics that are far superior to any wisdom or stupidity of Congress. There are certain economic laws that you will run up against. You may check them here and say, "You can not come in the front door," but you divert the stream around to the back door, and that is the thing that is in my mind and I was very much relieved to find that the author of the bill does not intend to change any law at all but still wants to make a stump speech more elaborate than the one in the last session.

Governor STRONG. Unless there is something you wish me to deal with, that covers what I had to say.

The CHAIRMAN. In reference to Judge Brand's desire to submit questions, he just informs me that he will submit those for the record to-morrow and they will be forwarded to you so that, as an extension of your remarks, you may submit your answers to his questions.

Governor STRONG. If the committee desires me to return later, I shall be very glad to at any time. I rather enjoy being here.

The CHAIRMAN. We enjoy having you here.

Governor STRONG. Before leaving, Mr. Chairman, I want to express to the committee and to you personally, my appreciation of the consideration you have shown me during my appearance here, as well as my gratification at the opportunity which you are giving to the members of the Federal reserve system to come here to exchange views with you on these important matters.

The CHAIRMAN. The committee will adjourn until 10.30 o'clock to-morrow morning.

(Whereupon, at 12.17 o'clock p. m., an adjournment was taken until Tuesday, March 20, 1928, at 10.30 o'clock a. m.)

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HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Tuesday, March 20, 1928.

The committee met at 10.30 o'clock a. m., pursuant to adjournment, Hon. Louis T. McFadden (chairman) presiding.

The CHAIRMAN. The committee will come to order. The committee is continuing hearings on H. R. 11806.

We will hear Mr. Goldenweiser, of the Federal Reserve Board, at this time.

STATEMENT OF E. A. GOLDENWEISER, DIRECTOR OF RESEARCH AND STATISTICS, FEDERAL RESERVE BOARD

Mr. GOLDENWEISER. Mr. Chairman and gentlemen of the committee, Governor Young said yesterday that the board would be represented by Doctor Miller and myself, and I should like to say at the outset that this is a matter in which it is very difficult for anyone to represent anyone else. It is so much a matter of judgment and there are so many different lines of approach to the problem that he can only speak for himself. The only thing I can do for the committee is to give them the kind of information and opinions that I would give the Federal Reserve Board if they requested them, as they have, and as I have given them.

My feeling about this bill is that, as Congressman Strong will be the first to admit, its primary object is the stabilization of the price level or of the purchasing power of the dollar, and back of that, no doubt, is his feeling of the distress and trouble that violent fluctuations of prices have caused, and more particularly to producers of raw materials. I feel that the rest of the bill, as Congressman Strong, I believe, says himself, is made up of various suggestions and ideas to meet objections; but the fundamental purpose of it remains in the stabilization of prices.

Mr. STRONG. Average prices.

Mr. GOLDENWEISER. Average prices, of course. I understand you are not speaking of individual prices.

The thing that I should like to do briefly is to analyze somewhat the various kinds of price movements that enter into the fluctuations of prices during different periods. I have had a chart prepared, one that Governor Strong referred to in his testimony. It is a chart that gives the price fluctuations from 1800 to 1927.

The CHAIRMAN. Let me ask, Mr. Goldenweiser, when did Governor Strong refer to this chart? Is it already in the hearings?

Mr. GOLDENWEISER. There is a similar chart in the hearings.

The CHAIRMAN. Is it brought up to this point?

Mr. GOLDENWEISER. I think not. I should be glad, if agreeable, to have this chart put in at this place.

The CHAIRMAN. That is the reason I was making the inquiry.

Mr. GOLDENWEISER. I will have one made that will fit into the testimony and put it in.

The CHAIRMAN. Without objection, then, this chart will be inserted, as prepared by Mr. Goldenweiser, at this point in the hearings, being a shart showing wholesale prices in the United States from 1800 to 1927.

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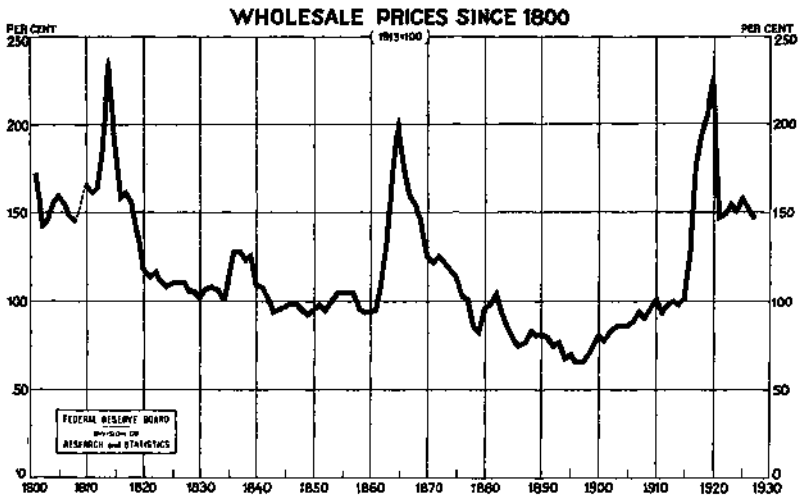
Mr. LUCE. Mr. Goldenweiser, what month does it end with?

Mr. GOLDENWEISER. This is an annual chart. It ends with the average for 1927. It is not a monthly chart. It covers a long period.

(The chart referred to is as follows:)



Mr. GOLDENWEISER. This chart is primarily made for the purpose of bringing out the different kinds of price fluctuations. You see the three big peaks, those three tremendous advances in prices about 1812, 1865, and 1920. Those are all war peaks. They are all the results of war inflation. It is these very violent convulsions of prices that cause most of the great distress which underlies the sentiment in favor of this bill. As to the more recent one, in 1920, while the war was over in 1918 as a matter of fighting, financially it was not over for a year or more afterwards, because some of the war financing had to continue.

The CHAIRMAN. Mr. Goldenweiser, this covers, as you say, a long period of time, from 1800 to 1927. This is the general wholesale price level?

Mr. GOLDENWEISER. Yes, sir.

The CHAIRMAN. Were the same commodities used as component parts of it in 1880 that were used in 1927?

Mr. GOLDENWEISER. No, sir. The earlier figures, of course, are on a much smaller base. The figures are not as good for earlier years as they are for later years. They are the best that have been found.

The CHAIRMAN. They are the best index that you have?

Mr. GOLDENWEISER. The best index for the whole period.

Mr. STRONG. Why was it necessary, after the war was over, in order to complete the war financing, to have continued inflation?

Mr. GOLDENWEISER. Congressman, that is a point that I can not discuss in great detail. It has been discussed here. It was first the flotation of the Victory loan, and then later the issue of Treasury certificates in connection with the very heavy expenses that continued a long while after the armistice. I am not saying that it was

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necessary, and I am not in a position here to give any judgment as to what could have been done to change the Treasury program.

Mr. KING. Do you know what could have been done?

Mr. GOLDENWEISER. What could have been done to prevent it?

Mr. KING. Yes.

Mr. GOLDENWEISER. On that point I have nothing more than purely personal opinion, which would not be worth the committee's while.

Mr. STRONG. Well, that is all we are getting from you, anyway.

Mr. KING. I do not know about that. I think it would be worth while.

Mr. STRONG. All we are getting is your personal opinion, anyway, is it not?

Mr. GOLDENWEISER. That is all I can give you; yes, sir.

Mr. STRONG. That is what I think is valuable.

Mr. GOLDENWEISER. I think that it would have been possible, in 1919, to have issued Government securities at higher rates, and probably to have reduced some of the credit expansion that followed.

Mr. STRONG. If that had been done, they could have stopped the inflation before it went to the peak of 251 in 1920, could they not?

Mr. GOLDENWEISER. I think that some slight modification of that peak could have been accomplished.

Mr. STRONG. If we had stopped it before it got to the peak of inflation, then we would have prevented a good deal of the damage from deflation that followed, would we not?

Mr. GOLDENWEISER. I think this, Congressman: I think that instead of this peak you would have had a peak like this [indicating]. It would still have been an outstanding peak.

Mr. STRONG. I know it would have been an outstanding peak, but it would not have had so far to deflate?

Mr. GOLDENWEISER. It would have been more moderate in either direction, probably.

Mr. STRONG. Would not that have been better for the country generally?

Mr. GOLDENWEISER. I am inclined to think that it would; yes, sir.

Mr. STRONG. Then that tends to confirm the theory of using these powers for stabilization, does it not?

Mr. GOLDENWEISER. Yes, sir.

Mr. STRONG. That is what I am trying to do.

Mr. GOLDENWEISER. Mr. Strong, I should like to discuss this chart somewhat in perspective for the century, and, if you will permit me, we will discuss more recent changes a little later.

Mr. STRONG. All right.

Mr. LUCE. May I ask that in the course of your discussion, while very properly emphasizing the effect of the war, you do not overlook the desirability of addressing yourself also to the rise that your chart shows from 1896 to 1910——

Mr. GOLDENWEISER (interposing). I am going to speak of that in just a minute, Mr. Luce.

Mr. LUCE. Where there was, by your chart, an apparent increase of nearly 50 per cent in prices, and when the disturbance of business and the suffering by the debtor class was so great that there were cost-of-living commissions, National and State, and very widespread uneasiness—in fact, reaching proportions almost as great as those that

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accompanied the depression from 1873 to 1896. I do not think we should address ourselves entirely to temporary and accidental conditions of war while this palpable change in 14 years was so serious.

Mr. GOLDENWEISER. No, sir. That is the very next thing I want to take up.

Mr. LUCE. Very well.

Mr. GOLDENWEISER. To what extent these war peaks can be modified is a matter largely of fiscal policy and of taxation, and it is something that is outside of the province of my discussion now. The largest peaks are war peaks, and no statute would prevent them, I think; because, no matter what statute was on the statute books, in time of war it probably would be repealed or ignored in view of a national emergency. All the countries of the world had violent inflation, and the reason that ours was less violent was that we were less involved in the war financially than the other countries.

The other kind of fluctuations that I want to speak about are the ones that Congressman Luce just referred to; that is, the fluctuations from the seventies to the nineties and from the nineties to 1913—a long decline during a period of 30 years, which caused distress and made it very hard for the debtor class—and then the advance after that.

Those are technically called secular movements of prices—long-time movements of prices. They are periods in which prices are moving so slowly on the whole—a matter of 30 or 40 points over a period of 30 or 40 years—that the movement from month to month is slight and hard to notice, although the cumulative effect is very serious. The causes of these movements are still extremely obscure; there are great differences of opinion among the best informed as to the reasons for this big decline and this big advance. Perhaps the best opinion, so far as I can judge, is that the period of declining prices from 1870 to 1896 was due to a large increase in production, and that the period of advance from 1896 to 1913 was due both to the increase in the gold supply, by reason of the cyanide process and other things, and to the fact that population growth was rapidly catching up with the growth of raw materials and there was a pressure on the raw materials.

The CHAIRMAN. Then it is a fact, Mr. Goldenweiser, that the influx of gold raises the wholesale price levels?

Mr. GOLDENWEISER. It tends to.

The CHAIRMAN. In any situation such as we have now, a great influx of gold does not affect the wholesale prices because that gold has been managed by the Federal reserve system; is that correct?

Mr. GOLDENWEISER. I should hesitate to say that it was because it was managed, Mr. Chairman. What I would say is that because of the existence of the Federal reserve system it was at certain times absorbed in the repayment of discounts.

The CHAIRMAN. That might be construed as management.

Mr. GOLDENWEISER. Yes, sir. But the real reason that the gold imported during 1920 and 1921 had little effect on prices—and that period stopped about 1922—was that the member banks were so heavily in debt at the reserve banks that the gold was used to repay the debt and therefore did not become incorporated into member-bank reserves.

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The CHAIRMAN. But at the present time, if I understod Governor Strong correctly yesterday, he stated that the United States and the world are not back on a gold basis. The statement has frequently been made in recent days that we are on a managed gold basis, because of the impounding of the vast amount of the world's gold in our country, which was the reason why that gold did not cause inflation.

Mr. GOLDENWEISER. Yes.

The CHAIRMAN. In other words, if this gold had not been impounded in some manner by the Federal reserve system, would it have resulted in a continuing increase of the average price level?

Mr. GOLDENWEISER. I think, Mr. Chairman, that that statement applies to the period from 1920 to 1921. At that time, if there had been no Federal reserve system and the member banks had not been so heavily in debt as they actually were, the gold might have become a basis of credit expansion. As it was it reduced the earning assets of the reserve banks and had no effect on the volume of outstanding credit. But I think that since 1922 the gold has had as much effect, and more, than it could have had before the Federal reserve system. The reason I say more is that the reverse requirements had been reduced by the Federal reserve act, and as a consequence member banks could expand their credit more largely than they could before the Federal reserve act, when the reserve requirements were up to 25 per cent.

Mr. WINGO. So that I may follow you, by "effect" do you mean inflation?

Mr. GOLDENWEISER. Growth of credit.

Mr. WINGO. As I gather from what you said, you do not concur in what the chairman has said, that it was managed, and for that reason there was no inflation because of this surplus gold coming in. You contend that there was an inflationary effect?

Mr. GOLDENWEISER. I would not call it inflationary, Mr. Wingo. I would call it a very rapid growth of credit.

Mr. WINGO. Well, expansion?

Mr. GOLDENWEISER. Expansion; yes.

Mr. WINGO. Some people have called it inflation and others expansion. But there was a swelling of the volume and a resultant decrease in the purchasing power of gold. I think the chairman and you and I could agree upon that definition, possibly.

Mr. GOLDENWEISER. Except——

Mr. WINGO (interposing). Am I to understand that that is true; that you differ with the chairman about the effect of it?

Mr. GOLDENWEISER. I am inclined to think that our opinions on the matter are not exactly alike. I think that between 1922 and 1927—quoting from memory—there was about $750,000,000 in gold added to the stock of gold in the United States. Of that $750,000,000 about $450,000,000 went into member bank reserves, and about $300,000,000 went into meeting the additional demand for circulation. On the basis of the $450,000,000 added to the reserves, there was a growth in member bank credit of eight and one-half billion dollars. That is a growth at the rate of about 18 or 20 to 1—unless I have my figures wrong, and I will correct it if my memory is not right. Anyway, it was an exceptionally large increase, and the reason that it

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was so large on the basis of the reserves was that much of the growth in the member bank liabilities was in time deposits rather than in demand deposits, and only 3 per cent reserves were required against the time deposits, so that the average reserves of member banks compared with the total volume of credit were much smaller at the end of the period than at the beginning.

Under these circumstances, Mr. Chairman, it is difficult to say that the Federal reserve system impounded gold, or sterilized it, as it has sometimes been called, or had any other influence of that sort; because the gold has had, I should say, a larger effect on the total volume of credit than any gold at any time anywhere.

The CHAIRMAN. Is it a fact, then, Mr. Goldenweiser, in that connection, that the management of the Federal reserve system was used in the control of the gold, in view of the possible expansion which might inflate prices, in such a manner that there was no amount of inflation that took place?

Mr. GOLDENWEISER. If I should say yes to that question, it would imply that the Federal reserve system has practically complete control of prices, which is the very thing that I have very serious doubts about.

Mr. STRONG. Be careful about saying that.

Mr. WINGO. Mr. Chairman, let me ask a question right in that connection, which will possibly elucidate what you have in mind. As I understood you, Mr. Goldenweiser, you said that there was an increase in the member-bank credit of eight and one-half billion dollars?

Mr. GOLDENWEISER. Yes, sir.

Mr. WINGO. Based upon the $450,000,000 increase in our gold reserve?

Mr. GOLDENWEISER. Yes, sir.

Mr. WINGO. If this increased volume of gold that came into the United States had not come in, would there have been that eight and one-half billion increase in that time, in your judgment?

Mr. GOLDENWEISER. In my judgment, no, sir.

Mr. WINGO. Then it did have an effect to the extent of an eight and one-half billion increase—whether you call it expansion, inflation, or what not—in the credits created and sold by the member banks?

Mr. GOLDENWEISER. The only modification I would make to that statement is that when I said "no" I did not mean there would not have been any. I mean there would not have been eight and one-half billion.

Mr. WINGO. That is the next question I am coming to. How much of that eight and one-half billion represented the normal and natural increase that would have come if this surplus gold had not come in? Have you any way of estimating that, or have you attempted to estimate it arbitrarily?

Mr. GOLDENWEISER. In a country that is as young as ours, and is developing as rapidly as ours, and in which conditions are changing as rapidly, I hesitate to call anything normal, and I do not know what would have been a normal growth. There are so many new developments, the use of bank credit increases, and the number or size of banks increases, and the financial habits of corporations

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change as well as the financial habits of individuals, so that I feel that we have not sufficient factual data to speak of a normal growth of credit.

Mr. WINGO. Can you do this? Possibly I can arrive at it in this way: I have about the same idea that the chairman has, and I am trying to arrive at your judgment on the same thing that he is. Assume that the very same activities in business would have taken place had this gold not come in; then what would be your estimate as to how much of that eight and one-half billion increase would have taken place?

Mr. GOLDENWEISER. I am not able to make that estimate.

Mr. WINGO. You are of the opinion, though, that that increase, whether you call it normal or whatever you may call it, was accelerated—if that would be the word—by this gold coming in?

Mr. GOLDENWEISER. Yes, sir.

Mr. WINGO. In other words, you are of the opinion that this surplus gold pouring in did have an effect upon swelling the increasing volume of credits in this Nation?

Mr. GOLDENWEISER. Decidedly.

Mr. WINGO. And whatever the Federal reserve system could have done in advance toward managing, sterilizing, or whatever you may call it; whatever they may have done or tried to do, it is your conviction that there was an increase in the volume of credits directly traceable to the increase in the volume of gold?

Mr. GOLDENWEISER. Yes, sir.

The CHAIRMAN. Mr. Goldenweiser, did I understand you correctly to say that we are on a gold basis now?

Mr. GOLDENWEISER. The United States is on a gold basis, absolutely.

The CHAIRMAN. So far as the United States is concerned?

Mr. GOLDENWEISER. Yes, sir.

The CHAIRMAN. But the world is not on a gold basis as yet?

Mr. GOLDENWEISER. No, sir.

Mr. LUCE. In this connection, Mr. Goldenweiser, the Federal reserve system introduced the possibility of a large expansion of credit through its various features. Do you take it that what I may call the full normal effect of the Federal reserve system had been reached before war conditions brought in an abnormal factor?

Mr. GOLDENWEISER. If I gather the purport of your question correctly, Mr. Luce, I may answer it in this way: The Federal reserve system has never functioned without war conditions. From 1914 to April, 1917, the United States was not in the war, but the world was in the war, and that was affecting the situation here from the very beginning; and when the United States entered the war, of course, that introduced still another factor, so that I think that there had been no test of the Federal reserve system. There really has not been a test of the Federal reserve system functioning under more usual peace-time conditions up to the present. I think it is only with the gradual return of the world to the gold standard that the Federal reserve system is beginning to function under more nearly normal business and financial conditions, and it is still a pretty good way from that.

Mr. LUCE. I had the impression that not sufficient weight has been given to the effect on the price situation of the expansion of credit

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produced by the creation of the Federal reserve system, and I wondered if any attempt at all had been made to measure that effect; I mean the normal effect of it.

Mr. GOLDENWEISER. The possibilities of it, you mean?

Mr. LUCE. Yes.

Mr. GOLDENWEISER. In view of the fact that the whole relation between the volume of credit and the level of prices is still very largely undetermined, and that those of us in the Federal reserve system who have been working on it have a great deal of doubt of the directness and constancy of that relation, it would be impossible for me to say what the effect of the Federal reserve system on the price level might or would have been, or whether the full effect had been exercised or not.

Mr. LUCE. Have you any doubt that an expansion of credit by increasing the use of bank checks is a direct addition to the volume of money?

Mr. GOLDENWEISER. No, sir; I have no doubt of that.

Mr. LUCE. And does not that have a considerable bearing upon the quantitative theory?

Mr. GOLDENWEISER. It certainly has a bearing, Mr. Luce; but there are times when the volume of deposits is increasing very rapidly and prices are going down. For instance, take the period from 1925 to 1927. During that period member bank credit and deposits throughout the United States increased at a very rapid rate, and prices declined about 10 per cent.

Mr. LUCE. Have you any explanation of that yourself, in your own mind?

Mr. GOLDENWEISER. Yes, sir.

Mr. LUCE. May we have it?

Mr. GOLDENWEISER. Surely. I think that the decline in prices during that period was due to the increased efficiency of production, transportation and distribution, and the keen competition among the producing and marketing agencies.

Mr. WINGO. You would not say, though, that the cause to which Mr. Luce referred did not have its effect? What you mean to say is that the counterbalancing effect of the causes to which you direct attention were so much larger than the effect of the things that Mr. Luce referred to that there was a net falling instead of an increase. If this increased efficiency that you refer to had not taken place, then the natural effect to which Mr. Luce refers would have taken place; would it not?

Mr. GOLDENWEISER. Probably.

The CHAIRMAN. You are referring now, Mr. Goldenweiser, to those commodities that enter into domestic transactions?

Mr. GOLDENWEISER. Yes, sir.

The CHAIRMAN. Would that have the same effect on production which enters into the international market?

Mr. GOLDENWEISER. I think that the commodities that enter into the international market respond to changes in conditions in different countries more promptly than those that do not.

The CHAIRMAN. What conditions; the gold conditions?

Mr. GOLDENWEISER. The general conditions of demand and supply, in which bank credit and gold reserves are a factor.

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May I go on and finish the general sketch of the price fluctuations that I wanted to bring out?

The CHAIRMAN. Yes.

Mr. GOLDENWEISER. The price movements that I was talking about are the long-time price movements such as took place between 1870 and 1896 and between 1896 and 1913—movements which were very gradual and very difficult to determine at a given time, because, as you notice, there were fluctuations all the time. In 1880, for instance, prices were rising, and that is all that was known at the time, and whether this rise indicated that the general decline had stopped and a rather rapid rise had begun, it was impossible to determine until after the next few years had elapsed. In other words, the long-time trend of prices is something that becomes identified only after it is over. After this upward movement had started and continued for some time, it became clear that this was a continuous movement of about 30 years, with fluctuations.

The CHAIRMAN. The low price being reached in 1895?

Mr. GOLDENWEISER. Yes, sir. Prior to that it was difficult, from month to month and from year to year, to determine which way prices were moving except on the shorter-term fluctuations. It would be difficult for a credit policy to influence the long-time movements, partly because they are obscure while they are happening, and become clear only after they are over, and partly because there are underlying trends that might very easily be misleading; because a situation might develop in a period of this sort when all the guides to credit policy would indicate tighter money, and yet the general trend was downward. In other words, it would be a very difficult proposition to regulate credit policy in any way with a view to those long-time trends.

The real question before this committee, as I see it, deals with one class of price fluctuations, namely, the relatively short-time fluctuations like those that have occurred between 1922 and the present time. The big peaks are war-time peaks, and require a special kind of approach. The long-time trends, for reasons that I have attempted to enumerate, are both elusive and misleading.

Mr. WINGO. Is there any contention among the experts over the conclusion that you have just arrived at? Do you all agree? Let me see if I understand you. First, in the passing moment, you can detect the force that you refer to as causing upward or downward movements in the price level?

Mr. GOLDENWEISER. Yes, sir.

Mr. WINGO. But whether the current movement is a mere temporary movement or whether it is a part of a long-time movement is something that can not be detected at the passing moment; is that your conclusion?

Mr. GOLDENWEISER. Yes, sir.

Mr. WINGO. The point I want to get at is this: Do the experts agree upon that conclusion that you have just expressed or is there a contention as to that theory?

Mr. GOLDENWEISER. It is a little difficult at any time to find any subject on which experts agree.

Mr. WINGO. I realize that. I have practiced law for a great many years.

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Mr. GOLDENWEISER. But I should be inclined to think that this comes as close to one that they would agree on as any.

Mr. WINGO. Are there any major or sharp conflicts between them? Let me put it this way: Is there any outstanding economist in the United States who contends that at the present moment there are signs that are obvious to those who are learned in reading those signs, from which they can determine whether 10 years from now they can look back to the year 1928 and that their present contention will be verified that it was a long-term downward movement; or, if there should be a sharp upturn in the price movement, say, during the month of April, can they say whether or not it was simply a temporary upturn and that the general trend was still downward? Is there any outstanding economic writer or student in the United States who contends otherwise than that which you have expressed?

Mr. GOLDENWEISER. By limiting it to the United States you are facilitating my answer. I think there is not.

Mr. WINGO. Is there any in any European country?

Mr. GOLDENWEISER. I think that Prof. Gustav Cassel, of Sweden, thinks he knows.

The CHAIRMAN. May I interject one thing at this point?

Mr. WINGO. Certainly. You see what I am driving at, Mr. Chairman.

The CHAIRMAN. That is a very interesting question. I have heard many of these economists and prognosticators to which the gentleman is referring express themselves as quite at sea in regard to these movements because of the introduction of a new element, namely, the management of the Federal reserve system and its influence on the credit policy and gold movements in its work in connection with the central banks of issue in different countries of the world.

Mr. WINGO. They do take the same position, do they not, as has just been expressed; that while they can observe, of course, the temporary month-to-month fluctuations, they are not and have not been able to determine whether the passing movement is part of a long-term fall or a long-term rise, and that the things which you mention, the habits and practices that have grown up with reference to management of gold, have only added to the confusion and the uncertainty? Is not that true?

The CHAIRMAN. Yes.

Mr. WINGO. In other words, my understanding has been that the conclusion that he has expressed is a correct one, and Cassel is the only man that I have heard suggested who disagrees. In other words, the expert who says "I can tell right at the passing moment whether we are going east or west, or up or down," is uncertain whether it is a temporary or a permanent swing of the price level. Now, the confusion, as I understand, has been added to recently by the manipulation or sterilization or management of gold, or whatever you may call it, and instead of clarifying it and making it easier for the experts to say at the passing moment whether it is a permanent upward or downward trend, it has added to their uncertainty.

The CHAIRMAN. The policy adopted recently of earmarking gold is another source of confusion.

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Mr. WINGO. I included that in managing gold and all those different devices that have been adopted.

Mr. KING. Mr. Goldenweiser tells us that this line which he has on his chart, representing the price level, can not be drawn until the events have taken place, and then he can commence to see which way they are going. That would indicate that there is no living man that can draw that in advance.

Mr. LUCE. How do you reconcile, Mr. Goldenweiser, the inability of the experts, who give their lives to these things, to form judgments, while the masses of the people seem to reach rather definite conclusions? I may say that 50 years ago at this time the people of this country had such a clear idea upon this subject that in my native State cannons were placed about the statehouse and the armed forces of the State were brought up to insure the change of administration which had been brought about, or was threatened by the action of the voters who knew what was going on. Now, you may say that your experts can not tell whether it is a rising scale of prices or not; but throughout the history of this country, in 1837 as well as other periods, the masses of the people have known that they were suffering great hardships and that there was widespread misery; and yet you come here and tell us that your experts do not know that fact. What we are after, I take it, is to prevent the miseries of the people and not to satisfy the uncertainties of the experts.

Mr. GOLDENWEISER. Yes, sir; there is no question about the misery. The question is about the cause of the misery.

Mr. LUCE. I do not understand that at the moment.

I understood you to give the committee the impression, if I may jump to a conclusion, that attempt to meet this situation is sought because as American people we do not know what the situation is. A large number of the American people have known what the situation was.

Mr. GOLDENWEISER. I should like to answer that in this way, that the only fluctuations that the people feel are the short-time fluctuations. They do not feel the long-time fluctuations.

Mr. LUCE. I beg your pardon; I put a preface in there that I know the people do not understand the long-time fluctuations. I have seen the populists arise and I have been part and parcel of that rise in 1906 and 1910.

Mr. GOLDENWEISER. Did they know in 1880 that prices were going up, or that the trend was downward?

Mr. LUCE. They knew they were suffering from the deflation of currency, and in several States in this country they became a formidable political factor, and again in 1910 the same thing was threatened, and it was for that reason that the various States and Congress itself attempted to find out what the trouble was, and again in 1921, when Congress created the Commission on Agricultural Inquiry.

I am pointing out to you that I will put in a caveat against the suggestion that because you can not tell from day to day, or can not forecast, that, therefore, there is to be no recognition of what conditions are, that prices are either rising gradually or falling gradually.

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Mr. GOLDENWEISER. I can understand this position; I certainly recognize that the long-time decline in prices causes a great many hardships. The only question I raise is whether it is at any time possible to determine whether the long-time decline has come to an end or not.

When prices turned up in 1880 there was not a man living who knew that the long downward trend of prices still continued and that the rise was only a temporary fluctuation; that is something that neither the people nor the experts could tell, and in so far as credit policy may have any bearing on the price situation, its bearing would be on the relatively short-time movements. It is the question of those short-time declines and advances of prices that I should like to discuss for a few moments in completing my testimony.

The CHAIRMAN. Before you do that, might I ask you whether, in your judgment, the only effect that the operation of the Federal reserve system has on these rising and declining prices is through their management of the credit policy?

Mr. GOLDENWEISER. I am not quite sure I understand your question.

The CHAIRMAN. In other words, is the sole influence of the Federal Reserve Board on the general price level through their management of the credit policy of the banks? Are there any other influences which are exercised by the bank?

Mr. GOLDENWEISER. By "credit policy" you mean discount rate and open market policy?

The CHAIRMAN. Yes.

Mr. GOLDENWEISER. I should say that in so far as they may have any effect on prices that would be the only channels through which it can be exercised. The only other thing is that the system may have a certain influence on the conduct of individual member banks, which is perhaps what you had reference to, and I think that that has no broad general effect except in improving the soundness of banking conditions.

Mr. LUCE. How do you tie up with that the factor of the increase or decrease of the volume of Federal reserve notes outstanding?

Mr. GOLDENWEISER. The volume of Federal reserve notes under the Federal reserve system is influenced entirely by the general demand of the people for currency, and that demand is in turn influenced by the volume of business.

Mr. KING. Right at that point, what do you mean by the general demand of the people for currency?

Mr. GOLDENWEISER. I mean that a certain amount, and rather a small proportion, of all the payments made by the people in the course of a year are made in cash, and the amount of cash that a person has to carry in his pocket depends on the level of retail prices and his own personal habits. In the aggregate there is a certain amount of cash that will do the business, and that business includes what we all carry in our pockets to pay for our lunches, car fares, etc., and the amount that the retail stores have to carry in their tills to make change, the amounts that the commercial banks have to carry in their tills to meet the demands of their customers, that experience has taught is apt to be needed in the course of a day, and the amounts that corporations and other industrial concerns have to carry to meet

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their pay rolls when they are in the habit of meeting those pay rolls in cash.

That is the demand of the people for currency.

Mr. KING. Is that the demand that arises for Federal reserve money?

Mr. GOLDENWEISER. That is the demand that arises for currency, and it makes no difference to the recipients whether the currency that is received is in the form of gold certificates, Federal reserve notes, national bank notes, greenbacks, or silver certificates.

Mr. KING. Is it necessary to supply them with, or do they demand, the Federal reserve notes?

Mr. GOLDENWEISER. I have never heard of any case where anyone asked for a specific kind of money.

The CHAIRMAN. Take the case of the United States Treasury in paying out a billion dollars of gold certificates: Did that operation result in a lessening of the amount in circulation of Federal reserve notes, or an increase in the total circulation outstanding?

Mr. GOLDENWEISER. It resulted in no change in the total. It substituted gold certificates for the Federal reserve notes.

The CHAIRMAN. In other words, if that transaction had not taken place, the additional Federal reserve notes outstanding would be practically the amount of the outstanding gold certificates at this time?

Mr. GOLDENWEISER. Yes, sir.

Mr. WINGO. Will you develop that further? What option was there upon the part of the Treasury in issuing this billion?

Mr. GOLDENWEISER. May I answer that, Mr. Wingo?

I think the chairman probably did not intend to convey the impression that it was issued by the Treasury. Those certificates were paid out by the Federal reserve banks. The Federal reserve banks adopted the policy in meeting their constant demand for currency of paying out a certain amount of gold certificates instead of Federal reserve notes, and that is where that policy originated.

The CHAIRMAN. They had been previously issued to the Federal reserve banks on the deposit of gold by the Federal reserve banks with the Treasury?

Mr. GOLDENWEISER. Yes.

Mr. WINGO. So then it is not true that the demand of the people, as you have just stated, is the sole factor in determining the amount of Federal reserve notes, because the arbitrary distinction of any one of the Federal reserve banks would determine whether they will issue gold certificates or national bank notes. Say my bank wants $10,000 in currency, and if they do not ask for any particular currency it is then up to the Federal reserve bank to determine whether they will send Federal reserve notes or national bank notes.

Mr. GOLDENWEISER. That is true.

The CHAIRMAN. In addition to that the determination on the part of the Federal reserve to issue credit or Federal reserve notes or gold certificates lies entirely within themselves?

Mr. GOLDENWEISER. It lies with themselves, within the limits of their reserve.

The CHAIRMAN. In other words, the Federal reserve could, if they saw fit to do so, go into the open market and buy paper and

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take surplus paper and deposit the gold and the paper with the Federal reserve agent and issue Federal reserve notes, could they not?

Mr. GOLDENWEISER. They could issue Federal reserve notes against acceptances, yes; not against Government securities.

The CHAIRMAN. I was not speaking of Government securities. Of course, in the open market their policy is to buy Government securities and acceptances.

Mr. GOLDENWEISER. They do not buy acceptances of their own initiative; they buy acceptances when they are offered to them by member banks and by dealers in acceptances. The only thing the Federal reserve banks buy on their own initiative——

The CHAIRMAN. They could take their acceptances which they hold in their investment account and place them with the Federal agent, together with gold reserves, and make the determination within the banks themselves.

Mr. GOLDENWEISER. They not only could do it, but the fact is that practically all the eligible paper the banks have is pledged for Federal reserve notes.

I might repeat in the record here, although I think it has been mentioned in the previous hearings several times, that none of these transactions that you have been discussing now affect the total volume of money in circulation, and they do not affect prices, and they do not affect the credit position. They have no effect on anything except the balance sheet of the Federal reserve banks. To give you an illustration: If you have in your pocket $20, and you are going somewhere, it would make no difference to you whether it was a gold certificate or a Federal reserve note.

Mr. KING. Unless you wanted to offer it as legal tender.

Mr. GOLDENWEISER. Yes, theoretically; but it rarely happens that the technicality of legal tender comes up.

Mr. KING. If I were practicing law now, I think I would know enough about legal-tender money to refuse a tender on behalf of my client in Federal reserve money.

Mr. GOLDENWEISER. That would not affect the general situation. It would be a very rare case.

Mr. KING. Of course not.

Mr. GOLDENWEISER. Now, when the Federal reserve banks pay out gold into circulation it diminishes the volume of Federal reserve notes outstanding and it has no effect on the volume of currency outstanding to meet the demands that I described to you.

As a result of this transaction, none of you gentlemen, nor anyone else, kept more money in his pocket; no stores kept more change; no pay rolls were enlarged. The whole situation remained exactly as it was before, and the only consequence was that the Federal reserve banks had a somewhat smaller gold reserve. Even the reserve ratio of the Federal reserve banks changed little, because their liability was diminished by the same amount that their reserve was diminished. While there was a slight decline, it was slight, because both sides of the equation were diminished by the same amount.

I think it is a current misconception and one that has caused a good deal of criticism of the Federal reserve system at times, that the policy of paying out gold had an effect on the credit situation

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or on the volume of purchasing power of the people, or on any other really pertinent condition. It is purely a matter of what kind of pictures are printed on the money you pay out; that is all, and had the effect in the Federal reserve system of somewhat reducing their reserve ratio.

The CHAIRMAN. Then an instrument that will pay a bill—such, for instance, as a check—in the discharge of that duty is no different than a gold certificate or a Federal reserve note?

Mr. GOLDENWEISER. A check has certain different qualities in connection with the ability to pass it along, and there are other differences between a check and money.

Mr. KING. This money is guaranteed by the Government.

Mr. GOLDENWEISER. But there is no difference in the general effect on the situation, if any of the kinds of money we have outstanding now, any kind of cash is substituted for another kind; no difference from the point of view of credit policy, of purchasing power, or of the position of member banks.

Mr. KING. Before we leave this, I would like to ask one simple question, and that is this: When the issuance of this Federal reserve money is based upon acceptances, is that issued upon the amount specified in the acceptances or the value of the commodity which those acceptances are supposed to cover?

Mr. GOLDENWEISER. When an acceptance becomes cover for Federal reserve notes, it is the face amount of the acceptance.

Mr. KING. And who fixes the amount of the acceptance?

Mr. GOLDENWEISER. That is an arrangement between the buyer and seller of the goods at the time that they arranged for the credit.

Mr. KING. And if they fix them too high, why that is a matter of inflation, is it not, by individuals?

Mr. GOLDENWEISER. That is a matter that the bank which accepts would have to look into, and, when it gets into the Federal reserve bank, of course it has been scrutinized, both by the accepting bank and by the Federal reserve bank, and the Federal reserve bank has the indorsement of the member bank.

Mr. KING. Does that practice have anything to do with the fact that on your chart, beginning with 1913, at the time of the adoption of the Federal reserve system as the law in this country, the line there seeks high mountain tops—you might say peaks—applying to wholesale business, whereas the farmers' prices run along on a sort of a level, or even lower?

Mr. GOLDENWEISER. If your question, Congressman, is whether the creation of the Federal reserve system had anything to do with it, my answer is no; this practice had no bearing whatever on the matter.

Mr. KING. You do not think the aid furnished to industry has caused the separation of those lines?

Mr. GOLDENWEISER. In the first place, those lines are not as widely separated as you imply, because during the peak advance in prices, agricultural prices advanced even higher than industrial prices.

In the second place, the face value of the acceptance and the prices fixed for the underlying commodities would not have the slightest influence on the price level. Incidentally, I might mention that acceptances are in very large proportion drawn to finance agricultural movements.

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Mr. KING. Those who handle the agricultural end of it?

Mr. GOLDENWEISER. Yes.

Mr. KING. And not the farmer.

Mr. STRONG. If the price of commodities in general trend downward month after month and month after month and the Federal Reserve Board would send for you and ask you what could be done about it, what advice would you give them?

Mr. GOLDENWEISER. That would depend on a large number of considerations.

Mr. STRONG. What could you do? What could the Federal Reserve Board do to change conditions if the trend of prices month after month would gradually be downward?

Mr. GOLDENWEISER. That would depend on a large number of other considerations. If that decline in prices were occurring at a time when bank credit was growing rapidly, when money rates were low, and there was no evidence of a decline in prices being related to a shortage of credit or tightness of credit or a high price of credit, as was the case from 1926 to 1927, I should have to say to the Federal Reserve Board that in my judgment there is nothing that the Federal reserve system can do to arrest the decline.

Mr. STRONG. You do not think, if the prices were going down in this country, that increasing the volume of money among the people and lessening the cost of it and the expanding credits would be of advantage?

Mr. GOLDENWEISER. I think that you can not make people use credit when they do not wish to, and that the price of credit determines the volume used only at certain times.

Mr. STRONG. You might not make them do it, but you could induce them to do it by giving them cheap money and plenty of it.

Mr. GOLDENWEISER. It is difficult to keep my own position straight because there are so many angles to this question, and this is just one corner of it.

The Federal reserve system can, if it sets its mind to it, influence the price level, especially in the direction of an advance.

To do that it would have to make that its sole object for the time being, continue to buy Government securities, say, and the proceeds of those funds would be used by the member banks to reduce discounts; keep on buying after all the discounts were paid off, until the funds thus released would begin to accumulate as reserves in the member banks and would induce those member banks to revise their credit policies and to increase their loans, and finally it would find its way into those channels of business that offered the greatest opportunity. That might be speculation in commodities; it might be speculation in stock exchange securities or in real estate. If the Federal reserve system made its one purpose to cheapen money, it could cheapen it, and the chances are that in the long run it would raise commodity prices, but in the meantime there would be no way of preventing it from doing a lot of other things, nor would there be any way, after that price advance created by deliberate and unconscionable inflation got under way, in which the Federal reserve system could arrest it, because inflation feeds on itself and it would inevitably in the long run lead to——

Mr. WINGO (interposing). You want to qualify what you just said, that they could do it, do you not?

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Mr. GOLDENWEISER. Probably.

Mr. WINGO. Here is a qualification: Suppose at the time they wanted to affect the discount rate the banks were in such condition that they did not have to rediscount? Suppose that my bank did not have to rediscount any paper, what effect would it have on me? So the effect, then, is always circumscribed by the limit and the volume of the instruments they can add.

Mr. GOLDENWEISER. I was saying that they could inflate, and if the banks were not in debt to the reserve bank that would make the process easier.

Mr. WINGO. I think it might be fair to assume that recently conservative bankers, and even the members of the Federal Reserve Board, came to the conclusion that brokers' loans were too high. What happened? When we had a decrease in brokers' loans by the banks themselves, that was matched to the extent of $500,000,000 in a certain period of time, and the directors of industrial concerns, corporations, said, "All right; if the Federal reserve bank says that our banks have got to get out of the call-loan market on brokers' loans, that is all right; we will take the deposits of our corporations that are in our banks, in which we are directors, and we will put them on the call-loan market." I think you know that that took place to the extent of about $500,000,000 in a short length of time. In other words, the efforts of the Federal Reserve Board and Federal reserve banks and the conservative banks of the country, especially in New York, to check that inflation of brokers' loans in New York was counterbalanced by the gentlemen whom they call on and who said, "All right; as directors of commercial enterprises we will take our surplus funds and go in and substitute our commercial deposits or surpluses for our bank surpluses," and the effect was nullified. Is not that true? Have you not always got that to face whenever the Federal Reserve Board or bank starts out on such a policy?

The CHAIRMAN. Do you mean to say that brokers' loans are inflated?

Mr. WINGO. No; I do not know. I just know this much, that what I said took place without any dispute, that every time, up to the extent of $500,000,000, they reduced the banks' volume of brokers' loans, they had these corporate surpluses used to take their place, so that to the extent of $500,000,000 there was not a bit of change in the volume of brokers' loans; just a change of bookkeeping, whether for the banks or for others, and the effect on the banks of the world was just the same, because it was taking it out of the same banks. So, whenever you go to saying what the Federal reserve banks can do, my point is that you must limit what they can do to its instruments.

Mr. GOLDENWEISER. What I meant to say is that, particularly with its present high reserves, the Federal reserve system could, if it determined to, bring about a certain inflation in credit which ultimately would probably result in an inflation of prices, and I think that that is unquestionably true so long as we have 75 per cent of gold reserve and $1,500,000,000 of excess gold.

The CHAIRMAN. In other words, the fact that it is not done is due to the management of the Federal reserve?

Mr. GOLDENWEISER. Due to the fact that the Federal reserve system does not set out to do that. The Federal reserve system is there to

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meet the demands of the public for credit, and it does not force credit on the public, is conscious of its responsibility in the matter, and would not set out to accomplish a purpose that would be obviously criminal.

The CHAIRMAN. In other words, you are answering my previous question that the management of the surplus gold which is impounded in the Federal reserve system is the reason why prices have not advanced?

Mr. GOLDENWEISER. It is in a way true. I would have to agree with you to the extent that I might say it was a matter of common decency rather than of management. It is not a matter of real management to refrain from undertaking a course that would be dangerous to the interests of the country.

Mr. KING. What prices do you refer to, Mr. McFadden, when you say "prices"?

The CHAIRMAN. The average prices.

Mr. STRONG. You have said in answer to my question that when a long period of gradual deflation came the Federal reserve system could check it and bring about inflation by what you think would be an unconscionable extension of credit or purchase of Government securities. Well, now, could they not also check inflation, if it was a continued, positive, aggressive inflation?

Mr. GOLDENWEISER. I think so; yes, sir.

Mr. STRONG. Then, do I understand that the reason they did not take that action after the armistice, when the price level kept going up, was because of the necessity making it possible for the Treasury to carry on its operation?

Mr. GOLDENWEISER. This question has been asked in this committee many times. It dates back to the period before I came to the Federal reserve system; it was a policy matter at the time when I was not connected with the Federal reserve system.

Mr. STRONG. You mean that it is a delicate thing to inquire about?

Mr. GOLDENWEISER. It is a matter that is rather awkward for me to discuss, particularly because I do not know much about it.

The CHAIRMAN. It was a Treasury policy, was it not?

Mr. GOLDENWEISER. Yes; and it has been discussed both before the Commission of Agricultural Inquiry and before your committee, and Governor Strong discussed it two years ago when he was before you, so you have the information on the subject.

Mr. STRONG. Has the Federal Reserve Board the power now to attract gold to this country?

Mr. GOLDENWEISER. The Federal reserve system could attract gold to this country by making money rates higher here; yes.

I should like, if I may, to continue to discuss those short-time price fluctuations, because——

Mr. STRONG. I want to ask you some questions before you are through.

Mr. GOLDENWEISER. I will be very glad to try to answer them. I wanted to speak about these short-time fluctuations, because it seems that they are the ones with which you are primarily concerned, and it is somewhat technical stuff that I want to say in this connection.

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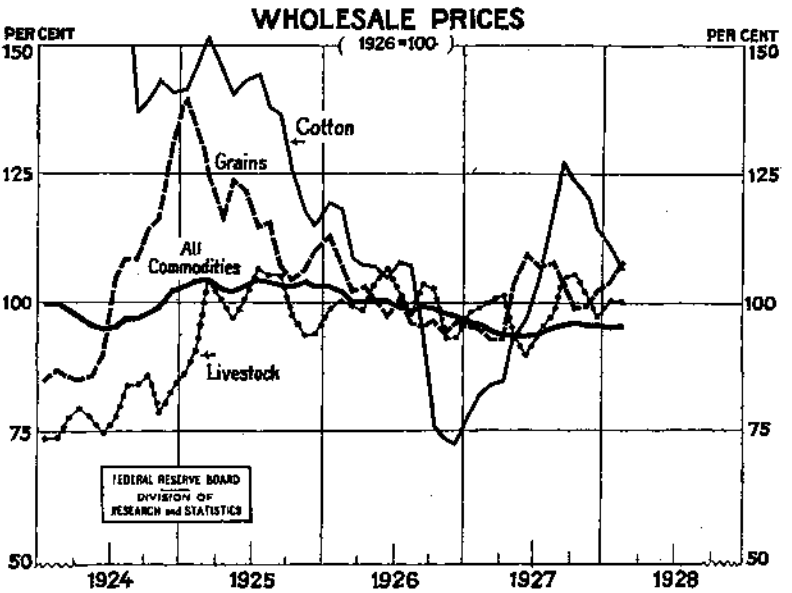
The level of prices is something that probably exists, but it is very difficult to measure. The wholesale price index of the Bureau of Labor Statistics, which is the best available index of wholesale prices, includes 550 commodities; in getting up the index, they weight these in accordance with the amount that is used, and the index, I have no doubt, is an excellent index. Nevertheless, that index is an index that reflects the result of the movements of those 550 commodities and no others.

The CHAIRMAN. Is that price index affected by a practical movement of stocks, bonds, and securities up or down?

Mr. GOLDENWEISER. No, sir. I want to point out to you on this chart the points that I want to make here. This is a chart of wholesale prices for the period from 1924 to 1928, and it shows certain groups of prices: Cotton, grains, and livestock.

The CHAIRMAN. Without objection, this chart, which the witness is now referring to, will be placed in the record at this point, being a chart showing the wholesale prices from the year 1924 to the year 1928.

(The chart referred to is as follows:)



Mr. GOLDENWEISER. The purpose of this chart is to bring out the elements that sometimes cause the advance in the wholesale price index. In 1924 there was a relatively sharp advance in prices. That sharp advance in prices was brought about by the rise of this yellow line [indicating], and this green line [indicating]. It was the year during which the wheat crop was short in the world, and that caused an advance in the price of wheat and a sympathetic advance in the price of other grain, and also there was an advance in livestock, particularly hogs.

Those things were the ones that caused the index to advance. This advance was one that reflected these things, and the only way that

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any credit policy at that time could have stopped this rise in the index would have been by exerting its influence on the whole business situation, and in so far as that would be reflected in the price trends it would depress the prices of other commodities than those that advanced, because the world shortage of wheat was such that its price could not be affected by credit. The effect of any influence exerted by any banking organization at that time would have been to make the person who sells boots and shoes or steel rails get less for his product because the farmer got more for his wheat, a situation that, if it were entirely within the power of the system to bring about, would neither be desirable nor equitable.

The CHAIRMAN. In other words, the changed policy in regard to credit control only affects the general price level?

Mr. GOLDENWEISER. Yes.

The CHAIRMAN. And not of any individual commodity?

Mr. GOLDENWEISER. It does not affect any individual commodity, but the general price level reflects the movements of those groups.

The CHAIRMAN. For instance, in the case of cotton, if it was at a very high price, the tendency would be this, that if the credit policy was working, then the change would be to affect the price of all other commodities, to bring them down to an average level.

Mr. GOLDENWEISER. That is right; that is just the point I want to make.

Mr. STRONG. But the rise of the price in wheat and livestock did not affect the average price of commodities to any great extent, did it?

Mr. GOLDENWEISER. Yes, sir.

Mr. STRONG. What does your chart show on that?

Mr. GOLDENWEISER. This does not look like it, but this chart is on a scale that had to be made smaller to allow room for the wide fluctuations of group prices. Though the rise in the average is relatively smaller, it was a rise from 97 to 106.

The CHAIRMAN. Which corresponds to the high peak in cotton.

Mr. STRONG. It is only a change above and below the line of 9 per cent total.

Mr. GOLDENWEISER. That is right.

Mr. STRONG. You would not consider that a very violent fluctuation?

Mr. GOLDENWEISER. It is a more violent fluctiation than we had ever seen before the war. A change in the price level of 6, 8, or 10 per cent in the course of three or four months is a violent change of prices, and it is one that does not occur in ordinary times.

This cotton starts up here [indicating on chart] in 1923. I had to have it cut off.

The CHAIRMAN. It reaches its highest point in the middle of 1924.

Mr. GOLDENWEISER. It was in 1923. It had dropped quite a bit by 1924.

This last year we had some advance in prices, between June and November, and that advance in prices was largely due to cotton and cattle.

Mr. STRONG. But as to those violent fluctuations in individual prices, as shown on your chart, your average price shows pretty fair stability, does it not?

Mr. GOLDENWEISER. The average price shows much smaller fluctuations, but fluctuations that are for a price level pretty violent fluctua-

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tions. They are wider fluctuations than are at all likely to occur under any normal conditions with the functioning of the gold standard.

Mr. WINGO. It is nothing unusual for the representative averages to be less than some of its component factors. The law of averages is that which runs through and equalizes all.

Mr. GOLDENWEISER. That is always the case.

Mr. STRONG. But the fact that they have gone along about five above and five below is not comparable to what would have happened if they had had a continued downward trend month after month until they dropped 15 or 20 per cent.

Mr. GOLDENWEISER. No. Your question is that it would not have as bad an effect?

Mr. STRONG. Yes.

Mr. GOLDENWEISER. No.

Mr. STRONG. It is the continued inflation or depression until trouble comes that I am talking about. I am not talking about a moderate fluctuation. I realize that that has got to come according to the law of supply and demand on individual prices of commodities.

Mr. LUCE. May I bring out also that those irregularities are flattened out still more when they are translated into retail prices, and it is the retail prices that led from 1,000 to 2,000 people to gather in the House Office Building yesterday and demand a change in their salary level, and what this committee is primarily concerned with is to meet those facts—the retail prices—and there the fluctuations are by no means as unstable as are the wholesale prices?

Mr. KING. Have you any charts showing the retail prices?

Mr. GOLDENWEISER. I have charts of retail prices, but we have not as good material on retail prices, because the market for them is much more scattered, and as Congressman Luce says, retail prices are much more stable than wholesale prices; they move much more slowly.

The CHAIRMAN. If the credit policy is used for the purpose of stabilization, for the maintenance of a steady average price level of all commodities, then when there is a drastic inflation of cotton, grain, or any other commodity——

Mr. GOLDENWEISER (interposing). By "inflation" do you mean rise in price?

The CHAIRMAN. Yes.

Mr. GOLDENWEISER. Because it may not be inflation.

The CHAIRMAN. It affects all commodities that are below the general price level.

Mr. GOLDENWEISER. It affects all commodities, whether below or above.

The CHAIRMAN. Yes; but to a greater extent those which are below, does it not?

Mr. GOLDENWEISER. I should say not. I should think that if there were pressure on prices, from whatever source it might come, it would affect all the commodities that would be capable of responding to it, whatever their level, and, probably, if their level is somewhat higher they would feel it more.

The CHAIRMAN. An intensive rise in the price of cotton would have a tendency to increase the price of all other commodities?

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Mr. GOLDENWEISER. No; I should think not. I do not see how you reach that conclusion.

The CHAIRMAN. I reached that from what you just said.

Mr. GOLDENWEISER. Perhaps we misunderstood each other. I did not mean to say that.

The CHAIRMAN. I meant to say that those commodities that were below the average price level would, under the management of the stabilization powers and the management of the credit policy, start an inflation. For instance, a very drastic high-price inflation of cotton would have a tendency to increase the price level on all commodities that were below the fixed price level.

Mr. GOLDENWEISER. I think what would happen if the price of cotton advanced, beyond control, and that carried the index up above where it had been, and by some power the index was kept where it was, it would result in a decline in all prices other than on cotton.

Mr. WINGO. The truth of it is that you and the chairman both must not overlook the fact that, in the chart you have before you at one time you had just the reverse of his illustration. Instead of having a high price of cotton, you had a declining price of cotton, and yet at the same time you had livestock and grain both going up. If you were to assume that, say, cotton and wheat—we will pick those two commodities—each only has the same weight in your price level, and that there was an equal difference—in other words, that cotton was going up, as the chairman suggested, and yet to the same extent and to the same value and to the same weight wheat was going down, then the effect upon all the other prices would remain unchanged, would it not?

Mr. GOLDENWEISER. Yes; they would offset each other.

Mr. WINGO. So you can not always pick out one particular commodity, because its effect on the general price level may be counterbalanced by just the opposite condition in some other commodity of equal value and equal weight in your price scale.

The CHAIRMAN. In a case like that, those who are charged with the operation of the credit policy which was being used for the purpose of stabilization would not find it necessary to do anything to affect the general price level by the change in the credit policy.

Mr. WINGO. It might not be necessary economically, but it would be politically under some conditions. If the price of cotton were going down and if my cotton farmers believed that Governor Young was such a wizard that he could bring it up, they would be determined to have it go up, and at the same time if wheat were climbing up, the consumers of wheat products would come around to him and say, "You have been invested with this extreme authority; try to get us relief"; and he would be between the devil and the deep blue sea and, after all, they would all be against it.

Mr. STRONG. Just like it is when one man wants to borrow money and the other says, "Don't lend it; we have too much now."

The CHAIRMAN. If the gentleman's theory is correct, any attempt to stabilize the price level by the management of the Federal reserve people who are in control of the credit policy, would be affected by the price of individual commodities?

Mr. WINGO. I think it would.

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The CHAIRMAN. How are you going to administer an instruction to the Federal Reserve Board, as contemplated in this bill, without taking into consideration individual prices of commodities?

Mr. WINGO. I think possibly they may have to do it unless Congress undertakes to do what I think it can not—repeal both the law of supply and demand and the law of gravity.

Mr. LUCE. The trend of your testimony really disturbs me somewhat.

Mr. GOLDENWEISER. I am sorry.

Mr. LUCE. There has been a growing use of index figures in the last 15 or 20 years. Until now there has not been a day go by that they are not referred to in all the financial publications and the general discussion of financial matters, and they are repeatedly being brought into the committees of Congress. Yesterday the chief witness used them as a proper basis of his argument on a very important matter, the wage scale of the Government employees, and what you have been saying tends, I fear, to deprive index figures of any value.

Mr. GOLDENWEISER. I should hate to have that impression created. I think it should be realized that the index number can be nothing more than the average of the things that enter into it, and I think that the thing I am trying particularly to bring out is that there is a mistake in the contention that, by some means or other, the price level is compensatory so that if one thing goes up the other thing goes down.

I feel that, in the first place, no price index, no matter how comprehensive, can include all the things for which money is paid, and therefore there may be a number of things that can go down that may not be reflected in the index. The index may go up because cotton went up, and if there was no change in the purchasing power of the people the corresponding decline may show up in the number of servants somebody has or in the number of automobiles they buy——

Mr. KING (interposing). Or theater tickets.

Mr. GOLDENWEISER (continuing). Or other things that do not enter into the price index.

Another thing is that I feel that the price index could go down entirely as the result of the increased efficiency and economy of production and distribution, and could be reflected in larger consumption rather than in a compensating rise in some other price. For instance, automobiles have become much cheaper so that people buy two automobiles instead of buying one, and there is nothing in that development that would cause prices of other commodities to go up in order to compensate it, because the purchasing power released by the decline in the price of automobiles has been absorbed by the buying of an additional automobile. There may be a release in a person's income during a decline in the price of meat and he may use it to buy a radio, and so the decline in the price of one commodity or group of commodities may result in larger consumption rather than in an advance of the price of some other commodity, and that is the point which I think that the theorists of the price level frequently overlook.

The one other thing I would like to say on prices, and then I am through with that phase of it, is that certain fluctuations in groups of commodities and individual commodities are distinctly desirable

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and are a part of our economic mechanism, and the reason that I bring it in here is not because I do not realize that Congressman Strong is aiming his bill at the general price level, but because, in the first place, that is not as widely understood as it might be, and, in the second place, because I have just pointed out that frequently the general price index—not the price level, but the price index—reflects movements of groups of commodities.

Now, the function of price in that connection is a perfectly well-known function. The advance in price in one group of commodities makes a larger group of individuals go into that particular industry, with the consequence that there is a boom in it and ultimately the price declines somewhat; and the low price of another commodity makes industry move out of the production of that commodity, with the consequence that there ultimately is a shortage and a rise in that price.

In other words, price movements are to a certain extent business stabilizers, and price stability and business stability are in that sense not entirely consistent.

Mr. LUCE. I want to say something more about that, because I think you have got down to the core of the matter. Now, I understand you to impugn the value of the price index, pointing out its inadequacies and warranting the conclusion that it would not be a prudent guide for the Federal reserve system in its financial transactions.

If that be the case, can it be a guide to committees of Congress in passing judgment upon the questions with which they deal? If it is of no value to the Federal reserve system, can it be of any value to anybody else? What is the good of it, if it is to be vitiated by the authorities which you have pointed out?

Mr. GOLDENWEISER. I am glad you raised that question, because your statement goes further than I intended it to go. I had not intended to give the impression that the price index is of no consequence. It is one of the indicators of the business situation.

In presenting material to the Federal Reserve Board along the lines of business statistics I bring to their attention whatever lines of information we have, and prices are one of these lines.

I think nothing that I have said was intended to mean that the price index is no good. I merely meant to point out its limitations at times as a sole guide to credit policy or as the determining guide to credit policy.

For instance, in determining the wages or the salary level of Government employees the retail price index or the cost of living index would be a perfectly valid index to go on. It has limitations even there. It is rough; it may not absolutely represent the exact condition, but the movements of it would be reasonably fair, and there is no reason why it could not be used for that purpose.

Index numbers, like any tools, must be used with discretion, and to have that one index picked out as the thing that could determine credit policy is made more difficult by some of those considerations——

Mr. BLACK (interposing). May I ask this one question, to see if I understand the purport of your testimony? It is that if the

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Federal reserve system did exert any influence on the price level it would have to be an arbitrary action on its part? If it wanted to depress prices it would have arbitrarily to restrict credit, and if it wanted to inflate prices it would have to willfully and arbitrarily inflate credit; but that if it observed its normal functions, to wit, to supply the needs of credit, as the act intended, then it would not have any appreciable effect on the price level?

Mr. GOLDENWEISER. In general, I should say that that is correct.

Mr. STRONG. Do you think it would be fair if, when these Government employees come to us with an index of general prices that have gradually gone up for things they must use their money to purchase, we should begin quoting special prices to them?

Mr. GOLDENWEISER. No, sir.

Mr. STRONG. That would be just as unfair as it is now, when we are talking about an index number of average prices to continually keep referring to individual prices, would it not?

Mr. GOLDENWEISER. The only purpose I had in referring to individual prices was to bring out the point that it is the individual prices and the fluctuations in individual prices that are reflected in the price index. The price index is not a self-determining entity that is created by the Federal Reserve Board.

Mr. STRONG. Why, certainly.

Mr. GOLDENWEISER. It is the average of 550 commodities.

Mr. STRONG. Absolutely.

Mr. GOLDENWEISER. And can be affected only by changes in the prices of these commodities.

Mr. STRONG. Certainly; and it is affected, of course, by the general trend of the average of prices, and individual prices are not taken into consideration except as they might reflect a slight change.

Mr. GOLDENWEISER. Take, for instance, the period from 1925 to date. Industrial prices are not individual prices but the price of a large group of commodities, and the price of that group has changed very little and the big movements in prices in the last five years have been in agricultural commodities.

Mr. STRONG. Changed individual prices are matters that those groups that are affected by those prices must solve if they are to be solved at all, and that is what labor or agriculture or any other body must pay its attention to, but what concerns the Nation in its prosperity is the rise and fall of average prices.

Mr. GOLDENWEISER. I think that is probably true to the extent that you have your eye on the very big fluctuations in prices.

Mr. STRONG. Big fluctuations generally grow out of little ones.

Mr. WINGO. I am sure neither one of you gentlemen means that; I know my friend from Kansas does not. Here you have had a rise in the general price level, and yet the farmers have not had it. They are interested in their general price level.

Mr. STRONG. That is the reason the farmers are down here trying to get the McNary-Haugen bill.

Mr. WINGO. The point I wanted to get at is this, that you do not mean that people are not interested in specific prices.

Mr. STRONG. No; I am talking about the Nation's prosperity, which has to be gauged or figured upon the stability or the rise or fall of general prices.

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Mr. WINGO. I do not know. Suppose that you went out and talked to the farmers. They would not say that there is general prosperity in the country.

Mr. STRONG. I just said that individual groups, of course, would come back on any deflation or change to them by the falling of their own prices, but I am talking about the whole; I am trying to quiet this continual harping on individual prices when we are only talking about general prices.

Mr. WINGO. Well, take your position, if the witness will rest for a while. The two general classes are the credit and the debit classes. Is it the part of the Government to say which one of those they are going to have?

Mr. STRONG. No; but I think it is very necessary to the success of both classes that they shall have a policy that they shall use in loaning and borrowing between themselves, to have as near a stable purchasing power as possible. I think it is an outrage to ask a man who borrows, when the time for payment comes, to pay back with a dollar of half the purchasing power if it can be avoided.

Mr. WINGO. I agree with you on that, but you are off on something else.

The CHAIRMAN. Before you proceed, it is now 12.30. What is the pleasure of the committee?

Mr. KING. I move that we adjourn.

The CHAIRMAN. I should like to finish with Mr. Goldenweiser if possible.

Mr. STRONG. I would like to ask Mr. Goldenweiser some questions.

You have said that you thought, in a large decline of average prices, the Federal Reserve Board could, by directing its efforts, check the deflation, or vice versa. Why should they not use their powers to that end?

Mr. GOLDENWEISER. They should, and they would.

Mr. STRONG. Then there is no direction of that kind in the law now, is there?

Mr. GOLDENWEISER. No, sir.

Mr. STRONG. What objection could there be to writing such a direction in the law?

Mr. GOLDENWEISER. The only objection that I have to writing that in the law is that I feel that the powers of the system in the matter are applicable only at times when the rise or decline is extremely violent. That is the only time when the system could be pretty certain to exert an influence, and those times occur rarely. The fluctuations in prices ordinarily are very much milder and are not directly influenced.

Mr. STRONG. But it is those periods of inflation or deflation that bring the greatest disasters to the country.

Mr. GOLDENWEISER. Yes; and those are brought about by war conditions in every case, and no law could prevent it.

Mr. STRONG. But you could have lessened the inflation in 1918, after the armistice, if you had had these powers to that end.

Mr. GOLDENWEISER. I think, as you are going back to that point, that I ought to say that the Federal reserve system at that time did its level best to do so, but was not able to do it.

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Mr. STRONG. It could have softened the deflation after 1920, could it not, if it had had all these powers?

Mr. GOLDENWEISER. I think not.

Mr. STRONG. You do not think it could be done?

Mr. GOLDENWEISER. That is a matter of opinion, but I believe that after the prices had gone up to the levels they had, there was practically nothing that the Federal reserve system could do to prevent that deflation.

Mr. STRONG. Then you think that these powers that we have given in periods of violent inflation and deflation can not be of much avail to change the situation?

Mr. GOLDENWEISER. That is, the violent deflations and inflations of that sort do not occur in ordinary times, but at times when they do occur there are questions of national safety that would prevent any central bank from exercising its powers and which have prevented them so far in the history of the world from keeping from inflation.

Mr. STRONG. One of the present works in which the Federal reserve system is engaged is to bring about a world stability as to gold, is it not?

Mr. GOLDENWEISER. Yes, sir.

Mr. STRONG. And in doing that, will we have to part with a good deal of our gold?

Mr. GOLDENWEISER. That is a difficult question. I am not sure. If you just want an opinion that is not worth anything more than my present state of mind——

Mr. STRONG (interposing). You would not have to part with the gold in order to put the other nations on a gold basis?

Mr. GOLDENWEISER. My opinion is that we would not have to lose much of it, but that opinion is not worth much. When you talk about the future, there are so many incalculable things. I am not a prophet, but my judgment, on the basis of the amount of gold that is produced in the course of a year and the estimate of the available reserves of those countries that are not yet on a gold standard, and of those that are, is that there is not likely to be a very large demand for our gold. Another reason for my belief in that respect is that we are a creditor nation now in a very large way. There is always going to be such pressure for American exchange to pay the interest on those debts that we would have to have a tremendous excess of imports over exports or of foreign lending before we could lose much gold.

Mr. STRONG. Then you feel that the going upon an absolute gold standard, both in this country, as you say we are, and in other countries who trade with us, is not going to bring about a necessary decrease in our price level?

Mr. GOLDENWEISER. No; I think not.

Mr. STRONG. You do not think we will gradually go back to a prewar level?

Mr. GOLDENWEISER. No.

Mr. WINGO. Do you not think that we will lose a large amount of gold in the next 10 years?

Mr. GOLDENWEISER. When it comes to 10 years, that is a guess. My guess is no.

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Mr. WINGO. In the light of the policies that you know are in existence in the different countries, is it not the general opinion that there will be a gradual depletion of our gold to the extent of $1,000,000,000 in the next 5 or 10 years?

Mr. GOLDENWEISER. I have heard of the suggestion. I have not recently heard it so much as some years ago.

Mr. WINGO. What steps are they taking, then, to change what they expected to be a general movement? You are the first one I have heard suggest that may be there has been a change in that trend.

Mr. GOLDENWEISER. It is a question of analyzing the situation. The world produces about $400,000,000 in gold in the course of a year. Industry consumes between $150,000,000 and $200,000,000 for jewelry and other purposes and the remaining $200,000,000 goes into reserves, but a reasonably large amount of that goes into India and stays there. India has been for generations the sink for gold, and they have absorbed a couple of billion dollars's worth of gold in 50 or 60 years. The remainder is distributed among the other nations that require additional gold reserves, and it is only after that is absorbed, so to speak, that the demand would come to us.

Mr. WINGO. Instead of their being a probable increase in the production of gold there is a probable decrease, is there not?

Mr. GOLDENWEISER. Well, I do not know.

Mr. WINGO. Is not that the general trend? Take the trend for the last few years; there has been a downward trend in the production of gold.

Mr. GOLDENWEISER. No, sir; I think not. I think the last year was the largest year since 1915.

Mr. WINGO. I believe you are right; but is it not expected that if you put these nations back on the gold standard, the management you are going to have of the gold and the expedients that are going to be resorted to are to be temporary so as to gradually ease it back to a free flow of gold which will cause us to lose a billion dollars in the next 10 years?

Mr. GOLDENWEISER. I will follow you right up to the last point. I think that the intention is to return to the full gold standard and to restore the free flow of gold, but I have doubts whether or not that will result in our losing gold.

Mr. WINGO. If we do not lose gold, what we will have to do, if these nations get back to the gold standard, will be to raise the rates as high as a cat's back and hold them.

Mr. GOLDENWEISER. Not necessarily. If our price level and our money rates are on a fairly even keel, that is not necessarily so.

The CHAIRMAN. There are some students of this subject who are of the opinion that the increase in the demand for credit facilities in this country will require the retention of all of our surplus gold within a period of 10 years in this country or else it will slow up our credit facilities.

Mr. GOLDENWEISER. I am inclined to think that that is essentially correct. The thing you have to recognize is that gold is an expensive commodity for a Government, that they would rather buy our cotton and our grain and our automobiles and sewing machines than our

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gold. They will not buy our gold unless they find that their reserve position, the stability of their currency and their credit structure, require it. It is the least attractive thing to buy; no one contemplates giving our gold away and those countries are not going to pay for it unless they find that they have to and that they have the means to.

Mr. WINGO. That is the very point. Take the situation the chairman called attention to. It is contemplated that there will be an increased demand, accelerated to a geometrical ratio in the United States, on our gold. To that extent we will need to hold this gold. If that is true, it will be because of world-wide evidence of growth in business, a revival of industrial activity which will be world-wide. You would not have that great demand in the United States if all the rest of the world, instead of getting back upon the gold standard, upon a stable, economic basis, slipped back, and if they slipped back it will be bound to affect us and reduce the demands we have for currency; but, if that goes on, and it spreads all over the world, and when we stabilize these other nations we serve our selfish interest, because their prosperity affects ours—if we do get them upon a stable basis, we increase their demand for currency. That increases the demand for gold by those nations, and so one evens up the other. You have relatively the same agument, and when you restore the free flow of gold it will go where the price is the highest, and in order to hold it we will have to increase the discount rate in this country.

Mr. GOLDENWEISER. Not necessarily.

Mr. WINGO. Or else they will have to reduce it in Europe.

Mr. GOLDENWEISER. There has been nothing in what you said that would indicate that the price abroad would be better than the price here, even if our discount rates are no higher here than they are abroad. If we should here continuously maintain a very low discount rate and have extremely easy money, I think that then a considerable amount of our gold would move out, but if our rate structure was going to be in a relationship to the rate structure abroad, approximately such as it is now, there is not likely to be that condition, I think, and I say I am not sure of that and I can not give you any expert opinion on it. I have been asked about it, and I say that it is a question of judgment; but I think—and I do not attach too much significance to it—that it is not very likely that any very large movement of gold is going to move out, for the reason that there are so many other things that the world would rather have, and there are two hundred millions or so of gold available every year outside of the gold of this country.

Mr. WINGO. I arrive at the conclusion that you think that these gentlemen who are controlling the central banks of the world have concluded that the gold standard has lost its real value, that you do not have to have a free flow of gold, that you could simply buy and sell upon a dollar basis or sterling basis, and that your gold standard has lost its basic virtue. That is the only conclusion I can arrive at if your judgment is correct—that you do not need the gold standard and you do not need the gold.

The CHAIRMAN. If that is the conclusion it is quite in contrast with the statement of Governor Strong yesterday.

Mr. WINGO. Certainly. You are assuming a position here that is so contrary to all my reading in the last 12 months that I am rather surprised at your conclusions.

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Mr. GOLDENWEISER. I may be wrong; but I want to say this, that I feel myself in entire agreement with Governor Strong's statement. I do not know what he thinks about the movement of gold, and I do not know whether he would agree with my statement that the gold would not move out, but I believe that the tendency is toward the reestablishment of an absolutely free gold standard everywhere, and there has been great progress made in that direction in the last year.

The CHAIRMAN. Is it not pertinent that in this period in which we are accumulating this vast amount of gold, for the major portion of which we have no immediate use, that in the constitution of the Federal reserve system we have the ability now, because of the fact that the Federal reserve system is not organized as a money-making institution, to impound that gold? In other words, if that gold had come in to a system here that had been differently constituted and which had to earn money, had to earn interest, it would result in an inflation in this country which would be beyond the control of anyone?

Mr. GOLDENWEISER. Yes, sir; no question about that.

Mr. STRONG. I fear, from your testimony here, that you believe that, rather than have Congress direct the Federal reserve system to use its powers toward stabilizing the purchasing power of money, it should be left just to use its powers as directed by the present law to the accommodation of commerce and industry?

Mr. GOLDENWEISER. To use its powers primarily for the purpose of having elastic currency and sound banking conditions and the gold standard.

Mr. KING. Then the conclusion of the whole matter, in the words of Saint Paul, is this, that, taking advantage of the suggestion of the gentleman from Arkansas that a certain condition would place the governor of the Federal Reserve Board betwee the devil and the deep blue sea, the passage of this bill would place the whole Federal reserve system in a similar position, would it not?

You need not answer that.

Mr. GOLDENWEISER. I will avail myself of that privilege.

Mr. STRONG. What have you to say regarding the matter of publicity set out in the bill.

Mr. GOLDENWEISER. I would like to say a few words on that.

The thing I would like to say about publicity is this, that as the bill now reads, the publicity is so regulated and there is so much discretion given to the governor of the Federal Reserve Board that I do not believe it would create any serious embarrassment. I would like to point out to the committee, however, that a certain amount of publicity is being continuously given by the Federal Reserve Board in its bulletins. If I may, Mr. Chairman, I would like to introduce into the record the last paragraph in the review of the month that appeared in September, which summarizes the circumstances under which the easy money policy last summer was adopted.

Mr. CHAIRMAN. Without objection, that will be inserted.

(The paragraph referred to is as follows:)

This advance of sterling and of other European exchanges will assist foreign buyers in making their autumn purchases of grain, cotton, and other American farm products. At the same time the decline in rates charged on bankers' acceptances in New York will have a tendency to attract a larger volume of the financing of exports to the banks of this country, and consequently to reduce

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the demand for credit for this purpose abroad. Thus the establishment of lower rates for money in the United States at this season of the year is facilitating the marketing of American crops and at the same time, by relieving the pressure for funds on foreign banks, is exerting a favorable influence on the international financial situation.

Mr. GOLDENWEISER. Then, later in the year, there was a change in policy in connection with different developments, and the circumstances under which this change occurred were summarized in the bulletins for February, on page 111. I shall give these passages to the secretary or insert them at the given points in my testimony.

(The passage referred to was as follows:)

The system's policy in not offsetting the gold exports in the last weeks of the year was due largely to the fact that, in the absence of demand for additional credit from trade and industry, there was a continued and rapid growth in the volume of member bank credit used for investments and loans on securities. Thus, notwithstanding the drain on member bank reserves through gold exports, reserve balances of these banks with the reserve banks increased in the autumn and early winter as a consequence of the growth of the member banks' deposit liabilities.

Then, when the annual report of the Federal Reserve Board for 1927 was written, which will be presented to Congress in a few days—it is now in page proof—the whole thing was summarized here on pages 11 and 12, which I can pass on to you now if you like.

(The passages referred to were as follows:)

During the period from June to September, while changes in gold stock were small, the reserve banks purchased about $80,000,000 of Government securities in furtherance of a policy of easing the credit situation. This policy was adopted by the system in consideration of the recession in business in the United States, of the relatively heavy indebtedness of member banks, and of the tendency toward firmer conditions in the money market. During this period it also became evident that there was a serious credit stringency in European countries generally, and it was felt that easy money in this country would help foreign countries to meet their autumn demand for credit and exchange without unduly depressing their exchanges or increasing the cost of credit to trade and industry. Easier credit conditions abroad would also facilitate the financing of our exports and would thus be of benefit to American producers. By purchasing securities at that time the Federal reserve banks were in fact successful in easing the condition of the money market and in exerting a favorable influence on the international financial situation. The purchase of securities in the open market during the summer months was accompanied by reduction of the discount rate at all of the Federal reserve banks from 4 to 3½ per cent.

* * * * * * *

At first the reserve banks pursued the policy of offsetting the effects of these decreases on the money market through purchases of securities, but after the beginning of November such purchases were both absolutely and relatively in much smaller volume. The larger part of the gold withdrawal toward the end of the year, therefore, exerted its usual influence upon credit conditions in this country, contributing to an increase of member bank indebtedness at the reserve banks and to a somewhat firmer situation in the money market. The system's policy in not offsetting the gold exports in the last months of the year was formulated in consideration largely of the fact that in the absence of demand for additional credit from trade and industry there was a continued rapid growth in the volume of member bank credit used in investments and in loans on securities. There was a corresponding growth in member bank deposit liabilities, and notwithstanding the drain on member bank reserves through gold exports, reserve balances of member banks with the reserve banks increased in autumn and early winter.

Mr. LUCE. How long was that explanation in that monthly Bulletin from the time when the thing took place?

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The CHAIRMAN. This is a part of the annual report which I understand will be released about the 26th of March?

Mr. GOLDENWEISER. Yes.

The CHAIRMAN. Inasmuch as this is an official publication for release at that time, I wonder if this can not be held in abeyance until the report is issued?

Mr. GOLDENWEISER. It will be out in a few days, and I will be glad to insert this in my testimony. I asked Governor Young yesterday whether there would be any objection and he said there would not.

The CHAIRMAN. The thing that I had in mind was that it should not be taken account of by the newspaper men.

Mr. WINGO. He is simply embalming it in the record.

The CHAIRMAN. It will hardly be fair to give it out in advance, and if any newspaper men are here they should not take notice of it.

Mr. KING. I doubt very much whether this will be of any benefit to the committee. It bears the same relation to this matter as George Creel's official bulletins used to bear to the war. I have them all bound on my shelves, and also the Federal reserve bulletins.

Mr. STRONG. How often are these Bulletins issued?

Mr. GOLDENWEISER. Monthly.

Mr. STRONG. To whom?

Mr. GOLDENWEISER. They are sent free of charge to all the member banks of the Federal reserve system and for $2 a year to any other subscriber.

Mr. LUCE. Take that first Bulletin; how long was that explanation made after the thing happened?

Mr. GOLDENWEISER. The purchases of securities and reductions of rates last summer occurred during August, and this came out in the September Bulletin, which was released to the press on September 1. The Bulletin actually did not appear until the 10th or 12th, but the review which was to appear in it was mimeographed and released to the press on September 1. That was pretty prompt.

Mr. LUCE. Would you say that ordinarily less than a month follows?

Mr. GOLDENWEISER. I think that, as the bill contemplates, that is in the discretion of the governor of the board. There are times when it is considered desirable to have a very prompt explanation. At other times it is desirable to have the explanation take its regular course and come out later.

Mr. WINGO. It is all a question of when the necessity for secrecy ends and the necessity for publicity begins. A good many people think that the President's Cabinet ought to have open meetings and the juries open sessions and the Supreme Court consider its decisions in public. There is a difference of opinion about that.

Mr. KING. They have to be careful about publishing this material.

Mr. STRONG. What have you to say with regard to the direction for a study of these various subjects?

Mr. GOLDENWEISER. I feel about the same as Governor Strong felt yesterday, namely, that to have a specific authorization for the studies which we make would be a desirable thing. It would give us a feeling that Congress is back of us in this work. On the other hand, I do feel, in connection with this long list of questions enumer-

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ated, that the system's and the public's purposes would be better served if that list were not so elaborate, because a long list carries with it the idea of excluding other topics, and the list is made up from the point of view of price stabilization. That is only one and a relatively small part of the material that the Federal reserve system needs to have. Our investigations are continuous. We try to present to the board all the data that are available that bear on credit policy. Our work has been for a number of years quietly and unobtrusively done there, and we have, with the assistance of many Federal reserve banks and many private agencies, built up a large body of information that we are constantly giving to the board to use as a basis for credit policy.

In that there are some of the problems that are included in your list, but most of it deals with other problems. Giving these problems by enumeration would, by the prominence they will have, center attention on them, and would lead to a large expenditure both of funds and energy on those problems and might result in less funds and energy being available for a large number of other things which we feel we ought to be doing in order to keep the board and the system properly informed.

I would feel, therefore, that it would be desirable to have this section, if it is passed, framed in a general authorization for the Federal reserve system to make investigations of all those matters that come before it as a basis of credit policy. Then, if the other part of your bill passes, of course, the price level becomes a part of it, but this is apt to be interpreted as exclusive.

Mr. STRONG. Of course, the questions are based upon the main purpose of the bill, if Congress directs, in addition to your present use of the Federal reserve system for accommodation of business and commerce, that you should use this power to try to stabilize the purchasing power of money. I have guarded that direction so carefully by the various suggestions I have got from members of the Federal reserve system that I have been led to put in the final clause directing a study of those questions.

Mr. GOLDENWEISER. The study of those things, in a way, is continuously being made and will continue to be made. I would not say that I am opposed to that section of the bill, Mr. Congressman, but I simply pointed out certain things about it that seemed to me as possibly undesirable, that it would be preferable if they were——

Mr. STRONG (interposing). You would like to have those things regarding stabilization quite different and some other things included?

Mr. GOLDENWEISER. I would like to have it done.

Mr. STRONG. Will you furnish me with a statement of what you think should be included?

Mr. WINGO. Has he not already done that?

Mr. STRONG. I would like to have the language he suggests; I want the benefit of his ability.

Mr. GOLDENWEISER. On that section of investigation?

Mr. STRONG. Yes, sir.

Mr. GOLDENWEISER. Yes, sir.

Mr. STRONG. I would appreciate it.

Mr. GOLDENWEISER. As an indication of the kind of things we do, I might in closing say that this is a set of charts that presents

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most of the information that we currently present to the board, and we have just decided to print it. This is a page proof of it, and I will be glad to present a copy of it to the chairman now and to any member of this committee as soon as it is out in print.

Mr. STRONG. What is the purpose of presenting these charts to the board?

Mr. GOLDENWEISER. It is to point out to them the various developments that have a bearing on credit policies.

Mr. STRONG. For what purpose?

Mr. GOLDENWEISER. For the purpose of deciding those questions that it is up to them to decide, whether it is open-market policy or any other policy.

Mr. STRONG. Is that for the purpose of advising them as to whether or not they should extend credit to commerce and industry; whether or not they should accommodate commerce and industry?

Mr. GOLDENWEISER. As to whether they should do so at a higher or a lower rate.

Mr. STRONG. I see. Well, if they did it at a higher rate, it would not be so nice an accommodation as if they did it at a low rate.

Let me ask you one more question. Is not the real purpose of those charts to enable them to use the powers of the Federal reserve system toward stabilization?

Mr. GOLDENWEISER. If I have to answer that in one word, I would say no.

Mr. STRONG. Then they are not using the information they have for that purpose?

Mr. GOLDENWEISER. Only incidentally.

Mr. STRONG. Incidental to what?

Mr. GOLDENWEISER. Incidental to those things that are more directly the duties of the Federal reserve system.

Mr. STRONG. That is, to accommodate business and industry?

Mr. GOLDENWEISER. To maintain sound banking conditions.

(Thereupon, at 1 o'clock p. m., the committee adjourned to meet to-morrow, Wednesday, March 21, 1928, at 10.30 o'clock a. m.)

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Wednesday, March 21, 1928.

The committee met at 10.30 o'clock a. m., pursuant to adjournment, Hon. Louis T. McFadden (chairman) presiding.

The CHAIRMAN. The committee will come to order. We will proceed with the hearing on H. R. 11806, and will be glad to hear Prof. John R. Commons, of the University of Wisconsin.

I would suggest, inasmuch as the doctor has a considerable statement to make, that he be permitted to proceed and make his connected statement without interruption, after which we will be glad to answer any questions that may be propounded.

I might say also, before we start, that Dr. Adolph C. Miller, a member of the Federal Reserve Board, phoned this morning that he would not be able to be present this morning on account of illness. Doctor Miller is very anxious to be heard, and I gave him the assurance that at a subsequent date, these meetings being held open,

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we would give him the opportunity to be heard at the convenience of himself and the committee.

Doctor Commons, the committee will be glad to hear you at this time.

STATEMENT OF PROF. JOHN R. COMMONS, OF THE UNIVERSITY OF WISCONSIN, MADISON, WIS.

Professor COMMONS. Mr. Chairman, I testified, as you know, before this committee a year ago in February, and I do not wish to cover the ground again, except as it may be drawn out in the questions.

I have had certain criticisms made on that testimony. Governor Strong recently said to me that he had read it all through, and while he thought it was very interesting he said it was somewhat exaggerated. I have studied the testimony of the others and listened to those that have appeared, representing the Federal reserve system, including Mr. Stewart, who was the predecessor of Mr. Goldenweiser, and I find that they take the extreme opposite to mine; they minimize or belittle the power of the Federal reserve system, going almost as far as to say that it has no economic power. I distinguish the economic power from the phrase used in the bill, which is "powers and authority," which I understand to mean legal power. But I shall speak only of the economic power.

Among economists there are these two different points of view: Some will say that the Federal reserve system has great economic power to determine commodity price levels; others say that it has very little power. I think, myself, that that is a matter of investigation. The hearing on this bill practically resolves itself into one question: What are the economic powers of the Federal reserve system? Not whether anybody was mistaken or guilty of misusing those powers. That question does not arise. The question simply is, as I understand it, If it uses the economic power which it now has, could it control the price level?

The first thing to which I would like to call your attention is the difference between the bill upon which testimony was taken a year ago and the present bill.

The former bill attempted to make only one change in the Federal reserve act. That one change came under the head of the rate of discount. You will find this on page 1 of the hearings on that bill. The original act said that the rate of discount "shall be made with a view to accommodating commerce and business." Congressman Strong's bill of that date struck out the word "business" and added the words: "And promoting a stable price level for commodities in general. All of the powers"—that is, including others that extend beyond the rate of discount—"all of the powers of the Federal reserve system shall be used for promoting stability in the price level."

As I examine the purposes of the Federal reserve act, not only those stated in the title of the original act but also those which can be read into the act creating the Federal reserve system, I would say that they can be summarized as about four or five. The first was to furnish an elastic currency; second, to afford a means of rediscounting commercial paper; third, to establish a more effective supervision of banking in the United States, and, under the rediscount clause, ac-

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commodation of commerce and business; and, lastly, there can be read into it, and undoubtedly is implied in it—it is really the substance of the whole act—the centralization of the reserves of the member banks. We may call those the purposes of the act as enacted into law in 1913.

I would say that this bill now before us, H. R. 11806, adds four purposes: First, the idea of stabilization; second, the relations between the American reserve system and foreign banks of issue; third, publicity; and fourth, investigation.

Also, it should be observed that this bill has been worked over at great length in order to meet all of the objections which could be obtained from individuals on the Federal Reserve Board or individuals in the Federal reserve bank at New York, or others.

It must be evident to all persons that any administrative authority—and here I can speak from my own experience, if you will allow me, for I was for two years on the Industrial Commission of Wisconsin, and also served on the Federal Industrial Commission—every person upon whom is placed responsibility for carrying out legislation may be looked upon as having two different psychologies. The first is his opinions and thinking as an individual; the second is his opinions and thinking as a member of the system which he is trying to maintain and continue. Consequently no administrative commission follows out exactly the law as laid down mathematically in a congressional enactment. It necessarily changes the meaning of the law somewhat in its administration. It either enlarges its meaning or contracts its meaning, and that enlargement or contraction of the meaning of the words used in the act is a change actually in the act itself. It is an administrative change in the act itself.

Consequently we can not always tell from the wording of an act just what will follow when that act is interpreted by the administrative authority. We can not tell what is going to be done under that act. The same is true of the judicial authority. The same process appears in the courts in interpreting an act. The court endeavors to interpret the act as applying to an individual case. Consequently the courts for several hundred years have always added the word "reasonableness" to any legislation which they have interpreted. For example, in our public utility legislation, which says, "This commission shall ascertain the value," when it comes to the courts, and even the commissions themselves, they endeavor to ascertain the "reasonable value." So when we have the words "stable gold standard" or "stable purchasing power" the word "stable" must always be interpreted as "reasonably stable."

We have the decision in the famous public utility case of Smythe *v.* Ames, which has defined this word "reasonableness" in the case of railroads. It says that in ascertaining the value of railroad property the commission shall take into account all the factors—cost of production, earning power, etc., enumerating a large number of factors—and then goes on to say that in taking into account all of the factors it shall give "due weight" to each—that is, proper weight or reasonable weight.

That is attempted to be cared for in this bill by enumerating various things besides the stability of the purchasing power. There

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are enumerated commerce, industry, agriculture, and employment, as well as an international gold standard and a domestic standard of the purchasing power of the dollar. All of these factors are to be taken into account by any administrative body, and they must be given their due weight.

I am going on the assumption that this bill, if enacted, makes the primary purpose of the Federal reserve system the stabilization of the purchasing power. My arguments will be directed to that interpretation. Mr. Goldenweiser yesterday very correctly interpreted that as the meaning of this proposed enactment.

I will say, then, that what is intended by this bill is a reasonable stability of the purchasing power of money, whether it be gold or credit or any other thing which might come under the head of purchasing power.

I confess that I have, in my former testimony, shown a good deal of confidence in my theory, if you can call it such, that the Federal reserve system does have these great economic powers over the price level.

I think I ought to qualify as a witness right here, Mr. Chairman. It happened that in the years 1922 and 1923 I was made president of an association called the National Monetary Association. It was composed mostly of eastern men, eastern bankers and economists, but they seemed to have some reason in their minds why they ought to have a western professor to head them. I found as I worked with that committee in New York and Washington for six or eight months, possibly longer, that one of the most important things in the minds of the bankers and eastern people in this National Monetary Association was the question, What is Henry Ford going to do? Henry Ford had come out with an inflationistic proposition that the Government should buy Muscle Shoals by issuing paper money, and one of my commissions as president of the National Monetary Association was to call upon Henry Ford and Thomas Edison, who did the statistical work for Henry Ford, and explain to each of them the error of their ways. I had quite a long talk with Henry Ford, and I took with me very much the same chart which I presented to this committee a year ago and which you will find on page 1077 of the hearings. It did not contain all of the curves, but it contained the essential curves.

I feel that by taking a chart like that to Henry Ford, who is an engineer and who thinks out things by seeing them charted on paper, I had some influence on him. He explained to me all of his views; excused himself for advocating a paper-money inflation; and I think I had some influence, because about three or four months afterwards Henry Ford declared for Mr. Coolidge for President. As soon as Henry Ford declared for Coolidge the National Monetary Association dropped out of existence. There was no more financial support for it, and I was left in the air as the president of a paper organization.

During that process the people in the Federal Reserve Bank of New York, and to a lesser extent in Washington, were quite eager and willing to explain to me all of their inside operations, and the most interesting event to me was this: Some representative in New York in the Federal reserve bank received a letter from a high per-

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sonage in Washington in about February, 1923—when by the chart you will note prices were rising very rapidly, more rapidly even than they did in 1919. This personage in Washington wrote to the other in New York to the effect that there was a great inflation sentiment in Washington, and wanted to know what could be done about it. Thereupon, when the letter was shown to me—a letter of introduction was given to me to this personage in Washington, whom I had already known—I called upon him. I might have been called a sort of voluntary liaison officer. He took me over to the Federal Reserve Board about the 1st of February, and I learned there that they were perfectly aware of the inflation, that they knew their powers, and that they were just waiting the opportune moment for acting.

Mr. WINGO. February of what year?

Professor COMMONS. February, 1923.

I learned also, through this sort of semiparticipation in the Federal reserve system, what those powers were. It was explained to me what was the power of the open-market operations. Prior to November, 1922—I think I can give that as the proper date—the 12 banks had been buying and selling securities without any concerted action, and it had been deemed necessary that they should all act together. So about November, 1922, they created the open-market investment committee, centralizing all of the buying and selling of securities on the open market in the hands of a committee of three to five governors of the various banks. We had here a new phenomenon that had never occurred before in monetary history, and the Federal reserve people did not themselves know what that instrument could do. Prior thereto they had scattering and conflicting buying and selling of securities by the reserve banks, so they could not have any particular effect. But in November, 1922, they concentrated it all, for all the 12 banks, in the hands of one committee. There was now concerted action. Thereafter, instead of each reserve bank throwing its own ball, all of them together threw all of their weight at one time in one direction.

This was a new power which had never been known before, and it could not have been known before the large issues of Government securities during and after the war. Of course, those acquainted with banking history would know to what extent the Bank of England had used it, but I will not go into that.

Anyway, here was a new power. So they began selling those securities and continued the sale for some time in 1922, until they got down to the minimum in 1923. The idea of that, of course, is quite familiar to you all. I have simply stated the historical setting of it in order to show you why I have confidence in my so-called exaggeration.

Then, in the middle of February, about a week after I happened to be interviewing the people at Washington, they raised the discount rate in two districts very slightly. Prices of commodities kept on rising until about the middle of April, for about two months; but from the beginning of that operation, which was November, 1922, until April, 1923, we had about five months of operation of, first, the open market, and, second, the discount rate, as an instrument to check the further inflation of prices.

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After the thing was all over, and statisticians began to study it—and possibly within the Federal reserve system itself there were differences of opinion about this open-market matter and the discount rate, because it was all new to them; they were just experimenting with it—after it was all over, and the statisticians came along and tried to explain what had happened, what was cause and what was effect, that that was a post-mortem investigation. All statistics are post mortem. They do not take into account what the administrative authorities had been doing previously.

Let me illustrate this doctrine of cause and effect. We have two movements going along in more or less parallel lines. We will say that one is price and we will say that the other is volume of money. Now, nobody can tell from which side the cause arose. It may have arisen from the commodity side, more demand for money, or it may have arisen from the money side, a greater supply or restriction. Nobody can tell from statistics which was cause and which was effect; and that is the reason why it seems to me that this investigation that is proposed here should be made by the Federal reserve people themselves, because it must take into account the ideas and principles on which the responsible authorities were themselves working, and not merely what a statistician might find afterwards. I will speak about that later.

I will now take up, if you will allow me, the testimony of one of the witnesses in the former hearing—Mr. Walter W. Stewart. Mr. Stewart was the predecessor of Mr. Goldenweiser as the head of the research department and was with the board in 1922 and 1923.

He takes the view in that testimony, beginning at page 735 of the hearings, that the price movements in 1922 and 1923 would have been practically just the same as they were if there had been no Federal reserve system in existence; in other words, that all of the rise of prices from the middle of November to April, 1923, and then the fall in prices in April, 1923, and down to 1924 would have happened substantially just as they did happen if there had been no Federal reserve system existent.

That is the other extreme theory. It is the theory of those who belittle the power of the Federal reserve system. I ought to say, of course, that Mr. Stewart did make modifications, but they were very slight. He made hardly any modification different from what Mr. Goldenweiser made yesterday. Mr. Goldenweiser simply had the same idea as Mr. Stewart in his testimony.

So that is the other end of the theory—the theory that the reserve system has little or no power whatever; that all of these movements are caused by circumstances which arise outside of the monetary and credit policy of the concentrated reserve system, and that the system has no influence.

I want to make one or two points about that line of argument, and it applies not only to Mr. Stewart but to the various representatives whom I happen to have talked with in the Federal reserve system who take similar views and is generally applied to the testimony presented by the Federal reserve system in these hearings.

There are two points which I think they omit in the criticism which they make against those who propose to use the powers for stabilization. For the sake of brevity, I will give names to those two and try to demonstrate them.

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They omit the factor of velocity, and they omit the factor of what I would call futurity or expectation, which is sometimes called psychology. I will just call it futurity.

Mr. WINGO. Will you explain just what you mean by those terms, Doctor? I want to follow you.

Professor COMMONS. We are going to have hard trouble getting there. I am going to explain what I mean by velocity.

Mr. WINGO. Take "futurity" and "psychology." You used them as synonymous?

Professor COMMONS. They are the same thing.

Mr. WINGO. All right; maybe I will catch up with you.

Professor COMMONS. I am giving an academic term; a comprehensive term which will cover everything. It depends upon how a human being acts. He acts in the present, in view of what he expects will happen in the future; so that the theory of causation which should be applied in economics is a theory of expectation. That is, his present act is caused by what he expects in the future. In other words, in all these affairs that we are dealing with, the causation is not in the past; the causation is in the future. It is in their expectations; and I find that the power of the Federal reserve system has, to control the demands of business for money or credit, lies in its power to modify the expectations of business men throughout the world.

As to the question of velocity, Mr. Stewart made the inference in his criticism of those who advocate stabilization that we have a theory that if we can change the volume of money, the volume of credit, we can thereby change prices. I am quite surprised that an economist of such great ability as Mr. Stewart should ever have put himself on record as saying that any economist holds that a mere change in the volume will change prices. Every economist who has ever given any study to the subject always includes, not merely the volume but the velocity of circulation.

Let me explain the two ideas, first by an analogy. If you have an automobile with a 3-foot wheel, and you are going along the road, the top of your tire is always 3 feet above the level of the road. We will call that the volume. That volume is constant. It does not change; it does not go up and down. But suppose that you are operating that automobile at the rate of 5 miles an hour. You have a certain rate of turnover, a certain velocity, or, in other words, a certain amount of work which your engine is doing. It is turning it over. It is not enlarging the diameter of the wheel at all, but it is turning it over slowly. Then, if that automobile is pushed up to 50 miles an hour, you do not change the diameter of the wheel but you change the velocity by putting more punch, more power into it, and if it is going at 50 miles an hour, with the same height of wheel, you will be getting ten times as much work, ten times as much power out of that machine, as if it were going 5 miles an hour. That is the difference between volume and velocity.

Let me apply it to the banking system. We have in the figures of demand deposits what we might call the volume of money. I will attend to the credit end of it, and call them demand deposits. We will say, for illustration, that there are $50,000,000,000 of demand deposits—bank credit—in existence. Now, it has been calculated

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that those deposits turn over every 15 days; that is, they turn over 26 times a year. The amount of work they are doing in one year, in buying and selling commodities, is twenty-six times $50,000,000,000, which is a pretty big figure, of course.

Now, suppose we change the velocity of the circulation of that money; not changing the quantity of money—$50,000,000,000—but changing its velocity. Suppose we double its velocity. Then you would have to multiply the amount of work it does, and the amount of power which the system has, by fifty-two times fifty billion—fifty billion being the constant volume, and 52 being the number of times each dollar, on the average, does a piece of work in buying and selling. Or, if you reduce the velocity so that it would turn over once a month, instead of twice a month, so that the whole volume would turn over only every 30 days, you will evidently reduce the amount of work that that monetary system can do by one-half. That is, it turns over only 12 times a year, and it is doing just half the amount of work if its velocity slows down.

Let me apply that to Mr. Stewart's testimony and to the various publications of the Federal reserve system in justifying itself after the depression of 1920.

Mr. Stewart says in his testimony that there was actually more bank money in circulation—bank credit—while prices were falling in 1923 than there was before, and my figures show that also, in the chart which I presented formerly; during 1922 and 1923 the demand deposits were increasing. But we will suppose that there was about the same amount of demand deposits. Prices fell then, not because of anything having to do with the volume of credit, but because its velocity slowed up. So it was said in the reports of the Federal reserve system and in testimony given by various members of the Federal reserve system before other committees, that the volume of money in circulation after 1920 was not reduced; in fact, the Federal reserve system actually increased the volume after 1920, and yet prices were falling tremendously in the latter part of 1920, with a larger volume of credit. Well, the explanation that I would make is that much of that credit was frozen credit; it did not turn over; it was not doing business; it was just being renewed on the bank books and showed up as a constant or increasing volume of credit in the country. But what happened was that the velocity or rate of turnover enormously decreased; that is, the size and number of transactions decreased.

So I attach much more importance at times to velocity than I do to volume.

I will give you another illustration. Governor Young, you remember the testimony you gave before the Senate committee the other day, in which you gently intimated that you thought the loans on stocks were sound, safe loans. The stock market in New York took from Governor Young's statement the idea that the Federal reserve system was not going to put any brakes upon the stock market. The next day there were about 3,000,000 shares sold. Perhaps you can give me the exact figures, but I do not care what the figures are.

Mr. YOUNG. Doctor, that was an unfair assumption from my testimony.

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Professor COMMONS. You are right. I say they jumped at their conclusion. I am going to bring that out on the question of publicity. I think the responsibility of an officer for publicity is tremendous in this whole question.

For illustration we will say that on the preceding day the volume of sales was 2,000,000 shares. The next day, after his testimony, the volume of sales was, say, 3,000,000 shares. Now, was there any increase in the volume of credit on the stock exchange? Very little. The first thing that happened was that there was an enormous increase in the velocity of transactions of buying and selling, and it was that increased velocity, say, from 2,000,000 shares up to 3,000,000 shares, that caused prices to rise.

I have not the figures, but as a result of that velocity, and as a result of the increase in prices, there may have been an increase in the quantity of credit necessary to sustain those stocks at that higher level of prices; but the primary cause, and the one that is taken into account by all advocates of stabilization—that is the reason we attach so much importance to this section on publicity—is that you can speed up the velocity by an announcement in advance of what you are going to do or what you are not going to do. The velocity in that case may have resulted from misinterpretation. It undoubtedly was, as I know from Governor Young's position and explanation of the matter, because I heard the testimony and the way in which it came up. I myself never would have guessed that the amount of sales on the stock exchange the next day would double. But the point I want to bring out now is simply this difference between volume and velocity. It is in part the speeding up of the velocity or the slowing down of the velocity that causes prices to rise or fall, and also increases or decreases the quantity of products that are going to be produced.

Let me give another illustration from Governor Strong's testimony day before yesterday on the publicity clause of this act.

He said that it would be very dangerous for the Federal reserve system if it should announce, say, two weeks in advance, that it was going to raise the discount rate 1 or 2 per cent. What would happen? He said, in effect, that everybody would get scared; the quantity of business would fall off; prices would fall, and at the end of the two weeks they might find that instead of raising the discount rate they must reduce it in order to save the country from the publicity which they had previously given. What he actually meant there was, of course, interpreting it in terms of velocity, that the velocity of business, the amount of transactions, the amount of money that would be called for to support those transactions, would fall off, which means also that the prices would fall.

So this publicity feature is perhaps the most important part of it; and I am sure the Federal reserve authorities themselves recognize the tremendous responsibility of publicity. That accounts, perhaps, for their reticence in giving out any information, and thus keeping the public in the dark as to what they are going to do. I appreciate that thoroughly. But let me show you what happens if the Federal reserve system does not give out publicity in advance.

In my former testimony, at page 1092, I give a record of the publicity which was given out from different sources during this

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same period which I happened to be observing, 1922 and 1923. While the Federal Reserve Board was beginning in November, 1922, to tighten the money market by its sales of securities and to raise its discount rate in February, in nearly all of the publicity that was given out, not only during that period but until a month or two after February—up until April, indeed—we have a repetition of forecasts of rising prices and increased prosperity. Then, on April 20, 1923, the first definite warning was given by a person who might have been supposed to be familiar with the members of the Federal Reserve Board, but evidently was not familiar with their purposes, namely, Mr. Hoover. On April 20 he gave a warning against inflation. But the inflation had already stopped. It stopped in April, 1923, and prices started down.

Going through the record, I find that during the preceding months, January, February, and March, the general publicity given out by Mr. Hoover and others indicated great prosperity; no danger to future prosperity; there was going to be a boom year, and everything. Well, it was starting to be a boom year faster than the year 1919.

What I say happened there is this: If the Federal reserve system does not give out publicity in advance as to what it is going to do, or might do, there is going to be misleading publicity given out by those who are very near to the Federal reserve system. We have seen recently two cases of misleading publicity. I think we can say that President Coolidge's statement was misleading publicity. I think Mr. Mellon's statement was definitely misleading publicity—that there would be no change in the discount rates.

Now, this kind of publicity, coming from parties who are supposed to be close to the system, misleads people and leads them to make commitments which are not justified. So, in this bill it is proposed to concentrate the responsibility for publicity upon the governor of the Federal reserve system.

Mr. WINGO. Doctor, if you will pardon me, I do not recall that President Coolidge ever said that they would not raise the discount rate.

Professor COMMONS. He was not talking about the discount rate. I forget just what he said.

Mr. WINGO. That was the inference that I got, and which I think anyone reading your testimony would get. I understood you to say—and that was the only positive statement you made—that they said there would be no increase in the rediscount rate.

Professor COMMONS. That was Secretary Mellon.

Mr. WINGO. Both of them discussed the brokers' loans, and the President confined himself to stating that he thought that the increase in volume of brokers' loans was a normal development justified by the increased wealth and increased volume, and I do not think that he gave any intimation as to any changes in policy. I direct your attention to it because I know that you do not want to misquote him.

Professor COMMONS. I am glad you directed my attention to it. I am only speaking from memory. I have not looked this up. I ought to say, however, that I talked it over with various members of the reserve system, and I know that they have difficulty in explaining how these misleading statements got out in advance.

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Mr. BLACK. I do not think, Doctor, that the President's statement or Secretary Mellon's statement, either one, referred in any way to the rate of rediscounts.

Mr. WINGO. It might have been unwise, but I am sure, certainly so far as the President is concerned, that he was simply responding to an inquiry and gave it as his personal opinion—a very natural explanation from a man who is not a financial expert—that it was a normal development justified by the increased wealth and volume of business. I know I read it at the time, and while it occurred to me that possibly it was not a very wise thing to say and might mislead, it never occurred to me that he was trying to mislead anybody.

Professor COMMONS. No; if I gave the impression that they were consciously trying to mislead people, of course I was entirely misunderstood.

Mr. WINGO. That was the impression that I got from your statement, Doctor, and I did not think it was fair, because I do not believe either one of them intended that.

Professor COMMONS. Oh, I did not say that they intended it. I say that it was misleading in the sense that the public generally interpreted it in that way; and it would apply in the same way to the misinterpretation by the public of Governor Young's statement. The essential point is that we should have an authoritative source of publicity, which would be a man canvassing all the methods which are used in the reserve system, and such a man is evidently the governor of the Federal Reserve Board. He is in direct long-distance or telegraphic communication with all the reserve banks. He could give out the publicity. Now, that does not mean anything like centralization of control, as Mr. Owen D. Young seemed to think it might. It would not concentrate control. It would simply mean that he would be the responsible one for giving out information.

Another point on that publicity: There has not been understood, apparently, the great discretion which is placed in the hands of the governor by the clauses of this bill. On page 2 of the bill there are prescribed three fields of discretion. He may choose the time when he will give out the publicity; he may choose the place where it is to be given out; that is, it may be given out in New York or in Washington; and—this is the most important one, which has so far been overlooked by witnesses—he may give it out "in such detail as may be deemed by him to be most effective in furthering such purposes."

The detail is the whole thing. Of course, if the governor of the reserve board should give out a very foolish statement, such as Governor Strong used in his illustration, namely, "We are going to raise the discount rate in two weeks," the thing is all off. But I am assuming that he would give out a considered statement. Suppose, for example, that the governor of the reserve board in January, 1922, had given out a general statement like this: "We have a law which says that we shall maintain stability of prices. We find that prices are rising very rapidly, as rapidly as they were in 1919. It may be necessary in the future for the Federal reserve system to take account of this rise in prices." I am assuming that the statement would be something like that; not a foolish or wild statement, but a well-considered statement, based on the experience that they had gained.

Mr. BLACK. On that point will you permit just one inquiry?

Professor COMMONS. Yes, sir.

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Mr. BLACK. I recall that in 1919, when the price level was so high, the Senate passed a resolution declaring it the opinion of the Senate that the inflation ought to be stopped.

Professor COMMONS. Yes.

Mr. BLACK. And there is a very widespread impression, and a very unfavorable one, among many farmers that in response to that resolution the Federal reserve system did set about deliberately to bring about deflation and that the whole collapse in prices was due to an action taken by the Federal Reserve Board and the Federal reserve system. Would not the whole system be getting on dangerous ground if it should undertake to make a pronouncement of that kind?

Professor COMMONS. Here is where the question of timeliness comes in, and also the use of their powers. It is quite plain that, since they waited, as they did in 1920, up until March or May, 1920, to take effective action, the inflation had gone too far for anything except a drastic reduction. But suppose they had used those powers much earlier; and I am not saying who is responsible for using them or not using them. Here was the rediscount rate, 3½ per cent in 1919. It rose, on commercial paper, to 7 per cent in July, 1920—a very rapid increase. Supposing that increase had been made in March, 1919, when business had only just started to increase, then it seems to me that that inflation could have been headed off; that it would not have gone to that high point. They raised the rate one year too late; and if they had watched the rise of prices which started in March, 1919, they could, as I see it, by raising the discount rate at that time—which then on Government collateral was about 3½ per cent—if they could have raised it then, they could have given a warning to the public.

I think that that inflation after the war, in 1919, is the only one known in history. Such certainly did not occur in 1865. There was then a continuous deflation for three or four years. But a post-war inflation was a new thing, and the explanation, I think, is quite evident to everyone. The rate of discount was kept down until it was too late for any effective influence on the market.

I will come back to that if it is not clear.

Mr. WINGO. Just on that point, you seem to agree with one conclusion of that so-called joint agricultural commission. They did not say so in so many words, but I understand that their position was that they thought the mistake was made in not deflating earlier; that it ought to have been done a year earlier. It would not have hurt quite so bad, so they seemed to think.

Professor COMMONS. I do not intimate that they should have deflated. If they had raised the rate to 7 per cent in March, 1919, that would have caused deflation, no doubt; but if they had raised it from 3¼ per cent to 4 or 5 per cent in March and April, 1919, they would have slowed down this velocity. The velocity of business had gotten too much for them when they got into May, 1920, and then they had to make most drastic and sudden increases in the discount rates. But if they had taken it gradually, beforehand—as I conceive they later learned to do in 1922 and 1923—anticipating and looking ahead, it would have been a different matter. As it was, they began to use their powers very gradually six months—November and December, 1922—before they took effect on prices in July, 1920.

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Mr. LUCE. In connection with what Mr. Wingo has said the record might well show my own recollection, that the commission divided, a majority thinking the board acted too soon, and the minority, with Mr. Ogden Mills as the spokesman—and I am not sure whether there was anybody besides him—thought that they acted too late, but they agreed that that factor of the Treasury operations was an important consideration.

Mr. WINGO. I only took what the report indicated, and got myself in trouble once on the floor of the House by paraphrasing that report. I have a good recollection of what was intended to have the commission report. I was barred from that commission because they said I was not conservative enough and would not agree in advance what my findings would be.

The CHAIRMAN. May I suggest to the committee here that when Doctor Commons started I suggested that he be not interrupted until he had completed his statement, in order that he might make his statement connected to the members of the committee.

Professor COMMONS. Mr. Chairman, I have finished three of the five points I wanted to talk on. Publicity was the third.

I want to bring in this matter of futurity now. The reserve system, so far as its powers over credit are concerned, and over the velocity of circulation, operates through the expectations of business. They can act without publicity through their statistical service and their clues as to what is going to come relative to all kinds of considerations. They can act long before the public is aware of what they are doing, but as soon as the public begins to get the idea that prices are going to rise, then you are going greatly to increase the velocity of business transactions and consequently the line of credit needed to support the new high prices and the new quantities of production is increased.

So that those two items which I consolidated in the two terms—velocity and futurity—are really the important instruments in the power of the reserve system, and I think I have given illustrations to point that out.

Let me take up the investigation. It is quite true that the investigation called for in this bill has as its basis the idea of stabilization. I do not think that the investigations of the Federal Reserve Board have been based primarily on the idea of stabilization. They would have to collect and combine different kinds of figures, or additional, or make new combinations.

They have also abandoned the idea of continuing the investigation and publication of their own average of prices of commodities, leaving that to the Bureau of Labor, and these other things which are itemized here all turn on the question of their power to control the price level. That is additional, I should say, and is a necessary addition to the powers of the Federal reserve act as originally passed, which did not include the idea of stabilization.

How would such an investigation naturally be conducted? I will give my idea of what such an investigation should be. I think it would be the kind of an investigation that the Federal Reserve Board, on consideration, would probably adopt.

It is an investigation similar to that which Mr. Hoover is now conducting through the agency of the National Bureau of Economic Research in New York. I understand he has raised $150,000 on the

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outside by private subscription and placed one of his representatives in association with the national bureau. I also understand that Mr. Miller, of the Federal Reserve Board, is already a member of that advisory committee of the National Bureau of Economic Research.

This bureau has published 10 volumes, and the last one is on Business Cycles, by Professor Mitchell.

The bureau spends about $80,000 a year normally. This year they have $150,000 additional, which is spent under the direction of Mr. Hoover along with the bureau.

That bureau is a representative bureau, which has on its board of directors representatives of opposing interests and different lines of thought in the country. I have here—I will pass it around and if you care for it, it might be put into the record—a page indicating what the National Bureau of Economic Research is, including the directors and the research staff.

The CHAIRMAN. Without objection, that will be placed in the record at this point.

(The page referred to is as follows:)

NATIONAL BUREAU OF ECONOMIC RESEARCH (INC.)

[Incorporated under the Membership Corporation of the State of New York, January 29, 1920]

ITS ORGANIZATION AND PURPOSES

The National Bureau of Economic Research was organized in 1920 in response to a growing demand for exact and impartial determinations of facts bearing on economic, social, and industrial problems.

It seeks not only to find facts and make them known but to determine them in such manner and under such supervision as to make its findings carry conviction to liberal and conservative alike.

Entire control of the bureau is vested in a board of 21 directors, representing universities, learned and scientific societies, financial, industrial, agricultural, commercial, labor, and technical organizations.

Rigid provisions in the charter and by-laws guard the bureau from becoming a source of profit to its members, directors, or officers and from becoming an agency for propaganda. No report of the research staff may be published without the approval of the directors, and any director who dissents from any finding approved by a majority of the board may have such dissent published with the majority report.

The members of the board of directors are as follows:

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RESEARCH STAFF

Edwin F. Gray, director; Wesley C. Mitchell, director; Willford I. King; Frederick C. Mills; Frederick R. Macaulay; Leo Wolman; Willard L. Thorp; Walter F. Wilcox; Harry Jerome; Simon Kuznets.

Professor COMMONS. You will notice that there are directors at large, there are directors selected by university appointment, and there are directors by appointment of other representative organizations. Among the latter are the American Federation of Labor, the American Economic Association, the American Management Association, the American Bankers' Association, the American Statistical Association, the National Publishers' Association, and the American Farm Bureau Federation. There are five universities represented.

In other words, the kind of an investigation which they make includes supervision not simply by one interest, but by all interests, and among the privisions of the constitution of this bureau is the provision that any member of the board of directors who disagrees with the findings of the staff of investigators may send in his disagreement. If it is taken account of by the investigators adequately, then nothing more need be done, but if it is not taken account of by the investigators he has the right to publish it as a dissenting opinion in the findings.

I am not saying that the Federal Reserve Board would join in with the National Bureau of Economic Research, but I do say that it will take a good deal more money for expenses than they are now paying; that it would involve the whole question of the power of the Federal reserve system over prices of different kinds and one of the most complex problems in the whole field of economics.

One other thing about the gold standard: As I understand it, there are three types of gold standards. First is the one described by Governor Strong the other day, which means that each central bank of the world shall have a separate reserve in its own vaults to pay its liabilities on demand so that its money is immediately convertible into gold; and, furthermore, that there is a world free market of gold, no obstructions placed in the way of gold passing from the country where its purchasing power is low—that is, where prices are high—to another country where its purchasing power is high—that is, where prices are low. That is the free pre-war gold standard.

Now, there has, along with this, been growing up in the last 30 years the gold-exchange standard. This is familiar to you, but the only question I want to bring out is what the differences are and the effect on the world demand for gold.

The gold-exchange standard is a standard in which the country need take no gold at all, like Bolivia or Austria and many of the countries that have come on the gold standard, so called. It is called with them a gold standard, but it is really a gold-exchange standard, because they require only their own paper money, and they have a running account through bills of exchange on New York or Lon-

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don, which are the two strictly gold-standard countries of the world at the present time, and by means of which the gold does not move at all in international trade. It is simply a change in the foreign balance account which they must keep up sufficiently, and the exporters and importers of their own country, instead of importing gold or exporting gold, simply call upon the government for foreign exchange.

I need not go into that; it is doubtless understood. The point of it is that other countries, other than England, are on a partial gold-exchange standard, like Germany, and they have a quantity of gold, but they have also changed their laws since the war to the effect that they may count as part of their resources, foreign balances, practically always in New York and London. The only two nations that are on a strictly gold standard, where they have enough gold to redeem their demand liabilities, are the United States and England.

Now, the difference between this gold-exchange standard and the gold standard is in the quantity of gold which will be needed to satisfy the world's demand for gold to carry on its business. The gold-exchange standard is not an automatic gold standard. It is a managed standard, a managed gold standard.

The third system is a strictly managed gold standard. There is always some management in a gold standard. The Bank of England, we may say, first learned the management principle about 1860, when they learned that in the rate of discount was their power to prevent an outgo of gold or to attract an inflow of gold. The year 1860 was the first time that they learned that their discount rate was enough to do that. They paid no attention to the effect on prices of that change in the discount rate. That is partly a managed gold standard, because evidently the central banks are attracting gold or are allowing it to leave the country.

Now, the managed gold standard, it seems to me, is what we have in this country, and it grows out of the fact that we have over half or nearly one-half of the world's monetary gold supply, and that other countries are owing us a billion dollars in gold each year, which gives us not only a control of the total quantity, or a large share of the total quantity, but it also gives us a continuously increasing and continually incoming supply of gold or of gold exchange without selling our commodities abroad; that gold exchange can be obtained by other countries only by selling their commodities in foreign countries and buying American exchange.

So that I would say that our country is on a managed gold standard, and that the gold in this country, coming in in such quantities, has not been allowed since 1922 to increase the price level materially. It has rather been counteracted by these activities of the Federal reserve system.

So that the whole question of stabilization—well, we may say, the whole question of future long-run stabilization—is going to depend on two things, whether the world is going to return to a complete full gold standard with full gold reserves, as Governor Strong apparently is contemplating, in which case there would be a tremendously increased demand for gold and, secondly, it is going to turn on the question of what is the probable increase in production from the mines.

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This bill, instead of being merely a bill designed to correct business cycles, is designed also to maintain a stable gold standard, and that is particularly cared for on lines 11 to 13, on page 2, where it says:

Relations and transactions with foreign banks shall not be inconsistent with the purposes expressed in this amendment.

In other words, to give a concrete illustration, arrangements were made with England about 1925 which enabled England to come to the gold standard. In order that she might do that she had to have a loan or, rather a promise of a loan if needed, which was partly arranged for in this country. Her price level was about 10 per cent above the gold price level. She had to retire enough of her paper money and place gold in its stead in order to bring her general price level down about 10 per cent, as was estimated by the Manufacturers' Association in England about that time.

No consideration was given either by those in the Bank of England or by those of our representatives in the reserve bank who took care of this resumption—no attention was paid, or no practical attention was paid, to a resulting or a following fall in the prices of commodities, or, in other words, a rise in the value of gold.

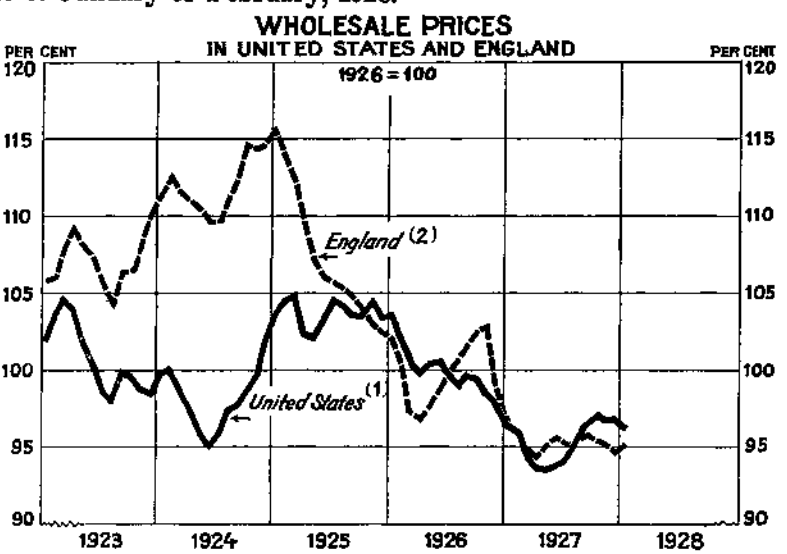
Since England went onto the gold standard in 1925 the price level of England, as well as the price level of America, has gone down something like 10 per cent. Two countries on the same gold standards will have a similar movement in their price level.

Mr. Goldenweiser, you have a chart on that, showing the different price levels.

Mr. GOLDENWEISER. Would you like to have it?

Professor COMMONS. I would like to have that put in as an exhibit.

The CHAIRMAN. Without objection, the chart to be furnished by Mr. Goldenweiser will be placed in the record at this point. It is identified as Wholesale Prices in United States and England from 1923 to January or February, 1928.



(1) Bureau of Labor Statistics. (2) Board of Trade.

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Professor COMMONS. Taking the English price levels, 1925 is this red line, the price level was there about, say, 106, on the pre-war basis. It was at that point [indicating on chart] that England came onto the gold standard.

Mr. KING. These charts will not be printed in colors, so that whenever you refer to a color it will not give us any information so far as the record is concerned.

Professor COMMONS. I mean the price level for England which runs from about 106 in the middle of 1925 down to about 95 in the beginning of 1928.

What the percentage of fall is I can not figure quickly, but you see that there has been a very rapid decline and an increase and then another decline. These are cyclical changes, which are not so much on account of gold as they are on banks' operations, credit operations; but the trend has been, since 1925, down to 95 from 106.

Mr. GOLDENWEISER. About 10 per cent.

Professor COMMONS. About 10 per cent. So that, in order to get down to that price level, England had previously to retire her paper money and substitute gold. She had previously, in 1925, brought her prices down from 115 to 106. That would be another 10 per cent, practically.

So she had two causes of deflation, one the retirement of her paper money when she went onto a gold international level with the United States and the second a decline in the price level of the two countries on the gold standard.

Now, let us take the United States. At that time the United States price level was about 104, and it has come down, with certain cycles, so that at the present time it is 97, from about 98 or 97.

Mr. Goldenweiser, that does not quite work out with your commodity price level, which shows about a 10 per cent drop.

Mr. GOLDENWEISER. Ten per cent is to the low point.

Professor COMMONS. Since that time there has been an increase.

Mr. WINGO. You had better identify the low point for the record.

Professor COMMONS. The low point is about 94 in the middle of 1927. There has been since that time an increase in prices, in the price level, to about 96 in the beginning of 1928.

You will notice also that England is recovering, a rather belated recovery.

As to all these other countries, I do not know any of the special causes operating—Sweden, Switzerland, Germany, and the Netherlands. It will be sufficient for my purpose if this chart were drafted to include simply the United States and England.

Mr. GOLDENWEISER. We would be glad to draft it to cover the United States and England, to insert in your testimony.

Professor COMMONS. Thank you.

Now, the gold standard, then, may itself increase in value, so there will be two reasons for a decline of prices, one the retirement of paper money and the other the increased world value or, at least in this

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case, the free gold value of prices, which would indicate the price level.

If you will allow me to refer to this other chart——

The CHAIRMAN. That represents the wholesale price level covering a range from 1800 to 1928.

Professor COMMONS. This is already in Mr. Goldenweiser's testimony. I have a little different interpretation, Mr. Goldenweiser. This is the American price level. I do not know why it went up so high at that point.

The CHAIRMAN. What year?

Professor COMMONS. 1816 was the high point of our price level. The figures were very defective in those early days.

There are two things to notice, that in France there was no paper money. France remained on a silver basis; England went onto a paper-money basis, silver being the standard at that time. So we have the English price level here [indicating on chart], and you can see what the French situation was.

There was a relative scarcity of gold from that time down to the gold discoveries of 1849. We had here in 1836 a paper-money inflation, wild-cat banks in this country, which caused that cycle, but we have a continued trend of a falling price level, owing to the main fact that the mines were not keeping up in their production with the demands of business.

Then began the gold discoveries in 1849, and by the time of 1854, 1855, and 1856 we have a rise of gold prices.

There is no paper money involved in that. Then we have, as a result of the rapidly increasing gold prices, a world-wide depression, and the panic of 1857. Then we went into the war and the greenbacks jumped that level up in America, but if you had the German and British price level you would not it running along something like this [indicating on chart] down to 1879, when we got back to the gold basis. There was the gold basis, so you would have England running along something like this [indicating on chart].

Mr. KING. All that does not mean much in the record.

Professor COMMONS. From the low point in 1860 to the low point in 1896, omitting the American inflation of 1862 to 1879, would be the gold deflation in England and Germany.

Now, notice that there are three circumstances that happened in that decline in America: First, the rapid retirement of our greenbacks, which brought us down to this point, which is 1867. Congress stopped the retirement of greenbacks and has left that heritage of $346,000,000 in greenbacks. That caused an inflation, as I interpret it, which ended in the panic of 1873.

Then we have the continuous decline until we reached the gold standard in 1879, and that is the low point indicated. Having reached that standard, we have an expansion, which I would say was a credit expansion, an optimistic expansion of business, owing to this velocity idea, owing to the fact that business was optimistic,

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expectations were good. Then we had the decline. You will notice at this time what happened, the demonetization of silver.

The CHAIRMAN. Between what periods?

Professor COMMONS. It did not begin to show itself until 1879, and then up to 1896. Silver was taken out of the currency, so that we had then a strictly gold standard extending through here [indicating on chart 1879 to 1897]; that is, an abandonment of the bimetallic standard.

In 1896 there was discovered the cyanide process, by which low-grade ores could be made profitable, and consequently we have an increase in the quantity of gold, faster than the increase in the demands of business throughout the world, which, I take it, accounts for that upward trend from 1896 until the war, up until 1914. We were having then an increase in the gold owing to the cyanide process.

The CHAIRMAN. Which resulted in that increase in the price level.

Professor COMMONS. Yes; from about 68 in 1896–97 to about 100 in 1913—that is, about 45 per cent increase.

Mr. KING. I notice in about 1913 an immense rise, like a mountain peak, in the price level. Was not that the time of the adoption of the Federal reserve act?

Professor COMMONS. That peak starts in 1915; the Federal reserve act in 1913 and the war in 1915 started that.

This [indicating on chart 1896 to 1914] is the period that Mr. Luce spoke about of great unrest amongst consumers.

The CHAIRMAN. Between what dates?

Professor COMMONS. Between 1896 and 1914. This [indicating on chart 1879 to 1897] was the period of great unrest amongst the producers. Wholesale prices were falling——

The CHAIRMAN. Between what dates, Doctor?

Professor COMMONS. If we omit the cycles, it is this period from, say, 1879 to 1897, a general fall of about 20 per cent purely on the gold standard; if I had taken the paper standard, it would have brought me back to 1865, but purely on the gold standard it fell 20 per cent in the neighborhood of about 18 or 19 years, with some cycles intervening.

Now we have reached this period [indicating on chart], and our price level, after going through this index——

The CHAIRMAN. Do you mean the period of 1913?

Professor COMMONS. From 1913 to 1928. We have had an inflation which need not be explained. We have discussed that. We have now reached the point where the price level is running 150, 50 per cent above the pre-war level—that is, this [indicating on chart] being the pre-war level, 100. This point in 1913 is usually given as the pre-war level.

We are now on a price level of 150; that is, about 50 per cent higher than the pre-war level.

Mr. STRONG. Doctor, the bell is calling us to school now. I wonder if we could not adjourn until, say, 2 o'clock?

The CHAIRMAN. Without objection, I am going to suggest that we adjourn until 2 o'clock.

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Mr. KING. As I will be unable to be here this afternoon, I would like to ask just one question. Taking that indication of where the price level was in 1913, at the time of the adoption of the Federal reserve act, where would the line go so far as agricultural prices are concerned? Where would it run on your chart?

Professor COMMONS. The farmer was getting more than anybody else during that period [indicating on chart].

Mr. KING. I do not mean that period. I mean during the period where the line starts up.

Professor COMMONS. I mean this period from 1896 to 1914.

Mr. KING. I mean from 1914 on.

Mr. GOLDENWEISER. Agricultural prices went up higher than the others.

Mr. KING. Would you indicate it there with a pencil?

Professor COMMONS. There is another chart which Mr. Goldenweiser has here of agricultural prices.

Mr. GOLDENWEISER. I have it, but not that far back. It begins with 1922, so it would not cover the period that you had in mind; but agricultural prices went up about 10 per cent higher than the others.

Professor COMMONS. Mr. Chairman, if I might close at the point that I started with, the question for the future, then are our prices going to fall again because of a limitation of the future gold supply? Is the price level going to fall from 150 down to 100? Or will there be such an abundance of gold that the price level may start up again? That is the question of prophesy as to the future gold supply.

My notion is—and I am just like Mr. Goldenweiser or anybody in this—that the gold production is not going to keep up with the new needs of the population if we go to a full gold standard. If we maintain a managed or gold exchange standard, we can keep prices from falling.

The CHAIRMAN. The committee will adjourn until 2 o'clock this afternoon.

(Whereupon, at 12.20 o'clock p. m., a recess was taken until 2 o'clock p. m.)

AFTER RECESS

The committee reassembled at 2 o'clock p. m., pursuant to recess.

The CHAIRMAN. The committee will come to order. Doctor Commons, you may proceed now.

Professor COMMONS. Mr. Chairman, I want to clear up something that I was speaking about from memory this morning, about the rates of discount from 1917 to 1921. I was intending to give not the rates on commercial paper but the rates on Government collateral.

There were two rates in operation during that period from 1917 to some time in 1921, a low rate on Government collateral and a higher rate on commercial paper. Usually we have been taking the commercial rate, and in my exhibit last year, page 1077, I used the commercial rate. Properly considered, one should use the rate on Government collateral, because I find that during that period of 1919, when we had the greatest inflation, 90 per cent of all the borrowings

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by member banks, the total holdings of the Federal reserve system, were on Government collateral, and only 10 per cent were commercial paper. I have drawn a chart which shows the change in proportions, showing that the Government collateral had a lower rate, one-half of 1 per cent, and that whenever the rate was changed on commercial paper the rate on Government collateral was changed so as to keep the same differential. However, in 1920, when the commercial rate in New York went up to 7 per cent, the rates secured by Government collateral went up only to 6 per cent, a differential of 1 per cent. That distinction or discrimination of one-half of 1 per cent in favor of Government collateral continued until about June, 1921, when the two rates were combined into the one rate on both classes of paper. So that since 1921 the two rates have been combined and no distinction is made.

Mr. WINGO. You had better give them some kind of legend.

Professor COMMONS. This is headed "Federal Reserve Bank Holdings at the End of the Month, 1917 to 1928."

The CHAIRMAN. Doctor, this morning you referred to a discount rate of 3¾ per cent. Is that correct?

Mr. WINGO. Three and one-half.

Professor COMMONS. I will introduce this other exhibit——

Mr. WINGO. If you will pardon me right there. I think it was 3½ per cent in 1919, wasn't it, that you said this morning?

The CHAIRMAN. I think you mentioned the rate of 3½ when you meant 4¼.

Professor COMMONS. It should have been 4¼. That was an error of memory which I have corrected by introducing this chart.

Mr. WINGO. You said 3½. I take it you really meant 4½?

Professor COMMONS. I meant 4¼. The commercial rate is 4¾ during 1919, but rate on Government collateral is 4¼.

I will introduce this chart, which shows it differently from my morning statement. This exhibit is, "Money rates at New York," showing the differential rediscount rates May, 1917, to July, 1921, and the dates are from 1917 to 1928.

Now, the point is simply this: My argument of the inflation of prices is based on a continuously low rediscount rate of 4¼. Take the usual statement; it would have been 4¾ during the year 1919, but it should be put at 4¼, and so on, because 90 per cent of the borrowings were secured by Government collateral and only 10 per cent by commercial paper. (See Chart III.) I introduce that as an effort to correct what I said this morning from memory—that the rate on Government collateral was 3½ per cent.

Mr. WINGO. Do you want to introduce these in the record—these charts?

Professor COMMONS. I thought may be Mr. Goldenweiser could furnish you that. I will introduce this one as an exhibit.

The CHAIRMAN. Without objection, it will be placed in the record at this point.

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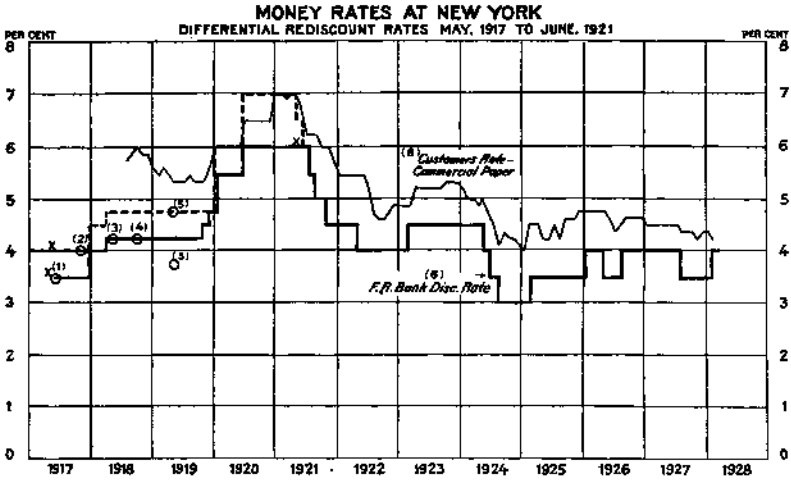
(The chart referred to is as follows:)

CHART II

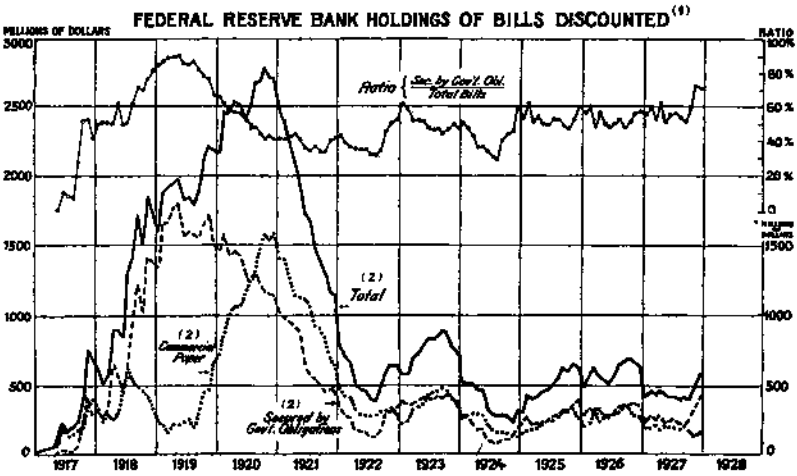


(1) First Liberty loan, 3½s.
(2) Second Liberty loans, 4s, and first Liberty loan, converted, 4s.
(3) First Liberty loan, converted, 4¼s; third Liberty loan, 4¼s.
(4) First Liberty loan, second converted, 4¼s; fourth Liberty loan, 4¼s.
(5) Victory loan, 4¾s; Victory loan, 3¾s.
× From May, 1917, to June, 1921, a differential rate was charged for bills discounted secured by Government obligations and for bills discounted secured by commercial paper and rediscounted paper.

The CHAIRMAN. We will number these charts No. 2 and No. 3. Without objection, they will be inserted at this point. We will begin with the charts that were inserted this morning and number them 1, 2, and 3. The last two are the ones that Doctor Commons just placed in the record at this point.

(The charts referred to are as follows:)

CHART III



(1) End of month figures from the Federal Reserve Board.
(2) Includes bills discounted and member banks collateral notes.

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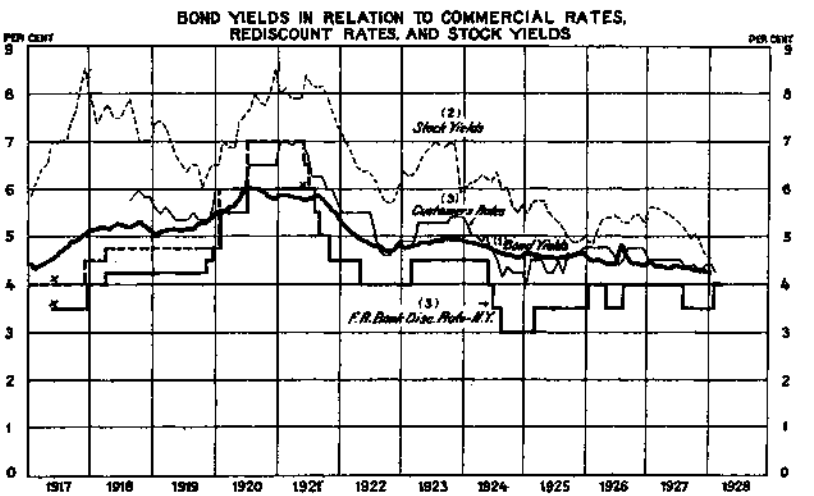
Professor COMMONS. While I am on that point, I should have a chart to show how low a rate that was [producing another chart]. To determine whether that was a low rate or not, we should compare it with the bond yield. If we do that, we find that the bond yield along in 1919 and 1920 ranged from 5 per cent to 6 per cent. So that any discount rate below the bond yield rate would be a low rate of commercial discount, and would tend to have an inflationary effect.

The CHAIRMAN. Without objection, this chart will be inserted in the record at this point, and will be properly numbered.

(The chart referred to is as follows:)

CHART IV



(1) Yield on 45 high-grade bonds from Carl Snyder's "Business Cycles and Measurements," p. 205, from 1917 to 1925, and brought to date by the same method.
(2) Standard Index of Industrial Common Stock Yield from the Standard Trade and Securities Service.
(3) From the Federal Reserve Board.
X From May, 1917, to June, 1921, a differential rate was charged for bills discounted secured by Government obligations and for bills discounted secured by commercial paper and rediscounted paper.

The CHAIRMAN. The rates that you just referred to were of the Government bond yield?

Professor COMMONS. No. That is the rate which I took from the Standard Statistics Corporation, showing the average bond yield on certain selected bonds.

The CHAIRMAN. Stocks, not Government securities?

Professor COMMONS. Not Government securities. No; they are not Governments. If you can see this chart at that distance, you will see that running along there is a dark line. That is the bond yield. I might say that the bond yield is what we may call the point of transit. If the commercial rate goes above the bond yield, then I would say it would be a high rate. If it goes below the bond yield, it would be a low rate. So I have traced the commercial rates with reference to the bond yield, showing whether they are above or below.

Mr. WINGO. When you speak about the bonds, I understand that you mean corporate bonds and not Government bonds?

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Professor COMMONS. Corporate bonds, not Government bonds.

Mr. WINGO. When you speak about the bond yield, you mean the corporate bond yield, not the Government bond yield?

Professor COMMONS. It means the yield which investors expect on corporate bonds. Whenever the commercial rate is higher than the yield that investors expect, I would expect it to cause a deflation of commodity prices. This really goes back to the theory of Wicksel in 1898, and I have tried to apply it. I could go into the reasons for it a little later to show the correlation between the bond yields and the stock yield.

This is also the method used by Colonel Ayres, of the Cleveland Trust Co., with its bearing on the prices of stocks.

The CHAIRMAN. Well, Doctor, in view of what you have said now it would seem to indicate that the present Federal reserve rate is low?

Professor COMMONS. The Federal reserve rate is below the bond yield rate; yes, sir. The rediscount rate at New York, is 4 per cent, and the bond yield has gotten down to a little above 4. So the rediscount rate now is low but the commercial rate is the one I measure by. That indicates easy money, which is just exactly what the situation is—a situation of easy money.

Then I have a curve here of the stock yield, which I will go into later when I compare one other point, the stock market and the commodity market.

To complete my remarks this morning—I am not certain whether I got at this point with this chart——

The CHAIRMAN. Being the chart of wholesale prices from 1800 to 1928 which was placed in the record yesterday by Mr. Goldenweiser, now being referred to by you?

Professor COMMONS. Yes. Now, the gold prices have reached 150, where the pre-war level was 100.

Really the practical question before the banking system of the world is whether we are going to have a repetition of what happened during these two long trends, 1816 to 1849 and 1865 to 1897, or whether we can for the future stabilize it at 150. If we don't stabilize it at 150, then the price level will come down in the future owing to the scarcity of gold until—what level it will reach nobody knows—but the tendency would be, barring these credit cycles, the tendency would be to continue the depression until the whole world is on a free-gold basis.

The CHAIRMAN. I was going to ask you right there, Doctor, in connection with the remarks made by Governor Strong the other day, in which he advocated, of course, a return to the free gold basis throughout the world: Now, suppose that that takes place. What effect would that be apt to have on this wholesale price level? Would it have a tendency to lower it or hold it stable or a tendency to raise prices?

Professor COMMONS. I would say that over a period of 10 years or more it would cause it to fall continuously, because the gold production is not keeping up with the increased demands of the world for gold for monetary purposes, that increased demand being due partly to the high prices and partly to increased production and population.

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The CHAIRMAN. If we maintain our present situation with a surplus of gold and the management of the Federal reserve is applied to stabilize it, it would have a tendency to hold the price level at its present point, would it not?

Professor COMMONS. At its present point.

The CHAIRMAN. Approximately 150?

Professor COMMONS. 150.

Now, I say that if we go to a gold standard, as Governor Strong described it, we will have a continuously falling price level, as we did in this period [indicating on chart]; I refer to the period of 1879 to 1896 and 1820 to 1849.

Mr. STRONG. You mean 1899?

Professor COMMONS. No; 1879 to 1896. Or from the period about 1820, when England resumed the gold standard, down to the discovery of California gold in 1849. There was thereafter an increase of gold, of course, as I was saying this morning.

Now, my idea about that is this: If we should have a managed currency, with the United States controlling it, it would have to be by cooperation with foreign banks of issue. Those arrangements would have to be made. It could be so arranged that the price level need not go below a reasonable fluctuation around the 150 level. Nobody knows anything about the future gold discoveries, but look at the alternative——

The CHAIRMAN. Right there, Doctor, may I ask you this: As the price level has fallen during this period, giving gold a greater value, would not the production of gold tend to increase?

Professor COMMONS. That is quite likely, and it has increased. I think that you were told yesterday that in the last year it has increased over the previous year. There will be a tendency to increase the gold production.

Mr. STRONG. Doctor, you were speaking about the alternative.

Professor COMMONS. The alternative is this: Suppose we have some other new discovery, some great discovery of gold. It would have the effect again of raising prices, as the cyanide process did from 1896 to 1914, in which case this bill would come in operation to prevent that inflation from gold mining from inflating the world price level. If, on the other hand, there is, as I predict, a diminishing quantity of gold—that is, a greater scarcity of gold relative to business—it should tend to bring the prices down. But the purport of this bill, requiring a stable gold standard when international arrangements are made, would tend to prevent that deflation and maintain stability.

In either case, whether the prophets of a gold increase are right; that is, whether there is a production of gold increasing faster than the needs of business, or the prophets of a gold decrease are right; that is a production of gold increasing less than the needs of business—either one of them would be cared for by the present bill, which recognizes the agreements and understandings of foreign banks. That, I say, would be necessarily a managed currency, with all of the difficulties, which I do not underrate, which were mentioned by Governor Strong; that is, a great distrust of the ability of mankind to manage anything. He prefers to get back to an automatic level, where the free flow of gold will——

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The CHAIRMAN. Does that mean this, Doctor, that we might return to the basis of 1913, where the price level——

Professor COMMONS. That is my idea of what the present tendency is.

The CHAIRMAN. And then the only thing that would obstruct that from going back to normalcy which would be influenced by the return to the gold standard would be the management of the operation of the contral banks?

Professor COMMONS. The central banks, of which the United States is now the controlling factor.

Mr. WINGO. Don't both you gentlemen overlook the fact that you are living in an entirely different industrial world now? Take one factor, the multiplication of machine power and the comparison of machine power to man power relatively, which has been accelerated or, rather, pyramided so rapidly since the war that you know now that you can not have anything like as low a level of production relatively to world population that you had in 1913.

Professor COMMONS. What is your inference from that?

Mr. WINGO. My inference is that you will not have the same conditions existing, and therefore you need not look for the same level, because—you take one big factor. One big factor is the operation of the increased man power as translated in machine power. It will give you such a great production to the same man power that the volume of production is bound to have some effect on the price level.

Professor COMMONS. And to cause the price level to fall?

Mr. WINGO. You think it is more apt to accentuate it?

Professor COMMONS. Whose inference is that?

Mr. WINGO. I don't know. I am just calling attention to conditions not being the same as in 1913, and that your idea was going to affect the probability of returning to the 1913 price level.

Professor COMMONS. Do you think that with increased efficiency of industry prices will fall? That is what your theory amounts to.

Mr. WINGO. Well, I don't know; I'm not doing the theorizing.

Professor COMMONS. Mr. Goldenweiser thinks prices would fall. It is the argument of the Federal Reserve Bulletin that with an increase in efficiency prices will fall, and they put that forth as justification for the fall of prices since 1925 of about 10 per cent. They make an estimate that the increased efficiency of man power in this country owing to machinery and the rapidity of communication, and so on, has increased output 10 per cent, just about equal to the fall in prices.

The question then arises, Is a fall of prices necessary along with increased efficiency? I say no; because you have to take into account that on the one side is money and credit and on the other side is the output of this increased efficiency. Now, if money and credit keep up relatively to the output, there is no reason why prices should fall on account of increased efficiency.

Mr. WINGO. Whether that is desirable or not depends upon whether you belong to the debtor or creditor class?

Professor COMMONS. That is not the sole question.

The CHAIRMAN. You have increased by that development of efficiency the consumption and larger percentage of profits to the manufacturers and producers, and you have also increased the wage level? It has had a tendency to do that, has it not?

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Professor COMMONS. Those who advocate this reduction of prices to correspond with the increase of efficiency, looking at it from the consumer's standpoint, think that in that way we salaried people would get more. The creditors will get more, because our money will buy more.

Now, suppose you look at it from the standpoint of the producers. The producer is the business man who borrows, and the producer is the wage earner who works for him. If you take the increase of production and of employment and the decrease of production with unemployment, you will find that they coincide quite closely with the rise and fall of prices. That is, as prices rise profits increase and employment increases, not necessarily wages; but employment increases, and that means that it resolves itself into this question: Is the laborer gaining more by an increase of wages per day or by an increased amount of employment per year? He and the employer are partners in that.

On the other hand, when prices fall you will nearly always find that, on the whole, profits are decreasing and the business men are laying off their employees. The rate of wages has not fallen, but the amount of employment has fallen; so that while the employee may maintain the higher rate of wages per day or per hour, yet he may lose two or three months of work on the average.

Mr. WINGO. As to the volume?

Professor COMMONS. As to the volume of the amount of work he does. And furthermore, he can never be a consumer unless he has earned something as a producer.

So, I say from all standpoints that the public interest should be directed toward the stability of prices for the business man which enables him to look forward to his production, not to overproduction or underproduction, but to get a steady line of production. And as to that standpoint I would include under that, of course, the farmer as both an employer and an employee, performing both functions.

On the other hand, all employees whose rate of annual earnings——

The CHAIRMAN. Doctor Commons, in connection with Mr. Goldenweiser's talk he referred to the result of increased efficiency in the production of automobiles; and he said that because of that increased efficiency the prices of automobiles had been reduced; and if I understood him correctly he stated that where one person had one automobile prior to that time he now had two. Now, is it to be inferred that the farmer would suffer from the decline in the price of automobiles?

Professor COMMONS. Not at all. Efficiency should be encouraged. And I think that the stability of prices will be the greatest encouragement that can be given to business, because there would no longer be gambling with a rise and fall of prices that they have no control over, but they will make their profits out of their own efficiency.

The CHAIRMAN. Does this increased efficiency, as in the development of electric energy and all these new appliances, mean, as some people suggest, that instead of working six days a week it will mean four or five days a week?

Professor COMMONS. It might be very likely.

The CHAIRMAN. And that the people of this country will enjoy more leisure than heretofore?

Professor COMMONS. It might be.

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The CHAIRMAN. That is a possibility, isn't it?

Professor COMMONS. It is a possibility. There is a possibility of shorter hours and a shorter week.

The CHAIRMAN. With a reduced production?

Professor COMMONS. No; an increased production, if the efficiency of the country increases faster than the reduction of hours.

The CHAIRMAN. But there would be a corresponding lowering of the hours spent in production?

Professor COMMONS. Yes, sir; on condition that the price level does not fall. Look at the employer who has increased his efficiency; look at the employers as a class. Say they, as a class, increase their efficiency 10 per cent. At the same time the price level falls 10 per cent. What reward is there for their efficiency as a class? It has all been taken away from them. There is no premium on efficiency for them as a class if the price level falls. They are in just as severe competition with each other as they were before.

But, if, on the other hand, the price level remains stable, then they get the difference as a class between this price level, this constant price level, and the reduction of the cost which they have made. That is their efficiency earnings; that is a real earning, or income, to which they are entitled. It benefits the community. Furthermore, it benefits the wage earner, because his employer is more likely to be willing to advance his wages if he is making more profits.

But if all these prices fall, as happens to be the case for the last two years, he inevitably must lay off his men, and he has more severe competition, and the inferior ones will be wiped out. The question really resolves itself into a big social question as to who you think ought to be benefited by the stabilization or rise or fall of prices.

Mr. WINGO. Wouldn't that be an argument in favor of stabilization—that if you stabilize and maintain prices on a stable level, then in the long run over a long course of years both the creditor and debtor classes will adjust their business to that level and you will avoid a penalty upon one and a premium to the other that always comes from fluctuation?

Professor COMMONS. Yes; and I apply it not only to the creditor and debtor, but I apply it to employer and employee. The laborers will benefit by having more steady employment and the business men by getting their profits out of efficiency instead of speculation.

Mr. WINGO. And it is axiomatic also that if you reduce the risk you decrease the margin in doing business?

Professor COMMONS. Well, generally the fall of prices is something that the employer can not control. He has no control over that.

Mr. WINGO. None at all?

Professor COMMONS. I contend that it is the banking system of the world that controls that.

The CHAIRMAN. This question has suggested itself, Doctor: Does the individual producer who has been able to increase efficiency and more production because he always seeks higher sales by lowering the selling price—how could stabilization offset this kind of situation?

Professor COMMONS. That gets back of the whole question of the difference between a particular price and an average of all prices. We are not going to increase credit to help just one man or one class of people, or we are not going to restrict it because one class of

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people are getting higher profits, and so on. We are going to have our eyes on the average of all. That is, money and credit stand over against the average of all prices.

Remember that these prices that are set out in this index do not include automobiles and highly manufactured or processed commodities; they include staple commodities which have a standard quality. That would make it possible, even if they should rise at all, as Mr. Goldenweiser explained yesterday, it would make it possible for this greatly increased processing which goes along in this unstandardized commodity like automobiles, and so on, to increase their sales and profits through more steady employment in all industries. But they do not enter into the index number or could not in a workable index number——

Mr. GOLDENWEISER. The Department of Labor has automobiles in its index number.

Professor COMMONS. In the index which you put in now?

Mr. GOLDENWEISER. In the index.

Professor COMMONS. That is one reason why I want to have that index number investigated.

Mr. STRONG. Do you mean investigated by——

Professor COMMONS. By the Federal reserve system.

Mr. STRONG. That is set up in this bill?

Professor COMMONS. Yes.

The CHAIRMAN. Reverting to the return to the world-wide gold standard, which I think we can reasonably assume is the tendency and is being encouraged by the management of the Federal reserve system here as a proper thing to do. That movement is proceeding. Supposing such a measure as is now under consideration should be enacted at this time, it would divert, would it not, a return to a world-wide gold basis; or, at least, if this law was applied to the direction of the Federal Reserve Board, it would be applied in the direction of holding up the general price level?

Professor COMMONS. The world-wide price level.

The CHAIRMAN. To that extent, then, it would be in conflict with the natural law which would be in operation by a normal return to a world-wide gold basis, would it not?

Professor COMMONS. It would not interfere at all with any natural law. All the countries that care to keep their gold-exchange standard could do so, which includes, you must remember, a very large part of the world—India, all of South America practically, all of the minor countries of Europe, and partially includes Germany on a partial gold-exchange standard, and I think all the continental banks have provided for either complete or partial gold-exchange standards. Now, considering that in connection with the proposition that all of these countries have central banks that manage these gold-exchange standards, my idea is that the supply of gold will go much farther and would not necessarily cause this reduction of prices. It would still be a gold standard, but there would be also many varieties of a gold-exchange standard.

I notice in reading recently the law providing the gold-exchange standard for Bolivia, as worked out for them by Professor Kemmerer—he doesn't call it an exchange standard; he calls it a gold standard—Bolivia is on a gold standard, and yet they haven't a cent of gold in the country for monetary purposes.

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The CHAIRMAN. The same thing is true of Poland, is it not?

Professor COMMONS. Yes; I think Poland and Austria certainly are the same.

Mr. WINGO. Let me ask you why they haven't any gold in Bolivia. For all practical purposes, measured from the standpoint of the "pull" of the demand upon supply, there is to a slight degree that "pull" of the demand on the gold there is in the United States? It would just simply lessen or make it relatively not quite so great a "pull" on the supply? Isn't that true?

Professor COMMONS. As I understand it, they can carry a balance in the New York banks, say, of $15,000,000. That is like any other deposit. The New York bank has its reserves in the Federal reserve system in whatever form it may be. Now, if Mr. Goldenweiser's statement is correct, that there can be eighteen times as much credit outstanding in the American banking system, eighteen times as much bank deposits as there is gold reserve—I think I understood him to mention it that way—then you can see that the demand on gold is only one-eighteenth of the total needs of business. Bolivia is on a gold-exchange standard, equivalent to a gold standard, even though they have no gold down there. The $15,000,000 that they have in the New York bank can go down there at any time as their reserve, if they can afford it.

Mr. WINGO. While it is true that it is less, still there is a certain pull on the supply of gold?

Professor COMMONS. Oh, yes.

Mr. WINGO. Assume that they carry out the plans that they have in view to put the world back on a gold standard, either actual or managed or otherwise, in spite of that management won't there ultimately, unless there are some artificial checks, some ingenuities of management, won't there ultimately flow from the United States in the next 5 or 10 years some of this gold that we have?

Professor COMMONS. I think that I should have to disagree with Mr. Goldenweiser on that point. It all depends on whether he had in mind a gold managed or gold actual standard; that is, Mr. Strong's full gold reserve in each country.

Mr. WINGO. Will you give your views on that?

Professor COMMONS. My views are that unless we have a world-managed gold standard, with many countries on a gold-exchange standard, we shall have a continuous fall in the world prices. Does that answer your question?

Mr. WINGO. Yes; only it doesn't go quite far enough.

I think it is assumed that we intend to have a managed gold standard or an exchange-gold standard in most of these countries. My contention is, or, rather, I got the idea—not my contention, because I don't know enough about it—but I got the idea that notwithstanding the fact that we put in this managed gold standard, that while you may not take quite as much gold from us as you would if you had a free gold standard, yet there will ultimately be compelled a certain amount of gold to go out even under a managed gold-exchange standard. Is that not so?

Professor COMMONS. It is not necessary if those countries are willing to trust New York and London. If they thought that the bankers there would confiscate their property, they would not do it. But

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I see no reason why they could not remain on a gold-exchange standard.

Mr. WINGO. Under that managed gold-exchange agreement they could, if they insisted on it, demand actual gold, couldn't they?

Professor COMMONS. I presume that the banks in New York, if they were drawn on for gold—I am not certain about it, and as to the terms of those gold-exchange agreements I would have to——

Mr. WINGO. Let me give you this suggestion: While we did not send out the two hundred million in gold under the agreement that we had with the Bank of England—my recollection is that we did not send that out at all——

Professor COMMONS. No.

Mr. WINGO. Yet, they had a right to demand that two hundred millions in gold at any time that their conditions or necessities required it?

Professor COMMONS. Yes.

Mr. WINGO. My understanding on these other agreements is that they are on practically the same basis; and I assume that they took that as the standard in making the same arrangement with other nations.

Professor COMMONS. Presumably you are correct.

Governor YOUNG. That is true, Mr. Wingo.

Mr. WINGO. These countries have practically the same kind of arrangement with the several banks of Europe.

Governor YOUNG. Mr. Goldenweiser explained that. He says that it is a little different from the English agreement.

Mr. GOLDENWEISER. They are distinctly different for this reason: All the other agreements are purely agreements to buy bills of exchange for the account of those banks if they so desire. The English agreement was one to sell gold to them on credit. All the other agreements are agreements to buy acceptances from those banks if they choose to sell them.

Mr. WINGO. Yes; and we not only agreed to sell them gold on credit, but that carried with it that the credit should be put off by our maintaining an average amount of their bills purchased.

Mr. GOLDENWEISER. It had an alternative, though. It had that alternative to which I called Governor Strong's attention. The other agreements are different in that they do not directly call for gold, but they call for an agreement to buy acceptances from the Bank of Belgium and the Bank of Poland as those banks may desire.

Mr. WINGO. I can reach the same thing a little differently. Suppose that under those agreements they should find their necessities such that they should demand actual gold. They could get it under those agreements, couldn't they?

Mr. GOLDENWEISER. They could buy those bills with gold if they choose; yes.

Mr. WINGO. If they bought those bills and they were gold bills they could demand gold, couldn't they?

Mr. GOLDENWEISER. Well, now, I think they could get gold. Not just the way you say, but they could sell the bills and ask gold in exchange.

Mr. WINGO. Anyway, whatever may be the details by which they get it—and as I understand it, it would probably be to their interest

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not to do it—but I am speaking about the possibility. There is all the time a possibility that changed conditions in anyone of those countries might make them feel like it was their duty to themselves, whatever might be the machinery, to bring actual gold there and take it away from us?

Mr. GOLDENWEISER. Yes.

Mr. WINGO. And if that happened, I think we would all agree that it would reduce our supply of gold approximately a billion dollars if all of them should do it in the next few years to maintain their standard over there. Did you get that proposition?

Professor COMMONS. I say that this bill contemplates, and it must necessarily contemplate, agreements with foreign banks of issue regarding the policy of gold.

Mr. WINGO. May not that also be necessary not only with the gold standard—maybe I am pointing out an effect and describing it as a cause—I notice on the chart that we had before us this morning, entitled "Wholesale Prices in the Principal Countries from 1925 to 1928, Inclusive," I notice quite a strong similarity in the wholesale prices of the principal countries. It seems to be practically the same with the exception of temporary contradictions. That is true, isn't it?

Professor COMMONS. It looks that way.

Mr. WINGO. I don't know whether that is the effect of the management of those or whether the effect of other things brought about this wholesale price level. But, anyway, there is an interlocking of business the same as there is an interlocking of our use of gold, which would make it necessary to manage from our own standpoint these standards of those countries.

Now, getting back to this same chart here, I notice that in the year 1927 the line which indicates the wholesale prices in the United States starts at the beginning of the year at about 98 and goes down to a point somewhere in May about 93. Then it runs along until along about November, October of November, it gets up to about 97. Then it starts going down. Did you realize that from January to about May, when that drop was going on, did you realize that that was a permanent downward trend, or did you think it was just a temporary recession?

Professor COMMONS. I could not guess.

Mr. WINGO. You did not?

Professor COMMONS. I agree with Mr. Goldenweiser entirely on that.

Mr. WINGO. I understand that you agree that at the time, at the passing moment, it is impossible to determine whether it is a temporary increase or decrease in price or whether it is a permanent swing one way or the other? You can not tell on that?

Professor COMMONS. May I explain?

Mr. WINGO. Yes.

Professor COMMONS. If you straighten out that cycle, you necessarily straighten out the trend.

Mr. WINGO. I noticed, from what you said a moment ago, that if we do not have this bill or some other device by which to stabilize prices, in your opinion there is a tendency or an expectation of a continued downward trend of the price level?

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Professor COMMONS. That is my idea of it.

Mr. WINGO. Is that contemplated by the other economists? Do they think that the general trend is downward?

Professor COMMONS. I think that probably we might divide the economists somewhat into two classes; that is, those who are in favor of a stabilization, like Ohlin and Cassel, foreign economists, and similar economists in this country, like myself, who are expecting a scarcity of gold, in that gold is not going to keep up with the demands of modern business; and those who are not afraid of the situation, like Mr. Goldenweiser and Governor Strong. They must have in their minds that there is going to be an abundance in the future supply of gold.

The CHAIRMAN. Is that confidence inspired by the fact that they have discovered that countries can go back under the gold basis by going back under a gold-exchange basis, and therefore will not take as much of the metal as they otherwise would?

Professor COMMONS. Well, no. My idea is something like this: We can make a contemplated return of all countries to a full gold reserve, the gold being in each country separately, which would necessarily reduce the supply of gold relative to the demands of business, and thus reduce prices. They can contemplate that situation without a fall in prices, providing they have some confidence back of them that there is going to be an increased quantity of gold to offset that accumulation of gold reserves in the central banks.

The CHAIRMAN. But if they haven't got that it means that in the final analysis we will have to have management, does it not, of the gold?

Professor COMMONS. My interpretation is that in either case it means management, whether the gold increases or not. If the gold increases, we have got to manage it to keep it from inflating the currency. For example, if we want to get rid of the thing that happened in this period here, from 1897 to 1914, if we want to get rid of gold inflation, or if we want to get rid of gold deflation, which is a relative scarcity of gold compared with the demands of business, if we want to get rid of either of them, we shall have to have a managed currency.

The CHAIRMAN. You spoke a moment ago about this general movement to get back on the gold basis or gold-exchange basis; that is, some countries; and you said that the confidence that these countries might have in the management of the central banks of New York or London was a considerable factor. Just what did you mean by that?

Professor COMMONS. Considerable factor in what? In their agreements?

The CHAIRMAN. In their agreements.

Professor COMMONS. In their readiness to make agreements?

The CHAIRMAN. Their confidence; yes.

Professor COMMONS. To get back to the gold standard?

The CHAIRMAN. Yes.

Professor COMMONS. Well, I think that was pressed upon them by the necessities of the world. They must get back to a gold standard.

The CHAIRMAN. Well, of course, there is a large amount of gold that we have now, New York being the world's money center; and leadership is bound to be exercised there?

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Professor COMMONS. In this country?

The CHAIRMAN. Yes.

Professor COMMONS. Yes; I think so.

The CHAIRMAN. Therefore, the management that is exercised by the Federal reserve system, if it would prevail on the other banks of issue of these different countries of the world, they are going to acquiesce largely in that leadership. If, on the other hand, the Federal reserve system were poorly managed, lacking confidence in the system, what would be the natural consequence of that?

Professor COMMONS. If we can not establish confidence, of course we can not do anything. You have got to have international confidence. There is no question about that.

But I think in this way: It would be easier to bring these countries to a gold standard if they knew that the Federal reserve system was going to prevent a fall in prices, that it was going to prevent a rise in the value of gold.

England did not pay attention to that when she came under the gold standard. She did not consider whether through the influence of the Federal reserve system or other influences the value of gold was going to be increased. So she doubled her burden of getting back under the gold standard. She got under a rising gold standard and a falling price level, instead of a stable-price level.

Mr. WINGO. Did she really have any choice, or was she compelled to do it?

Professor COMMONS. I was talking with an English investor in this country who belongs to the Liberal Party. He said to me that a great mistake was made by England when she made that gold settlement, that debt settlement with us, in that she did not attach an index number of prices to it.

The CHAIRMAN. I know that when I was in London last December discussing the Senate amendment, there were two theories or lines of thought on that subject. On one side, as you say, there was the same line as the Liberal Party and the Labor Party, criticising the Baldwin régime, what you can term the Bank of England viewpoint. That included a large part of the industrial interests of England. Their expression, as I termed it, was to the effect that England had been forced back under the gold basis prior to the time in which they thought they were ready. The industrialists and liberals felt that if they were forced to stabilize at that time, they should have stabilized on a $4 basis instead of $4.86 basis.

Professor COMMONS. Then they would not have had falling prices.

The CHAIRMAN. They would not have had falling prices, and it would help to rehabilitate more rapidly without the hardships that exist to industry in England. On the other hand, the theory of the class supporting the Bank of England is the opposite to that.

Mr. WINGO. I have had that contention made to me. I remember it was made by one gentleman. I asked him, "If you were to be stabilized on a $4 basis instead of a $4.86, you would not have been on a gold standard; you would still have been at a discount?"

The CHAIRMAN. There is a certain school over there that feels that the amount of inflation which would have been permitted under that would have given them just the impetus that was necessary to have rehabilitated their industrial situation quicker than they have been permitted to do.

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Professor COMMONS. Italy is going now to a gold standard. But its lire is not worth 19 cents; it is worth 5 cents. Belgium has gone under a gold standard, but it is not a franc that is worth 20 cents; it is a franc that is worth 4 cents, isn't it?

Mr. GOLDENWEISER. Two and half cents.

Professor COMMONS. Two and a half cents. Still, they are on a gold standard. They have greatly defrauded their creditors. All right. But still they are on a gold standard.

Mr. WINGO. I don't want to interject my opinion, but I can not conceive of how they are ever going to get back on a gold standard until they can get to par.

Professor COMMONS. That is the way Mr. Baldwin thought and others thought.

Mr. WINGO. The lire down there ought to be worth 19 cents, ought it not?

Professor COMMONS. That is what Mussolini attempted to do. Mussolini attempted to reduce the excess of paper money until they could get the lire back until it was worth 19 cents in gold. He kept that up and brought the lire up from about 2½ cents to 5 cents. By that time the whole industrial population, including all the business men, you might say, of Italy, poured in upon him, and he changed his mind overnight and said, "We will stop at this point and we will not go any further." The lire was then up to 5 cents. There are some things which even a dictator can not do, you know.

Mr. WINGO. I don't think that a dictator can do any more toward stemming the operation of natural laws than Congress can do. Congress frequently tries to do it. They may divert the channel of the law, but they won't really change the permanent effect. That is, they can only make or alter the conditions under which natural laws operate.

Professor COMMONS. Do you think it is a natural law that the lire should be worth 19 cents in gold?

Mr. WINGO. I got the impression somehow that that was the standard. That was my impression.

Professor COMMONS. There is nothing natural about it.

Mr. WINGO. Was it an arbitrary standard to start with?

Professor COMMONS. Arbitrary; yes.

Mr. WINGO. Did the law provide for so many grains of gold?

Professor COMMONS. They arbitrarily said that 19 cents gold shall be a lire. Now they say that 5 cents of gold shall be a lire. Both are arbitrary. There is no natural law about it. But both are on the gold standard.

Mr. WINGO. Well, to get back to this proposition: As I understand it, the school of economists to which you belong contend that this bill will not only eliminate temporary fluctuations in the price level but will check what you fear to be a disastrous downward trend in the long-term swing of the price level?

Professor COMMONS. I don't say that it absolutely will. It depends upon the management.

Mr. WINGO. You hope that it will?

Professor COMMONS. I hope that it will. It gives a direction to the Federal reserve system to use all of its powers to do that very thing.

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Mr. WINGO. And the school to which you belong believes that unless something of that kind is adopted, the downward trend will be a bad thing?

Professor COMMONS. It will be a bad thing.

The CHAIRMAN. Doctor, in that connection are you speaking of the price level in the United States?

Professor COMMONS. I am speaking now of the world price level.

The CHAIRMAN. You believe that a bill similar to this would, of course, enter into the world stabilization?

Professor COMMONS. Yes.

The CHAIRMAN. Wouldn't it?

Professor COMMONS. Yes.

Mr. STRONG. You think that the power is there? It is simply to have it directed to such a use?

Professor COMMONS. I think they have full legal power. There is no question about that. They have power to make these agreements with foreign banks. That is one great power. They have power to make arrangements with those banks if necessary to determine the rates of discount, so that there will be a certain ratio between the rates of discount. If gold starts to go to one country, they by agreement about changing the rates can almost stop the movement of gold, providing they have an agreement or a mere understanding.

Mr. WINGO. Still, there is a distinction between the power and the exercise of the power. A blind man may have the power to walk out of this window, but it would be criminal for me, if I had charge of him, to allow him to do so.

Professor COMMONS. What is your application of that?

Mr. WINGO. My application is that there is quite a distinction between the Federal reserve banks having the power to buy and sell gold to foreign countries and to pay all of the countries' foreign bills, and telling them to bend their energies to detracting from their inherent duty to serve commerce and agriculture and the needs of the country as represented by the pressure upon them by the member banks, and going out in the world and trying to stabilize the world currency and put the world central banks back on a gold basis and furnish the world central banks with a basis for a gold issue.

Mr. STRONG. That is what they are doing now.

Mr. WINGO. The reason I say that is that I feel that there is quite a distinction between the two propositions. There is quite a distinction between my recognizing that in the past I have given somebody power to do something, and then for me to come along and not only give him power to do that, but for me to direct him to do it. That calls for determination of whether I think that policy has been wise. It may be right in some instances.

Take this English case, for example. I thought we might all agree that that was proper from a selfish standpoint at the time. But I notice that sooner or later we start on this course, and I fear that we will reach that point where there will be a very decided and sharp division of opinion among the people of the United States as to whether some other arrangement will be made, some unwise one; and I am afraid, knowing the tendency of the American people,

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measured by their actions in the House, that regardless of their wisdom or their conclusions, if they act upon that conclusion, it will have a very serious effect upon the management of our domestic credit system, because they can bring pressure to bear upon this Federal reserve system through political action; and I am afraid you will provoke political action.

Professor COMMONS. First, there is a distinction in this bill, which might be said to be fallacious, between the stable purchasing power of the dollar and the stable gold standard. There is no such distinction. If we stabilize the purchasing power of the dollar in America, that is going to be stabilizing other countries through these agreements which they have already made. It is going to bring other countries, just as this chart shows, to somewhat the same price level, relative price level, as our American price level. So that the direction to the bill to stabilize the purchasing power of the dollar, when it comes to these negotiations which they have already been making since 1925 with foreign countries to get them on the gold standard, means to get them to something like the stable purchasing power of the dollar.

Mr. WINGO. Before you get away from that I want to call your attention to what is in my mind. You are proceeding upon the theory and the assumption that the conditions which are facing you now will in the main obtain in the future permanently. I remember very well some of the arguments that were made right at this very table in 1913, when we sat writing the Federal reserve act.

But I know that we put some things in that act, and there are some things in that act that would not have been put in there, and there are some things that we wanted to have put in there that would have been put in there if we had anticipated anything like the World War. In other words, we had certain theories about what demands would be made and the extent of the inflation that would result from reducing the reserve. And look what happened. Before we could fully install this system the world turned topsy-turvy, and you have never had a test of the Federal reserve system, and that is the thing that makes me so cautious now.

I am one of those who believes that from the standpoint of economic activities we are so interwoven with the activities of the world that we can not escape it, whether we want to or not; but will that condition obtain in the long run of years? I believe it will not, because as I view political conditions in foreign countries as well as the economic conditions I think there are two peoples that are deliberately intending to come to grips with us on the battle field inside of 10 years' time. If that is true, why should we assume now the burden of placing them back on the gold standard?

That is the thing that makes me cautious. I want to avoid not only entangling alliances, foreign alliances in a political way, but I want to avoid them in economic and banking ways, so that we will have at all times freedom of action.

Professor COMMONS. In the first place, this is 15 years after that act. Since that time you have had a world revolution, the greatest the world ever knew. That has brought new conditions and new responsibilities and has discovered new powers, namely, the open market operations, which the Federal reserve system never had before. Now we are proposing to regulate these new powers.

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Mr. WINGO. When did we give them that power?

Professor COMMONS. In 1913, open market operations.

Mr. WINGO. We knew it, and contemplated that.

Professor COMMONS. What was the quantity of Government bonds at that time?

Mr. WINGO. Less than a billion dollars, but under the open market operation they might deal with something else besides bonds.

Professor COMMONS. We do not propose to let them deal in private bonds.

Mr. WINGO. Under the statute they could buy bills that were eligible for discount in the open market.

Governor YOUNG. They could buy bills of exchange, acceptances, warrants of political subdivisions.

Professor COMMONS. But can they buy United States Steel stocks and bonds?

Governor YOUNG. No.

Mr. WINGO. Not United States Steel stock and bonds; they can buy acceptances and bills of exchange, any paper in the open market that is eligible for rediscount, unless they have changed the statute.

Governor YOUNG. I do not think they can buy promissory notes under the act.

Mr. WINGO. They can buy acceptances. I do not mean the ordinary promissory note, but they can buy any acceptance, which, for all practical purposes, as to the effect of it, is the same thing; it is another form of indebtedness, and there are some of us that will remember that they used to laugh at me because I insisted from the very beginning that the open market operation was the most powerful leverage they had. I always contended that our experience with the discount rate would be far different than the experience of the Bank of England. The open market operation is not something we did not anticipate. I anticipated it, and so did Mr. Paul Warburg, and many others.

Professor COMMONS. You are quite correct, but did you then have the quantity of Government securities?

Mr. WINGO. Oh, no; and never anticipated the extent, though we recognized the power, and it is strange the board did not earlier recognize it.

Professor COMMONS. That gives them more power than they ever had before, and they did not discover that until 1922, that they had that tremendous power. They now have now powers.

Now, would you not say that, as a general rule, new powers that developed unbeknownst to the original legislators might perhaps require 15 years later some corrective treatment?

Mr. WINGO. Certainly. You misunderstood entirely what I said. It not only requires it, but I say that nothing can be permanent; we can not figure out a policy that will entangle us with foreign banks of issue. I am perfectly willing to promote our trade, or, as the original act says, to accommodate the commerce and agriculture and industry of our country to enter into these arrangements that will help our foreign trade, our cotton export, and everything else. I am willing to do that at all times. But I want us to be in such a position that we can withdraw when changed conditions make it no longer to our selfish interest to continue.

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Professor COMMONS. Suppose that I call your attention to page 2, to the lines which relate to foreign banks, and you will notice it was put in the negative and not positive:

Relations and transactions with foreign banks shall not be inconsistent with the purposes expressed in this amendment.

That does not authorize them to deal with foreign banks; that is accepting an existing state of fact.

Mr. WINGO. I am glad to have your advice on it, because I pointed that out to the author of the bill, that that is what I call one of these "negative authorizations." In other words, they are dealing now under the authority to buy and sell gold. Now you have an authorization by way of negative, and what is that? That means the same thing as if you had it read this way:

Relations and transactions with foreign banks shall be consistent with the carrying out of the purposes above expressed.

And then you add to it a new authorization for these foreign transactions.

That is what I contend, that that is a negative authorization—what we legislators call a negative authorization—and every time we sit around a committee table we are constantly on the lookout for the negative authorization, an authorization put in the shape of a limitation when no authorization ever existed before.

Professor COMMONS. We started off by showing the terror and suspicion that the American people would entertain if we made these foreign agreements, trying to put Europe on a gold standard. That is the way you started. Now we switched it to saying that we should require and command that they should do these things.

Mr. WINGO. You misunderstood me entirely.

Professor COMMONS. As I understand it, what that amounts to is the thing that is already accomplished. They have been making these transactions with foreign banks. They report them every month, or at least in their annual reports of what they have done, and this bill does not take any position upon that one way or another. It simply sticks to an accomplished fact.

I do not see any difficulty in changing it in the way in which you would put it—"shall be consistent with the purposes of this act," because this act has introduced a new purpose, namely, the purpose of stabilization, and, we might say, those relations and transactions with foreign countries shall be consistent with this stabilization policy.

Mr. WINGO. You do not conceive what I have in mind. My agent may go out and he may abuse his agency and do things that I do not think he should have done, but there may be reasons of expediency that restrain me from discharging him; but simply because I do not condemn by an express declaration what is done, but simply keep quiet, that is not an affirmative authorization to him to commit the same thing again.

I am so convinced that at all times the ingenuity of those who are in charge of the Federal reserve bank at New York City will enable them to find perfectly lawful means under existing law to meet the necessities of our foreign trade from the standpoint of our own selfish interests that I do not want to give them an absolute leeway, by a negative authorization, to change and make one of their major

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purposes the doing of certain things abroad that may be perfectly all right now; and, however much I might approve it in the future, I anticipate a condition that might arise when the majority of the American people would not approve, and it would bring such political pressure to bear upon the Federal reserve system that it would cripple its efficiency in handling our domestic affairs.

I am proceeding with caution in directing them to inject themselves into something that may very well bring us trouble sooner or later. That is my fear about that feature of it.

Professor COMMONS. That is to say, if this bill starts out with the idea of stabilizing the American price level—and, incidentally, you know our dependence upon the world at large—and if we give them instructions in order that we may stabilize our own domestic price level, then we also say they shall not make any agreement with any other country inconsistent with stabilizing our domestic price level.

The CHAIRMAN. This thought was occurring to me in that connection: Suppose that this law were enacted and the management of the Federal reserve system should proceed to operate under it and it would result in holding the price level where it is now, or, maybe, drop to a much lower figure. Suppose, too, that in that case that operation affected the price level in other countres, as it would to some extent. Take, for instance, England. Suppose England prefered to have prices recede to the 1913 level; would we not be in rather a complicated position to proceed with the opeartion of that stabilization law here? Might that not bring us into a complication with England or any other country that might have a different idea of price level than we have?

Mr. STRONG. That is the object of that clause.

Professor COMMONS. Supposing that they wanted a different idea. We are now supposing that they want to get off the gold standard?

The CHAIRMAN. Yes.

Professor COMMONS. Well, I do not know how to answer that, because I can not think of anything like that.

Mr. WINGO. You can anticipate a condition whereby Italy and Japan would have a price-level interest contrary to ours.

Professor COMMONS. They might be on a silver basis; they might be on any other basis, but if they are on a gold basis or managed gold basis the price level would run pretty close in its rise and fall to ours.

The CHAIRMAN. Such a condition might prevail that the drainage from some country might force that country to go from a gold basis to some other basis.

Professor COMMONS. That would be because they were not wealthy enough to command the gold. A poverty-stricken country might be compelled to do that. They would then have paper inflation.

The CHAIRMAN. So you do not think there would be any embarrassment coming to us as managers of this gold situation?

Professor COMMONS. I can not see any.

The CHAIRMAN. During the operation of a bill of this nature?

Professor COMMONS. I can not see any.

The CHAIRMAN. You can not see any international complications coming as the result of our assuming that responsibility of leadership which would result in the enactment of this bill?

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Professor COMMONS. I do not see any.

Mr. STRONG. But even if there were this is an "America-first" policy.

Mr. WINGO. Suppose that we go ahead and make these arrangements, and suppose that in response to the demand of these countries for our gold we then do the obvious thing that we think our interests require, we put up the discount rate so as to try to hold the gold here. That would have an economic effect the world over, would it not?

Professor COMMONS. It would tend to bring gold to this country.

Mr. WINGO. In other words, if we got into that situation, say, that Italy and France and Germany should all about the same time find it to be to their interests to command the actual gold, and that we conceived that it was to our interest to hold that gold. Then the first step we would take would be raise the rediscount rate, or the discount rate, the price of gold, and put it so high above theirs that it would compel the pull toward the United States instead of away from it, and that would have an immediate economic effect not only in our own country but in Europe, would it not?

Professor COMMONS. If we contemplate a situation like that, where all of Europe is arrayed against us, that might be done, but I think we have other instruments besides the discount rate; we have many retaliatory measures.

Mr. WINGO. Suppose we would use that or any other retaliatory measure. Then you would have a state of war existing, not by conflict of arms, but you would have a state of economic war that will tend to produce friction and it would have a psychological effect and destroy confidence somewhere.

Professor COMMONS. From all the evidence I can get—and Mr. McFadden would know much better than I, because he has been in Europe recently—for the present and for as long as we can see in the future, they are our debtors. They are going to be afraid to take any hostile action toward us on the money question. That would be my way of saying it. We are so much more powerful than any of them economically, not only in our industries and population and fighting ability, but also in our control of the money of the world, that I doubt whether it would be necessary to take that into account in drafting a bill for that purpose.

Mr. WINGO. We thought in 1913 that the world could not afford the enormous expenditure of billions of dollars and the loss of millions of men in the World War, but yet we went through it, and somebody said, though not I, that the world is better off economically than before.

The CHAIRMAN. I think we have to realize that we are in a new era so far as international finance is concerned, brought about by the war and the changed conditions since that time and the fact that we have been made the reservoir for 50 per cent or more of the world's gold, and that is a leadership that implies a great responsibility.

My observation is, from my study of the situation abroad, that a spirit of cooperation is being manifested in, as well as a keen observation of, the management of this responsibility that we have here, in which they have a vital interest. In other words, they feel that the responsibility, for instance in London, has been changed to New York, and while they feel that they were the money center of the

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world and managed it quite capably, as was demonstrated at the outbreak of the World War in 1914, they are anxious to see this system so managed to-day that it can cope with any emergency similar to that, and to my mind that is one of the vital things in our whole situation to-day, that we keep this Federal reserve system in a position where it can discharge to the fullest extent the responsibility as the world's banker to-day.

Mr. WINGO. The gentleman knows there is quite a difference, not only in the economic condition but in the psychological condition, between both Italy and Japan on the one hand and England on the other.

Professor COMMONS. I would like to state my idea. We know of this feeling of the foreign nations' dependence upon us, and this bill, if adopted, would not only not interfere with those cooperative arrangements but would greatly encourage them, because then they could feel that they have a stable American dollar, that we are not going to let politics or any other influence change that dollar, so that they will have at least one country controlling half of the gold of the world that has pledged itself, we might say, to the world that we are going to stabilize our own dollar and that therefore they can trust us and make any arrangement with us, and that we will carry out the contract, in any creditor or debtor arrangement, that we are not going to get them in debt to us and are not going to increase the value of gold after they have agreed to pay so many dollars in gold, that we are going to keep it where it was.

I think that it would greatly facilitate all of those things.

The CHAIRMAN. I think you are absolutely right. Of course, we must recognize that this close relationship which has grown up because of the conditions we have been discussing here has resulted in the opportunity to work with these central banks of issue in the world to an extent never dreamed of when we created the Federal reserve act, and that in that lies an opportunity for splendid leadership; and if that confidence can be maintained, which apparently is growing now, it will help us to help the world. Of course, we have to recognize that with this world responsibility of financial leadership which is now lodged in New York, hundreds of millions of dollars are now subject to call in New York, which call demands must be met in gold. As we continue to occupy that position more and more, the world's money is bound to come to New York, because dollar exchange must be had.

Professor COMMONS. You fear that maybe they will suddenly call?

The CHAIRMAN. No; I do not. I can not imagine how they can call unless we should have a complete turnover in the balance of trade, where the trade should be against us and where we would become a borrowing Nation instead of a lending Nation.

Mr. STRONG. They would be less apt to call if our dollar would have a stable purchasing power all the time.

Mr. WINGO. I do not know how they will feel to-morrow; I know how they feel to-day.

When the chairman was talking about the opportunities for world leadership, I could almost see Woodrow Wilson at Versailles talking about the world leadership of the United States, and we all thought at first that was fine, but things have shifted and so we do

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not know. We are a little bit more cautious, at least I am, about this entangling business abroad. We are not sure we want to get into it even for our own selfish interests and burn our bridges behind us. We want to have a way open to get out at any time.

The CHAIRMAN. We are in it financially.

Mr. WINGO. That is what Woodrow Wilson said; that is what the League of Nations said, that we are part of the world and can not escape it, that we ought to go over there and go in the front door and hang up our hat and coat, instead of slipping in the back door, as we are doing now, but the American people did not think so, and I am afraid the American people would come to the same conclusion about this entangling financial policy.

I am not criticizing it, but some of these days somebody is going to ask why it is.

Mr. STRONG. You did say you could have us at all times close to our hats and coats.

Mr. WINGO. Well, as my youth passes I get more cautious. I want to save my coat even if I may lose my hat.

Professor COMMONS. We have started out to stabilize the purchasing power of the American dollar and not have domestic fluctuations; but we find ourselves in an entangling alliance with foreign countries owing to the foreign exchange situation, and therefore, incidental to that, these Federal reserve people have been compelled to have some understandings or relations about it growing out of our existing power, in order that we might protect our own American dollar.

Mr. WINGO. That is the obvious answer, and I made that in nineteen something or other when I was out defending the League of Nations. I pointed out how we were interwoven with them, how my cotton farmers had to sell 65 bales of cotton out of every 100 we produce in Europe, and that we had a cold-blooded pocketbook interest in maintaining world conditions, and that we ought to have some such arrangement, but my constituents looked suspicious and said, "That may be all right; we will vote for you, but we do not know about that." My people were against it and the American people were against it, when we made the same argument then.

I do not want to get into a financial League of Nations. But if we must go in, I do not want to go into the back door of the League of Nations. If we are going in, let us go in the front door and say that we are the largest stockholder and must be chairman of the meeting.

But pardon me for diverting you from an economic discussion.

Professor COMMONS. I agree with you. I am from the West. We are dead against the League of Nations and all that sort of thing.

Mr. WINGO. Maybe I am wrong, but I am just expressing our fears.

Professor COMMONS. We vote for America first, the same as your constituents, and the object of this bill, as I understand it, is to pay attention to America first, and, incidentally, as part of that proposition to permit the reserve system to go on and have relations which we have authorized in 1913.

Mr. STRONG. But not to the detriment of the stabilization of the American dollar.

Professor COMMONS. I had another thing that I thought might be brought up, the relation to the stock market and the commodity market. I do not know whether you care to have that.

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The CHAIRMAN. Suppose you proceed with your statement on that.

Professor COMMONS. On the speculation in stock and the leakage of Federal reserve credit I should agree with the witnesses who appeared before the Senate committee the other day, including, I think, Professor Sprague, from Harvard, and Governor Young. I may be wrong about that, but I would agree that we should not pay attention to the stock market; that we should direct our attention to the commodity market. The stock market is entirely different from the commodity market. In the stock market stocks and bonds are always of present value for future expected income running far into the future, and they carry their own correction.

I have compiled the latest figures which I can find on the earnings, the yield of stocks. The yield of bonds is now 4¼ per cent. The yield of common stocks, as I figured it out from the Statistics Corporation figures, is 4.63 per cent.

Now, look what is going to happen to common stocks if they have got their yield down to such a point that they can earn little more than you can earn on bonds. The rediscount rate has risen from 3¼ to 4 per cent; commercial paper is from 4¼ to 4½ per cent, and it is likely that already the stock market has reached the point where it must bring about a deflation, because the earnings will not support the high stock prices. Whether that will come soon or late one can not tell.

The stock market is speculation on future earnings. Those future earnings consist of two things, the expected prices and quantities of products and the expected costs of operation; that is, the net earnings are what those stock speculations depend upon.

If they could see an expected rise of commodity prices, the stocks might go up; if they could see an expected fall of commodity prices, the stocks might go down. They are influenced by considerations which look to the future of the commodity markets and not to the present.

So I would say that if people want to speculate in the stock market upon these future expectations, and if the money does leak out so that they can get possession of it for that purpose—and the recent figures show that the banks are withdrawing that money from the stock market and it is coming in from independent investors—if so, we can expect that the stock market should be left to itself just as under this bill we would leave every commodity market to itself.

The CHAIRMAN. Do you mean there that the money is being withdrawn by the Federal reserve member banks?

Professor COMMONS. That is what I understand.

The CHAIRMAN. And it is coming in from other banks and other sources?

Professor COMMONS. From other banks and corporations.

Now, if they wanted to put their money into boosting stocks, why should that affect the general commodity market? Why should it be allowed to divert the Federal reserve system from a proposition of stabilizing commodity prices?

Only about 6 or 7 per cent of the total credit goes into the stock market. That would be slight compared with the great bulk that goes into the commodity market. That is the great and important thing on which the prosperity of the country depends.

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The stock market is a speculation on what that future prosperity is going to be, and we have enough of this situation to make it rather a consistent statement that in any period of rise and fall of prices the first market to be affected is that most elastic market, which is the stock-exchange market. It is going to hit there first; it is going to raise their prices first or cause them to decline first. They are kind of a forecaster of what is to follow.

Then come along the most sensitive of the wholesale prices, like scrap iron or pig iron, those whose supply can not be increased rapidly. They will be affected next. Then other commodities.

Then you would have affected wages and rents and, last of all, I think, retail prices.

Now, in the process of stabilization, we have to pick out which one of those indices is to be used for stabilization purposes. Are we going to use the index of stock prices or the index of retail prices or the index of land values? Are we going to use the wholesale price index?

My notion is that the wholesale price index is the key one, because that is an index of the prices that employers get for their output, that producers get for their output, out of which they pay their wages and pay their interest, and so on.

So that I should think that this investigation proposed here would come to the conclusion that a properly constructed and weighted wholesale commodity index is the key to the regulation of stability, and that other fluctuations like retail prices and movements of stocks should be disregarded except in so far as they tend to modify this commodity index.

So that I will classify stock-market prices along with rents and wages and retail prices as things that we do not need to pay attention to when we are looking forward to keeping the business of the country continuing in prosperity, keeping employment as stable as possible, and thus having the productive energies rather than the consuming energies of the country, or the speculative energies of the country, stabilized. You can not stabilize everything; that is true.

Now, this bill leaves that matter open. It says that the board shall investigate the different price levels. I should hope that a very thorough investigation of the relative claims of these different indexes should remain, and this I want to state as my opinion on a subject matter which I should want to see submitted to that investigating body.

This is the chart of average wholesale prices, with individual commodity fluctuation, introduced by Mr. Goldenweiser yesterday, and the average is the figure for the all-commodity index, which I presume is the Department of Labor chart, showing the average movements and some of the particular movements.

Mr. GOLDENWEISER. You should also point out the fact that it is on the 1926 basis, and that the all-time chart is on the 1913 basis.

Professor COMMONS. Yes.

Mr. GOLDENWEISER. The Bureau of Labor Statistics now publishes its index on the 1926 basis as 100, and that is why this chart ends in 97 at present instead of 150.

Mr. WINGO. Will the legend show in the record that 1926 is the base?

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The CHAIRMAN. This chart has already been inserted into the record.

Professor COMMONS. That difference in the basis would greatly reduce the apparent fluctuations of wholesale prices. If you used 1913 as the base, those wholesale prices would move up and down somewhat differently than they appear, would they not?

Mr. GOLDENWEISER. I think so; yes.

Professor COMMONS. This wholesale price average of all commodities, representing the great quantity of business transacted by employers, you may say, of the country, is set over against the total money supply and credit supply. There go on, around that average, many individual fluctuations. This [indicating] is cotton; this [indicating] is livestock; this [indicating] is grain, and so on. It is not a price fixing of any of those individual commodities, but it is a stabilization of this average.

Now, the serious question arises, the most serious one, regarding the equity or ethics of an index number, and that is this: When the cotton rises in price like that [indicating], and thus brings the average like that [indicating]—I am pointing to the years 1924 and 1925—the question is, Should the influence of cotton be nullified by a credit policy which would bring down the average of prices and keep them stable?

Mr. Goldenweiser took the ground that that would be unjust to the cotton people, be unjust to the other people, possibly, if we are going to lower their prices in order to keep that inflation from starting.

That goes exactly to the essential nature of the difference between the average and the particular prices. I agree that when the prices go up by any influence whatever, whether it be shortage of cotton or some other thing, and there is not a counterbalancing fall of prices on some other commodity, then it is proper, under a theory of stabilization, that the price level as a whole should be reduced if monetary policy can do so. It all depends, you see, upon the general drift of a few prices or upon the general drift of all prices. Ordinarily, if we plan to have a stable price level, we would find that some prices are moving up and some down. That is evidence that no action need be taken if they counterbalance each other. But if enough of them start up and there are none or few that start down, that indicates that the general price level is rising and that therefore a stabilization program would require action.

As to the differences between individuals, that would work no injustice between the cotton people and these other people. Their quantity of cotton exchanged for a quantity of livestock would remain the same, only it would be on a lower average price level; it would not be on a high level like this [indicating on chart], but on a lower level. The difference between the two prices, the high price of cotton and the low price of livestock, would remain the same as it was, because that difference does not depend on the quantity and velocity of money but upon differences between the quantity of cotton and the quantity of livestock. But, instead of measuring the difference on a high level of prices in general the price of cotton would not go quite as high and the price of livestock would go a little lower. Conversely, if the average price level were raised, then

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the price of cotton would rise more on account of the general rise, and the price of livestock would not go quite as low for the same reason. The same difference between cotton and livestock would remain, but on a higher average level.

Mr. STRONG. And they will be greatly benefited.

Professor COMMONS. The relation between the cotton growers and the livestock people would be the same as it is now, only it would be on a lower or higher level of prices in general.

Mr. STRONG. And, as a general proposition, they would be greatly benefited in their business if all other commodities were on a stable value or close to it.

Professor COMMONS. I should say that that would follow. When you consider that this average is made up of 550 commodities, all of them moving in all directions, if there are many prices moving upward and no compensating offset moving downward which keeps the average stable, that indicates by its very nature that generally the average level is rising, and if the theory of control by the Federal reserve system is correct, then they should exercise their power. But the spread between individual prices, owing to differences in costs, efficiency, oversupply, or undersupply, and the like, would not be changed, and no injustice would be done as between them by a stabilization policy.

I want to say this: I do not know whether I emphasized it before; that you can not wait. You have got to start early, and the Federal reserve system has got to start two, three, and four months before that peak is reached. It has got to start five or six months often before the effect of the Board's action can be reflected in the general commodity markets. Its influence has got to pass through the stock market, possibly through speculative markets, before it begins to affect the commodity price level, and, consequently, unless they have—and I think they now have—sufficient statistical data for their forecasting, unless they can have a forecasting system which tells them what the prospects are several weeks and months ahead, they can not operate the system. It requires a highly technical ability and an enormous amount of good judgment in order to tell, and still it is just experimental, as we know. But by experience they gain more knowledge of just what to do, and when they have so many hundreds of factors to deal with their judgment has to be exercised.

Mr. CANFIELD. As I understand your entire statement, you feel that unless we have some plan whereby we can stabilize prices, deflation will continue until it reaches the pre-war level?

Professor COMMONS. That is my idea; yes.

The CHAIRMAN. Doctor, there have been a few questions added to the list during your testimony, and I will propound them and you may make such answers to them as you see fit.

This is the first question:

As the price level fell, giving gold greater value, would not the production of gold tend to increase? Mining costs would certainly be less.

Professor COMMONS. That certainly would be the effect. I recognize that. Notice this, that mining costs nowadays are mostly machinery costs; they are not labor costs so much as they were before.

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You can go through a gold mine and see what is done and you will see that nine-tenths of the work is done by machinery, and I can not say that that cost will be very much affected.

Mr. STRONG. Will not the needs of the country, as we increase in population and development, cause an increased consumption of gold?

Professor COMMONS. The only question is whether the rate of production of gold will increase as fast as the commercial business in the world and as more people are going into the commercial end of the world. I see a greater increase, far greater increase, in population and business than I do in the production of gold.

The CHAIRMAN. Under those circumstances, inasmuch as we are using $200,000,000 worth a year commercially, would it not be well perhaps to do something to discourage the use of that amount of gold? That would be one factor that would be equal, of course, to increasing production, by conservation.

The next question is:

How could credit be so managed as to increase with increased efficiency in industry generally? Why should industry ask for more credit with lowered costs?

Professor COMMONS. You are pointing to my assertion that there is no reason why the price level should fall when efficiency increases. Efficiency comes individually—by individual firms. It does not come in all firms. One firm or another will be increasingly efficient, but that does not necessarily mean that the total output of that industry, measured against the total money and credit that is offered to furnish that industry or all industries their purchasing power—it does not mean that the latter should necessarily decrease when output is increasing. Furthermore, this efficiency argument is based upon American efficiency. Other countries have not increased in efficiency as we have, and the world price level would hardly be said to be affected by American efficiency. It might be.

The CHAIRMAN. The next question is interesting because of what you have just said:

England has to buy nearly all her raw materials and foodstuffs. When she stabilized on a $4.86 basis, did she not buy all those things at a proportionately lower price and at the same time, by the same token, increase the real wages of labor?

Professor COMMONS. I can not answer about the price element. I can answer about the quantity of business, the quantity of labor that was employed in England. England has continually, owing to the falling prices, mainly the falling prices, since 1920 and up to the present time, had the largest number of unemployed working people of any country in the world. She has had a terrific deflation, and although she might have bought raw-material commodities cheaply, yet she had to sell her commodities at such a diminished price that the business men were simply up against it; they could not employ anybody. So she has had to call upon her taxing power to feed millions of people, more than any other country.

The CHAIRMAN. I was told in December that they have an unemployment there of 1,150,000 at the present time. Doles are still being handed out. One problem is that they can not divert trained labor from one vocation to another. They have tried to send some of

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their unemployed men and women to some of the colonies, but as some of the colonies have objected to taking care of England's problems in that respect that has not worked out quite successfully.

The next question was:

The first, or one of the first, three-million-share days on the stock market was in March, 1926, when the market had a big break. Was there not a great increase of velocity then?

Professor COMMONS. That is a pretty good question. There was a big break when the velocity was increased at the same time.

The CHAIRMAN. So that the velocity in a declining market might be just as rapid as in an increasing market?

Professor COMMONS. In that particular case, that looks so. I would like to look into that three-million-share day, when there was a declining market. I should expect again, if the stock market should start to fall, that we would have another big three-million-share day and a tremendous velocity without any corresponding decline in the quantity of money. In that case I would say that I would have to bring in my principle of futurity. I would simply say that everybody expected prices to fall and they hurried to sell before anybody else sold.

I can not figure how much effect that is going to have on the volume of credit.

Mr. CANFIELD. As I understood you, you do not feel that the increased supply of gold will take care of the increased demand for gold?

Professor COMMONS. I do not think so; that is, on a full gold standard where each country has all of the gold necessary as reserve to meet its demand liabilities.

Mr. STRONG. That is, the fear of a full gold standard and the need of a managed gold standard.

Professor COMMONS. But I do not have the fear in the case of a managed gold standard, which includes along with it a considerable amount of gold exchange standard which is also equivalent to gold.

Any other questions?

The CHAIRMAN. I think that is all. The meeting will now adjourn.

(Whereupon, at 4.20 o'clock p. m., the committee adjourned.)

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Monday, April 30, 1928.

The committee met at 10 o'clock a. m., Hon. Louis T. McFadden (chairman) presiding.

The CHAIRMAN. The committee will come to order.

This is a resumption of the hearings on H. R. 11806, the Strong bill on stabilization. We have here this morning Dr. Adolph C. Miller, a member of the Federal Reserve Board. We shall be very glad to hear your, Doctor Miller, on this subject. You may make a statement first, if you desire, then we will question you, perhaps, afterwards.

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STATEMENT OF ADOLPH C. MILLER, MEMBER OF THE FEDERAL RESERVE BOARD

Mr. MILLER. I have looked over this bill mainly with the thought of addressing myself not to the detail and phraseology of the bill but to the fundamental ideas that are embodied in it and the changes that would be involved, if the bill should be enacted into law, in the whole conception of the Federal reserve act and the procedure of the Federal reserve banks with regard to their more important functions in relation to credit and currency.

The bill falls into three broad divisions. The last of these (providing for an amendment to section 28 of the Federal reserve act) makes extensive provision for certain investigations to be undertaken and carried on by the authorities of the Federal reserve system. Let me say immediately that with reference to this I am sympathetic. I do not mean that I approve of all the details of the paragraph, but favor investigations by the Federal reserve system for the purpose of getting a fuller understanding of the economics of credit, currency, and prices, their relation to movements of industry, commerce, and so on, I am altogether sympathetic.

The next division is what is denominated here paragraph (i). That might be called the publicity section of this proposed amendment. I do not like this particular publicity proposal, but I can readily see that a clause providing for publicity might be drawn that probably, in time, would be productive of distinct improvement in the administration of the Federal reserve system and increased appreciation of its workings and its limitations by the public. If the committee desires, when I am through with what I have to say on paragraph (h), I will be very glad to give my ideas in detail, as well as point out some of the difficulties that I think will be encountered under any attempt at organized publicity in connection with the credit policies of the Federal reserve system.

The CHAIRMAN. I would like to say here that the committee will be very glad, Doctor Miller, to have that suggestion from you in detail, giving us the benefit of your judgment covering that subject.

Mr. MILLER. Shall I go on with that now or come back to it later?

The CHAIRMAN. You may come back to it later.

Mr. MILLER. Then we come to the major proposal contained in the Strong stabilization bill, to wit, paragraph (h).

I think legislation of the character contemplated in paragraph (h) is inadvisable. When I say that I am putting it rather more mildly than I feel it. I would say that it was perhaps objectionable, and mainly objectionable because it is premature and not founded on any solid basis.

Now, in saying that, and particularly with my good friend, Mr. Strong, the author of this bill, opposite me, I do not want for a moment to leave the impression that I think the last word has been said or written in the science or the practice of reserve banking. I am not against innovation simply because it is innovation. I am not a banker, either, by profession—that you know—but what you may not know is that I am not even a banker by instinct. I believe that experimentation is the law of life. The Federal reserve act, at the time of its passage, was opposed by many who now acclaim it as perhaps the greatest piece of constructive legislation that our Con-

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gress has ever enacted. They regarded it as a dangerous innovation, put through by men who were ignorant of the subject matter on which they were undertaking to legislate.

Mr. KING. Have you stated for the record what your business is?

Mr. MILLER. I was in university work before I came into the Federal reserve.

Mr. KING. Professor of economics.

Mr. MILLER. Professor of economics; yes. I ought perhaps to add that my general situation in life was such that I had a very considerable burden and variety of other contacts and responsibilities, so that I was obliged always to keep my feet right on the ground.

Mr. KING. I can see that.

Mr. MILLER. My experience was one that extended far beyond the walls of the university.

I repeat, therefore, that in opposing this paragraph it is not because I am constitutionally averse to innovation in legislation, even in legislation where perhaps there is more than the ordinary justification and warrant for making haste slowly; for being, in other words, conservative, if for no other reason than that the public is naturally apprehensive about anything that touches the monetary unit or the credit machinery.

On the other hand, I am not one of those who think that because of the poor performance that many of the central banks of Europe gave (possibly pardonably during the war, but probably not so after the war) that therefore we should regard the traditional working principles of note issue and reserve banking as outworn and to be scrapped and thrown into the discard. I think the experience of the war and the years immediately following—that is, until the period of financial reconstruction and monetary restoration was fairly under way in 1925 (when England restored the gold standard)—is not a fair illustration of what is to be expected in the future from the old principles of operation. The trouble has been not the principles but the atmosphere left by the war, and perhaps also the deterioration of the state of mind of those who were in charge of the great central banking institutions. They allowed themselves to be diverted from what their instinct and perhaps their judgment told them, on the whole, was the appropriate course to follow by governmental pressure of one kind and another.

Where are we at the present time? We are pretty close to seeing a condition in the monetary and currency affairs of the world that can be described perhaps best and most briefly as a restoration of the gold standard and all that it implies with regard to central banking policy and operation. We are not quite there, but we are close to it; and perhaps the most interesting and significant thing in the financial atmosphere of the past year or two has been a noticeable growth in the conviction (at least on the part of responsible authorities in the larger commercial countries of Europe) that in this matter of monetary standards no expediency compromises are likely to give satisfactory results. They are, therefore, moving pretty rapidly away from the so-called gold-exchange standard, which represented something of a compromise arrangement, to a fully restored gold standard, with all that it implies in the way of the free movement of gold and provision for the redemption of bank notes in gold.

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I state this thus briefly merely to indicate that we are very close now in the western world to a position where the beneficial results of the gold standard as a kind of banking and credit regulator in gold-standard countries are likely to be realized. My disposition, therefore, is to wait and see what the results of the operation of the restored gold standard are before entering upon any such striking innovations in reserve banking as are contemplated in paragraph (h) of this bill.

I say this with all the more emphasis because I think we are, in this country, in danger of overlooking the fact that under the pressure of necessity in the absence of the full operation of the gold standard the Federal reserve system has been developing a procedure of its own—notably, we will say, in the years 1922 to 1925—for handling credit problems which has great merit. When I appeared before this committee two years ago, I stated my belief that no country taken by itself alone can operate the gold standard. The gold standard assumes that gold flows freely from country to country, and in the process of its redistribution exercises a moderating, or, to use a favorite term, something of a stabilizing influence on credit conditions.

Now, it was not until 1925, and then only partially, that we again began to experience gold flows in something like their natural form. It was necessary, therefore, for the Federal reserve system in the interim—and more particularly as we had emerged from one of the most serious crises in commodity prices and one of the most devastating depressions, particularly in agriculture—to devise ways and means for adjusting the operation of its credit and currency mechanism to conditions as they were, with a view to achieving as good an economic result as possible.

What the reserve system then did is a matter of record. I content myself simply with saying that out of its own experience, applying its best judgment to circumstances and conditions and problems as they arose—practical problems that called for the exercise of an informed discretion—there was gradually developed something that, looking back, one might now very well describe as in the nature of a new procedure in reserve-bank management. My belief is that this suggests the kind of development that in the long run is most likely to result in a system of banking practice, whether in America or Europe, which will be, on the whole, most serviceable.

Experience in these matters is, in the long run, the best teacher, and whenever you have an agency of government like the Federal Reserve Board, or a system of institutions like the Federal reserve banks, that are capable of learning from their experience, it is, on the whole, best not to undertake to put blinders on them and say, "Henceforth we want you to see only this object, or look only in this direction."

I repeat my conviction that in banking growth and development based on experience are, on the whole, the best teachers and the best guaranty that you are likely to get that in the end a scheme of practices or "principles"—working principles, if you please—credit-policy procedure, and technique, as it is sometimes called, will be arrived at by the Federal reserve system superior to anything that can be accomplished through undertaking to draw up legislatively

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prescribed formulæ. Personally I am skeptical of formalæ in most matters of large human concern. I think, on the whole, there is nothing that is more certain to deaden the creative instinct in any public body than to put its mind into the hobbles of a formula. And it should not be overlooked that public bodies are too frequently ready to accept a formula if it is sufficiently explicit in its meaning and intent, because it relieves them of the necessity of exercising constantly, vigilantly, and responsibly, their own good judgment on actual conditions and circumstances as they may arise from time to time.

Mr. STEAGALL. I was not here when the gentleman began his statement, and I have been so unfortunate as to miss nearly all of the hearings on this proposed legislation. Would the gentleman object to a question now?

Mr. MILLER. I am entirely at your service.

Mr. STEAGALL. I am interested in the line of thought being presented, which I am sure has a degree of merit that everybody would readily recognize. But I have observed considerable complaint on the part of the member banks of the Federal reserve system on account of the practice of the very thing that you seem to regard as unwise when applied to the Federal Reserve Board itself, or to the members of the Federal Reserve Board themselves. When I go out among the smaller banks that are members of the Federal reserve system and get to picturing in my way what I regard as the great benefits of the Federal reserve system, I am nearly always confronted with the most severe arraignment of the management of the Federal reserve system on account of the multiplicity of rules and regulations and red tape—and I am using the language that these gentlemen employ in describing the situation to me—which you call "hobbles."

Mr. STRONG. "Blinders."

Mr. STEAGALL. Well, whatever it is. Anyhow, the meanest things are said to me. I am a friend of the Federal reserve system, and I always put in a good word for it when I can, because I think I know it has been of great benefit to the whole country, and especially to the people of my immediate section. I have never changed my mind about that at all; but whenever the subject is broached the bankers turn loose a storm of complaints about unnecessary red tape; "This rule requires something that we never had to do before," and "This other regulation interferes with our operations in this particular," and on and on they go. The whole truth is, I believe, that a large amount of the faultfinding with the Federal reserve system on the part of the member banks and the country banks grows out of this very thing of which I am speaking and which you seem to dislike when it is applied to the Federal Reserve Board, regulating the enactment of the judgment and the will of the American people in respect to a system set up by law and which you regard as an evil; and I see the reason for your view. But I am saying what I am to call to your attention things that I dare say the Federal Reserve Board does not always understand, namely, the resentments and the complaints that have sprung up among the member banks on account of this very matter of red tape and regulation. If you were to call upon me to particularize and select the particular rule or regulation and point out the defect and tell you what to do to cure it, I am not

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sure I could do it. It is like a great many criticisms. But the fact remains, and I fear justly so in some instances, that member banks are very resentful—they might not always express it to everybody, but they will express it to their Member of Congress—about the rules and regulations and red tape imposed upon them by the Federal Reserve Board.

Mr. MILLER. Yes. Well, I think that kind of resentment would be multiplied several fold if paragraph (h) of this bill were enacted into law.

Mr. LETTS. If the hobbles were put in the law?

Mr. MILLER. Yes, sir; and I think the resentment would not be limited to the member banks, but would be pretty widespread throughout the whole community. Resentment against bureaucratic meddlesomeness and tyranny. It is, on the whole, a healthy symptom. It does not trouble me that Americans, whether bankers, business men, or farmers, show on occasion a disposition to challenge the wisdom or decision of an administrative body. That is sometimes my own disposition.

Mr. STRONG. Would you mind saying why you think this would increase that difficulty?

Mr. MILLER. I think that will be implied in what I say very shortly.

Mr. STRONG. All right.

Mr. GOODWIN. What is there in paragraph (h) that is injurious or would be harmful to the Federal reserve system?

Mr. MILLER. Let me say, first and foremost, that it uses language that really means nothing definite or tangible.

Mr. LETTS. Then it does not put any hobbles into the law?

Mr. MILLER. Yes; it does, because it awakens expectations as to a general improvement in the operation of our whole social and economic system that will be pressed home upon the Federal Reserve Board for attainment. In other words, the whole conception in paragraph (h) is built upon the theory that whoever or whatever controls credit in the United States—and it assumes that such a control of credit resides in the Federal reserve system—has it within its power to do what?—to stabilize commerce, industry, agriculture, and employment, as well as prices and the gold standard. The theory is intenable; the thing can not be done. Let me say right here—and let me say it dogmatically, in order to be brief—that I think the whole of this paragraph (h) proceeds upon two assumptions; and I use the word "assumptions" advisedly. One of those assumptions is that changes in the level of prices are caused by changes in the volume of credit and currency; the other is that changes in the volume of credit and currency are caused by Federal reserve policy. Neither one of those assumptions is true to the facts or the realities. They are both in some degree figments—figments of scholastic invention—that have never found any very substantial foundation in economic reality, and less to-day in the United States than in other times. The more we penetrate into the mysteries of price movements the more complicated does the whole price system disclose itself to be. I have been reading in the last couple of days a recent book of substantial merit on prices. The title of the book is "The Behavior of Prices." The very title of the book is noteworthy. It indicates a point of approach——

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Mr. KING (interposing). Who is the author?

Mr. MILLER. It is written by Frederick C. Mills, of the staff of the National Bureau of Economic Research.

Mr. KING. Is he a member of the society of the learned which had a convention here in Washington a while ago?

Mr. WINGO. Which society of the learned?

Mr. MILLER. I do not know which one you mean.

Mr. KING. I could give you a list of the names. It was reported in the papers here.

Mr. STRONG. During the holidays.

Mr. MILLER. You mean the Economic Association?

Mr. KING. Yes.

Mr. MILLER. That is very likely.

Now, I was brought up as a student in the economics of 25 or 30 years ago; and as an instructor in economics at Harvard and Chicago and Cornell, I taught the economics that I think is at the basis of this provision (h) of the Strong bill. But even before I came into Federal reserve banking I had my grave doubts as to its tenability of the older price economics, and the closer attention to realities that has been forced upon me by having to deal with credit and related matters in a responsible way has added very much to those doubts. They have also been added to by reading the recent literature of the subject.

I would like to read a paragraph from this book. The Behavior of Prices. I think, Mr. Chairman, that it is worth putting into the record. I quote from page 34:

> It is certain that the main problems to be faced in an analysis of the price system are essentially problems of stability and instability. It is the instability of this system and the economic effects of this instability which render so imperative a fuller understanding of it, and make so necessary an increase in our power to control it. This necessity of understanding holds no matter what the cause or causes of price instability may be. Whether price instability be traceable to specific money and price conditions, whether price instability be merely a reflection of general economic instability, or whether price instability and economic instability react upon each other, this subject is a matter of crucial importance.
>
> The nature of price instability is itself a matter for investigation before methods of measuring instability may be considered. Our primary interest here is not in the instability of prices of individual commodities, though this is involved in the problem, but in conditions of general price instability where large numbers of commodities are concerned. But the term "price instability" in this general sense is often used ambiguously. What is meant by a condition of price instability? What kinds of instability may be present in the price structure? How shall price instability be measured? Are the currently compiled index numbers of prices adequate measures of all the disruptions and distortions which may develop within the system of prices? These are some of the questions which will receive consideration.

Mr. LETTS. Has the author expressed his opinion on protective tariff in that book?

Mr. MILLER. Not as I am aware. This, I believe, is the first of two or three volumes by this author on the subject of prices, and what is said in this first installment of his work clearly indicates that my reason for stating, as I did a moment ago, that paragraph (h) of this proposed legislation is built upon an as yet unproved assumption was correct. That assumption may later on be proved to be true, or it may later on be proved to be so far from the truth that as an adequate guide to banking policy or as a basis for stabilization

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it is useless. I am not opposed to banking innovations, but I am opposed to innovations unless there is a high degree of probability that they will prove a success. The proposal contained in paragraph (h) of this bill rests on no secure economic foundation. It must be regarded as a notion, an academic proposal.

Mr. LETTS. Does he speak about immigration restriction as having a bearing upon that subject?

Mr. MILLER. Well, I have had this book in my hands only a couple of days, so I can not tell you all that is contained in the volume.

Mr. WINGO. I think you will find when you read it clear through that he says that the behavior of prices is largely like the behavior of individuals. That is his theme.

Mr. MILLER. Yes. The title of the book indicates that it is conceived in the spirit of modern research and modern economics——

Mr. LETTS. You do regulate in a degree the behavior of individuals, don't you?

Mr. MILLER. Well, sometimes we think we do and find out that we don't.

Mr. LETTS. I mean, we try to do it by law.

Mr. STRONG. Shouldn't we do it?

Mr. MILLER. Not where we have not got a strong reason for doing so. Not where we don't yet understand what nature's methods and processes are in order that such laws as we may make may work along natural lines—the lines of "behavior"—instead of working against them.

Mr. STRONG. But we do try to regulate them. That is the theory of government.

Mr. MILLER. Well, do you want more theoretical regulation?

Mr. STRONG. If necessary, I do.

Mr. MILLER. I would say, Mr. Congressman, that it is a sufficiently serious thing to undertake to regulate conditions outside of matters that come so near to the heart of our whole economic system as does the credit mechanism. It may be a disastrous thing if it is done unintelligently, where it touches the very heart of the whole economic apparatus. My belief is that if this bill were enacted in its present form, nothing would be accomplished different from what is now the case in the Federal reserve system. But it is conceivable, so far as "stabilization" is concerned, that some highly mischievous consequences and administration misadventures might result.

Mr. STRONG. I am asking you why——

Mr. MILLER. After all, men can only do what they can do:, and anyone who is charged with as large a responsibility as are Federal reserve bank directors or the Federal Reserve Board will, in the face of an actual situation, no matter what vague phrases or formulas there may be in the law, use their best judgment.

Mr. STRONG. I think you have heard me say before that I am not trying to change the present policy. I want to continue it.

Mr. MILLER. If you think that is a fact, why change the law unless improvement is certain to result?

Mr. STRONG. That is the reason I put in the investigation clause.

Mr. MILLER. I think you are much more likely to get a good result if you leave the law alone or address your attention to the correction of specific weaknesses or inefficiencies in the present credit operation of the Federal reserve system.

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Mr. WINGO. Mr. Chairman, may I ask a question there?

The CHAIRMAN. Yes.

Mr. WINGO. I assume that you are referring to paragraph 8, on the very question that you discussed with the gentleman from Kansas on the changes in the law that it makes. You stated that it had one assumption which was false, that it had to do with control of prices.

Isn't there another assumption which you have possibly overlooked when you say that this makes a change in the law? That is, that the courts when they come to interpret an act of Congress start with this proposition: That they assume Congress intended to do something, to change the law, when it enacted a bill. That is true, isn't it, Doctor, in your understanding of the rules of interpretation?

Mr. MILLER. Yes.

Mr. WINGO. All right. They start by assuming that we do something. Then the courts will have to find that there is a change in the law.

Now, there is another thing that it does which may have been overlooked. The courts recognize that there can be a repeal or a change of law by implication as well as by direct declaration. Now, if this paragraph (h) means anything it means that there is a change of the existing law, certainly by implication if not by direct declaration. You can not escape that conclusion, can you, Doctor, with the two fundamental and elemental rules of construction of legislative enactments?

Mr. MILLER. I am not a lawyer, Mr. Congressman. But the position as you have just stated it is, according to my understanding, correct. I have been addressing my observations more particularly to the economic ideas that were involved in the proposal rather than to the problems of legal construction.

Mr. WINGO. If you will permit, that is the next question that I will come to.

This idea of a central Federal Reserve Board, sitting at Washington, who dominate and control the credit policy of the entire system for a specific purpose named—that is a declaration, isn't it?

Doctor MILLER. Yes. It does assume——

Mr. WINGO. Doesn't that answer that question? There are two schools, as I understand it, in your board. One school is that Congress did not intend anything when it permitted a diversity of the rediscount rates at the different banks. That school insists that there ought to be a uniform rate throughout the system. Another school insists that Congress intended, and that it was recognized at the time the act was passed, that there was a difference in Chicago, Kansas City, New York, and Dallas, that should be recognized and would be recognized by practical, experienced bankers in the conduct of those banks which would cause a difference, probably, certainly at times, in the rediscount rate.

Now, if you enact this, the courts will say, will they not, that there was a dispute at the time, and Congress undertook to settle that dispute and to say that we would give to those who insisted upon a centralized banking system that which we refused to give in 1913; and that by subsequent enactment and declaration of policy we gave them in 1928 a centralized system; that is, we made one bank out of 12 units. That is what one of the chief advocates of this measure has in mind.

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Mr. MILLER. I would say that it would present a problem of legal construction which might involve us in great administrative difficulties. But if the general objects and the general objectives defined in paragraph (h) here were desirable in the general economic interest of the country, I would say that ways and means of meeting the administrative difficulties might be found.

I think it is worth while remarking that in the modern economic situation a great many of the difficulties of a credit character; those, for instance, that give rise to a condition usually described as "inflation," are not born full fledged. They do not arise over night in the country as a whole. They begin insidiously in some particular area of the country or some particular section of the business community, and by degrees develop into a situation of credit excess and spread over the country and attain the character and dimension of "inflation" unless quickly recognized and arrested as involving a national as well as a local menace.

Such a situation in its inception is perhaps best dealt with as a local problem of regional discount policy or by other methods that may be found effective and appropriate. So I don't think that it follows of necessity that this provision of the contemplated amendment would carry with it the destruction of the regional quality of the reserve system.

I don't like the phrase that you have used about two schools of thought. I object to being obliged to take a permanent seat in one group or the other. I want to be free to adopt the attitude that seems to me most useful in the face of an existing difficulty or one that can perhaps be anticipated. That may sometimes mean regional action, or it may sometimes mean system action or sometimes regional action perhaps that sooner or later will show itself to have been part of perhaps a program of system policy.

Mr. WINGO. In other words, you recognize possibly the stupidity of trying to standardize men and conditions either by legislative enactment of bureaucratic decree?

Mr. MILLER. I think I do.

Mr. LETTS. Is there any reason why we should not attempt that with respect to interest rates and credits when we do it as to freight rates and other matters, such as controlling the price that public utilities may charge?

Mr. MILLER. I think, Mr. Congressman, that that is a relatively simple matter compared with undertaking to lay down a rate of charge for Federal reserve credit when that rate has got to be fixed, so to speak, for the purpose of stabilizing employment, industry, prices, etc.

Mr. LETTS. Well, the whole thing is a matter of policy, isn't it?

Mr. MILLER. It is a matter of policy; yes. It is a matter of policy. I suppose that the whole question involved is what will make for better Federal reserve credit policy.

The framers of this bill conceive, I take it, that if you set before the Federal reserve system certain objectives such as they defined in the bill, and then issue to the Federal reserve system a mandate to use their powers to attain those objectives, the country will get, on the whole, a better dispensation of credit than it has at the present time, or at any rate that the future will be protected against a credit

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dispensation that might be inferior to what we have been enjoying the last few years.

I don't think they are proceeding in the right way. If I did, I should be for this bill. To be frank—but I hope not offensive—these phrases in paragraph (h) are very magnificent phrases. They will do in oratory, they are suitable in chamber of commerce resolutions, etc., but they are vague and do not translate themselves into anything sufficiently concrete for handling the problems of credit administration. For instance, not infrequently a condition of price instability might be concomitant with stability of industry and instability of employment.

Mr. WINGO. In that connection, have you ever heard of Congress or the Interstate Commerce Commission devising a rate structure to meet that situation? Do you remember a case of that kind?

Mr. MILLER. I don't recall any case.

Mr. WINGO. Isn't that the cause of the row in the Senate now? They contend almost over night that that was the basis of Mr. Esch's decision—that he undertook to abandon the reasonableness of the rate—a question of trying to help the economic condition in one group of States as against another. Isn't that the charge against Mr. Esch? That is denied by all the States, that it is not the basis of any rate structure; that is, that the economic conditions in any State will not determine it. The reason I said that was that my friend, Mr. Letts, has suggested that possibly there is an analogy between interest rates fixed by any Federal reserve bank, or, rather, the rediscount rates, and freight rates. I don't follow the analogy.

Mr. MILLER. Yes; very much more. There is a definite assumption that when you change the discount rate of the Federal reserve system, you will have changed a condition of, we will say, instability to one of stability. I would say that it would be worth while to examine what is going on in the economic history of the country in this regard, because I think that it will give us some idea of the results that we must expect to get from legislation of this kind.

Mr. KING. Can you direct my attention to some illustration of the point that you are making?

Mr. MILLER. Yes. I will do so very briefly.

In midsummer of last year the Federal reserve system set as its objective, partly because of its desire to be of assistance in the international credit situation, and in the belief also, that a mitigation of the fairly severe credit conditions that obtained in Europe at the time would be indirectly of benefit to American trade (making possibly a broader demand for American farm products), and partly because it anticipated that economic conditions in the United States during the autumn months did not look promising, and that a moderation of money rates might be of some help in that situation, set about to create an easier condition of money by favoring a policy of low discount rates, which were lowered in the course of some four or five weeks to 3½ per cent at all the Federal reserve banks, and by purchases of securities in the open market, otherwise stated by putting reserve money into the market.

Now, it is a debatable question whether or not in a period of business recession, business recession can be arrested by making money cheap. My opinion is that it can't be done to any appreciable extent, if at all.

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Mr. WINGO. What is that, Doctor?

Mr. MILLER. My opinion is that you can't arrest a recession in business by a reduction of the official discount rate, the Federal reserve discount rate.

Mr. WINGO. You can postpone it, can't you?

Mr. MILLER. You can postpone it? In my judgment there is nothing to warrant that view; and I think it is a waste of a valuable instrumentality when you undertake to do it. It doesn't accomplish anything that is substantial.

Well, now, what have we seen taking place under this policy of cheap money? We have seen, looking purely at the domestic situation, that easy and cheap money, coming at a time when the speculative temper of the community needed no stimulant, but rather a deterrent, has contributed to the creation of a situation in the stock-exchange loan account that we are concerned about in the Federal reserve, that is the subject of comment in the press, and that latterly has been responsible for a policy of tightening money rates by an increase in the rediscount rates at the very time when, business being in a state of some recovery, a low discount rate might assist the recovery.

Mr. STRONG. Do I understand that the efforts of the Federal reserve system to encourage foreign trade by furnishing cheap money resulted in creating an increase of stock-exchange loans?

Mr. MILLER. You can take that as an indirect consequence. That was not, of course, its purpose.

The CHAIRMAN. Do I understand you to say, Doctor Miller, that we had a fictitious money rate?

Mr. MILLER. No; we didn't have a fictitious discount rate; we had a discount rate that was adjusted to the trend of market rates. But a most important factor in that trend was the Federal reserve open-market policy. It brought about cheap and easy money, and one of its results has been the absorption of a large amount of credit in the stock-exchange loan account.

The CHAIRMAN. You say that the result was that when there was a creation of a surplus of money and credit which can not be used in the industry and commerce of this country, it has resulted in a speculative situation. If that is the case, is there anything to indicate other than a fictitious rate, when the rate varies from 4 per cent to 4½ per cent in the face of a flutter of money?

Mr. MILLER. Oh, yes. The rates have been flurrying, and we have lost a considerable amount of gold, not only on the movement that began last autumn but in the early part of this year. The banks that have been obliged to provide gold for withdrawal have had to obtain it from the reserve banks by borrowing, with the result that the volume of reserve credit extended to the banks to-day is between two and three hundred million larger than it was a year ago, and this in spite of the fact that the total volume of business activity as reflected in production and trade is considerably less, and notwithstanding the fact also that the amount of money, pocket money, in circulation in the country is something over a hundred million—perhaps 125,000,000—less than it was a year ago.

Mr. BEEDY. Doctor, you spoke of increasing the rediscount rate at a time when business in on the upward trend. I believe you used the words "emerging from a state of depression." Thus money is higher

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at a time when it should be lower to assist in that stimulation of business. What period of business depression do you refer to as "emerging from a state of depression"?

Mr. MILLER. I am not referring to any period of business depression. I used the term "recession" in characterizing the business movement last autumn and in the early winter. That is quite different from depression.

Mr. BEEDY. I thought you used the term "depression."

Mr. MILLER. No. I used the word "recession." I think it is a pretty well-established fact that we can not by monetary operations arrest business recession. We can do something to stimulate the flow of money into use when business is "picking up" and something to check the flow when it is proceeding too rapidly, and thus exercise an influence on the pace of business.

Mr. LETTS. What is the cause of recession ordinarily?

Mr. MILLER. That can not be authoritatively answered, either with regard to this recent recession or with regard to recessions generally. Determination of the cause or causes of these fluctuations in the movement of trade is still involved in a good deal of obscurity.

Mr. LETTS. How much a part of that do our foreign trade and our foreign transactions play? That is the particular thing I had in mind.

Mr. MILLER. We had a good foreign trade during the period when business was in recession in this country last autumn and the early winter. With regard to the recession I would suggest that 1926 having been a year of unprecedented economic activity, consumer demand had been pretty well saturated by the end of the year, and that what occurred in the latter part of 1927 was in the nature of a reaction, a mild reaction, but nevertheless a real reaction from the pronounced and rather remarkable activity of the previous year.

Mr. LETTS. What caused that recovery?

Mr. MILLER. You are asking me questions now that I can't answer. These are matters of opinion. I don't believe anybody can answer them with finality. They are subjects of considerable scientific controversy.

Mr. LETTS. The thing I am particularly interested in is the last suggestion in this paragraph, which, according to the author of this bill, would indicate that our relations and transactions with foreign banks—and I assume that our foreign business generally is very decidedly dependent upon our conditions in this country——

Mr. MILLER. It may or may not be.

Mr. LETTS. The author seems to think that something ought to be done which would protect us against conditions of that kind which would depress business and finance in this country.

Mr. MILLER. Well, I don't believe that any group of persons, no matter how much they might know about the nature of the modern economic process, would be capable of effectively determining what could and should be done by way of credit policy with a view, for example, of avoiding a recession of business, even if they could quickly anticipate it. But generally you don't know what is going to happen until it is already under way.

Whenever men are charged with administrative responsibilities of the kind contemplated by this bill their intentions, attitude, and usual state of mind are the things that will determine the results.

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As a rule, unless a man is a very much more consciously controlled individual in his decisions than is usual or is very much abler than is apt to be the case with members of administrative boards, he will see conditions mainly in the light of his intentions and desires. If he happens to be a man who is intrigued with the idea of "stabilization," he would feel that this bill warranted him to go out and see what could be done by credit policy to "stabilize employment" at the present moment, when there is a complaint of a considerable shrinkage in the volume of employment. Unemployment would be on his mind, and he would find in this bill an incentive to experimentation with discount rates and open-market operations as social remedies.

As a rule, administrative policies developed or adopted in that kind of atmosphere seldom get anywhere. They usually get their main importance later from things they brought to pass which were never in anybody's mind and which nobody foresaw at the time of their inception.

I think, in order to make this specific, Mr. Chairman, that I might well invite the attention of the committee to a brief review of the last six months. In the subject under consideration here a chapter of experience is worth a whole library of theory. We are surprised in the Federal reserve system at the state of things which has developed in the credit and speculative situation. Nobody is more concerned. My feeling is that it may feel too much concerned, and that there is danger that——

The CHAIRMAN. Apropos of what you said there: When you spoke about the lower rate of last summer of 3½ per cent, which was produced by the purchase of Government securities, you meant that that was used for stimulation, I suppose?

Mr. MILLER. Either or both, I would say, resulted in stimulation.

The CHAIRMAN. I suppose the board took into consideration the two angles of that situation in the desire that you refer to to help the international situation, not merely the danger that the lowering of the rate might have on the speculative activities in this country?

Mr. MILLER. I think probably some foresaw that element. But when an administrative board sets out to accomplish what it believes to be a good and beneficent object it is very apt to underestimate or forget the shadow side of the picture.

The CHAIRMAN. You felt that the international situation should have more bearing than the effect on the speculative activities?

Mr. MILLER. I think that is what the board felt; I felt the reverse.

Mr. CAMPBELL. You deduce from that situation that when the Federal Reserve Board last summer furnished cheap money for the encouragement of foreign trade it resulted in an increase of stock-exchange loans for speculation?

Mr. MILLER. I should say that that was one of the by-products of it; yes.

Mr. CAMPBELL. Does that mean that we ought to confine our activities to trying to take care of our own conditions at home rather than to try to take care of European conditions?

Mr. MILLER. That is a very broad question. I think that if the credit policy of the Federal reserve system is properly adjusted to American conditions, that is on the whole the best thing that can

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be done by the Federal reserve for the benefit of America and broadly viewed, also, for the rest of the world.

Mr. CAMPBELL. Charity commences at home?

Mr. MILLER. It is not a matter of charity. It is a matter of prudence and wisdom in our economic management.

Mr. WINGO. Isn't this the major question that governs your board in deciding such questions? Don't you consider what your policy should be in regard to meeting the needs of legitimate business in the country, and not the effect on the stock market? If the needs of legitimate business require easy money, then you will meet that need, not be scared off because perchance there is an attendant evil that there may be a lot of speculation in the stock market?

Mr. MILLER. How do you propose to reconcile those two purposes? We have a securities market in this country that generally is ready to take advantage of easy and cheap credit.

Mr. WINGO. I don't think you caught my point. My point is this: The factor that should control in fixing the rediscount rates and in determining whether or not you will put more money in the market or take money out is not what is going on in the stock market, that is not the prime consideration, but what are the necessities of legitimate business?

Mr. MILLER. Yes.

Mr. WINGO. And the fact that in meeting the necessities of legitimate business you happen to stimulate a little bit the amount of speculation in the stock market should not deter you from meeting the major needs of business?

Mr. MILLER. What I would like to say on that is this: That it would be an excellent thing if Congress would clarify the intent of the Federal reserve act. I think the banking committee at the other end of the Capitol is occupying itself with seeking to devise some way by which Federal reserve credit can be made available to borrowers at times at cheap rates without constantly exposing it to diversion into stock-exchange loans.

The CHAIRMAN. Have they suggested a classification of credit?

Mr. MILLER. Well, that might perhaps remedy it. But I am not now trying to suggest a remedy for the difficulty in question.

Mr. WINGO. You still don't get my question. What they are doing on the Senate end has nothing to do with it. I think that is the trouble. The law is clear and specific now that you shall do what you can for the purpose of accommodating commerce and industry. My point was this: That the policy of the board should not be wholly controlled by what may happen in the stock market, but that it should be controlled by what the needs of legitimate business are. If legitimate business requires an easy money market, you should not deny that relief to legitimate business because, forsooth, there are stock gamblers who will take advantage of the easy money condition to bring about some little increase in speculation.

The reverse is also true. If the needs of legitimate business require you to put the bit on the money market, you should not hesitate to do that simply because, forsooth, someone says that it may create a panic on the stock market. My point is that the major thing to be considered by the board is the need of business.

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Mr. MILLER. I agree with you, Mr. Congressman, when you use the words "stock market." My view is that the Federal reserve has nothing to do with the stock market as such; that the stock market is no concern to the Federal reserve.

It is, however, a matter of great concern to the Federal reserve what becomes of the credit that it creates. When as a result of policies adopted for other considerations, it develops that a part, and more particularly when it is a considerable part, of the credit released by it goes into the stock exchange loan account, the resulting situation becomes its responsibility.

Mr. WINGO. I agree with you that that is a diversion that might defeat your efforts to meet the needs of legitimate business. You should try to see that your effort to accommodate commerce and industry is not defeated by diverting the funds that you intend shall be easy in order to go into commerce and industry, into the stock market.

Mr. MILLER. Yes.

Well, now, it is part of a well-recognized principle of reserve banking that you can not have your Federal reserve rate too far out of line with the actual going rates for money either in the open market or over the country of member banks.

Mr. STRONG. Do you know——

Mr. MILLER. Will you let me answer one question at a time, Mr. Congressman?

Mr. STRONG. Yes.

Mr. MILLER. Now, when a large volume of credit is being absorbed into the stock exchange loan account, the call rate is very apt to rise. It is very much more apt to rise if the Federal reserve bank is at the same time pursuing a policy of withdrawing from the open market money which it previously put into the market. The result is a rise in the call rate and particularly if it occurs, as it usually does, at a time when the stock market is very active and not easily discouraged by an increase of the call rate. The call rate thus becomes, momentarily at least, a very strong competitive factor in the general money rate situation. A banker, whether in New York or elsewhere, will then be confronted with an opportunity to lend his money on call at an attractive rate or lend it for business uses at home at a less attractive rate. He will not infrequently meet the situation by marking up his rates at home. In other words, there comes a point where the rate for money determines the direction in which money will go—whether to the call-loan market or to meet local demands.

Mr. WINGO. Right in that connection, isn't this true? Last fall, when you started this tightening up, or when it was just the same as the money last year, and you commenced raising the rate at a time when there was a general flow of money, as the Chairman has pointed out, every time you took a million dollars out of the stock market of New York, didn't another million come in from the country? In other words, when you had this so-called reduction of three hundred million in a period beginning over three or four months ago, when you had a reduction in the money put on the call market in your bank of three hundred million, you had a corresponding increase in the money that was sent to New York by country banks, so

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that the amount remained the same, or as a matter of fact, increased; and the increase came from the country banks? In other words. when you sought to check the diversion of these funds into the call-money market, that was effective so far as the New York banks were concerned; but the cold-blooded statistics that are a part of the reports of your banks show that the recent rise of that rate made it all the more attractive for country banks; and they shot it into New York City? Isn't that true?

Mr. MILLER. I wouldn't say "Yes" to that question without qualification; but if you will let me say "Yes" without going into all the qualifications, I think I would be satisfied.

Mr. WINGO. That, according to statistics, the fact is that for every decrease in your bank in the call-money market of three hundred million, there was a corresponding increase that flows from the country banks?

Mr. MILLER. Yes. There was a big flow from the interior.

The CHAIRMAN. Doesn't that also stimulate foreign money coming into New York?

Mr. MILLER. There isn't, as yet, any direct evidence of that. I don't know what may be taking place in that regard. There is, however, some evidence of the bringing back of American balances from foreign countries.

Mr. BEEDY. But, Doctor, when this money does come in from the country banks as the result of a rise in your rediscount rate, for instance, isn't that one of your most helpful indexes as to the need of legitimate industries throughout the country generally for money?

Mr. MILLER. I don't think I follow you in your position, Mr. Congressman.

Mr. BEEDY. For instance, it doesn't always obtain that the moment you put a check on a situation in your big industrial centers and take money out of the market, that it immediately flows in from the country banks? That doesn't follow, does it, when industry generally back in the localities concerned needs it legitimately? Now, when it does flow in, particularly from country banks, isn't that a very helpful index to you that legitimate industry in general does not need it?

Mr. MILLER. Not necessarily. It may be that there is such a considerable spread between the call rate in New York and the Federal reserve discount rate, say, at an interior reserve bank, as to put a temptation before the interior member bank, if it has any money loaned on call in New York, to leave it there and meet the demands of its local customers by rediscounting with its reserve bank. Such has undoubtedly been the case at times.

There is some evidence, though it is not of a very conclusive character, that this may be going on at the present time, not, perhaps, to a very large extent, but going on nevertheless, just as there was evidence of a similar situation in the autumn of 1925.

There was a remarkable increase in commercial loans in the early months of this year. If I remember rightly, it was between three hundred and fifty and four hundred millions, as deduced from the weekly reports. That is a startling increase for so short a period.

There has taken place at the same time a very considerable increase of loans on securities. Borrowings from Federal reserve banks have increased.

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There is no method, of course, by which we can tell how much of that increased borrowing occurred because of growth of commercial loans and how much because of growth in security loans. Some of it was due to exportation of gold. These demands for credit by member banks from their reserve banks do not come marked "wanted for this purpose or that purpose."

But when, as in recent weeks, with the call rate averaging 5 per cent of above, there is a flow of money from the interior to New York, and when at the same time there is evidence of increased industrial activity in some of the very districts from which money is coming into the call-loan market, and also of increased borrowing from their reserve banks, we think it shows that some banks, at least, have money in the call market which they ought to be using for the purpose of meeting their commercial needs at home, and which they do not withdraw probably because of the attractive return the high call rate enables them to get on it in New York. They prefer to leave their call loans alone and meet their seasonal commercial demands by borrowing from the reserve banks. The effect is to tie in reserve bank funds indirectly, at least, as a sustaining factor in the volume of money in the call market.

Mr. WINGO. Isn't there a possibility of misunderstanding by this illustration, Doctor? That is, you can not always determine when a broker's loan or a stock loan is one for speculative purposes. For instance, take this illustration: We all know that a great number of the safe and conservative corporations have in what they call their secondary reserve a lot of sound, seasonal investment stocks.

Now, take, for instance, that here is a corporation that needs some funds temporarily; say, $100,000. The call-money rate is low for its temporary needs, so they will take from their portfolio, their secondary reserve, say, 1,000 shares of General Motors or American Tin Can, and they will go and borrow $100,000 that they need for legitimate business purposes; and as soon as the pressing need for capital passes the loan is retired, and this General Motors stock comes back into the portfolio, or the secondary reserve. Yet this would look like speculative purposes and would add to the increase in stock loans.

Mr. MILLER. That is largely a matter of definition—of what constitutes a speculative purpose and what is "legitimate business" for this corporation. There would be difference of opinion on that matter. I am of the opinion that for the purposes of good administration in the Federal reserve system a tight control over the diverting of its credit into any kind of speculative loans is necessary.

Mr. BEEDY. As a matter of practical banking, you would know where that money went to, wouldn't you?

Mr. MILLER. It is not always easy to know it. But it can be sensed sufficiently soon to give an indication of what direction Federal reserve credit policy should take. If that direction is sensed soon enough and proper measures are taken, the development, practically speaking, can be controlled. As a matter of fact, we have had two episodes in the recent history of the Federal reserve system that do not reflect great credit on the system. In each case the difficulty has been occasioned, as I view it, by what might be called a paternalistic open-market policy. These periods of security-loan inflation have frequently been fed and accelerated because of the desire of the Fed-

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eral reserve, for one reason or another, to be helpful through open-market operations to the general money situation.

Mr. STRONG. Helpful to whom?

Mr. MILLER. To the general credit situation, for the benefit of the agriculture and commerce, or whatnot.

Mr. STRONG. In this country?

Mr. MILLER. Primarily in this country. In autumn of last year this country by way, so to speak, of Europe was, perhaps unconsciously, in the mind of the Federal reserve system. But it was this country, nevertheless, and its interests that were in the minds of those who were responsible for the policy of cheap and easy money then adopted.

Mr. BEEDY. What were the two episodes to which you referred that you said did not reflect great credit on the Federal reserve system?

Mr. MILLER. I had in mind mainly what has happened in the last eight or nine months and an earlier occasion, when there was a spread of some 2 per cent between the call-loan rate and the Federal reserve discount rate.

Mr. KING. That is where you were 20 years ago, when the law was enacted?

Mr. WINGO. I didn't catch the answer to Mr. Beedy's question. Doctor Miller was interrupted and didn't finish his answer.

Doctor Miller, what was your answer to Mr. Beedy's question? What were those two episodes?

Mr. MILLER. Mr. Beedy, will you state your question again?

Mr. BEEDY. You referred to two episodes which reflected no credit on the Federal reserve system.

Mr. MILLER. The other was the autumn of 1925, when there was a wide spread between prevailing call rates of 5 to 6 per cent and the discount rate of the New York Reserve Bank of 3½ per cent.

The CHAIRMAN. Are you referring to the Boston rise of rates?

Mr. MILLER. I am not referring to that increase, but to the ebullient condition of the stock market and the rapid growth of the stock exchange loan account, in part consequent on the liberal credit policy pursued by the Federal reserve system and the hesitation and the reluctance shown by it in advancing the discount rates to attempt to control the situation. As a result of that policy in New York for a period of several months there was a spread of 1½ to 2 per cent between the existing discount rate and the rate for money in the stock market. And there occurred a rapid growth of the stock exchange loan account.

Mr. WINGO. Let us go back over a period of eight years, back in December, 1920, when you had a Federal reserve issue of 3,700,000,000. To-day you have cut that down to one billion and a half, and your loans on the stock exchange now are about 4,000,000,000. Is that money or credit which is represented in that increase?

Mr. MILLER. That is largely a matter of which word you prefer to use.

Mr. WINGO. Isn't it obvious that it is credit?

Mr. MILLER. Well, money is credit. What we call "money" is for the most part "credit" in this country.

Mr. WINGO. But credit is not always money?

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Mr. MILLER. Well, as I said before——

Mr. WINGO. I don't recall ever getting any money on credit. All I got was credit.

Mr. MILLER. You are thinking of money in what form—gold certificates, greenbacks?

Mr. WINGO. My question was directed at the Federal reserve note issue. In other words, there were $3,700,000,000 in December, 1920. To-day that has declined to $1,500,000,000.

Mr. MILLER. Yes.

Mr. WINGO. And your brokers' loans have gone up to 4,000,000,000.

Mr. MILLER. Yes.

Mr. WINGO. It is obviously a difference in credit?

Mr. MILLER. Well, the Federal reserve note is credit. The only difference between it and the ordinary form of bank credit is that you have a piece of engraved paper in the one instance as evidence of credit and in the other case you have an entry on the books of a bank carrying a reserve account with the Federal reserve bank.

Mr. WINGO. In other words, one is a gold certificate and the other is credit at a bank?

Mr. MILLER. They are both obligations to pay on demand. You can make your purchases equally with the one or the other. There is no difference in substance. If you are going to use the term "money" in its strict sense, in the sense of money of account for the settlement of obligations international in character, then there would be a difference.

Mr. WINGO. But there is a different thought, Doctor, in what is back of the two things, isn't there? There is a difference in what is back of the Federal note or back of the deposit slip in the bank where I have gone and borrowed a thousand dollars and they have given me credit on the books to my checking account? There is a difference in what is back of it? There is a difference, I mean, in gold?

Mr. MILLER. If the bank is well managed, there is no difference in their value.

Mr. WINGO. I am talking about in gold. There is a difference, isn't there?

Mr. MILLER. The Federal reserve note is an obligation redeemable in gold coin at the Treasury of the United States and in gold coin or legal tender at a reserve bank at its option.

Mr. WINGO. I know it, but the condition of a few banks does not affect the volume of the gold reserve in its vaults. The point that I am making is this: You say that it doesn't make any difference whether it was money or credit. But the credit at the bank has far less reserve back of it than a Federal reserve note outstanding, hasn't it?

Mr. MILLER. You mean far less gold back of it?

Mr. WINGO. Yes. I am talking about the only recognized legal reserve; that is, gold.

Mr. MILLER. If you are thinking of the gold that is held by the Federal reserve system against its liabilities in the form of notes and that which is held as ultimate reserve against the deposit liabilities of member banks, the ratio of one to these two classes of liabilities, the Federal reserve holds an amount of gold equal to about 6 to 8

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per cent of the deposit liabilities of its member banks, as compared with a legal obligation to maintain a minimum reserve of at least 40 per cent against its own liabilities that are outstanding in the form of Federal reserve notes—that is true. But to my mind this is not a matter that in and of itself is important. The important consideration in good banking is not the relative reserves held against deposits and notes. It is not the amount of gold available against the deposit liabilities of the member banks on a show down, which probably never will arise, that is so important, but the amount and character of these liabilities.

If member-bank deposit liabilities are soundly invested, if they have arisen out of business transactions in the course "of accommodating commerce and business," if they have contributed to maintain the productive apparatus of the country in a state of healthy and not hyperactivity, in short, if they are genuinely of a self-liquidating character, we don't need to be concerned particularly with the ratio of gold held to them. I am not greatly worried about that ratio if it declines because of loss of gold. I think we need to be more solicitous about the character of the liabilities that the member banks are creating against themselves, even if at times when the ratio probably would be regarded as fairly sizable. You may have a high reserve percentage when the banking situation is not altogether good, and you may have a low one when it is good. It depends on the character of the transactions which have caused the change.

The CHAIRMAN. It is not important now in the attitude of the world's bankers?

Mr. MILLER. Yes; it is.

The CHAIRMAN. In world-wide obligations as a class?

Mr. MILLER. Yes.

The CHAIRMAN. The use of this money is important?

Mr. MILLER. Yes.

The CHAIRMAN. I want to direct your attention back to the six months' period a year ago, when the interest rates were lower and the purchasing of Government securities took place for the purpose of stimulation, which has resulted in improved conditions. It could be cited as a period of increase in stock prices or a speculative period. In that connection we had a tremendous increase in the price of almost every stock. I would like to ask in that connection whether you believe that the increase in the price of stocks is due to the fact that we are going on a lower interest-return basis, or is it pure speculation? In other words, are we registering ourselves on a lower income-return basis; and is that the reason that certain stocks have gone up, or is it pure speculation?

Mr. MILLER. I think it would still be "speculation," even if that assumption were true. But I do not think that there is warrant for believing that we are going into a long period of appreciably reduced investment yields. This is, however, a matter on which opinions differ and may well differ. Those individuals who believe the rate of investment yield is due for a long decline and who are quickest to anticipate it will adopt a speculative attitude toward the securities market and buy on this belief.

For instance, if there was anything to warrant some of us or any one of us to-day thinking that within three years the net yield

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upon high-class securities—bonds, and even common stocks of exceptional character—would drop to 2 per cent under the pressure of new capital accumulations, certainly there would be an opportunity to anticipate the market. Now, by anticipating the future market you help to make the present market and the course of market values. By buying in anticipation of a decline in the interest yield or net-investment yield we would be gradually raising the prices of securities.

That is one factor in the present market, I think. There is a good deal in the behavior of the securities market in the last few years that is based upon belief that for a considerable term of years capital funds will be so abundant that the net investment yields will be appreciably low as compared with what were thought usual yields to be expected from the same or similar classes of investments before the war. I don't, however, think that that is the only factor. I think there are others, and perhaps of equal or even greater weight.

Mr. STRONG. I started to ask you some questions a minute ago, but I was diverted. I would like to get some information now, if I may.

I asked you if we were to deduce from the fact that the Federal reserve banks brought about cheap money in order to encourage our foreign trade; that it had resulted in increasing the loans upon the stock exchange. I understood you to say that influence might be used to prevent that. Then why have you now raised the rate? Have you abandoned your theory of stabilization?

Doctor MILLER. I am not in a position to answer when you term it an "abandonment." It is a pretty broad question.

Mr. STRONG. Well, let me get my thought over to you. I am not trying to lead you into a trap.

Doctor MILLER. No; I am not worrying about that. I don't object to your questioning.

Mr. STRONG. All right. Go ahead.

Doctor MILLER. I think we are very close to the point where any further solicitude on our part for the monetary concerns of Europe can be altered——

Mr. WINGO. What was that last that you said?

Doctor MILLER. Can be altered. I am inclined to think that on the whole it will be better for Europe and better for us if the Federal reserve shows a less active and eager concern for them.

Mr. STRONG. And attend to our own affairs?

Doctor MILLER. Europe is pretty nearly in a position to take care of herself in a monetary way, and I think she will get into that position very much more quickly and on the whole more securely, if we keep in the background of the picture instead of in the foreground; in other words, leave more to natural forces in the national and international money situations.

Mr. STRONG. Then——

Mr. MILLER. Let me add, Mr. Congressman, because it is a part of what I was saying, that in my opinion the importance of discount policy as an instrument of credit regulation shall be emphasized by the Federal reserve henceforth and an abridgement of open-market operations as a primary instrument of credit policy. I am of the opinion that open-market operations have been the cause of almost

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as much mischief in credit and economic situations as of good. I am inclined to think that as we get far enough away to review the history of the past four or five years in fuller perspective that conclusion will be justified.

Mr. STRONG. Do you think that raising the rates in the last few months has tended to throw money to New York?

Doctor MILLER. Do you mean from abroad?

Mr. STRONG. No; in this country. Do you think that it has tended to increase the brokers' loans?

Doctor MILLER. Yes; undoubtedly.

Mr. STRONG. Well, do you think that the fact that the committee controlling the open-market operations are composed largely of eastern men has any effect on the brokers' loans?

Mr. MILLER. I don't think so.

Mr. STRONG. You don't think it is a factor?

Mr. MILLER. I don't think so.

The CHAIRMAN. Does the fact that he referred to have any effect upon open-market transactions?

Mr. STRONG. That is what I mean.

The CHAIRMAN. You said "brokers' loans."

Mr. STRONG. Well, I beg your pardon. I meant to ask whether it would have an effect of raising or lowering the open-market operations. In other words, do you think that the fact that the committee that controls open-market operations is composed mostly of eastern men associated with eastern banks has any effect upon open-market operations?

Mr. MILLER. Do you mean by "open market operations"——

Mr. STRONG. I mean the purchase and sale of securities. Does it affect in the way of increasing or decreasing brokers' loans?

Mr. MILLER. Well, I think those two questions have got to be answered separately.

Mr. STRONG. I would like you to answer both of them.

Mr. MILLER. I believe you asked, first, the question about the influence of the geography of committee on the open-market policy of the system.

Mr. STRONG. Yes.

Mr. MILLER. I would not say that it made any appreciable difference. In any event, the most important influence in that committee is exercised by the representative of the Reserve Bank of New York. New York is the money market of the country. It is the one definitely large open money market that we have. So that the attitude of the New York Reserve Bank will carry it with great weight if ably presented. It will be the most important influence in determining the views and recommendations of the committee, no matter what its geographical representation.

Mr. STRONG. New York, of course, is just as interested in the money market as in our foreign loans, the stabilization of foreign nations?

Mr. MILLER. Yes.

Mr. STRONG. Then is it the best thing for the country to have the committee that controls open-market operations, the buying and selling of Government securities, the increase and reduction of the currency and of the volume of money in circulation—is it the best thing for the country to have that committee composed altogether of eastern men?

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Mr. MILLER. Well, Chicago is represented on the committee; it is not an eastern city.

Mr. STRONG. Is that a very large factor in the operations of the committee?

Mr. MILLER. No; but it would not be even if Kansas City or San Francisco or Minneapolis were on the committee.

Mr. STRONG. Suppose it were composed of representatives of San Francisco, Kansas City, New Orleans, Chicago, and New York. Do you think that the New York situation would control them, anyway?

Mr. MILLER. Well, as a rule, it is only the men who are close to the money market who have very definite convictions as to what the situation of the market is and what is required. You know in New York banking is a primary industry. In most other places it is an auxiliary. New York is banking center not only for the country but for the world. The result is that men who come to the front in New York as bankers are men who, so to speak, belong to the master class in banking, and they usually put their ideas over upon those of less prestige and experience.

Mr. STRONG. Well, the Federal reserve system was created for the benefit of the whole country, wasn't it?

Mr. MILLER. I know that.

The CHAIRMAN. Let me ask you, Doctor Miller: These conclusions and recommendations of this open-market committee are referred to the Federal Reserve Board, are they not?

Mr. MILLER. Yes.

The CHAIRMAN. And approved or disapproved by the board?

Mr. MILLER. Yes.

The CHAIRMAN. Before they are put into operation?

Mr. MILLER. Yes; or modified.

Mr. WINGO. Doctor, the price level in Kansas City for money and credit is higher than the price level in New York City, isn't it?

Mr. MILLER. Yes.

Mr. WINGO. And that is true of Chicago not quite so much?

Mr. MILLER. Yes.

Mr. WINGO. I think it would be safe to say that the price level in Kansas City is a little bit higher than in Chicago?

Mr. MILLER. Yes.

Mr. WINGO. At times, especially?

Mr. MILLER. One moment. You have always got to except, of course, in any statement of that kind, the rate paid by borrowers who, so to speak, have access to the money market of the whole country. There are borrowers in Kansas City who can borrow in New York or Chicago. If the rate in New York City is lower than in Kansas City, banks in the latter place have got to meet the New York rate to hold the account, or at any rate, to get the current business of the customer. In other words, commercial rates are competitive for the best class of customers.

Mr. WINGO. That refers only to loans, I suppose?

Mr. MILLER. New York maintains a considerable competitive market for loans from other sections of the country.

Mr. WINGO. I am talking about the mass of banking credit. Perhaps there may be some exceptional cases in which people in New York City and in Pittsburgh in recent months have financed themselves in Chicago banks. But I am talking about the mass of bank-

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ing credits in Kansas City. The rates out there on individual loans are higher. Everything is higher from a banking credit standpoint. So that a rate in Kansas City as compared to New York is a relatively lower one if it is identical. In other words, a 5 per cent rate in Kansas City is a great deal lower in its effect in Kansas City than a 5 per cent rate is in New York City.

Mr. MILLER. You are now speaking of the discount rate?

Mr. WINGO. Yes; the discount rate.

Mr. MILLER. That is correct.

Mr. WINGO. The banking rate.

Mr. MILLER. That is correct.

Mr. WINGO. That is the real effect of these changes, because the local rate very rarely changes at Kansas City or Chicago, except to preferred customers.

Mr. MILLER. Yes.

Mr. WINGO. If that be true, Doctor, if you have the same identical rate in Chicago and Kansas City that you have in New York, a well recognized law will cause a flow of the surplus credit to New York City; and the only way that Chicago can hold that credit would be to raise her rates to a comparative level with New York, which would be higher in percentage?

Mr. MILLER. Yes.

Mr. WINGO. Isn't that true?

Mr. MILLER. It depends on what you mean by "law," and what the conditions at the moment are. The thing that attracts out-of-town money to New York is principally the call-loan market. Secondly, it is the commercial paper market, though that is a less important factor.

Now, you may have a call rate in New York through a period of weeks of 5 or 5½ per cent, with the discount rate in New York at the reserve bank of 4 per cent or of 4¼ per cent. In either case it would be the call rate that would bring money there, whether the discount rate happened to be proximately abreast of the call rate, or whether it happened to be lower, except in the contingency that the lower discount rate in the New York bank would act to draw money of the Federal reserve bank into the call market in competition with the flow of out-of-town money, and thus check the influx of out-of-town money by weakening call rates.

Mr. WINGO. This is true, isn't it, Doctor; and it is responsible for one provision of the Federal reserve law? It is true by actual experience as well as by theory that you may have a tightening of local money in Kansas City, and after the conditions have disappeared, you have freer money in New York City? Isn't that true?

Mr. MILLER. I think so. There would, however, be a certain tempering influence, I think. The New York banks go out and seek business where money is tight, if they can not get all the kind of business they want at home. The New York banks are competitors for good business all over the country, and have accounts from large borrowers in every section of the country. When they are under pressure to find an outlet for surplus funds, they are very much more likely to be keen competitors to get new customers from the interior than they are at times when they have no difficulty in investing their moneys to good advantage right in the New York market.

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Mr. WINGO. It is true that in the last few years there has been a great tendency on the part of banks in Chicago and St. Louis and Kansas City to invade the territory of New York and to invade the territory of each other on these large loans?

Mr. MILLER. Yes.

Mr. WINGO. I happen to know by hearsay of several instances of that kind in the last several months whereby one big concern in western New York was financed by money in Kansas City.

Mr. MILLER. Yes. Take the recent situation in New York and the advance of the discount rates in Boston and, say, St. Louis. The New York banks were reducing their funds in the call market, and the money market in New York was under a certain pressure because gold was being withdrawn for export, and also because of sales by the Federal reserve system of securities in the open market. The effect of open-market sales and purchase is, of course, always most immediately and keenly felt in the New York market, because that is in a special sense the national money market. The result of the recent pressure in New York was that those who were looking for money against collateral loans there had to get it somewhere else than from the New York banks; had, indeed, to get funds from the outside for use in New York banks. The demand for money in New York was spilling over into other districts. There was some evidence that such was the case with regard to Boston, and the Boston bank had to take some measure to protect itself against the diversion of its funds into uses that were not obviously local and commercial in character. The discount rate was their method of doing that, which bears out what Mr. Wingo said, that under a situation such as we particularly had recently a uniform rate as between New York and other districts means actually and effectively that the New York rate is the higher rate.

Now, the movement of loose money is toward New York when there is no adequate home demand; and that movement is stimulated by anything that puts up or works up the rate in New York. So that sometimes an interior district has got to, as it were, make a counter-demonstration against the movements that are going on in the New York money market by making the discount rate at the Federal reserve bank a little higher by making money a little less easy in the interior banks.

The CHAIRMAN. It is time to adjourn now. We will adjourn until 10.30 o'clock to-morrow morning.

(Whereupon, at 12.20 o'clock p. m., the committee adjourned until Tuesday, May 1, 1928, at 10.30 o'clock a. m.)

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Tuesday, May 1, 1928.

The committee met at 10.30 o'clock a. m., pursuant to adjournment, Hon. Louis T. McFadden (chairman) presiding.

The CHAIRMAN. The committee will come to order.

Dr. Oliver M. W. Sprague, of Harvard, is here this morning, and we will be very glad to hear you, Doctor Sprague, on the subject of this bill. Mr. Miller, of the Federal Reserve Board, will continue

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his testimony before the committee to-morrow, providing the committee adjourns until that time. He has very kindly given way to Doctor Sprague this morning, who has to leave this afternoon.

STATEMENT OF DR. O. M. W. SPRAGUE, HARVARD UNIVERSITY, CAMBRIDGE, MASS.

Doctor SPRAGUE. I appeared before the committee two years ago and discussed the bill in its then form, and much that might be pertinent was said then.

The bill in its present form seems to me more satisfactory than the earlier draft. The changes that have been made serve in some measure, at all events, to meet criticisms that were made against the measure—criticisms largely founded upon the fear that the bill would be misleading, suggesting to the public accomplishments by the reserve system which were beyond its powers.

I am not sure, however, that the modifications that have been made, or other modifications that might be suggested, would serve entirely to meet the objections that are raised against a measure of this sort. The purpose of the measure being to stabilize the price level, the question must necessarily present itself, How far is it possible to stabilize the level of prices through reserve bank policy, and the further and even more difficult question, Is it desirable to attempt such stabilization?

There are difficulties, as I see the matter, both practical and general. In the first place, the business community is not as yet converted to the proposition; and, after all, in executing this policy through the reserve system, the system must act upon and affect the business community. I am not sure but that there should be some years of further successful missionary work before it would be advisable to amend the Federal reserve act along the lines suggested by this measure.

In the second place, I am impressed by the conspicuous lack of belief in this measure on the part of those intrusted with the management of the Federal reserve system. It seems to me that it is a little as if a missionary society were to engage a number of agnostics to go out to China to convert the people of that country to Christianity. After all, the policy expressed in this measure must be executed by the officers of the reserve system; it is not a measure which provides automatic means for its execution. There is a provision in the reserve act to the effect that the banks must maintain a reserve ratio of 40 per cent against Federal reserve notes and 35 per cent against deposit liabilities. Even though officers of reserve banks might not believe that that was a necessary or desirable provision in the act, it is a perfectly clear-cut provision which can be readily obeyed and followed, regardless of beliefs as to its wisdom or desirability. When, however, you come to a provision directing the promotion of a stable value of the dollar, you are requiring the management of the reserve banks to do something that can not be done except by the exercise of judgment in a succession of situations.

I should, therefore, have very much more hope of successful results from this measure if there were a more general consensus of opinion of the public outside and in the management of the reserve banks

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both as to the desirability and the feasibility of the policy embodied in the measure.

I now come to a general examination of the possibilities of executing this policy through the Federal reserve banks, including the related subject as to whether the passage of this measure will in practice make any particular difference in the determination of Federal reserve policy.

I ask myself what I would do if I were a responsible officer of a Federal reserve bank, after the passage of this measure, other than what I would presumably do if the measure were not passed; and I am not able to say that I should do anything very different following the passage of this measure from what I would be disposed to do in any event.

If there were clear evidence of a rapid upward movement of prices and speculative purchases of commodities, accompanied by a growing demand for credit, manifested, among other ways, by an increased demand for rediscounts at Federal reserve banks, I should favor an advance in the discount rate, as well as, perhaps, other measures designed to check such undesirable developments. I would not measure the situation exactly by an index number, by the movement of prices, but I should consider the movement of prices as one of the factors leading to the action suggested, namely, an advance in the discount rate. But no particular advance in prices of 3 points or 6 points or some other number of points in an index number would determine the decision at which I think I should probably arrive. The upward movement of prices would be simply one factor in the situation, sometimes significant and at other times probably of minor importance.

If, for example, I had been concerned with the Federal reserve system during the last three years, I do not believe that the movement of prices would have been a large factor, in my judgment, as to what it was desirable to do. The movement of prices has not been sufficient to suggest that price movements have been a large factor in the situation. Other considerations would have been, in my judgment, controlling as guides of action.

Now, I wish to indicate certain situations in which an attempt to offset or counteract a given price tendency might be positively inadvisable.

Let us suppose, for example, that certain important lines of business activity should be overdeveloped—let us say automobiles and the building industry—so that a desirable readjustment presumably would involve some shrinkage in the amount of labor and capital employed in those industries; certainly not a further expansion. An adjustment or readjustment of that sort would probably involve a slackening in trade activity for the time being, and presumably would be reflected in some decline in the general level of prices.

Mr. KING. Do you object to an interruption?

Doctor SPRAGUE. No; I welcome interruptions.

Mr. KING. Is this all based upon theory, or have you some actual demonstration of what you are testifying about?

Doctor SPRAGUE. I am going to give you one in a moment. That would be my judgment as to the development of prices in that event; that prices would decline somewhat, and that an attempt to offset

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that decline might very readily defer that necessary adjustment and make it more serious.

I will now take the particular case of agriculture. Agriculture, in my judgment, throughout the world has been overdeveloped. I see no possibility of the speedy development of a largely increased demand for agricultural products. The adjustment that has been taking place in the last few years has been one which has been marked by some shrinkage in the acreage under cultivation. Agricultural prices in these circumstances have exhibited some downward tendency, and I do not believe that it would have been of advantage to agriculture at any time during the last few years, on the basis of average prices, to have injected additional credit into the situation. I should expect that that additional credit would in the main have stimulated other prices than agricultural prices. It may be that additional credit at various times during the last five years has been desirable, but I do not believe that the test of its desirability has been in the movement of prices during these last four or five years.

Now, let us take another situation.

Mr. WINGO. Before you leave that, may I ask a question?

Doctor SPRAGUE. Yes.

Mr. WINGO. Would you mind stating upon what you base your conclusion that, notwithstanding the probable continued increase in the growth of population of the world and a steady improvement in the standard of living the world over, you still think there will not be any corresponding increase in the consumption of agricultural products.

Doctor SPRAGUE. If you take the western world, I should say that most people have nearly all or quite as much to eat as they really want; that urban populations and machine-tending populations do not eat as much as a population that is working mainly out in the open air, doing heavy work. It is for this reason that I do not believe that an increase in the consumption of food can be brought about by a decline in its price. The demand for those products appears to me rather an inelastic demand; increasing, of course, with the growth of population, but with additional supplies to meet the requirements of the growing population available from a great many different sources in addition to the area under cultivation in the United States. I do not know of any agricultural product for which profitable prices could probably be secured in the event of an increase of, say, 10 to 20 per cent in the amount produced. For that reason I see very little advantage or hope of a complete readjustment in agriculture merely through diversification or a lowering in the cost of production.

Mr. STRONG. In response to Mr. Wingo's question you gave your opinion. Have you any statistics or figures upon which to base your opinion?

Doctor SPRAGUE. The Department of Agriculture and the Bureau of Food Research in California have developed a certain amount of data regarding the amount of food being consumed upon a per capita basis, and it has declined somewhat. I have not that data here.

Mr. STRONG. They hold that there is less food consumed in the United States than formerly?

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Doctor SPRAGUE. Per capita; yes. I think we all know that in our own experience; that the thick steaks that people used to eat are not apparently in demand any more.

Mr. STRONG. Not for us, Doctor, but for the young man and the workingman. Do not they consume just as much?

Doctor SPRAGUE. No; a man who is sitting before a machine does not eat as much month after month as a man who is engaged in active, arduous outdoor work.

Mr. KING. Would it not take his whole pay for one day to pay for a decent steak nowadays? Is not that one of the reasons why he is not eating them?

Doctor SPRAGUE. I might say that there are some possibilities of a refinement in the quality of the food consumed.

Mr. KING. Is it not due to the cases of diabetes and to food advice by the doctors?

Doctor SPRAGUE. Very likely that is a factor. But I take the fact as I find it, and I believe that it is exceedingly difficult, through any probable reduction in costs and any probable reduction in price, to bring into the market a very large increase in demand.

Mr. STRONG. Then it is your idea that farmers can not look for much success in this country in their industry?

Doctor SPRAGUE. They can look for the same sort of success which has been experienced by my friends in Vermont. We have lived under conditions since 1870 in which no one has anticipated that the price of land was going to improve. A large acreage of the less fertile land is not now in cultivation that was in cultivation in 1870. A comfortable living is derived from the better lands, and only from them; and I believe that that will be the case throughout a widening area in the United States.

Mr. STRONG. Then those who engage in extensive farming as a business must fail?

Doctor SPRAGUE. I would not wish to make that statement.

Mr. STRONG. That would be the conclusion. If there is a living to be had only from the better farms, and if a man who goes into farming extensively can not get more than a living, he can not possibly hope to get a fair return on his investment.

Doctor SPRAGUE. No; and no one is getting a fair return on his investment in Vermont if he reckons his investment at the price at which land was selling in 1870.

This is rather aside from the discussion of this bill, except that I do not see any particular relief for any particular overdeveloped industry in this measure. At most it will have a generally ameliorating effect upon all industries; it will be of as great advantage to the successful industries and the growing industries as to the others. But the contribution that it will make, at most, will not be sufficient to render the declining industries profitable or to render unnecessary from time to time a readjustment of the capital and labor force of the community, withdrawing it in some directions and increasing it in others.

Mr. STRONG. Do you not think the stable purchasing power of the dollar, if it could be brought about, would be of great benefit to all classes of the Nation?

Doctor SPRAGUE. It would, depending upon what you mean by the stable purchasing power of the dollar.

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Mr. STRONG. I mean as measured by what it will buy of commodities in general, of course.

Doctor SPRAGUE. Yes. But, the problem that will confront the management of the reserve system is to know when to act; what degree or amount of variation in the purchasing power of the dollar should be regarded as the basis for action on its part; and then a further inquiry as to whether action will be desirable. When prices are advancing by leaps and bounds, and there are speculative commitments in many commodities, that is a clear case for action; but I hold that there may be declines in prices which reflect a necessity for some readjustments in the capital and labor force of the community, and that in those circumstances the decline in prices will not be at the outset a reason for taking action on the part of the reserve banks.

Mr. STRONG. You are speaking of general prices?

Doctor SPRAGUE. Yes. And again I hold that a moderate upward movement of prices, beginning, let us say, now, may be at some date in the future a significant factor in the determination of reserve bank policy. Just when it will be is very uncertain. Let us suppose that the price level is now 96, measured by the 1926 level, and that prices begin to move upward, and they go to 97, 98, and 99. When is it desirable that the reserve bank management make an effort to restrain the upward movement of prices? Sometimes it might be desirable so to do when prices had moved to 99; at other times it might not be advisable to take any action until prices had moved, say, to 102. It will depend upon all the other factors in the situation as regards these slight fluctuations. Judgment must be exercised in any event as to when it is desirable to do something.

Mr. STRONG. But you feel that there should be a time when that judgment should cause the management of the Federal Reserve Board to act?

Doctor SPRAGUE. Oh, yes.

Mr. STRONG. Well, that is the purpose of the bill.

Doctor SPRAGUE. But I am inquiring whether the bill adds anything or compels the management of the reserve banks to do anything different from what sensible men would in any event do as regards short-time fluctuations. If this bill should compel or influence the management to make frequent changes in policy following slight changes in prices, I should be afraid of the bill. If the bill contained the words "extreme changes in prices in short periods of time," I should say that there would be less danger of misconception from the bill.

Mr. STRONG. The word used in the bill is "promote"—to promote stability.

Doctor SPRAGUE. Yes.

Mr. STRONG. Not to indicate that every little change should call for a change in policy, but that they should promote stability. Of course the price level will tend upward and then it will tend downward. If it tends to a violent ascension of prices, then they are to use their powers to promote stability; not for exact stability.

Doctor SPRAGUE. If that is the certain meaning of the measure; if the measure will not tend to magnify unduly the significance of price changes, I see no positive harm from the measure; and in so far as it may serve in the public mind to emphasize the desirability

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of general stabilization of prices or of the price level, it might do no harm and might not inconvenience the management of the Federal reserve banks. What I am afraid of is that in the process of converting the public to this measure overemphasis has been placed upon the importance of the price level over short periods of time. Much has been said, for example, before this committee regarding the influence which the Federal reserve banks have exerted upon prices during the last six years, and the impression has been created that prices have been the major objective of Federal reserve bank policy during the last six years. I question whether that has been the case. All sorts of considerations have had a bearing upon reserve bank policy.

Mr. STRONG. But you do agree that, as a policy, the Federal reserve system should aim for stability?

Doctor SPRAGUE. Yes; I think that I could agree to that.

Mr. STRONG. Then you do not think that, acting under this bill, a reasonable man of experience, such as we have and are apt to have in the Federal reserve system, would attempt to use his powers with every fractional increase or decrease in the price level?

Doctor SPRAGUE. I should hope not.

Mr. KING. Why are you afraid of the public?

Doctor SPRAGUE. I am not so much afraid of the public as I am of the sort of propaganda that has been used for the passage of this bill.

Mr. KING. Is not the public, as a matter of fact, keeping up with you professors on all these things, and following you very closely?

Doctor SPRAGUE. Well, the professors are not by any means in agreement about the possibilities of the determination of credit policy by price changes. They still feel that there is much to be learned from additional experience, and some of us wish to be quite certain that the movement of prices within moderate limits will not, either in the management of the reserve system or in the judgment or expectation of the public, be made the invariable controlling factor in reserve-bank policy.

Mr. STRONG. Doctor, to what propaganda do you refer as having been used in favor of this bill?

Doctor SPRAGUE. Not of this particular bill, but of priced stabilization as a possible gain to the community. For example, I noticed a statement by one professor a short time ago——

Mr. KING (interposing). What professor?

Doctor SPRAGUE. Prof. Irving Fisher—to the effect that the decline in prices of 1926 and the first part of 1927, when business was very active, was the prime cause of the subsequent recession in business in the latter part of 1927. Now, I am not prepared to accept that for a moment. In my judgment, in that period of 1926 and the first half of 1927, of very active business, had the Federal reserve banks, because prices were declining somewhat, injected more credit into the situation, it would have developed at many points unsound conditions in business which would have been followed by a more serious amount of recession in the latter part of 1927, or possibly at the present time.

It is that sort of contention that, in all circumstances the movement of prices should be a signal for taking immediate action, that I fear. If restraint in judgment and in expectation accompanies this bill, as to its possibilities, well and good.

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Mr. STRONG. You know, Doctor, that the plan proposed in this bill for stabilization, the using of the powers of the Federal Reserve System, is not the Fisher plan of stabilization.

Doctor SPRAGUE. Quite true; but if Mr. Fisher had been operating the Federal reserve system I take it that he would have injected a lot more credit into the situation in 1926 and the first half of 1927 merely because prices were going down, although business was exceedingly active and money rates were moderate.

Mr. STRONG. Because Doctor Fisher advanced an opinion with which you do not agree, you do not propose to believe that that is propaganda for this bill, do you?

Mr. BEEDY. He has not said that. Mr. Chairman, I would like to ask at this point, is the doctor making a statement, or has he finished and is he now being questioned by the committee?

Mr. STRONG. The doctor said he would welcome questions.

Mr. BEEDY. Then I want to make a motion that we hear the doctor.

Mr. KING. We have heard him, before you came in.

Mr. STRONG. You came in late.

Mr. BEEDY. That is why I am asking the question. If I had been here I would not have asked it.

Mr. STRONG. Mr. Chairman, I rather think, when the doctor makes the statement that there has been so much propaganda for the passage of the bill that, as the author of the bill, especially as I have sent out no propaganda, I have a right to ask what he refers to.

Mr. KING. He would be justified in saying that about any legislation.

Doctor SPRAGUE. It is propaganda for stabilization. What de we mean by stabilization? I am simply emphasizing the point that, both in the management of the reserve system and in the expectations of the public, it would appear to me that a restrained attitude as to expectations from the reserve system is proper.

Mr. STRONG. Let me suggest this, Doctor. Section (h) is practically the language of some of the officers of the Federal reserve system.

Doctor SPRAGUE. Yes.

Mr. STRONG. And it was drawn to avoid the very thought you are suggesting; not of a change of policy on each small change in the price level, but to promote stability in general by the use of the powers of the Federal reserve system. The language of section (h) was drawn and suggested by officers of the Federal reserve system and not by myself.

Doctor SPRAGUE. It was with that in view that I stated at the outset that the bill seems to me to be in much more satisfactory form than it was two years ago; and what I have said up to the present point may be regarded as in the nature of support for the bill in that I have indicated the desirability, in the event of the passage of this legislation, that the conservative and moderate qualifying expressions used should be very clearly in the mind of the public and in the minds of the management of the Federal reserve system.

Mr. STRONG. Would you suggest any change in the language of section (h) to make more clear the thought that you and I both have and agree on?

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Doctor SPRAGUE. It is probably impossible to express any view except in negative language, such as to avoid extreme changes; and possibly your positive expression, "to promote stability," serves the purpose.

Mr. STRONG. Let me suggest, Doctor, that there is one other change suggested in line 7; to add the word "promote" and change "maintain" to "maintenance," so that it would read:

To promote the maintenance of the gold standard; to promote the stability of commerce, industry, agriculture, and employment; and, after the word "stable" in line 9, insert the word "average," so that it will read "and a more stable average purchasing power of the dollar."

Doctor SPRAGUE. Yes; I have that in the draft that I have received.

I wish to turn from the situations presented by minor fluctuations in prices, of somewhat uncertain significance, to problems presented by prolonged trends upward or downward in the level of prices, and inquire whether this bill is calculated to lessen the likelihood of such pronounced or prolonged trends.

The trend of prices throughout the world over long periods of time will depend in large part upon the monetary supply of gold and methods of its use. If the world returns to the use of gold coin as an essential part of a full gold standard, it is my judgment that there will not be sufficient gold available to support prices at the present level over the years to come. On the other hand, if gold is conserved for bank-reserve use by its practical exclusion from use in hand-to-hand payments, then I am inclined to think that the gold supply will be adequate, and, at all events, that it will be a considerable number of years before a possible inadequacy in supply will manifest itself in a downward trend of prices.

Mr. WINGO. In other words, the management of the gold supply, you think, is going to affect the future trend of prices?

Doctor SPRAGUE. Yes. I should expect an immediate downward trend of prices if all of the gold-standard countries, present and prospective, endeavored to use gold coin. Even if they do not use gold coin, it is possible that there may be a downward trend in prices, but it certainly would not come as soon. It might be manifest in 5 or 10 years or more, but it would not be an urgent question. The question that is urgent in connection with this matter at the present time is the policy which may be adopted in different countries as to the use of gold coin.

The CHAIRMAN. In that connection, are you familiar with the statement of Dr. John R. Commons before this committee on this same subject?

Doctor SPRAGUE. Yes.

The CHAIRMAN. Do you agree with him as to his position on the possible decline of the general price level; if there is a fulfillment of the present tendency of the various countries of the world to go back to a full gold basis, that the price level may go back to the 1913 normal of 100, declining from the present level of approximately 150?

Doctor SPRAGUE. I would not agree to that; certainly, if gold is not introduced as coin. There is a statement which I handed Professor Commons, and which might be put into the record, by Professor Kemmerer, of Princeton, which presents a view with which I am in agreement, with supporting figures. I would suggest that that be placed in the record.

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The CHAIRMAN. Have you a copy of that?

Doctor SPRAGUE. Professor Commons has a copy.

The danger of such a trend of prices does not seem to me to be extreme, for the reason that a declining tendency in prices is disagreeable to almost all influential people in any community. The damaging effect which a prolonged downward movement of prices may have upon industry is such that I do not think we need fear that policies calculated to bring that about will be adopted, or, if adopted, will be persisted in.

The CHAIRMAN. Doctor Commons, who is present, has just handed me a copy of the American Economic Review of December, 1927, in which the article "Postwar Movements Discussion," by E. W. Kemmerer, on page 67, is recorded. Is that the one to which you refer?

Doctor SPRAGUE. That is the one; yes, sir.

Mr. STRONG. Do you want that placed in the record at this point?

Doctor SPRAGUE. I think it might well go in the record.

The CHAIRMAN. Without objection, then, this article appearing on page 67, and including the first paragraph on page 70, will be inserted in the record at this point.

(The article is as follows:)

POST-WAR PRICE MOVEMENTS DISCUSSION

[Discussion by Prof. E. W. Kemmerer, of Princeton University, at the Fortieth Annual Meeting of the American Economic Association, December, 1927. (Proceedings, American Economic Association, 1927, American Economic Review Supplement, March, 1928, pp. 67–70)]

I have read Professor Edie's paper with much interest and find myself in agreement with much of what he says. There are many points in the paper, however, concerning which I have serious doubts and, inasmuch as we profit more by discussing our differences than our agreements, I shall devote the few minutes at my disposal to one of these points, namely, to Professor Edie's apparent belief that the world's gold production will soon be so inadequate as to force upon gold-standard countries of the world a long period of falling prices. He says, "Barring some wholly fortuitous event, the outlook for a sustained increase in gold production is thoroughly discouraging," and his discussion concerning increased economies in the use of gold in the future yields an equally pessimistic conclusion. In such conclusions he has good support in the opinions of no less authorities on this subject than Mr. Joseph Kitchen and Prof. Gustav Cassel. And yet I have my doubts, and my reasons for them I will suggest briefly: First, those relating to the supply of gold, and second, those relating to the demand.

When, as a result of the war and particularly of the war-time depreciation in the value of gold, the world's annual gold production fell off from approximately 22,000,000 fine ounces in 1913 to 15,500,000 in 1922, and the South African gold production declined from 8,008,000 fine ounces in 1913 to 7,000,000 in 1922, we heard on every side pessimistic opinions as to the future production of gold and prophesies that it would be many years before pre-war figures of gold production would be restored, and that, at any rate, the return to these earlier high figures was highly improbable at best before the pre-war value of gold should be pretty well restored through a heavy decline in price levels. Well, gold is to-day worth only about two-thirds what it was worth in 1913, production costs in the best mines are actually lower than they were before the war, and the world's total gold production which by 1922 had dropped to 69 per cent of the 1913 production had risen by 1926 to 87 per cent of the 1913 figure. South African production exceeded the 1913 figure by 4 per cent in the year 1923, jumping in that one year from the lowest figure in 20 years, which marked the year 1922, to the highest figure but one in the history of the Rand, and every year since 1923 has registered a new high figure for the Union of South Africa, which to-day produces over half of the world's gold. A news item in the New York Times for December 18 says that the total gold output of the Transvaal for the first 11 months of 1927 was "9,280,000

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ounces, so that last year's total production of 9,962,852 ounces, which was a new high record in the history of the Rand, will certainly be exceeded this year."

The London Times of November 30, quoting a report for the year 1926 of the largest gold-producing company in South Africa, said: "The quantity of ore crushed, gold produced, and profits obtained show large increases over previous years." A couple of years ago I visited one of the largest gold mines on the Rand, where I saw gold mined at a depth of considerably over a mile, a thing which would have branded a man as a mad man if he had prophesied it a generation ago, while most of the gold was being produced from ores of grades so low that they would have been discarded in the nineties of the last century. Of the total world's gold production since 1492, about half has taken place since 1901. New gold-producing areas are continually being discovered, and it does not seem at all improbable that new methods may be discovered in the future that will materially reduce the costs of production and bring into use lower-grade ores than are to-day being worked, and of such ores there are enormous quantities available.

Furthermore, as in the past, any appreciation of gold by reducing the price level and, therefore, production costs, will tend to check itself by stimulating increased gold production.

Passing from the subject of the supply of gold to that of the demand for gold, the following brief observations may be made:

First, the evils of monetary instability are appreciated by the intelligent public much more than they were a few years ago; likewise the possibility and desirability of exerting strong stabilizing forces through cooperative action among the world's leading central banks and among governments. The frequent conferences we have seen mentioned in the press in recent years among the governors of the New York Federal Reserve Bank, the Bank of England, the Bank of France, the Reichsbank, and other central banks are hopeful signs. International conferences, like the Genoa conference, dealing with this subject are likely to occur more frequently in the future under like conditions than in the past because of the existence of the League of Nations. This sort of international cooperation would probably become more powerful and effective in the future if need should arise to combat any strong tendencies toward gold appreciation.

A possible form of international cooperation in the direction of stabilizing the value of gold which has not yet been resorted to but which could probably be used in case of great need in the future is the regulation of the flow of gold into the arts. One can imagine few things that are affected with a greater international public interest than the value of gold for monetary purposes, and, on the other hand, one can imagine few things affected with a less international public interest than the principal uses for gold in the arts. Roughly speaking, something like a half of the worlds' gold production normally flows into nonmonetary uses. Certainly the flow of gold into these uses could be materially restricted by taxes and other governmental measures, thus leaving the monetary uses a larger proportion of the total annual production than those uses now obtain under conditions of competition with industrial uses.

Second, we may expect, I believe, contrary to the opinion of professor Edie, a much greater development of the gold-exchange standard in the future than we have had in the past. There was a considerable development of the gold-exchange standard before the war, as, for example, in India, Java, the Philippines, and the Straits Settlements, and it exists to-day in many more countries than it did in 1913. In some of these countries, at least, it is not looked upon as a half-way house on the way to the more customary form of the gold standard. In the future the gold-exchange standard is likely to be adopted particularly by smaller states and by colonies and other dependencies of larger states.

Third, there is an enormous possibility for the development of the check system in most countries of the world, aside from Anglo-Saxon countries, and the use of checks in place of bank notes is a large economizer of gold.

Fourth, and closely related to the above, in fact, another phase of it, is the great economy in the use of gold that will result from increases in the rate of monetary and deposit currency's turnover or, as it is often called, in the velocity of circulation. The efficiency of monetary gold varies with the rate of turnover of the gold coin itself, when it is used in hand-to-hand circulation, and of the notes and deposit currencies based upon gold when the gold coin is withdrawn from active circulation and held as reserve against notes

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and deposits. As population becomes more dense, business more efficient, and transportation more rapid, we may reasonably expect increasing rates of monetary and deposit turnover. A gold coin that turns over, for example, twenty-four times a year in hand-to-hand circulation when placed in a 40 per cent gold reserve against bank notes of a central bank serves as the metallic basis of two and one-half times its value in notes, and as each dollar in notes will do as much money work as a gold dollar in hand-to-hand circulation the gold dollar thus withdrawn and used as the basis of note issues has its efficiency increased in the proportion of 60 to 24, or two and a half times. If the same dollar in turn is taken out of the note-issue reserve and put into a 35 per cent gold reserve in a central bank against deposits, and if these deposits in turn constitute on the average a 10 per cent reserve for the deposit of commercial banks, and if these commercial bank deposits in their turn have an average rate of turnover of thirty-six times a year, we have multiplied the monetary efficiency of our original hand-to-hand circulating gold coins about forty-threefold. The gold dollar in reserve against deposits is, roughly speaking, seventeen times as efficient as it was when held in reserve against bank notes. These figures are, of course, hypothetical, but they are based roughly upon estimates of monetary and deposit currency rates of turnover in the United States and our present legal reserve requirements for the Federal reserve system. The tendency of the world is likely to be strongly in the direction of using the more economical media of exchange and the rates of monetary and deposit turnover are likely to increase. The increasing influence of American banking methods, particularly with reference to the use of checks, on other countries of the world is likely to lead to more rapid development in the use of deposit currency in other countries of the world in the near future than it has in the recent past.

All things considered, I am inclined to think that our anxiety concerning the future of gold might better be directed less to the danger of currency appreciation through gold scarcity, although such a contingency is, of course, possible, and more to the question of what would happen to our financial structure, to the distribution of wealth, and to the welfare of our educational, benevolent, and other social welfare institutions if history should again repeat itself and modern science should, despite all the wise prophesies to the contrary, perform another miracle by devising a method for making synthetic gold cheaply. When the ordinary layman is told that synthetic gold is already produced, but only at extravagantly high cost, he is inclined to say, "If modern science can perform the miracle of producing synthetic gold at all, the world would do well to consider seriously ways and means for meeting the great problems that would arise if some wizard should suddenly announce to the world that he had devised a method of producing synthetic gold cheaply."

Mr. LUCE. Professor, for the 15 or 20 years prior to 1896 there was such a downward trend. Why do you think that the same force may not be repeated?

Professor SPRAGUE. Possibly because currency and credit are better understood and the administration of currency and credit is more highly centralized in central banks of different countries. We have the agencies now developed in the different commercial countries which are calculated both to recognize the presence of such a situtation and to take appropriate action in order to counteract its effects.

Mr. LUCE. Would that not seem, then, to prove that the manipulation of the price level is a possibility?

Doctor SPRAGUE. The price level over long periods of time when the basic question is the supply of reserves is subject to management and control through structural arrangements rather than by policies in banking operation, and will require, I believe, management and control unless it happens that the gold supply is such as to maintain prices at a desired level.

Mr. LUCE. Then, would it follow that this bill is not unreasonable in its basic proposition?

Doctor SPRAGUE. That has to do with the long-distance course of prices?

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Mr. LUCE. Yes.

Doctor SPRAGUE. Why, yes and no. The power of the Federal reserve banks in this matter is in some degree limited; they can not act alone. If the situation which I have indicated as a possibility should manifest itself of an inadequate supply of gold for monetary use, it would hardly be possible for the Federal reserve banks alone to maintain by their own action within this country either stable world prices or stable prices within this country. It would be necessary that cooperative action be taken among the various countries or between the various central banks, and, in so far as the last sentence of section (h) would appear to support or strengthen the authority of the Federal reserve banks to engage in cooperative undertakings with other banks, designed to meet an inadequacy in the supply of gold, I think that the provision might prove serviceable.

Mr. WINGO. Do I understand, Doctor, that you think that it is possible, by proper management of the world supply of gold, to prevent a long period of gradual decline?

Doctor SPRAGUE. Yes; to defer it certainly by the introduction of many economies in the use of gold.

Let me illustrate by another possibility. Assuming that the central banks of the world should eschew a policy of pulling and hauling in order to get gold, that they all recognized the desirability of free gold markets susceptible to influence through changes in lending rates, then it becomes less necessary for any particular bank to hold as high a gold reserve as would be needed if all the various central banks were working at loggerheads with each other, each scrambling to get all of the gold and each placing obstacles in the way of its going out.

Mr. WINGO. In other words, if there is a proper cooperation in the management of the world supply of gold you feel that a deficiency of gold would not be realized?

Doctor SPRAGUE. It would be certainly long deferred, in my judgment.

Mr. WINGO. Then do I understand you to take this position, that there is a period of decline facing us, and its velocity is going to be determined by how the gold supply is managed?

Doctor SPRAGUE. If you are thinking of periods of years and not of the shorter time fluctuations, I do not believe that there is necessarily a period of decline in prices facing us, for the reason that we have at least $1,000,000,000 in gold available to support either additional credit in this country or to export. That additional billion furnishes a very satisfactory margin for additional credit expansion here and in other countries.

The CHAIRMAN. You speak now of the cooperation with other central banks. Of course, we all know that the Federal reserve system here is cooperating with the central banks of issue of the important countries of the world now. In other words, there is a managed gold situation. Do you agree with that?

Doctor SPRAGUE. Yes.

The CHAIRMAN. Take, for instance, the present exports of gold. That is due to the carrying out of that cooperation in which we are engaged, is it not? It is not a free movement of gold; it is a managed movement of export gold, is it not?

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Doctor SPRAGUE. In part. It is managed in this sense, that we regard it on the whole with satisfaction and are not disposed to take measures directed toward checking it.

The CHAIRMAN. In other words, the present export of gold is benefiting the rehabilitation to a gold basis of some of these countries abroad?

Doctor SPRAGUE. Yes.

Mr. STRONG. And the system is permitting it?

Doctor SPRAGUE. Certainly. That is for the purpose, in large part, of replenishing what are regarded as inadequate gold reserves in various countries, in order to place them solidly upon the gold standard, but you come subsequently to a second stage, with most countries fairly solidly upon the gold standard, and then the question may present itself whether in the following years the supply of gold will prove adequate to support sufficient credit to maintain prices, or whether it will be inadequate with a consequent tendency of prices over the years to decline, and I contend that with a reasonable amount of cooperation among the central banks, and the establishment of free gold markets, and the practical elimination or continued exclusion of gold coin from circulation, that there does not seem to me to be evidence of a probable inadequacy in the supply of gold so far as, let us say, the next 10 years are concerned.

Mr. WINGO. Necessity will compel that management which will prevent the hand-to-hand payment of gold, will it not?

Doctor SPRAGUE. Yes.

Mr. WINGO. And confine its use to reserve purposes?

Doctor SPRAGUE. Yes.

Mr. WINGO. But the question of cooperation between the different countries is a different proposition from confining the use of gold within each particular country for reserve purposes, and your opinion is that the supply of gold, whether or not it will be adequate to maintain the price level over a long period, will depend upon whether or not there is that cooperation?

Doctor SPRAGUE. Yes.

Mr. STRONG. To permit that cooperation is the purpose of the language in lines 11 and 12 of section (h) of the bill.

Doctor SPRAGUE. That seems to me to be a desirable feature in the bill. The power may be implied now, but it is so important that it may very well be desirable to have it definitely embodied in the statute.

Mr. STRONG. Do you think the language of lines 11 and 12 in the bill, in section (h), is proper?

Doctor SPRAGUE. The provision as stated excludes any other relationships. I should prefer a positive grant of power which might leave open relations for other reasons which we can not now well perhaps foresee. A positive grant of power which does not exclude anything else seems to me to be preferable.

Mr. STRONG. I think I ought to say that that language is not my own but was suggested to me by officers of the Federal reserve system.

Doctor SPRAGUE. Well, that is a mere suggestion. I do not regard it as of vital consequence whether it is framed in this way which seems to exclude other relations or not. The main thing is that it certainly permits and authorizes those relations with central banks,

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which all experience shows to be the most important of the relations among the central banks of the different countries.

The CHAIRMAN. Right there, Professor, what you have said in connection with this gold situation and the cooperation of our Federal reserve system with the other banks of issue indicates to me the necessity for a continuance of these close working arrangements, at least over a period of the next 10 years.

Doctor SPRAGUE. I think so.

The CHAIRMAN. Else there will be chaos.

Doctor SPRAGUE. Yes.

The CHAIRMAN. And if gold is permitted to flow without any management, because of the important part it occupies in the world's banking and stabilization, gold might go to a premium and there might be a wild scramble for the accumulation of gold.

Doctor SPRAGUE. Yes; and that makes it necessary to hold more gold in any particular country than would be the case if the scrambling was not going on.

Mr. STEVENSON. As at present constituted, is it not pretty well conceded that the banks have the powers which are being expressly conferred in this bill?

Doctor SPRAGUE. Yes; I think so.

Mr. STEVENSON. Is it desirable to declare everything in explicit terms that the banks may do? In other words, is it desirable for the legislative department to step in and tie up and control absolutely the administration of the financial affairs of this country?

Doctor SPRAGUE. When you take into account all of the qualifications inserted in the measure, and also implied by Congressman Strong, I confess I do not see that the situation, so far as the reserve bank management is concerned, is essentially changed, and, as I said before, if I were an officer of a bank, on the passage of this bill I should feel that I could do practically what I was doing before, and exercise my judgment as to when it was desirable and how far it was desirable to take account of certain price movements.

Mr. STEVENSON. I notice in this morning's paper that on account of the peculiar loaning conditions in which somebody has probably short sold and somebody has probably long bought in New York, the Senate committee is now undertaking to take steps to administer the policy of the Federal reserve bank. What business have they got to do that, and what effect is it liable to have upon the independence of the executive branch of this Government?

Mr. KING. They merely passed a resolution, if you noticed the record, requesting a desistance and rescission of that practice. They did not pass any law.

Mr. STEVENSON. They have not passed a law, but they are interfering with the executive arm of the Government.

Mr. KING. Not at all.

Mr. WINGO. Of course, they intended to give the executive officers the benefit of their wisdom.

Mr. GOODWIN. Do I understand that the Federal Reserve Board now has the authority which Congressman Strong seeks to obtain through the provisions of his bill?

Doctor SPRAGUE. I think that they have. I believe they have a legal opinion to the effect that their various arrangements in connection with stabilization are entirely within the implied powers of

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the reserve banks and central banks, since they are the sort of things central banks have done for generations.

Mr. GOODWIN. Has the board failed in the exercise of that prerogative or power?

Doctor SPRAGUE. I do not think so. The board and the banks did not in 1919 and 1920 restrain the upward movement of prices, I do not think that there would then have been any difference if these provisions had been originally in the Federal reserve act, because the credit policy of the system was determined by the Treasury at that time, and it is only in the event that the presence of these provisions would have modified Treasury policy that it would have had any effect upon the volume of credit and the price movement in 1919.

I regard this as a measure for times of peace, and I see no great harm in it and I see no great change involved from its passage in the probable policies which the reserve banks will follow in the future. It is an expression of a pious wish that the reserve banks should give a good deal of attention to the movement of prices in the determination of policy, and I presume they do give a fair amount of attention to the movement of prices now, as well as to much else.

The CHAIRMAN. Your statement before the committee in relation to these powers this morning presupposes that the Federal Reserve Board, in the exercise of these various powers, has such influence, if exercised by them, either singly or totally, as to affect the general price level; is that correct?

Doctor SPRAGUE. Yes. Then the question that really presents itself in any situation is whether it is desirable to affect the price level, and I might further add that I am uncertain as to the possibility of smoothing out by reserve-bank action the slighter fluctuations in prices. I am convinced that at any time the reserve banks, by taking the bit in their teeth, could either engineer a decided upward movement of prices or a decided decline in prices, but no one supposes they will do that.

Mr. STRONG. Now, suppose that they will do that. Suppose that the membership of the Federal Reserve Board should so change that the men in charge might conscientiously believe that it was for the best interests of this country to have rising prices or falling prices; would not such legislation as this be very helpful at that time?

Doctor SPRAGUE. That seems to be an exceedingly improbable situation with the existing organization of the Federal reserve system. I should suppose, for example, that a decided movement of that sort, initiated by the Federal Reserve Board under, we will say, political impulse, would be promptly checked by, let us say, the resignation of the six selected members of the directorate of the Federal Reserve Bank of New York, and similar action on the part of the directors of other banks. If we are in a situation of public opinion of such a nature that the directors of all of these various banks do not oppose a policy of that sort, I should expect that, if necessary, this provision of the Federal reserve act would be repealed.

It is an improbable sort of a situation, in my judgment.

Mr. STRONG. But not an impossible one?

Doctor SPRAGUE. Perhaps not.

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Mr. STRONG. Well, in that case, this kind of legislation would be preferable to the remedy you suggest might follow, that of the resignation of the directors of the banks.

Doctor SPRAGUE. Well, I much prefer personally to legislate for positive, present needs rather than so improbable a situation. At all events, that possibility does not, in my judgment, materially strengthen the case for the bill. I rather prefer to consider it in its bearing upon the every-day operation of the system and its bearing upon large general problems, such as the adequacy of the gold supply.

The CHAIRMAN. Doctor, yesterday, before the committee, Doctor Miller, of the Federal Reserve Board, referred to the last six months' period of the operations of the Federal reserve in which he dealt with the lowering of the discount rate in the early fall, and he referred to its effect and spoke of the speculative situation or the increase in the rise of stock values, etc., and in that connection he dealt with the open-market transactions of the Federal reserve, rather expressing an opinion that, in his judgment, open-market transactions as conducted by the Federal reserve should be discontinued.

The committee would be very glad, I think, to hear you on that matter. It is a rather broad suggestion, but I think I have made it sufficiently clear so that perhaps you can give us a statement of your views of that.

Doctor SPRAGUE. I am disposed to think that the Federal reserve system can not function as an active influence in this country in the absence of open-market operations. When the reserve act was passed, I think most people presumed that the member banks would be regular or frequent borrowers of the Federal reserve banks, and that the demand for rediscounts would rise and fall with the varying demands for credit on the part of the industry of the country and that the supply of credit made available by the Federal reserve banks would be very nicely adjusted to requirements by a wise policy in the matter of the rediscount rate.

That, experience shows, is not the situation at all. The member banks are not regular and eager borrowers at the Federal reserve banks, and consequently the operations of many of the Federal reserve banks often have but a slight bearing upon the credit situation in their own locality. At the present time, for example, the Federal Reserve Bank of Kansas City is discounting for member banks only $19,000,000, and the reserve bank at Minneapolis is discounting some $3,000,000 for member banks.

Obviously the operation of these banks is not a large factor in the credit situation of those localities. If the Federal reserve banks were to eliminate open-market operations, the immediate effect would be to increase any rediscounts, but after a period of adjustment we should find our member banks borrowing very infrequently at reserve banks and the rediscount rate exerting a very slight influence upon the credit situation.

If we wish to accomplish anything in particular through the Federal reserve banks, whether to influence prices, money rates, or whatever it may be, I am inclined to think that most of that influence must be exerted and initiated through open-market operations, which will inevitably in large part be centered in New York, because that is the

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only market for large amounts of Government securities, whether for purchase or sale.

Mr. WINGO. In that connection, the open-market operation is not confined to Government securities but to bills and acceptances.

Doctor SPRAGUE. But the bills and acceptance in large part are also marketed and located in New York. The different reserve banks hold acceptances as well as Governments, but practically all of the acceptances and the Governments held by, say, the Kansas City bank, are purchased for their account in the New York market. The purchase by the Kansas City bank of acceptances and Governments does not directly affect the situation in the Kansas City district. What happens is that additional purchases of Governments and lower rates for acceptances initially place additional funds in the New York market tending to a reduction of rates there, with a seepage of funds out to the country, if there is a demand in the country, and a tendency toward lower rates throughout the country than would be the case in the absence of this open-market operation.

Now, the question presents itself whether in any particular situation it is desirable that there be an enlargement of open-market operations, an easing tendency in rates, or the reverse.

Last summer it seems to me that it was altogether advisable that there should have been some easing in rates and some addition to the supply of credit, because of the indirect effect in supporting or assisting the maintenance of the gold standard in other countries and because to some extent it facilitated the marketing of foreign securities here and the foreigners' ability to pay for a variety of our staple exports.

On the other hand, there was a certain price to pay for these advantageous results. Incidentally, it supported a further upward movement in the securities market. It did not give rise to speculative activities in the commodity markets. Had it done so, I would say that we had paid too much for the incidental advantages which I mentioned as arising out of easier money. It was confined to the stock exchange in large part. It is difficult to point out any other direction in which the open-market operations of last summer have had a possibly undesirable result.

Now, an advance in security prices on the stock exchange may go too far and the market may ultimately fall from its own weight, but that is a matter of secondary importance as contrasted with extreme expansion prices of farm lands or urban real estate or commodities.

Mr. STEVENSON. You have stated that it had practically no effect on the commodities market, although it did possibly stimulate the price of stocks. Why is it not desirable, if it is desirable to stimulate the price of stocks, to stimulate the price of commodities?

Doctor SPRAGUE. It is not desirable.

Mr. STEVENSON. You consider it an evil, then?

Doctor SPRAGUE. If it goes too far.

Mr. STEVENSON. But why is it not a good thing occasionally to stimulate the commodity markets?

The CHAIRMAN. As a matter of fact, is it not a fact that this action of the Federal reserve management did stimulate the price level of agricultural commodities?

Doctor SPRAGUE. It stimulated it, but it did not result in anything that anyone could style undue stimulation.

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Mr. STEVENSON. It did not become a speculative matter at all. It did not go to the point where it made a hardship on the consumers, but every stimulation that you give to commodities helps a man who has commodities to sell, and there are a heap more of them that have commodities to sell than there are of those who have stocks and bonds to sell.

Doctor SPRAGUE. But stimulation of commodity prices to the extent of bringing about undue speculation is far more dangerous and more serious in its repercussions upon the community than a similar development in the securities market.

Mr. WINGO. Doctor Miller's suggestion was, as I gathered it, that the open-market operations of the Federal reserve system are not so important, as controlling, as some people thought. What is your conclusion upon the statement you have just been making——

Doctor SPRAGUE. On the statement I have made, I consider they are vitally important in the conduct of the Federal reserve system, but that they require energetic and farsighted handling.

Now, I wish to go on to the more recent situation. Having secured the advantages that I have indicated from the open-market operations in the summer, with the incidental possible disadvantage of undue speculation on the stock exchange, we reach the beginning of the present year, when the advantages gained from increased open-market operations had been secured. The time was ripe for reversing the movement. By that time the position was such with regard to foreign-exchange rates and other matters so that a fair amount of pressure might be exerted upon the market, and this was initiated by a slight advance in the discount rate and some contraction in open-market operations, with apparently an expectation that the result would be as in 1926, when similar operations were followed by some decline on the stock exchange and the liquidation of 500,000,000 in stock-exchange loans.

Events have not followed that course this year, for the market, after a slight decline, began to rise once more and now presents the earmarks of a boom, analogous to the boom in Miami, Fla., two or three years ago. The more prices go up, the more active is the trading.

Mr. WINGO. Then you say that Doctor Miller's theory is correct—that the open-market operations as a controlling element failed?

Doctor SPRAGUE. No. The failure in this instance was not due to defects in the device, but to a failure to use the device of open-market operation adequately. At the beginning of March, the Federal reserve banks had sold three hundred million of governments, and on evidence that the pressure exerted was not adequate, rapid sales of one or two hundred millions more of governments would have served the purpose, in my judgment, but not having served that purpose what is happening? We are having rates advanced throughout the country solely on account of undue activity on the stock exchange. The rates have been advanced in St. Louis and Minneapolis and Chicago for no reason arising out of the local situation in those districts, but solely because of an undue absorption of funds on the stock exchange.

Mr. WINGO. May I point out, as I did yesterday, that, taking it as of the first of the year, when you reversed the policy, it started the tightening process for the purpose of checking these stock loans,

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and the net result has been that while you decreased the volume in the New York banks you increased the volume of the out-of-town banks, and there was really a net increase of brokers' loans which is now greater than it was at the beginning of the year.

Doctor SPRAGUE. Quite so. Now the question is the remedy, and I think the remedy is a perfectly possible one. There are two remedies, the one remedy being desirable and the other, in my judgmet, undesirable.

It will be possible to check the upward movement on brokers' loans and the advance in security prices by a progressive advance in rediscount rates by all of the Federal reserve banks to a high level. It may be that a general advance to 4½ per cent will turn the trick; possibly 5 per cent; maybe 6 per cent; but I think it is most unfortunate that the rediscount rate of the reserve banks should be merely determined by what is going on in the securities market. That seems to me to be too much like the tail wagging the dog.

Now, I wish to come to the other method which can be used in order to meet this particular situation. The Federal reserve act states that the purpose of the measure is to accommodate commerce, industry, and agriculture. It is not to accommodate commerce, industry, and agriculture to move up discount rates at the reserve banks merely because of a crazy stock market, and therefore I contend that it is entirely in accord with the spirit and purpose of the Federal reserve act that the Federal reserve banks should indicate their unwillingness to rediscount at any rate and for any appreciable period of time in the present juncture for banks that have a large line of call loans on their books. It is perfectly feasible to bring about a reduction of call loans by informing the 100 largest banks of the country that the reserve banks will be indisposed to lend as much as they may ask when they have a large volume of call loans which they can liquidate. It is perfectly possible to reduce the volume of call loans without any further advance in discount rates by the Federal reserve banks.

Mr. STRONG. Would not that be in violation of the present law just as they usually use the powers of this system to accommodate business?

Doctor SPRAGUE. It does not accommodate business to have your hand forced and be obliged to put up the rate at the Kansas City bank to 5 or 6 per cent simply because of prices on the stock market.

Mr. STRONG. But at long as they come with eligible paper——

Doctor SPRAGUE (interposing). Oh, no.

Mr. STRONG. Is not the language of the law "to accommodate business"? If the increased activity of business requires more money, and we have the eligible paper, and the wording of the law is that you should accommodate business——

Doctor SPRAGUE (interposing). A bank is a bank. It has a right to refuse to lend when the indirect result of that operation is to add to rather than to diminish the burdens of business.

Mr. STRONG. Then you think the powers of the Federal reserve system, I take it, should be used for stabilization?

Doctor SPRAGUE. I think that in this particular instance they should be used to check a particularly undesirable development in a certain direction which is having other reactions upon the business of the country.

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Mr. STRONG. That is the purpose of this bill.

Doctor SPRAGUE. Well, this particular situation has no particular reference to prices. Possibly your phrase, "stabilization of industry and commerce," might add force and support to my contention, but if anyone holds that the reserve banks are bound to lend to a bank simply because it offers eligible paper, then I think an additional provision should be put into the Federal reserve act to the effect that the Federal reserve banks are not obliged to lend merely because eligible paper is tendered.

Mr. STRONG. They should use their powers for stability and stabilization.

Doctor SPRAGUE. For a great variety of purposes.

Mr. WINGO. As I understand your suggestion, it is that the Federal reserve officials, who have the power, should say to their member banks that they shall not have loans for the purpose of doing indirectly what is now forbidden to be done directly; that is, stock-market loans are not permitted to be rediscounted under the Federal reserve act, and they are getting around that by bringing in eligible paper for the purpose of procuring funds for stock-market operations.

Doctor SPRAGUE. I would not put it on that ground. Take a situation like this: Suppose that brokers' loans were far below what they are now, and that the rate was below other lending rates, as was the case some months ago, and a bank comes into the Federal reserve bank to borrow and it has some call loans. I see no objection to granting accommodations to that bank in that situation. It is because stock-exchange expansion has gone to an undesirable extent, and even more because it is tending to raise rates on other classes of loans, that I contend that I would exert a little discrimination.

Mr. WINGO. But they now have the authority; that is the point I am getting at. It does not require a resolution of the United States Senate or an act of Congress to tell the responsible officials of the Federal reserve system that they must not permit loans indirectly that are barred directly.

Doctor SPRAGUE. If we regard it at the time being as undesirable, but I do not want to have it generalized that you are never going to lend to a bank that has call loans. It is because the demand for call loans has become so insistent that the rate is high, and it is drawing money from other sources and forcing up rates. Those are the reasons in this particular juncture for discriminating a little in the matter.

Mr. WINGO. But they have the authority to do that now. Suppose that we passed any bill that the Senate might send over here that would undertake to do that? If they can now get around the present provisions of the law and do it indirectly, is it not reasonable to suppose that these gentlemen would exercise their ingenuity and would still do just what is being done under the present law? So does it not come down to the wisdom and courage of the administration of the general laws that we have now?

Doctor SPRAGUE. There are two situations now in which the Federal reserve banks discriminate, or may discriminate. One is in the event a bank is in an uncertain condition and yet has some good paper and offers it for rediscount so that practically, if it then fails,

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it will have enough that is good. The reserve banks have in some instances discriminated in such a situation.

Again, where a bank is a continuous borrower for a period of years, they have insisted in many instances that the bank either reduce or entirely liquidate its borrowings at reserve banks.

The present situation is not of that type. The banks that are heavy lenders on the exchange are in general in and out of the reserve banks, it may be in to-day and out to-morrow, or in for two days and then out for two or three, and that has been regarded as entirely proper, and no one bank for a short time. But if 50 banks are borrowing, 20 of them to-day, 20 to-morrow, and 10 the third day, and each 20 is out part of the time, you may have a larger continuous aggregate amount of reserve-bank credits supporting the market, just as would be the case if one bank even borrowing throughout the period.

Now, I would say under the present circumstances that it would be reasonable to say to these banks that—

> Our policy is going to be, during the next few weeks, to limit the amount that you can borrow. You will probably be in here in two or three days, after you have liquidated what you now have, for another loan. Maybe you will want $20,000,000. Well, we think we will probably be disposed only to lend you $10,000,000 the next time you come in.

Mr. WINGO. Do they have the authority under the existing law to do that?

Doctor SPRAGUE. I believe they have.

Mr. WINGO. If the Federal reserve officials believe there is an undue expansion of brokers' loans, they have a plentitude of power now to put the screws on, have they not?

Doctor SPRAGUE. I think so.

Mr. WINGO. They can make the farm banks liquidate, and why can they not make these banks making the stock loans liquidate a little bit over a period of a few weeks or months, as you state?

Doctor SPRAGUE. I prefer that method to a liquidation brought rather than an indeterminate further advance in discount rates, for which there seems to be absolutely no reason at the present moment outside of the stock exchange.

Mr. WINGO. Would you please tell me wherein the law is deficient now to give the Federal reserve officials the power to check any unsound condition in brokers' loans?

Doctor SPRAGUE. I do not think that there is a need of any further legislation in that matter.

Mr. STEVENSON. And the method which you suggest would meet the situation. I believe this is the fifth Federal reserve district. This is the time of the year when a great number of the member banks in this district are borrowing for their agricultural, manufacturing, and mercantile concerns. They have marketed their crops last fall, and most of them have paid off their rediscounts. The rates have been low ever since they did that, but when it comes to the time for them to borrow, on account of this peculiar condition in New York, they are raising the rates in all of these agricultural districts as well as in New York, and the result is that the people who really are the bona fide borrowers on the right kind of eligible paper have to pay a higher rate for productive purposes.

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The remedy you suggested a while ago would fit that. I can see very readily that if they required these stock loan fellows in New York to liquidate before they loaned them any more money they could accommodate them without putting up the rate.

Mr. WINGO. The speculator never pays any attention to rates. He pays high; he can pay beyond what the legitimate business man can.

Mr. STEAGALL. Is there in the present situation anything that demands that the Federal reserve may either curtail loans to banks that are taking care of too many brokers' loans or raise the discount rate? Is there any situation that necessitates one or the other?

Doctor SPRAGUE. That depends really upon something that is a little indeterminate. I think the extent to which a collapse of considerable moment on the stock exchange is an independent force exerting an unfavorable influence on business; an ordinary decline in the stock exchange does not exert very much of an unfavorable influence upon business. If business is in sound condition it will go forward notwithstanding some decline, but a severe decline on the stock exchange might have a damaging effect throughout the community. The situation is strikingly like that which we had two or three years ago in Florida, in that trading increased when prices went up, and the market is not sensitive to changes in rates. I am rather fearful that if we adopted a 3½ per cent rate throughout the country because business warranted it we would have prices moving up on the exchange to dizzy heights and falling of their own weight to a level so catastrophic that it would have an independent unfavorable effect upon the whole business position. For that reason I favor attempts to put some check upon the situation by the direct-action method that I have indicated.

Mr. WINGO. We probably will get results with less injury to legitimate business than if you undertake to control it by a high speculative rediscount rate which only the speculator could pay.

Doctor SPRAGUE. That I object to decidedly. Some people argued that we should pay no attention to the stock exchange and perhaps reduce the rate to 3½ per cent.

Mr. WINGO. Is not this the correct rule? The purpose of the act is to accommodate business, industry, and agriculture, and when the needs of legitimate business require you to put the rate up or down should you not do it regardless of the nature of the business going on in the stock market and undertake to control brokers' loans through another method?

Doctor SPRAGUE. I think it would be desirable to experiment with this other method.

Mr. WINGO. I have before me an article in the Annalist of April 20 by you, Doctor. It has a heading, "Brokers' loans dangerous; reserve banks largely responsible for inflation."

Doctor SPRAGUE. I wish to say that I am not responsible for this heading and a careful reading of the article, I think, would indicate that the headings were not justified by the article.

The CHAIRMAN. I suggest, without objection, that that article be placed in the record at this time. I had intended to insert it later, but now, since the question has been raised, it may go in here.

Doctor SPRAGUE. Without the headings?

The CHAIRMAN. Without the headings.

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(The article referred to is as follows:)

[The Annalist, Friday, April 20, 1928]

BROKERS' LOANS DANGEROUS—RESERVE BANKS LARGELY RESPONSIBLE FOR INFLATION

(By O. M. W. Sprague, Harvard Business School)

In articles which have been published in successive quarterly issues of the Annalist during the last two years I have taken a definite position with regard to the causes and significance of rising security quotations and the increase in the outstanding volume of brokers' loans. It was insisted in these articles that the fundamental influence at work was an abundance of current savings seeking investment that was forcing down the rate of interest, and that rising security prices in the main merely reflected and discounted this condition. It was further held that in these circumstances brokers' loans could be readily liquidated in considerable volume, involving no doubt some, but by no means catastrophic, declines in the general level of security quotations.

These views were amplified as recently as March 7 of this year at hearings on brokers' loans conducted by the Senate Committee on Banking and Currency, when it was also urged that, since rates on such loans are normally below those on almost all other classes of bank loans, it was not reasonable to believe that funds employed in the security markets were withheld from other and possibly more desirable uses. And, finally, both in the articles and before the Senate committee, though it may be with insufficient emphasis, it was observed that in a period of abundant savings and declining interest rates there was grave danger that speculative enthusiasm might carry the market far beyond limits of safety, and that it was most desirable that the market be tested from time to time by means of advancing rates on collateral loans, and by some more than momentary contraction in the amount of credit employed in the security markets.

SPECULATIVE INFLATION CHECKED IN 1926

On a number of occasions in recent years, notably in the late winter of 1926 when a speculative craze seemed in process of incubation, the danger was removed under the impact of rising call rates, contraction of brokers' loans, and a fairly general decline in the level of security quotations. Developments so far in 1928 present a strikingly different and far from satisfactory picture. Even as late as the beginning of March it was still possible to anticipate that the security market was by way of being subjected to a test of its real condition—a test which would also serve to restrain unhealthy tendencies. The upward movement of brokers' loans had been reversed, money rates had advanced slightly, and a moderate general decline in security quotations had been experienced. The market had behaved in customary fashion. But the test was of short duration, and was far from thorough. In 1926, brokers' loans were reduced by more than 15 per cent, in the course of a period of several months, and the subsequent advance both in loans and in quotations rested upon a solid foundation of easier money and rising business profits in many industries.

The course of events during the last six weeks is an amazing contrast. An insignificant reduction in brokers' loans has been followed by a rapid increase to a new record peak, and this in spite of sharply advancing rates; the volume of dealings on the stock exchange and in other security markets have been of unprecedented proportions; and quotations have generally advanced, often abruptly to fantastic heights calculated to excite mirth as well as astonishment.

INFLATION AND SPECULATIVE CRAZE PRESENT

There has certainly been no change in the prospective earnings of business to provide support for recent advances. And the market has unquestionably much more than discounted any probable immediate decline in the long-term rate of interest. It is indeed a proper function of security markets to discount the future, but clearly a market is not accurately discounting the future when values are being boosted upon the treacherous foundation of increasing supplies of credit secured at advancing rates. It is a reasonable assumption that it is never wise to depart very far on borrowed money from the safe haven of a

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conservative capitalization of well assured earning power. A stock, shall we say radio, may pay huge dividends some years hence. That does not make it a good purchase on borrowed money at the current price.

The present security market exhibits all of the familiar earmarks of inflation and the symptoms of a speculative craze. It presents a situation altogether analogous with that in commodity markets throughout the world during the 12 months preceding the debacle in the spring of 1920, and not unlike the Florida land boom of more recent memory. In each instance is to be observed the same growing eagerness to buy among widening circles, stimulated rather than checked by advancing prices, and wholly oblivious to advances in lending rates, always provided that increasing supplies of credit are somehow made available.

A security market that is functioning within reasonably safe limits is sensitive to changes in lending rates. When it is found to be absorbing constantly increasing amounts of bank credit at rising rates, the stock market is unquestionably under the controlling influence of a demand that rests upon no solid foundation of intelligent foresight. Were the consequences entirely confined to those who are tempted into speculative excess the course of the market would not be a matter of general concern. This seems to be the case with ordinary or moderate fluctuations in the security markets. The psychological influence unfavorable to business activity of moderate declines in security prices is negligible. If business at the time is in good shape it goes ahead regardless. On the other hand, an extreme decline of catastrophic proportions may well be believed to exert an independent unfavorable influence upon the course of trade, even though it does not involve serious loss to the lending banks, and must certainly have that effect if it does go to that length.

STABILITY POLICY OF RESERVE SYSTEM PARTLY RESPONSIBLE FOR INFLATION

A security market that is impervious to rising rates may also exert an undesirable influence on business for a time before the inevitable break. With some qualifications, it may be said that brokers' loans ordinarily merely absor funds that the anks are unable at the moment to employ otherwise. But when security markets begin to absorb increasing funds at 5 per cent and upwards they do attract funds from other uses and tend to force up rates for those other uses. In the good old days before the World War it used to be said in London that a 7 per cent Bank of England rate would draw gold from the ground. Similarly, it may be said that a 5 to 6 per cent call rate in New York will attract funds from hundreds of banks in every section of the country, tending to subject borrowers everywhere to a higher range of rates. In sum, a crazy stock market is objectionable, both during its final stage of expansion as well as on account of the consequences of its ultimate collapse.

Responsibility for the present situation in the security markets is widely diffused, but the reserve banks can not escape some considerable share in that responsibility. Stability in the money market has been an avowed policy of the reserve system, and the achievement of stability has been emphasized as one of its notable accomplishments. But under some conditions the maintenance of stability may breed a dangerous situation. There are indications that clever speculators are relying upon the predilection for stability of the reserve authorities to protect the market from extreme strain. It is assumed that in no circumstances will liquidation be allowed to become sudden and violent. This is a dangerous assumption, not because it may not be realized but because it removes a restraining influence.

ALTERNATIVES AND CONSEQUENCES

If now we venture upon a look into the future, we are confronted with two contrasting possibilities in reserve bank policy. A passive, or at least relatively quiescent position may be taken. Reliance may be placed upon the gradual tightening of the money market in response to further gold exports and an increased demand for commercial loans. This is a policy which, unless the stock market speedily collapses from its own weight, may be expected to lead to a further advance in discount rates of the reserve banks in all districts, an advance for which local business requirements would be in no sense responsible.

The present situation in the security markets might, however, be subjected to the corrective of sharp and drastic action. But is the patient now in condition to warrant the adoption of a surgical operation? At the beginning of the present movement the risk would certainly have been by no means as incal-

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culable. If for example, in the latter part of February or early in March the reserve banks had sold rapidly a hundred or even two hundred millions of governments, an immediate advance in call money to 6 per cent might have been brought about. 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. An advance of the discount rate to 4½ per cent might further have been advisable as a means of emphasizing a policy of effective control.

Had measures along these lines been followed, it is reasonable to believe that the situation would now be far more satisfactory from every standpoint. Brokers' loans would presumably be well below instead of far above the February peak, speculation would be in a quiescent stage, and the community could anticipate a reduction rather than a prospective advance in discount rates.

Whether the adoption of drastic measures would now precipitate a spectacular collapse in the security markets is by no means certain, but were it to have that result, 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.

Mr. STRONG. I wanted to ask you one more question. Have you any plan by which you think the use of the Federal reserve powers could be used to regulate brokers' loans?

Doctor SPRAGUE. There is one further possibility, the technical effect of which I confess I am a bit uncertain.

In Bank of England practice, the minimum period for a loan is seven days. If a bank borrows at the Bank of England, it is there for seven days and it has to pay the rate.

Under our practice, a bank makes loans for a minimum period of 15 days, but it may repay them the very next day in full, so that in practice a large proportion of the borrowing at the Federal reserve banks is for day-to-day purposes.

Whether it would modify the condition in the New York market appreciably with reference to brokers' loans by initiating, say, a 5-day period as a minimum period for borrowing without any repayment, I am not certain. It is a highly technical matter affected by the practice of lending reserve-bank funds between banks, so that I would only say now that it seems to me that it is something that might be experimented with.

Mr. KING. Doctor, when the law is so amply meeting the situation in New York and the duty of the Federal Reserve Board is so plain, what is the influence that keeps them from acting, as you suggest, in that New York situation?

Doctor SPRAGUE. Why, long, and, I think, on the whole, satisfactory banking practice. It has been one of the recognized advantages of the reserve system that it frees the money market from extreme and often damaging short-time fluctuations. A stable money market has been set out as one of the advantages, conspicuous advantages, of the operation of the reserve banks; and, in my judgment, the predeliction of the reserve-bank people for stability in the money market has been taken advantage of by the speculative element. They do not believe that the situation will be subjected to jolts and jars, that any pressure that is put upon the market will be very gentle and gradual. I think that the speculative community is banking upon that to such an extent that stability as an objective, without exception, is perhaps becoming a positive danger. That is my reason for thinking that something that would suggest to the speculative element now and in the future that there are some uncertainties and some shoals and rocks might have a very good psychological effect.

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Mr. BEEDY. How is it that they have come to this predeliction?

Doctor SPRAGUE. Why, in general——

Mr. BEEDY. Let me ask you this question: Is it true that the board has at times pursued such hesitating policies that the speculative world has concluded that it may well go on with a rising price tendency, knowing full well that the board will hesitate to apply the checks?

Doctor SPRAGUE. Well, perhaps so.

Mr. BEEDY. Is it not so? Is it not a fact? Can you not answer it yes or no.

Doctor SPRAGUE. Many of these questions are difficult to answer yes or not.

I think I can answer that yes, and to illustrate the ingenuity of the speculative community let me take this point. It was quite generally believed about the street that no great amount of pressure would be exerted in March of this year because of the Treasury financing. The desire of the Treasury to market its securities so as to save one-eighth of 1 per cent more or less is recognized on the street as perhaps exerting quite a potent influence at certain periods.

Mr. BEEDY. Now, Doctor, I am left in this state of mind. Here is a situation at the present time demanding some action, some courageous action by the Federal Reserve Board if an ascent in rates is to be checked so that it will not become highly disadvantageous to business in general. You say, and others think, that the existing law needs no amendments, that the powers are already there, and we also seem to admit quite generally that many times in crises the board has pursued a hesitating course.

Now, I assume that the purpose of the men who are behind this legislation is to meet that very situation and to make it mandatory upon the board, which has been hesitating and feeble in times of crises, to exercise the powers which they already have. Is that an unreasonable demand?

Doctor SPRAGUE. No, it is not; but the particular situations which you say imply hesitation do not seem to me to be generally the situations that are of the type that are very definitely covered in this bill. If they are, well and good; I should be delighted.

Mr. STRONG. What would you suggest, Doctor?

Doctor SPRAGUE. I can not suggest anything. The only thing I can suggest is that with experience the management of the Federal reserve banks will take more definite action than it has at times taken. The system is a cumbersome system, and the number of people who must agree upon a particular course is rather large, the officers of the banks, the directors of the banks, and the board.

Mr. BEEDY. Is that true as to open-market policy?

Doctor SPRAGUE. The open-market policy has a committee of five. It is necessarily in large part influenced by views in the New York bank, because it is in the New York market that most of the open-market operations must occur. But then there must be an agreement between the open-market committee and the Federal Reserve Board, and, further, there must be consideration, I take it, of the predilection of the Treasury for getting the best possible rate on its certificates, so that you have got a diverse group that must reach an agreement before any action can take place, and that inevitably

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means hesitation unless the case is as plain as a pikestaff, and when it is as plain as that probably action is a little belated and the consequences may appear to be so serious that there is still further delay.

Mr. BEEDY. It seems to me that in my somewhat long and involved question and your answer just made we have reached rather the crucial situation here. Your answer was that if this bill were adopted to meet such situations as have been characterized by hesitancy on the part of the board and unwillingness to deflate at crucial periods, you would be heartily in favor of it?

Doctor SPRAGUE. I said if it does that.

Mr. BEEDY. Well, now, turning to page 2, under section (h)—and I have just read it over now—I can not see how human language would better cover it. [Reading.]

> The Federal reserve system shall use all the powers and authority now or hereafter possessed by it to maintain a stable gold standard; to promote the stability of commerce, industry, agriculture, and employment; and a more stable purchasing power of the dollar, so far as such purposes may be accomplished by monetary and credit policy.

What is there in that language that would not meet the situations that I refer to in my question?

Doctor SPRAGUE. Take the particular situation of brokers' loans, and assuming that you generally assent with the statement just made, with the provision "to promote the stability of commerce, industry, agriculture, and employment," furnish additional ground for taking the direct action that I urge in the matter of brokers' loans?

Mr. BEEDY. Possibly not, but coupled with the phrase—

> and a more stable purchasing power of the dollar, so far as such purposes may be accomplished by monetary and credit policy—

it seems to me it would.

Doctor SPRAGUE. Well, if it would accomplish that result, make the decision in matters of policy at times a little more immediate, and the decision itself a little more definite, then there would be, I think, an advantage from the passage of the bill. I probably agree with you that the defects in the operation of the Federal reserve system are not so much in positive errors of judgment that have been made but rather in the hesitating manner in which at times policies have been decided upon and then executed.

Mr. BEEDY. I want to state that this is my position: I feel that there is law enough and power enough conferred by the law on the Federal reserve system to meet any exigencies such as the present or even more marked crises, and I am naturally averse to an attempt by the legislative body to direct in detail the policy of a board such as the Federal Reserve Board is; but if it is true that these hearings have demonstrated a sufficiency of power in the board and that the failure on the part of the board to act at the proper time was not because of poor judgment but because—let us be blunt about it—of a lack of courage, then I am getting to the point where I am ready to vote for a law which will not give them the chance to hesitate but which will read, in effect, that "you are not only authorized but commanded to act."

Do you not think that something like that might be helpful to stimulate their courage?

Doctor SPRAGUE. If it serves that effect; yes.

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Mr. BEEDY. What other tendency, Doctor, would such a law have but to prick them a bit and stimulate their courage?

Mr. KING. You do not need a declaration of Congress to do that.

Doctor SPRAGUE. It might do as you say, but inasmuch as the management of the Federal reserve banks involves the exercise of judgment in many somewhat confusing situations, I think it is the character of the men and the experience that is developed by the passage of time upon which we must mainly rely.

Mr. BEEDY. Do you not think it would be a good thing for these men to be able to say, "Well, we no longer have to wait; we are commanded to act"?

Doctor SPRAGUE. It is possible.

Mr. BEEDY. Would you not say "probable"?

Doctor SPRAGUE. Not until I had discussed the matter with quite a number of people who are charged with the responsibility of conducting the system.

Mr. STRONG. I can tell you what they will say. They will say, "Leave us alone."

Mr. WINGO. Aside from the bill, I am inclined to doubt the possibility of any legislative declaration giving either wisdom or courage to anybody.

Mr. BEEDY. It will not give them any courage, but it will serve as an incentive.

Mr. WINGO. Moral support.

Mr. BEEDY. Moral support.

Mr. STRONG. I would like to have the doctor give his opinion on the other clause of the bill, that of publicity, and the direction for an intensive study of this question.

Doctor SPRAGUE. I can do that in a very few moments, I think.

Mr. KING. Can you make a man study by legislation?

Doctor SPRAGUE. The provision about publicity is very much improved since it contains the word "thereafter," which will give the governor of the board power to defer to a convenient and proper time any statement of reasons for policies that have been pursued by the board and by the banks. I think it will probably serve a useful purpose and would have served a useful purpose if somewhat more detailed analyses of the purposes of the various policies and the process of executing them and the results of those policies in execution had been set out, although the reserve banks already have done much more than any other central banks, but I think they might do somewhat more than has been done in the past, and this section seems, therefore, to my mind, unobjectionable.

Now, with regard to these studies, they suggest various lines of investigation, some of which probably have been followed and will be followed in the absence of this legislation, and they indicate some other lines of investigation which have not yet been developed. I take it that this investigation paragraph does not limit the investigations in any way, that the sort of investigations that have been made in the past, and other investigations not indicated here, could properly be undertaken by the reserve banks. The difficulty that I see about some of these investigations is rather in securing an adequate number of competent investigators, but that is a detail of administration. Upon the whole, I see no objection whatever to

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inserting these specific suggestions for investigations in the event that it does not exclude by implication or otherwise such other investigations as the board and the banks may deem desirable.

Mr. BEEDY. What would you say as to the desirability either of coupling with this legislation or enacting apart from this legislation a measure which would help to bring the very results which this legislation aims at, namely, a flat prohibition upon the Federal reserve system to permit the use of its credit for speculative purposes and the enjoinment of a duty upon the system to ascertain at all times the use to which credit which it was supplying was being put?

Doctor SPRAGUE. I will frankly say that I would be violently opposed to such a proposal and would feel that it was impossible of execution. After all, the member banks must be allowed a reasonable amount of latitude in their operations. The particular operations of a given member bank seem to me to be a matter of no great concern unless it threatened the solvency of that bank or unless so many other banks are doing the same sort of thing that an unhealthy situation may be created.

Now, at times the possibility of using funds in certain more or less speculative directions is probably a safeguard for the depositors of a given member bank. Let us suppose a local bank in Maine had more funds than it can at the moment employ to advantage locally. It puts some of those funds into the New York market. It is probably very much better that it should do that from the point of view of its depositors, even though the use is speculative in New York, than it would be to inhibit that bank from such use, directly or indirectly, forcing it into making loans which may not be speculative in the ordinary sense but which may involve uncertainties and possibly serious loss.

Mr. BEEDY. Then the logic of the situation would force us to the conclusion, would it not, that a more or less unrestrained use of credit afforded by the system for speculative purposes is incidentally helpful to the proper development of agriculture, industry, commerce, and employment?

Doctor SPRAGUE. Yes; but at times it may reach such proportions as to become damaging or threaten damage, and then you have a possible situation for demanding direct action.

Mr. STRONG. You think a little fire might help, but very much would burn you.

The CHAIRMAN. Much has been said this morning about speculative loans. I have not been able to find anyone who is able to tell with any degree of certainty how much of this $4,000,000,000 worth of brokers' loans is speculative and how much is legitimate; nor have I been able to find out in this rise of the stock market how much of it might be a legitimate rise and how much of it might be a speculative rise. Do you care to say anything about either one of these subjects?

Doctor SPRAGUE. I do not think it can be measured by the amount of brokers' loans. That is one factor in the situation, the amount, and the increase that has taken place. Those are the two things that are significant as regards the statistics of the loans themselves.

Coupled with that, however, you have extreme activity on the exchange, rising quotations, and apparently a market that is in-

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sensitive to the usual normal extent to advances in rates actually made and more or less threatened in the future.

When you take all those factors together you have, it seems to me, the earmarks of a situation that is getting or may get out of hand.

Now, I do not believe that a contraction in brokers' loans, if it should come in the near future, will involve an extreme decline in quotations of catastrophic proportions. I believe that with the abundance of savings currently made in this country there is a large buying demand for securities at moderate concessions in price.

The CHAIRMAN. Some of this increase in price in the stock market is due to anticipation that we are going on a lower net interest return basis, is it not?

Doctor SPRAGUE. It is; and until recently I had held that that was an adequate explanation for the general upward movement in quotations, but in a period of abundant savings and also in a period in which the accumulation of capital is adequate to meet business requirements, from time to time, a slackening in the upward movement is desirable in order that we may go forward perhaps on a more healthy basis a little later.

Mr. BEEDY. Doctor, I am wondering if I made my question quite clear or if you misunderstood it a bit as to the desirability of prohibiting the use of the credit of the the system for speculative purposes, etc.? You began your answer by what the member banks might do. Of course, I did not refer to member banks, but my question was directed to the thought that that inhibition and direction might be upon the Federal Reserve Board and the central banks.

Doctor SPRAGUE. Assume that a bank has made some of these loans and then is temporarily deficient in its reserve. It wishes to rediscount. I should be inclined to think that unless there is clear evidence of an unsound and undesirable situation developing that satisfactory the operation of the credit machinery of the country renders it advisable that the rediscount should be made almost as a matter of course.

A certain amount of speculation is desirable and necessary in order to create a market, both for commodities and for securities. Assuming an abundant cotton crop, the holding of that is facilitated by the readiness of some people to speculate in cotton and borrow in order to do so. It is only the excess of speculation that may be a serious matter, such as seems now to be present, and the general prohibition would destroy elasticity in the functioning of the reserve banks in their relations to the member banks to a most undesirable degree.

The CHAIRMAN. I suggest that it is 1 o'clock.

Mr. KING. I just want to ask him a question.

I was not here when you first went on the stand, and I very much regret it, but I want to know whether you are a fellow in the society of the learned who had their convention here in Washington during the early part of this year?

Doctor SPRAGUE. I did not attend that meeting, although I am a member of the association in good standing, I hope.

Mr. KING. Thank you.

The CHAIRMAN. The committee will adjourn until to-morrow morning at 10.30.

Thank you very much, if you are through.

Doctor SPRAGUE. I think I have said enough.

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Mr. BEEDY. The doctor is not going to be here another day, and as one member of the committee I want to thank him for coming here.

(Whereupon, at 12.55 o'clock p. m., an adjournment was taken until Wednesday, May 2, 1928, at 10.30 o'clock a. m.)

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Wednesday, May 2, 1928.

The committee met at 10.30 o'clock a. m., pursuant to adjournment, Hon. Louis T. McFadden (chairman) presiding.

The CHAIRMAN. The committee will come to order.

This is a resumption of the hearings on H. R. 11806. Doctor Miller, we will be glad to have you proceed with your statement.

STATEMENT OF DR. ADOLPH C. MILLER—Continued

Doctor MILLER. I think it would be worth while to go back to one or two points that were very briefly developed in my testimony last Monday and point out certain conclusions that I draw from them as to the practicability as well as the expediency of an instructed Federal reserve policy with respect to credit, such as this bill contemplates.

I was very much impressed, as I sat here yesterday morning as a listener to the questions of the committee that were addressed to Professor Sprague, and his answers, with the thought that in a hearing of this kind an atmosphere is generated and a logic, so to speak, develops itself, and that for the most part we are all apt to fall into a certain frame of mind, except those who are, so to speak, obviously in rebellion, and that we lose touch with not only fact, but what is more serious, we also lose touch with reality; I shall be greatly interested when I come to read what Doctor Sprague had to say, to see whether I am right in my recollection that in the latter part of the hearing, when you were getting pretty near to the vitals of reserve credit operations, nearly every sentence of his in answer to questions propounded began with an "if." In my opinion, testimony that is liberally sprinkled with "ifs" is for practical purposes of little value. So my disposition is, in what I may have said here, to have little concern with the academic potentialities of the Federal reserve system and keep close to the solid substance of fact and reality.

If you ask me as a member of the Federal Reserve Board what can be done, my disposition is to go and see what has been done in a situation that is most nearly similar to the one contemplated in your question, and one which is of fairly recent date; because in all matters of administrative control one of the important factors is—let us put it in a broad way—the competency of the administrative body that is concerned with the proposed legislative remedy. I think we are all very apt to think—that is one of the besetting temptations, so to speak, of Congress when it comes to legislate in matters of the kind here under consideration—to feel that it has solved a problem when it has said, "We will set up a body of capable and competent men; we will invest them with broad discretionary powers; we will tell them to go to it, and with that the job is done."

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Mr. STRONG. Might I suggest to you right there that I think you have a very wrong idea of Congress? The majority of the men here agree that it is fairly easy to prepare proper legislation; the trouble is in getting it properly administered.

Doctor MILLER. Then, why does Congress go on creating more and more commissions and adding more and more to the discretionary authority of those that are already created?

Mr. STRONG. To try to get the thing done that the people of this country want done.

Doctor MILLER. Well, I am tempted to——

Mr. STRONG (interposing). For instance, I gather from your suggestion that you think the attitude here yesterday led us into fancies, while you were the only man who sat back and analyzed the question correctly and properly.

Doctor MILLER. I am not assuming any such arrogant attitude as that, I hope. But I do think that the latter part of the discussion yesterday developed this conclusion—that if you want to understand the Federal reserve system you must reckon with its human limitations. That is what I have in mind; its human limitations. Administration is nothing except what the men who do the administering make it.

Mr. STRONG. Certainly.

Doctor MILLER. If they are ordinary men, it does not matter what you say to them; you will get an ordinary result.

Mr. STRONG. Certainly.

Doctor MILLER. If they are men of extraordinary ability, imagination, force, you will get an extraordinary result, no matter how little you say to them.

Mr. STRONG. In other words, one man will make a corporation and operate it under the law and make it a success, and another man will make it a failure?

Doctor MILLER. Well, whether he makes it a failure or not, it becomes a failure in the one case and a success in the other, irrespective of what the law may or may not say.

Mr. STRONG. That is true.

Doctor MILLER. The most difficult think to exercise competently is discretion. When you come to matters touching the operation of the credit mechanism you have entered a field in which the exercise of discretion is peculiarly difficult, and the more difficult the problems that present themselves to a discretionary authority the less likely——

Mr. STEVENSON (interposing). Doctor, if you will permit me, as I understand, you are deprecating the tendency of Congress to commit matters more and more to the discretion of boards.

Doctor MILLER. I deprecate that personally, and I refer to it merely as an illustration.

Mr. STEVENSON. If we bring this discussion right down to the bill in hand, this bill rather tends to diminish that discretion and to make a mandatory direction to you, does it not?

Doctor MILLER. I think not.

Mr. STEVENSON. That was the idea that I got out of it; that it was making mandatory what was merely implied in the present law, and therefore is in the discretion of the board.

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Doctor MILLER. I do not think so. I recognize that that is a matter on which opinions might well differ. In fact, as I think I stated here Monday—and I think Doctor Sprague said something of similar purport yesterday—I think it would not make very much difference.

Mr. STEVENSON. Well, I think so myself.

Doctor MILLER. You might just as well, from my point of view, put in here that all the powers of the Federal Reserve Board shall be used to promote prosperity or to promote social justice.

Mr. STEVENSON. Yes. As he put it yesterday, it was the expression of a pious wish that they would increase the prosperity of the country.

Mr. STRONG. Then he followed it up by saying that a hostile board probably would not operate it properly.

Doctor MILLER. Well, let us leave a hostile board out for the present.

Mr. Congressman, as I said here the other day, I am not temperamentally hostile to experimentation and innovation; but I have made it an observance in my personal relations that whenever a surgical operation was to be performed I wanted it performed by the most competent man whose services I could command. I would feel more confident of the outcome where a competent surgeon undertook a very delicate operation than where an unskilled surgeon undertook a simple one.

You can accomplish almost anything if the men who are to do it are masters of the technique and of themselves and know what they are about. But it is not safe to go on the assumption that such will be the case, and that is what I am disposed to remind you of. When we are thinking under the active stimulus of the imagination and are animated by a desire to make things better, we are very apt to minimize practical difficulties; most of these difficulties, administratively speaking, resolve themselves into human limitations and frailties.

So my disposition usually is to estimate the attainable in the light of the attained; to see the human factor in the problem. Possibly I am more alive to that element in relation to problems of this kind because I am a part of the human factor or administrative set-up. I am a part of the problem. My state of mind, my capacity, my limitations are a part of it, and I am more and more impressed as I go along how mysterious these credit matters are. I do not want to be instructed where I know that the instruction is going to be an embarrassment to me and a source of confusion to others who are, perhaps, less prepared by training to deal with matters of this kind, or else to lead to careless and ill-advised experimentation. I am not opposed to experiments, but I want the experiment to carry with it a probability of success.

The CHAIRMAN. Doctor, is it fair to assume that in the administrative duties that are upon the board, of which you are a member, you are probably in one of the most trying situations now that the board has experienced since its inception?

Doctor MILLER. You ask that question; therefore I will answer it as fairly as I can. It is my opinion that the Federal reserve mind at the present time is more perplexed than it has been at any time

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since the troublesome period of 1920–21; that it is in a state of mental confusion largely because of surprise. "Surprise" usually comes, I think, as the aftermath of an undue indulgence of desire and expectation. You stand back when you see the fruition of the devil's work in your angelic plans; and, speaking personally, I have usually found——

Mr. STRONG (interposing). To do the angelic part of it?

Doctor MILLER. To maintain an attitude of relative calm about situations in which there is a danger of an unconscious hysteria developing. I think one of the chief troubles with the Federal reserve system in 1920 was hysteria—hysteria in part due to the interference of Congress through a Senate resolution, with the maintenance of a well-balanced frame of mind in the Federal reserve system.

The CHAIRMAN. You liken that somewhat to the resolution that the Senate passed the other day, known as the La Follette resolution?

Doctor MILLER. Well, I think the part of the resolution which calls for suggestions or proposals, if I remember correctly—you are referring to the resolution reported out by the Banking Committee?

The CHAIRMAN. Yes; the La Follette resolution on brokers' loans.

Doctor MILLER. The La Follette resolution itself I did not think very much of; but I thought you were referring to the report of the committee on the resolution.

The CHAIRMAN. I was.

Doctor MILLER. That, if I am rightly informed, asks the Federal Reserve Board to report to Congress what legislation, if any, is needed in order to protect the system against abuse by loans for speculative account, or something of that kind.

The CHAIRMAN. It infers that there is speculation existing, as evidenced by the large amount of brokers' loans outstanding, as a dangerous tendency, and refers the matter to the board for some report.

Doctor MILLER. Yes; for investigation and report.

The CHAIRMAN. And my question was whether you liken that kind of legislation to the resolution of 1920.

Doctor MILLER. No. Part of it, I think, is altogether desirable. I think it is a good thing to ask the board to report what, in its opinion, is necessary.

The CHAIRMAN. You do not consider that as an interference with the operations of the Federal reserve system?

Doctor MILLER. I do not. But there is a part of the resolution which I think was referred to yesterday morning, which was the first time I had heard of it, that asks the Federal Reserve Board to direct the Federal reserve banks to admonish or advise member banks against making speculative loans, or something of that kind.

I regard that as—I would rather not have this go into the record, but if you feel it is an essential part, I have no objection——

Mr. STRONG. I think it had better go in.

Doctor MILLER. I regard it as an unhappy interference at this time. I do not think it will accomplish very much there. When you have a stock-market movement of the dimensions that this present market has attained, you either want to do nothing or you want to do something that has substance to it. I think that provision of the resolution will be construed as implying a temporizing attitude.

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Mr. STEVENSON. It would become another New Year's resolution?

Doctor MILLER. Something of that kind. It does not amount to anything substantial at this stage.

Mr. BEEDY. Would you mind stating to us what the factors in the present situation are that have caused surprise to the Federal Reserve Board?

Doctor MILLER. Yes; if I can do it briefly. It has been pointed out in earlier hearings here that the Federal reserve system, in midsummer of last year, set out, by a policy of open-market purchases, followed in course by a reduction of the discount rate at the reserve banks, to ease the credit situation and to cheapen the cost of money. The official reasons for that departure in credit policy were that it would help to stabilize international exchange rates——

The CHAIRMAN (interposing). Stimulate the exportation of gold?

Doctor MILLER. Stimulate the exportation of gold. The two things really hung together. In other words, it would lead to a shifting of balances from the American market to the London market because of the difference in going rates for short money, there always being a large amount of money—and that is particularly true at the present time, and especially true as regards our country when you compare it with conditions 20 years ago—that is international and migratory in its habits; that is, so to speak, loose money, which will go where it commands the highest price. The lowering of money rates in the central money market of this country by Federal reserve action and policy would necessarily have the tendency to transfer some money to London, where the rate was higher.

On the other hand, it would also tend to keep the London rate from going higher at a season of the year when normally it would go higher, and, through keeping money easier in London, have a tendency to facilitate the sale of American farm products abroad, by reason of the fact that the exchange would be favorable to the pound and some other continental currencies, and thus have some repercussion in the total money receipts realized from the sale of the crops.

The CHAIRMAN. May I ask you right there, Doctor, did this idea originate on this side, or did it originate as a part of our close contact with the banks of issue of the other countries?

Doctor MILLER. You are asking me an unpleasant question, even if I could answer it. But I should say, stating the thing as well as I can, that the circumstances, the general situation then existing, perhaps produced a state of mind, an outlook, among the men concerned with the operation of these banks that made it, on the whole, rather easy to come to an accord. It is always a matter upon which opinions may well differ, whenever there are problems in which there is an international interest, who is the more influential. I think there may be some ground for the view—if that is what you have in your mind, Mr. Chairman—that perhaps the Federal reserve ear is a little too sensitively attuned to foreign viewpoints, and perhaps animated by too sympathetic a spirit of cooperation. I say that from a personal point of view.

The CHAIRMAN. When you speak of the "Federal reserve ear," do you mean the Federal Reserve Board or Federal reserve banks?

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Doctor MILLER. I have in mind, vaguely, whatever happens to be the dominant influence in the Federal reserve system, and that is expressing itself in the line of policy undertaken. It may to-day be this individual or group; to-morrow it may another. But wherever any important line of action or policy is taken there always will be found some one or some group whose judgment and whose will is the effective thing in bringing about the result. Their's is the ear which does the hearing for the system.

Personally, I feel a deep interest in the state of the European world. I first saw Europe shortly after I was out of college, and I have tramped hundreds of miles in Europe. I know it; I know the people; I know the country, its lovely valleys, its impressive beauty; and above all I have a very tender and warm feeling for the peasantry of western Europe. But I also know something of European psychology. I have not traveled there simply for fun, but have observed something of their mental and emotional traits; also of the state of mind that the terrible war left behind it in Europe. I think I told you, Mr. Chairman, when I was before your committee two years ago, that I was about to go to Europe for the first time since the war to find out how long it would be before they began to show anxiety about the working gold standard, toward which they were then stretching out their arms as a sort of sheet anchor.

Let me add parenthetically that I saw very little indication of any concern or alarm at that time. A year later, however, it developed, and the European central bankers about a year ago, I think, were in a distinctly anxious frame of mind. I think they were in something of the frame of mind then that can be compared to the Federal reserve mind now. They were surprised. They thought that with the nominal return to the gold standard all would be well, and they found that that brought with it some new and difficult and very anxious problems. So that constituted again, if you please, in the general background of the situation in which Federal reserve policies were taken last summer what might be phrased as a desire to be helpful in, as I may put it, mediating the actual return to the gold standard. They had it and they did not have it. They had it on such a precarious tenure at the time that they might have found difficulty, especially in England, in doing justice to the credit requirements of English trade and industry and at the same time maintaining an atmosphere in the British community that would not be apprehensive as to whether or not the gold standard was actually on a solid and tenable foundation. So that was part of it.

Mr. BEEDY. You started out, Doctor, to give us the reasons assigned for the operations in the open market and the lowering of the rediscount rate, and you started by saying that they were official reasons. I inferred that there might be other reasons. If so, I would like to have them, if you can give them.

Doctor MILLER. No; I do not want to give that impression. I use that term as against "personal," and largely because you asked me a question upon which my own personal views did not fall in with the board's. I was opposed to what was done last year.

Mr. BEEDY. I understand. And then you were going to lead up to what there was in the present situation, having resulted from that policy, that now causes surprise to the system?

Doctor MILLER. Yes, sir.

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Mr. STEVENSON. Doctor, as I understood you, you made the statement that the course was taken which affected the export of gold to ease the exchange situation and stimulate the exporting of our products abroad?

Doctor MILLER. I did not use quite as strong language as that, and I do not think it would be fair to——

Mr. STEVENSON (interposing). What I wanted to ask you was: Just what effect did the course have in stimulating the foreign trade of the country. For instance, I always think in terms of cotton. We are exporting an enormous amount of cotton. What effect did it have, and why?

Doctor MILLER. I will be very happy to tell you what I can. At the same time you must bear in mind that you are getting this from a witness who was not in sympathy——

Mr. STEVENSON (interposing). You were not sympathetic with the course?

Doctor MILLER. No; and possibly because I think a good deal of what is called stimulating foreign trade by an operation of that kind is largely scenery. I think there is not nearly enough substance to it to warrant language of that kind. But to the extent that it is true, I would say that anything—I will make it specific—anything that enables the pound sterling to buy more dollars and cents in this country enables the pound sterling to get more cotton for the same price, and thus have a tendency to stimulate the buying of more cotton. You must remember that in England particularly, where the textile trades are the most important in the whole world—approximately, I suppose, one-half of the cotton produced in the world is spun in Great Britain—and especially at a time when there is intense competition, a very little difference in the price at which you can buy raw cotton may determine the attitude of the cotton buyer and the cotton spinner. He may say, "At this price I will buy more, because I think I can find a bigger market for my output."

The CHAIRMAN. Doctor, is it not probably a fact that if we had not made that change in our rate here, the rate in London would have gone up necessarily, and that as the result there might have been a changed situation as regards foreign exchange and our ability to settle with the world?

Doctor MILLER. Yes, sir.

The CHAIRMAN. It was helpful to that extent?

Doctor MILLER. Yes; it might have been. But the important thing, as I see it, or as I saw it at that time—and such situations will occur again; they will be of frequent occurrence—is not the absolute level of the rate, but the relation of the several rates in the existing structure of rates. In other words, it does not make very much difference from the point of view of your question, Mr. Chairman, whether you have a 3½ per cent rate in New York and a 4½ per cent rate in London, or whether you have a 4 per cent rate in New York and a 5 per cent rate in London. That is to say, you can maintain that relationship either by their putting their rate up or by our putting ours down. Now, I think the method that actually was pursued, to wit, of not interfering with the London rate—the Bank of England is keeping that rate where it was——

The CHAIRMAN (interposing). The reason I asked that question was that when I was in London in December I discovered a feeling

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among the bankers there of gratification that we had lowered the discount rate when we did——

Doctor MILLER. Yes; no doubt.

The CHAIRMAN. Otherwise they would have been embarrassed, they felt, by a high rate in London, and they felt that it was a splendid thing for the United States to have done in that matter.

Doctor MILLER. There is no doubt that they appreciated it and that it was of substantial——

The CHAIRMAN (interposing). And they look upon our action as very helpful, and helped them to avoid a serious situation that was developing——

Doctor MILLER. Yes.

Mr. BEEDY. I wish I could interject this suggestion: That if we could restrain ourselves from breaking in upon witnesses so that they can not complete their sentences, I think the record would read better.

The CHAIRMAN. Yes.

Mr. BEEDY. You started to make a statement which I think was quite important, and I want to bring it out. You said that it did result in substantial——

Doctor MILLER. May I have my answer read?

(The reporter read as follows:)

There is no doubt that they appreciated it, and that it was of substantial——

Doctor MILLER. Help in maintaining the London money rate at a lower level.

Mr. BEEDY. It was substantial assistance rendered England in a crucial time, was it not?

Doctor MILLER. Yes, sir.

Mr. STEVENSON. To come back to the concrete subject, let me put this question: Suppose the pound sterling was selling at $4.50; what effect would that have upon our export trade?

Doctor MILLER. I should say that if the pound sterling went to $4.50 next autumn, we would have a devil of a time in this country to get rid of our surplus produce.

Mr. STEVENSON. I am putting an extreme case now. In other words, the pound would only buy $4.50 worth of cotton instead of $4.85 worth, and, of course, it would tend to restrict the purchase of our commodities here.

Doctor MILLER. Of course, when you put it as extreme as that, I think you can eliminate the word "tend." It would.

Mr. STEVENSON. It would restrict it?

Doctor MILLER. Yes, sir.

The CHAIRMAN. I might interject something that I observed in London in talking with men who were considering that situation at that time, to give you their viewpoint.

Mr. STEVENSON. Yes.

The CHAIRMAN. There are two classes of thought in England on the question of stabilization—as to the time when they should have stabilized and the basis on which they should have stabilized. The industrialists of England felt that the stabilization was premature. England is pretty well divided on that subject. The industrialists felt that if they did stabilize they should stabilize on a $4 basis rather than on the $4.86 basis; that that would thus have permitted

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a sufficient amount of inflation to take place to permit the rehabilitation of industry in England, which would result in making England industrially more keen competitors with the United States. Now, there is an extreme conflict, as I discovered, even among the financial men of London on that question. I wanted to interject that at this point because it had a bearing on the very thing that you were suggesting.

Mr. STEVENSON. Yes. Now, if you will let me continue my interrogation, suppose it was up to $4.95; what effect would it have on their purchase of our cotton?

Doctor MILLER. Of course, it could not get up there.

Mr. STEVENSON. If it went to $4.90?

Doctor MILLER. It could not get to $4.90.

Mr. STEVENSON. Well, its maintenance at $4.85 is, of course, the ideal situation.

Doctor MILLER. That is a matter of opinion. The opinion that prevailed last year was that it was desirable to get sterling exchange up to whatever might be the new so-called gold shipping point, which was a little over $4.88. Gold moved at $4.88, and sterling got up to $4.88 in November. You see, sterling was rising, and as it rose, especially with a higher discount rate in London—in fact, that was the thing that gave the impulse; we have got to look at the money rates all the time if we want to explain these things—as balances were shifted, sterling rose. I mean, there was a movement of gold outward, and that movement of gold outward not only kept the money market of London easy, but it also brought up sterling. In other words, when a banker in New York or Chicago wants to transfer $10,000,000 to London, he is buying sterling. He wants to buy sterling currency, sterling credits. Sterling is in demand, and sterling rises, and as it rises it comes nearer and nearer what is called the export point; and then gold begins to move, or gold credits begin to be transferred, and perhaps be locked up as earmarked money in New York institutions.

Mr. STEVENSON. In other words, if it gets to a point where it is cheaper to ship gold than it is to pay exchange, they ship gold or earmark it for shipment?

Doctor MILLER. Yes.

Mr. STEVENSON. Of course, I understand that it can not; but I was taking the extreme position of $4.50 and $4.90 in order to have visualized the effect it has upon our commodities that they buy. All this talk about the effect that exchange has, and all that, is fine for the experts, but when we talk to a countryman we want to know what effect it has in a specific instance. Then we understand it.

Doctor MILLER. I can say, Mr. Stevenson, putting it in a very simple way——

Mr. STEVENSON. That is what I like to get, because I am a very simple-minded man.

Doctor MILLER. A British importer who is concerned with cotton or wheat wants to know how much he can get for the pound sterling in terms of dollars and how much he can get with his dollar in terms of wheat, cotton, or whatever the commodity happens to be; so that the price he pays for his dollar exchange, or that he gets for his sterling exchange as a seller, is a factor in the actual cost of his importations.

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Mr. STEVENSON. A man wants to buy in New York a cargo of cotton. He has his money in London. The question of how much he can get for his draft on London in dollars and cents determines really what his cotton costs him, does it?

Doctor MILLER. Yes; that is part of it. In addition, in this particular situation that we are discussing there is this factor: The low money rates obtaining in New York, especially for bills—so-called bankers' acceptances—during the crop moving and the crop exportation period, made it very easy to finance those operations. That is to say, a bill drawn against an exportation of cotton last autumn could be discounted in the New York market at 3 per cent, or even below 3 per cent, as compared with a London rate of 3⅝ to 3⅞, or somewhere along there. At any rate, there was a spread of one-half to three-fourths of 1 per cent between the London and the New York cost of financing bills drawn in connection with the outward movement of cotton. But—and this is a thing that is very frequently overlooked——

Mr. BEEDY (interposing). Now, you are in the midst of a sentence; but, to make it concrete, did that operation by our Federal reserve system actually result in a more favorable price to the cotton producer and the wheat producer?

Doctor MILLER. That is a matter of opinion; and especially is it a debatable matter whether it resulted in a better price being realized by the actual grower of the cotton or the grower of the wheat.

The CHAIRMAN. There was a little upturn in the price level of agricultural commodities immediately thereafter, was there not?

Doctor MILLER. Yes, sir.

Mr. GOODWIN. Was that anticipated by the board at the time they made that reduction?

Doctor MILLER. I do not feel competent to answer the question stated in that way.

I think it was certainly in the minds of some members of the board that it would strengthen the market for American farm products and probably result in better prices being realized for them.

The CHAIRMAN. And also go a long way toward helping the international situation?

Doctor MILLER. Yes. But I don't think you can dissociate the two. I think they were pretty much interwoven. You help the international situation when you help the movement of American products abroad and you help our domestic situation when you help the foreign buyer.

The CHAIRMAN. I see.

Mr. STEVENSON. You started right there to discuss bankers' acceptances. Now, here is a man who wants to buy a hundred thousand dollars' worth of products. Instead of paying cash, he pays in bankers' acceptances. Now, he has his money in bank in London, or he has his credit there. He has his bank there accept a draft for a hundred thousand dollars. Isn't that the procedure?

Doctor MILLER. It may be handled in London, but, as things were last autumn, it is more likely that the credit would be provided in New York.

Mr. STEVENSON. Well, he gets a bankers' acceptance for, say, 60 days.

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Now, is there usually a difference in rate on that in New York and London?

Doctor MILLER. Yes; there frequently is. Generally speaking, there has been a difference. You are, doubtless, aware that in the days before the Federal reserve system there was no acceptance banking practiced in the United States to speak of.

Mr. STEVENSON. Yes.

Doctor MILLER. And the outward movement of American crops was financed by drafts drawn on London.

Mr. STEVENSON. Yes.

Doctor MILLER. Since the Federal reserve has been in operation the situation has changed materially. If we go back over the last few years we find that there have been a few cases where the London rate has been under the New York rate. In such cases a good deal of the shipment of these American farm staples would be financed through sterling credits. At other times—such was notably the case in 1924, for instance, and again last autumn—the New York rate was more attractive. This international banking business is very apt to go to the market where it can get the best terms. And the increase in the volume of acceptances carried on this side of the water during the last year was some three hundred millions greater than what was usual. This increase represents approximately the amount of the load taken off the credit machinery of Europe, notably of England.

Mr. STEVENSFN. Now, the rate—that is, the charge on the bankers' acceptances—of course, affects the amount of cotton which he can buy for the hundred thousand dollars. So that a low rate on the bankers' acceptances tends to help the export of our commodities?

Doctor MILLER. Precisely.

Mr. STEVENSON. And the rate is usually lower, as you say, in New York than it has been in London?

Doctor MILLER. It has been in these recent disturbed years. It has not always been so, even since the war. As to the future, we do not know. There is going to be keen competition to determine whether New York or London is going to have the primacy in the market for this kind of international short-term financing paper. That remains for the future.

Mr. STEVENSON. What element tends to bring that rate down?

Doctor MILLER. Competition.

Mr. STEVENSON. Competition?

Doctor MILLER. Competition for the business, and the factors influencing the competitive position of the two markets.

Mr. BEEDY. I understood a moment ago—am I interrupting you Mr. Stevenson?

Mr. STEVENSON. I am through, Mr. Beedy. I wanted to sort of visualize the process that he has indicated a while ago. It was entirely intelligible to him, but not entirely so to me. So I wanted his explanation.

Mr. BEEDY. I understood that you were about to speak about one important factor that ought not to be disregarded.

Doctor MILLER. That was in connection with the exchange?

Mr. BEEDY. Yes.

Doctor MILLER. I was about to say that by the same token by which an increase in, an improvement, let me say, rather than an in-

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crease, in the exchange of any foreign country gives an advantage to the importer over there, it puts the importer here under a disadvantage, because he gets less sterling for his dollars. Just as the English importer gets more dollars and cents for his pound sterling, the American importer gets fewer pounds and pence for his dollars. So a rise in the foreign exchanges has a tendency to stimulate outward movement and to retard inward movement of merchandise. And therefore, if the question is regarded in other than its transitory aspects it may be a nice question to determine where balance of advantage will lie as between the two countries.

Let me go further, because one can not easily reach a limit in the analysis. It can be extended further and further until it eventually gets back to where it started. As the rise, we will say, in sterling makes British goods, perhaps also, European goods, more expensive to the American importer, it tends to diminish American purchases of British or other European manufacturers, and thus to act as a retarding influence on the growth of their export trade. So it is only in a very limited view, that is to say, limited in point of duration, that it can be said that its effect is to stimulate the export trade of the country, because, while it is doing that, it may do a great many other things that may not be immediately noticed, and the thing has got to be handled with the utmost appreciation of all that may be involved, and yet with a full appreciation of the importance of the time element.

Let me add this, for I think it is pertinent to this discussion, Mr. Strong: In the psychology of "cheap and easy money policy" as a rule even people who are pretty wise in money market matters are apt to see only the things they have at heart as the objective of their money policy, are apt to see only what they want, and are apt to lose sight of the counteracting factors.

Mr. STRONG. May I suggest that we get back to this bill?

Mr. MILLER. Have I finished your major question, Mr. Beedy?

Mr. BEEDY. No. I thought you started out to say that there were certain factors in the situation which caused surprise to the Federal reserve system.

Doctor MILLER. Yes.

Mr. BEEDY. Who expected a beneficent result and found that the devil had been at work. "Angelic," I believe, was the term you used.

Mr. STRONG. "Angelic desires."

Doctor MILLER. I have tried to describe the objectives that were in mind in this policy of easing and cheapening money through the summer and autumn and into the early winter of last year.

Now, as to what resulted in connection with this policy, that is a further chapter in the story. When money rates went down in New York last summer American business was, as we now know, in a state of recession. I suppose it might be said that the recession extended back even into the early summer or late spring of last year. The result of slackened trade was that there was a light demand for commercial credit. The actual volume of commercial credit in the latter months of 1927 declined below that of 1926.

Doctor MILLER. That is to say, there was a slackened demand for commercial credit, lower relatively than we have had for some time.

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The money that was released by the Federal reserve banks to the open market through its policy of open-market purchases had to go somewhere.

The effect that was expected and intended was that it should bring about a lowering of money rates. The one market that we have had in this country during recent years that apparently has an insatiable appetite for credit is the securities market. By the securities market I mean, of course, something more than the market for stock-exchange loans. I mean the market for all kinds of collateral loans made for the purpose of floating domestic or foreign securities—governmental and corporate. An easy-money market is always favorable to operations of that kind.

Now, the low money rates that resulted from Federal reserve policy, in the light of subsequent developments, appear to have been particularly effective in stimulating the absorption of credit in stock speculation. As we look back the rise of security prices has been more nearly perpendicular, I should say, in the last six months than in any period since the Federal reserve system has been in existence. So that, Mr. Beedy, answering your question quite frankly—I want to be just as candid as I know how—I would say that cheap and easy money in the New York market the last autumn must be recognized to-day as having been a distinctly provocative factor in the remarkable speculative movement that has been in process now for several months.

The CHAIRMAN. Doctor Miller, in that connection: If that money that was realized by the purchase of securities for the purpose of easing the whole money-market situation had been absorbed by the railroads and industries and commerce, it would have resulted in a better business situation. But, as a matter of fact, it was not used by business and industry and the railroads to improve and better their conditions, but was largely used in the stock market?

Doctor MILLER. Yes. Well, it was used to a greatly increased extent in the stock market.

Mr. BEEDY. I suppose it would be fair to those who determined upon and finally consummated that policy of cheap money for the Federal reserve system to say that they were not then advised of the tendency towards recession in legitimate business at that time as they now are?

Doctor MILLER. Well, of course——

Mr. BEEDY. I nother words, there might have been an honest hope that a very appreciable portion of the money thus released upon the market would be absorbed in legitimate business?

Doctor MILLER. Yes. Of course, we know now what happened. At the time the policy was adopted the Federal reserve was confronted with the necessity of forming an estimate as to what might happen, as to what the probablities were. In this particular instance my fear was that cheap money would give an unhealthful stimulus to activity. What has taken place has not particularly surprised me, therefore. I was absent from Washington at the time action was taken on the 27th of July, but I immediately wired in and urged that action be held back at least until September and that action of the kind in contemplation would prove an unhealthful stimulus.

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Now, gentlemen, that may simply have been a lucky guess. It is quite conceivable that at least some of the officers of the Federal reserve system who recommended the policies adopted, and who believed in them, might also have entertained some apprehension and have concluded that what the Federal reserve was after in this case would more than compensate for possible harm from the stimulus that cheap money might give to speculation.

There was an element that appeared later on that probably nobody could have predicted would occur. Gold began to be withdrawn from the United States in large amounts. The monetary reforms being put through in South America had reached the stage where they wanted the actual, physical gold in their custody. There was a considerable movement of gold, partly into "earmark" account, partly into actual exportation. In either case the gold went out of the Federal reserve and the American banking picture.

When gold is wanted for "earmarking" it is physically locked up in the strong box of some New York bank; it is just as much gone as if it were put on board a ship and sent out of the country. It is no longer America's gold. The Federal reserve, therefore, in this situation and still adhering to its policy of maintaining an easy condition of the money market, decided to offset withdrawals of gold for either "earmarking" or exportation by purchase of securities in the open market. Whenever gold is withdrawn for foreign account it means that the member bank handling the account has got to get the gold. And normally the place to get that gold is the reserve bank. The member bank will therefore have to go to the reserve bank and rediscount, unless at the time the reserve bank relieves it of that necessity by pursuing a policy of open-market purchases. The effect of offsetting open-market purchases is to put reserve money into the market at the time when member banks want it in order to get gold for shipment.

A purchase of securities in the market by the reserve bank, as far as the member bank is concerned, is identical in its effect with an importation of gold, just as a withdrawal is equivalent to an exportation of gold.

The CHAIRMAN. That is what gives it its power and influence?

Doctor MILLER. That is it exactly. That is what gives the reserve bank its power and influence. So that the reserve system in pursuing its policy of easy money said, "As gold is withdrawn for export we will make offsetting purchases in the market so as not to allow the withdrawal of gold to firm money rates in New York and thus defeat the policy we are operating on."

But as autumn wore on, and the absorption of funds into the stock-exchange loan account grew to amazing dimensions, a feeling of misgiving arose with regard to what was taking place.

Well, now, I think it is a fair statement in accounting for the extraordinary ease of money in the autumn of 1927 to say that in part it also was due to the fact that there was then a real recession of business, and therefore a relatively slack demand for commercial credit, and, what was more important, a diminution in the volume of currency required by the ordinary business of the country. The figure I have in mind is a reduction of a hundred millions or thereabouts in the volume of money in circulation as compared with a year earlier.

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We are lower in the actual amount of money in circulation in the country than we have been since 1922.

Mr. BEEDY. You are referring now to all kinds of currency?

Doctor MILLER. All kinds of money; money in circulation, whether greenbacks, gold certificates, Federal-reserve notes, etc.

The CHAIRMAN. You are not talking about Federal reserve credits?

Doctor MILLER. I am talking about currency, total money in circulation, as the official statements call it.

The result of that diminution was practically equivalent, from the point of view of the member banks of the country, to an importation of some 100,000,000 of gold, exactly the same. In brief, as currency became redundant and flowed back to the banks of the country, the member banks turned it in to the Federal reserve banks and got credit in their reserve accounts dollar for dollar, exactly as they would if they had received an importation of gold.

So that at the very time—I am looking back, now—at the same time that the Federal reserve bank was putting money into the market in order to offset the restrictive effects of gold exports the country, because of reduced requirements for monetary circulation, was, so to speak, also putting money into the market, thus adding to the supply of basic credit, and giving rise to what, I think, can be very properly described as a plethora of money in the autumn and early winter of the year under review.

Mr. BEEDY. I don't know—I may be dull, but I think I have lost a step here somewhere. I understood you to say that our circulation of currency per capita was to-day less than at any time since 1922.

Doctor MILLER. I said that the total amount is less; and inasmuch as the population has increased in the meantime, the per capita is even still less.

Mr. BEEDY. You are speaking not only of Federal rsserve notes but everything?

Doctor MILLER. I am speaking of everything.

Mr. BEEDY. You are speaking of America?

Doctor MILLER. Yes.

Mr. BEEDY. Now, then, I understood your next statement to be that as through the open-market operations the member banks were able to avail themselves of money made cheap by that operation, they in turn instead of coming and rediscounting, reduced their indebtedness at the central banks, and also turned money back into the central banks and thus retired it from circulation. Is that correct?

Doctor MILLER. That is correct.

Mr. BEEDY. I think your next statement was so that you have a plethora of money?

Doctor MILLER. Yes.

Mr. BEEDY. Where?

Doctor MILLER. Well, a plethora of credit.

Mr. BEEDY. Locked up in the Federal reserve system?

Doctor MILLER. No; in the money market.

The CHAIRMAN. That made that money available for stock loans?

Mr. BEEDY. That is, this money that is tied up in stock loans is withdrawn from the general money or currency in circulation and caused to be reduced to this low level per capita?

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Doctor MILLER. If the committee is not advised on this fact of present-day banking practice, perhaps it will be worth while to put it into the record at this point.

The banks to-day carry no surplus reserves. Under our old banking system, there was a good deal of variety in the practice of banks according to the different temper——

The CHAIRMAN. You mean the member banks of the reserve system?

Doctor MILLER. Yes. Under the old régime, before we had the Federal reserve system, there were conservative bankers and there were bankers who sailed pretty close to the wind. There were country bankers who felt uncomfortable if their reserve ran below 40 per cent, even though their required reserve was only 15 per cent. They wanted a good reserve. There were others that would go just as far the other way as the comptroller's office would permit.

As the banks look at the situation now there is no reason why any bank should carry a surplus reserve. I think one of the things that is overlooked in banking changes under the Federal reserve system, with its safeguards, is that the banker has been released from that constant sense of responsibility for his own good condition that was characteristic—at least, more characteristic—of banking under our old money system. This has introduced a new factor, the full influence of which on recent movements and conditions is just beginning to be appreciated in the Federal reserve system. The result of the habit of carrying no surplus reserves was that the hundred millions or more of currency which flow into the banks, because trade did not need as much pocket cash and pay roll requirements were diminished, was deposited by the member banks with their respective reserve banks and credited to their reserve accounts, giving them in first instance surplus reserves.

Now, since the banks do not any longer carry surplus reserves they would immediately look around and invest their surpluses; make the money which flowed out of circulation and into the banks earn a return without interruption. That is one of the noteworthy things in the reserve system—the immediate and constant investment of bank funds has been very much heightened by the smooth-working Federal reserve machinery; its system of transfers and quick clearances. There is no country in the world probably where the rapidity of turnover of money is as great as it has become in the United States under the reserve system.

The CHAIRMAN. Velocity, I think it is commonly referred to.

Doctor MILLER. Velocity, or, as I would prefer to call it, efficiency of performance of the monetary unit of value under the operation of the Federal reserve system. The American dollar has become an efficiency marvel. Currency, we will say, is retired from circulation in San Francisco to-day. To-morrow it is loaned on call in New York City. This means that the San Francisco member bank gets credit in its reserve account with the Federal Reserve Bank of San Francisco on the day it deposits redundant currency, immediately arranges for a transfer wire to New York, and it is out on call to-morrow.

Mr. STEVENSON. It is money from banks all over the United States that is being loaned on call in New York so much?

Doctor MILLER. Yes.

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Mr. STEVENSON. Have you any figures on that?

Doctor MILLER. Let me explain. The disposition of the banks not to carry surplus reserves, the disposition of the banks to invest the last dollar they can up to the legally required reserves and the modicum of cash in till they have got to have at the beginning of the banking day in order to meet the counter demands for cash is to a large measure responsible for the increased importance that the call-loan market has acquired in recent years.

The CHAIRMAN. That brings up an interesting question here, too, Doctor. There has been some suggestion of going back and repealing this change in the reserve requirements known as the war amendments, because now that the war is over and we have this plethora of money and credits which you refer to here as available for perhaps too much speculation, perhaps we should go back to the old methods of reserves. Are you suggesting that that might be a possible correction of this great plethora of money which is now used in the speculative market?

Doctor MILLER. I think there are some things there worth considering. I think, however, that as a general proposition it is a very difficult thing and a thing of very doubtful expediency to turn back in banking legislation when it involves a stiffening of reserve requirements. It might be tantamount to deflation by legislation.

Mr. STEAGALL. What did you say, inflation or deflation?

Doctor MILLER. Deflation.

Mr. STEAGALL. I thought that was what you said.

Doctor MILLER. I do think, however, that this is a very important question, and if the committee is interested in it it might well be made the subject of a separate hearing.

The CHAIRMAN. Yes.

Doctor MILLER. I just want to mention——

The CHAIRMAN. Two or three years ago I made a proposal in the form of legislation, and the attitude of the board then was that it should not be done, and the American Bankers' Association went on record that it should not be done. But the situation is still with us?

Doctor MILLER. It is still with us.

The CHAIRMAN. I was just wondering whether it would be feasible to reconsider this.

Doctor MILLER. It might be well worth while for the committee to consider what is practicable in the way of an increase in the reserves required against time deposits.

The CHAIRMAN. This whole question of reserves is an arbitrary one that we set up supposedly to cover the situation. I think that some of these days we are going to come, perhaps, to a readjustment of the basis of these reserves as between the different classes of banks and as between the different classes of deposits.

Doctor MILLER. Yes. I think that is quite true.

Mr. BEEDY. I think that Congressman Strong feels that because we have not been talking about this bill that our time has been wasted.

Mr. STRONG. No. I don't think that the time has been wasted this morning, but I was going to suggest that to-morrow morning we meet for the purpose of having Doctor Miller resume his testimony with regard to this bill.

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Mr. STEVENSON. Let me ask Doctor Miller one question first.

Mr. STRONG. Go ahead.

Mr. STEVENSON. You are speaking of the question of checking the unusual investment in call loans, the unusual amount of brokers' loans. What is your attitude as to the position taken by the witness yesterday—that the most effective method would be for the Federal reserve banks to be able to say or be instructed to say to a bank that comes for rediscount, "You are carrying a very heavy amount of brokers' loans. We deny you any further rediscounts while that condition exists." Now, that is a practical suggestion that he made yesterday, and it would no doubt be an effective method of dealing with it. The question would be whether it is a judicious method or not.

Doctor MILLER. Well, I would be inclined to answer a bit cynically by a quotation from a great man: "Thought is easy, action is difficult; and action in accordance with thought is the most difficult thing in the world."

Theoretically the thing is perfectly conceivable; and if we were dealing with a theory instead of a condition, I not only think it could be done but would have been done long ago. The fact, however, that it has not been done is the thing to be explained when talking about what is and what is not practicable. It might be that a clarification of the law with regard to the borrowing status of member banks could be brought about so as to leave the Federal reserve banks and the member banks, so to speak, no loophole for misuse of Federal reserve credit. I think one or two questions were asked yesterday by Mr. Beedy on this subject of the witness. He did not seem to think well of amending the Federal reserve act so as to prohibit the use of Federal reserve money for so-called speculative loans, if I remember correctly.

The CHAIRMAN. May I suggest this: The members are required on the floor of the House, and I think we ought to adjourn very shortly.

Mr. STRONG. I move we adjourn until to-morrow at 10 o'clock.

Mr. STEAGALL. What would be the effect in the matter of feeling created, and all that sort of thing, that would result from such action as this on the part of the Federal Reserve Board to take over the control of policies of all of the banks of the country?

Doctor MILLER. Well, it can't be done, and should not be done. That is not a function of government.

Mr. STEAGALL. In other words, the Federal Reserve Board, sitting in Washington, should not assume responsibility and control and management of a member bank of the Federal reserve system in a distant city as to the details of its business?

Doctor MILLER. No. Of course not. But it can do a great deal, in my judgment, that would be effective without any such invasion of the field of management of the member banks.

Mr. STEAGALL. But suppose the Federal Reserve Board concludes that here is a situation that has sprung up where we think there is a certain character of loans that is being extended beyond the point that we think is wise and healthful; and when banks that have got into this practice apply to us for loans, even if it is in every sense desirable and satisfactory otherwise, because of this particular situation we will arbitrarily refuse them loans. Would that not be a direct interference with their management?

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Doctor MILLER. Yes.

Mr. STRONG. I move we adjourn until to-morrow at 10 o'clock.

Mr. STEVENSON. I second the motion.

The CHAIRMAN. It is moved and seconded that we adjourn until to-morrow at 10 o'clock. We had better make that 10.30. The committee will now adjourn.

(Whereupon at 12 o'clock noon the committee adjourned until Thursday, May 3, 1928, at 10.30 o'clock a. m.)

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Thursday, May 3, 1928.

The committee met, pursuant to adjournment, at 10.30 o'clock a. m., Hon. Louis T. McFadden (chairman) presiding.

The CHAIRMAN. The committee will come to order.

STATEMENT OF ADOLPH C. MILLER, VICE GOVERNOR FEDERAL RESERVE BOARD—Resumed

Mr. STRONG. Mr. Chairman, Doctor Miller has indicated his wish to go on where he left off yesterday, and at the conclusion I would like to ask to have Doctor Commons, through questions, develop lines of thought by the use of charts, which I think will be very enlightening to the committee, if there is no objection.

The CHAIRMAN. In the absence of any objection on the part of members of the committee or Doctor Miller we will be very glad to proceed in that matter.

Doctor MILLER. I would be perfectly happy to have it go on by questions, but my thought when I spoke to you a moment ago, Mr. Congressman, was that the episode that was being discussed yesterday morning—the operation of the Federal reserve system during the last 8 or 10 months, say, since August of last year—had better be concluded before new subjects were taken up. I will not say that the best way would not be to have it done by questions. Mr. Beedy was asking some very pointed questions yesterday morning.

The CHAIRMAN. Yes. Of course you appreciate as we do that a review of the experiences of the last six months is very pertinent to this subject of this investigation—to the subject of stability—because it is a practical illustration of a part of the dilemma in which we all find ourselves at this time.

Doctor MILLER. Precisely.

The CHAIRMAN. And it has a very great bearing on the operation of this proposal if it was enacted into law; so that it seems to me that it is all very pertinent, and I think your position is right, that you should finish up what we had before us yesterday, and then that you should submit to questioning to bring additional light on this particular subject that Mr. Strong has referred to.

Mr. STRONG. All right.

The CHAIRMAN. So that, supposing then, Doctor Miller, you proceed with your statement on that matter.

Doctor MILLER. Toward the conclusion of the hearing yesterday morning I had carried the account of banking developments of the

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period under review to the close of the year 1927. Let me say here that one difficulty I have in recollecting what has already been said is that during the days these hearings have been in progress, the spring conference of the Federal reserve bank governors has been going on here in Washington, and while I have been here in the mornings I have been there in the afternoons, and a great many of these same questions have been under discussion there; so that I am not always sure as to what I may have said here and what I may have said there. Toward the end of the year 1927 after the Federal reserve system had been pursuing the policy, mainly through open-market operations, but assisted by the lowered discount rate, of creating an easy credit condition—a policy which manifested itself when an outward gold movement began in the autumn of 1927, in so-called offsetting purchases of securities in the open markets by the Federal reserve system; in other words, by the restoration to the open market of the money which has been taken out of the market by gold withdrawn either for ear-marking or for foreign shipment—there was evidence of steady and pretty rapid absorption of credit into security loans, not only speculative loans of the kind that are reported in our weekly statement as brokers' loans, but of other security loans also.

At the same time the best information obtainable by the board was to the effect that the commercial loans were running at a lower level. Is that right, Mr. Riefler?

Mr. RIEFLER. In comparison with the year before.

Doctor MILLER. That is what I mean; they were lower than the year before.

The Federal reserve, I think, began to feel that somehow or other its plan of easing money conditions was bringing about some unexpected consequences, and the first real result of that in policy was the suspension of these so-called offsetting purchases of securities—these purchases of securities in the open market—against gold exports.

I want to see whether that is clear, because to my mind it is a rather important detail in the history of this policy.

The CHAIRMAN. You mean by that that exports of gold were made and that the Federal Reserve Board changed its policy with regard to purchases in the open market?

Doctor MILLER. Yes; instead of purchasing securities in the open market—in other words, of putting back funds into the market equal to the amount of gold taken out for export or earmarking—it pursued a policy of allowing the gold so withdrawn to exert some pressure.

The CHAIRMAN. In other words, a tightening of the money market?

Doctor MILLER. A tightening of the money market. But even that did not register the effect that was expected and that might normally be expected. It became fairly clear, therefore, that there must be some mysterious forces in the situation of which the Federal reserve was not cognizant.

The CHAIRMAN. And over which the board had no control?

Doctor MILLER. And over which the board had no control, except as it always has control over its action if it knows what conditions are. You have no control over the rain, but you can protect yourself by carrying your umbrella and gum shoes with you. A subsequent study of that situation indicated what these influences were. I do not know whether they are generally appreciated.

The CHAIRMAN. Would you care to express your views on that?

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Doctor MILLER. Yes; if I have not already enumerated them in the last hearing.

One is the great reduction in the amount of money in circulation. My recollection is that by the last figures the reduction is approximately $125,000,000.

The CHAIRMAN. What caused that reduction? What brought it about?

Doctor MILLER. Presumably slacker trade and slacker general business activity in the year 1927.

The CHAIRMAN. You are talking now of a reduction in the Federal ratio?

Doctor MILLER. No; I am talking of reduction in the total amount of money in circulation, irrespective of its issue.

Mr. GOODWIN. What is the total?

Mr. RIEFLER. Four and seven-tenths billions.

Doctor MILLER. Yes; approximately five billions. I think probably that slow trade was the most important factor in the reduction. Another factor, I think, is the increased use of checking accounts. The checking habit has spread pretty rapidly in recent years among sections of the population that were strangers to such devices and practice only a few years ago. I think undoubtedly that——

The CHAIRMAN. That might be termed an increase in velocity or organization which is brought about by the Federal reserve system of credits, and the tendency to settle by check increasingly?

Doctor MILLER. Yes; it might be explained in that way. Fundamentally, I would say, it is a change in monetary usage that grows out of a change of habit, and that change of habit is, I think, in part explained by the growing intelligence of the public, especially as the wage-receiving classes have an increasing familiarity with banking customs.

The CHAIRMAN. And the influx here of foreign money had some influence on that, did it not?

Doctor MILLER. It had an effect on the composition of the currency, but I think not upon the total volume.

The CHAIRMAN. Yes.

Doctor MILLER. The total volume of money in circulation is determined by the community. The Federal reserve system has no appreciable control over that and no disposition to interfere with it.

Mr. STEVENSON. The rather widespread tendency of labor to organize banking systems and to get the laborer who is paid by the week or every two weeks into those systems has had a good deal to do with it?

Doctor MILLER. I think a good many things have been great contributing forces. I think the automobile habit has a great deal to do with it. In part, I suppose the frequency of burglary and robbery has something to do with it now. A man is a little more hesitant about carrying a wad of currency with him if he has means of identification, so that having a checking account he can check against it here and there.

The CHAIRMAN. Modern influence as applied by banks to get business has had its effect also?

Doctor MILLER. Yes.

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The CHAIRMAN. And the organization of small community banks, labor banks, and all kinds of financial institutions. Installment buying has been a stimulent?

Doctor MILLER. Yes; and I would say, on the reverse side, it has stimulated installment buying. It has certainly stimulated, in my judgment, mail-order purchases. The fact that a man can sit in a tent or a log cabin in Idaho or in the mountains of California, and if he has a banking account, order merchandise without the trouble of going to the bank and getting the currency and buying a money order or draft, without the trouble of doing anything except dropping his list and his check into a letter and then into the nearest box on the mail route certainly has tended to increase the mail-order business. Generally, making things easier makes them more used.

At any rate, the fact is that there has been this considerable reduction in the volume of money in circulation, not wholly explained, I think, by diminished industrial activity nor by employment changes.

Mr. GOODWIN. Does the amount of money in circulation bear any relation to the amount of bank loans?

Doctor MILLER. Yes; but a varying relation. We used to assume, and it was a fairly justified assumption, that the amount of money in circulation was perhaps a sixth part of the volume of commercial credit as indicated by demand deposits. A member of the board's statistical staff is here, and I turn to him to sell me whether I am too far off. There was formerly a ratio of one to six. The ratio is subject to change, as monetary practice and banking habits change; but that is approximately a statement of a working ratio.

The reduction of money in circulation from the point of view of the member banks of the Federal reserve system, is the same in effect as though an equivalent amount of gold had come into the country from foreign sources. It is the basis of reserve credit. So that, at the time that the Federal reserve was losing gold and making offsetting purchases of securities in the money market, the circulation of the country was becoming redundant, and was being sent into the banks and by them into the Federal reserve banks for virtual retirement. This returned-currency flow acted exactly as though there had been a counteracting gold import movement into the country at the very time the gold export movement was on, and when there was solicitude on the part of the Federal reserve that the gold export movement should not interfere with the maintenance of low and stable money rates.

That redundant currency was an element not quickly detected It was one of the mysteries at the time when the Federal reserve was wondering why its policy was not working as anticipated.

The CHAIRMAN. There is no direction that caused that retirement of circulating medium?

Doctor MILLER. Not at all.

The CHAIRMAN. It was just natural conditions of supply and demand?

Doctor MILLER. Yes. Currency became redundant in comparison to the volume of transactions that needed to be handled through currency.

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The CHAIRMAN. With the natural sequence of lessening the business, the perils of utilization of checking accounts for the payment of bills?

Doctor MILLER. Yes; all of that is involved in it. Now, at the same time, notably in the autumn, business was getting a bit slacker month by month. It was indicated, among other things, by the fact that the volume of commercial loans in the latter part of the year 1927 was lower than it was in the year 1926, showing that there was a certain amount of credit that was, so to speak, released from commercial use. So that at the time that the Federal reserve was pursuing a policy of maintaining an easy money market through open-market purchases, combined with a lower discount rate, the commercial system of the country, so to speak, as indicated by reduced requirements for actual money and commercial credit, was returning, so to speak, to the reserve banks a part of the currency, and returning the facilities that it did not need, and thus was easing the market at a time when the market did not need easing—when it did not need, at any rate, additional commercial facilities—and was content with less, as indicated by the fact that it took less, notwithstanding the fact that the funds were abundant and the rates were cheaper.

Incidentally—I put this in parenthesis—as I have perhaps stated here before, in a time of recession you can not stop the recession by the lowering of the discount rate, the cheapening of the cost of credit, or by making credit more abundant.

You have a good illustration of that in 1928. I may come to this later on, when we get down to the real nub of the bill.

To the extent that the Federal reserve has that influence over credit movement it can influence it only when the market itself is moving. You can not, as it were, restrain a horse that is standing still. It is no use. You can not, so to speak, make a horse go by slackening the reins, standing still, if you do not give him some other impulse or direction. There must be motion before you can very the motion.

Mr. STRONG. Does anything in this world stand still?

Doctor MILLER. Of course, I am using that in a loose, practical sense. You have got to have a demand for something before you can either stimulate that demand or restrain it. And at a time when the business community does not want to make any business commitments, when it wants to reduce commitments, when it is hesitant about the business outlook, you can not do very much with your rate; and, in my judgment, when you undertake to do it you are really wasting your ammunition. You are putting yourself in worse position to do what you might possibly do in the future. You put yourself in a more awkward position.

Mr. LUCE. Once in my life I received a great compliment, undeserved. A banker friend of mine met me on the street and asked me if I could not borrow some money of him. He had more money on hand than he wanted to use, and he suggested to me the possibility of doing something in the way of building, or something. Wisely, I declined the temptation. But does not a plethora of money sometimes result in a bank trying to put out its funds, and inviting and encouraging men to enter into enterprises?

Doctor MILLER. Eventually the plethora of money will cure itself, but it may take a year or more before that eventuality is reached.

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We have not experienced this in recent years. But if you turn back in our economic history you will find that we have had so-called money plethoras and stagnant trade conditions, with discount rates lower than any we have seen in the Federal reserve system in recent years with the possible exception of the year 1924. After the revulsion of 1873 such was, I believe, the case.

There have been such times in the history of the Bank of England. Perhaps that gives the most complete catalogue of episodes where even a very low rate of interest will sometimes fail to stimulate the use of money.

Of course, there is some foundation, I think, for believing that these episodes are going to be less frequent and less severe than they have been in the past, but we have had them in the past, and we had in this country in 1924 a 2 per cent rate on bankers' acceptances and on call-market loans that did not have very much stimulating effect for some months. People were still under the influence of the memory of 1920 and 1921, and the reaction that came in 1923, and they were in no state of mind to borrow simply because money was cheap.

Mr. LUCE. Must we disabuse ourselves of the impression that the discount rate is an indication of conditions?

Doctor MILLER. We must rid ourselves of the impression that lowering the discount rate will stimulate business when business is not in a mood to respond to stimulation. A part of the rare wisdom and the rarer skill in the application of discount policy is the knowing or sensing when you may and when you may not expect to get a response. It can not be done mechanically.

An economic rule in this matter is not possible of formulation. At least that is my opinion, based upon observation and experience in the Federal reserve system, and that is, I think, what is in large measure responsible for some of the surprises and unexpected consequences that were involved in the development of the credit policy that was followed by the Federal reserve system last autumn and on into this year.

Mr. LUCE. I venture to push my interrogation, because it strikes me you are getting right down to the core of this provision. If we were to adopt Mr. Strong's proposal, and if it would be possible either to stimulate or retard business activities, I should be glad to know quite definitely whether it is your opinion that that is of no great consequence?

Doctor MILLER. It is my opinion that looking at the thing in its practical and practicable aspects as well as its theoretical aspects, there is not a sufficiently close relationship between the two things to make it certain that any ordinary body of men—and by ordinary I mean in point of, let us say, mental equipment for a highly delicate task; for, let me say, an act of economic statesmanship of, perhaps, as delicate a character as has ever been conceived or proposed.

Therefore, I would say, it awakens exaggerated expectations and probably will result in miscarriages—the disappointment that usually comes where you have an unfulfilled expectation. And the criticism. I think it would be a matter of very grave doubt whether, if it were possible to put the control of the Federal reserve system or any other great reserve banking system into the hands of, say, six or eight

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of the ablest men that could be found in the world, it could be done—I question whether it could be done.

Mr. STRONG. We have done it.

Doctor MILLER. What?

Mr. STRONG. They have the power.

Doctor MILLER. They have the power?

Mr. STRONG. We have given it to them.

Doctor MILLER. But I say I question whether it would accomplish what Mr. Luce has in mind. We have had a very dramatic demonstration in this country in the last few months, in the field of the air. Why are we celebrating Lindbergh more than we are any other flyer? And why are there so few? Why is there none other as yet?

There are reasons for those things, and until you get, so to speak, a species of Lindberghs in the field of public administration, to my mind you are not going to get Lindbergh results, no matter how many *Spirits of St. Louis* are going to be legislatively constructed. You can write whatever you want into the text of this bill, but you will get out of it only what the men who are given the administration of it can get out of it; and in respect to this particular bill, my opinion is you will get less of what you want because the presumption is that the Federal reserve has got to accomplish something by the use of the immensely delicate and unusual instrumentalities that would have to be developed for the purposes proposed.

Mr. STRONG. Then do you think men should be given these tremendous powers?

Doctor MILLER. I think they should not be given the powers.

Mr. STRONG. They have them now.

Doctor MILLER. They have them? I think you overestimate the powers the Federal reserve system now has. I would like an account, a statement, as to what your conception is of "all" these powers; when they use all the powers that now exist.

Mr. STRONG. My conception is that when we give to a board of men the right to control the volume of money in circulation among the people, and largely to control the price of money, and the right to control the expansion or contraction of credit, that is the greatest power that has ever been given to any men by any government, except the power of life and death and liberty.

Doctor MILLER. I would say that is all right for oratorical purposes.

Mr. STRONG. Is is not true?

Doctor MILLER. No; it is not true.

Mr. STRONG. What other rights have we given to men greater than those?

Doctor MILLER. Let us not discuss——

Mr. STRONG. It is either true or not true.

Doctor MILLER. I deny that it even has these powers that you say it has; that it can contract or expand, as you say. When has the Federal Reserve Board contracted credit? Has it in this last year?

Mr. STRONG. I do not know whether it has or not; but do you not think that it can?

Doctor MILLER. I answer those questions realistically. I am not concerned with what can be done in a vacuum. I am concerned as to what actual, living men, sitting here in the shadow of the United States Capitol, can do. No; it can not do it.

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Mr. STRONG. It did not bring about a reduction or deflation in 1920?

Doctor MILLER. I think it would be unprofitable to go into that. I am perfectly willing to, but I think that it would be an unprofitable investigation.

Mr. STRONG. Put it the other way; what power do you think that you have not?

Doctor MILLER. The mistake that the Federal reserve made then (1920) was in not saying there was no use doing those things, and of putting itself in the position of accepting responsibility for what happened more or less under the impulse of fear of the investment and banking community; and more or less the impulse of fear of the Senate of the United States.

The CHAIRMAN. That includes the Treasury as well, in that?

Doctor MILLER. I think that is a more complicated question.

Mr. STEVENSON. As I understood you day before yesterday, I think it was, your idea was that the open market operations were not particularly efficient in either stabilizing or reducing prices, or raising them.

As I understand you to say, the rates of discount being raised or lowered, if business is in a static condition as my good friend from Indiana used to say, does not have any particular effect. Those are the two principal ways in which it is supposed that the Federal reserve system affects business.

Now, I want to ask you this. Suppose you have had a period of, as I said a while ago, static condition in business; just marking time. When is the time to begin to loosen it up; or is there a time when the Federal Reserve Board could? And, in addition to that, is it not necessary—I will put two questions in one because you comprehend them both—is it not necessary to create the condition which may invite business to come out of its marking time and begin to march? Does there not a time come when that should be done; and what could be done to do that?

Doctor MILLER. Yes. I think I have said, perhaps, two or three times that I think it is reasonable to believe—I hesitate to put that more absolutely, because I think experience is the only real guide in this matter, and the reserve system, though in some respects very old, in other respects is still an infant; but without specifying a lot of qualifications and details, I think that the discount policy of the Federal reserve system, or of any central banking system, properly timed in a period of what I would call business recovery following after a period you have described as one of static conditions, is capable of having a stimulating effect. And I might add that on that basis right now, in our own country, it would be far better if the discount rate—I am now looking at the matter exclusively from the point of view of the effectiveness and relationship of the discount rate to the business activity of the country—it would be far better right now if the discount rate were 3½ per cent than when that rate was established last autumn.

We know now—I am not saying this in any critical way, but we know what has happened—that we have been in a period of business recession during the last part of the year 1927. We know that the average growth in economic activity was only 2½ per cent.

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The CHAIRMAN. In other words, to refer to the Lindbergh flight which you mentioned a minute ago, that is pioneering. The Federal Reserve Board and system have been pioneering in the last six months? You had unusual conditions, and there was no chart to show you. You had to gauge your own course.

Doctor MILLER. Yes.

Mr. STRONG. If, right now, you feel that business could be stimulated by the power of the Federal reserve system, do you also feel that it could be deflated by the use of their power?

Doctor MILLER. We are now just about reaching the culmination of what is called the period of spring trade, and for the most part, the commitments that were made by business men to finance them through this interval were made two and three months ago.

Mr. STRONG. Say two or three months ago. If it could have stimulated it at that time, could a contrary action have deflated it?

Doctor MILLER. It could have restrained it somewhat.

Mr. STRONG. That is exactly what I want to use this bill to do.

Doctor MILLER. Then I would add, not in a technical sense, because I do not want to be trapped into admitting anything that will embarrass me——

Mr. STRONG. I understand that you will not admit anything. Even though you admit it by implication, you will get around it. I appreciate that.

Doctor MILLER. I do not think the difference in your specified case would be a very marked one; but I might as well, having said that, say why; and I think why may have some considerable pertinence to your inquiry.

Mr. STEVENSON. Now, you have practically answered my question. I want to ask one there. You say now there is a beginning of recovery. Then the lowering of the discount rate would facilitate, in your judgment, the recovery?

What indications does the board follow to determine the period at which the lowering of the discount rate should be started, after the stimulation has started or before it has started. In other words, when a machine has been standing in the road for a good while, can you crank it up by putting on the brakes, or do you wait until it gets started and then add a little more gasoline? Which is the logical way?

Doctor MILLER. You are asking a question that I am afraid, honestly, I can not answer. I think it is always well to bear in mind that the Federal reserve system is a very large organization. There is not only the Federal Reserve Board but there are 12 banks and their officers and directors, many of whom are very able men, and they have their own ideas, and so forth; and I would say that if anyone would undertake to describe how an impulse, an action, generates in the Federal reserve system or in the Congress of the United States, that is one of those things.

Mr. STEVENSON. It is impossible to say the point at which and the intentions upon which you would act?

Doctor MILLER. It is difficult for a man to find out just what it is that gives him a feeling of uneasiness that finally changes his attitude and leads to action. You know that most men in matters of large responsibility have not very much capacity to act. It is very easy to imagine that all have, and so forth; but my observation is that the

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men who have a combination of imagination and will, and what I would call sound selective judgment, or, much more rare still, creative judgment, are very, very rare; and that calling men by high-sounding titles and putting them in high positions in the Federal reserve, or anywhere else, does not do anything except, in some cases, paralyze them a little bit in the exercise of the native ability they might have. I have seen a lot of that, where men by reason of the fact that they are expected to do the wonderful, can not even do efficiently the things God intended them to do. I do not know that that should stay in the record. I am talking here pretty frankly to you men.

Mr. STRONG. Do you think that these powers that have been given to the Federal reserve system are too great and important to be handled by men of human limitations?

Doctor MILLER. What do you refer to?

Mr. STRONG. To the great powers we have given them.

Doctor MILLER. I would say that the two important powers the Federal reserve system exercises are powers over discount policy and over open-market policy and operations.

Mr. STRONG. Do you think those two powers should be taken away from them?

Doctor MILLER. I do not, because you might as well shut up the Federal reserve system; but I am inclined to think that the exercise of the power of open-market operations, of the Federal reserve system, should be subjected to limitation rather than to be left as elastic and in some respects uncertain as it is.

Mr. STRONG. How would you suggest doing that?

Doctor MILLER. I would suggest that we clear up this episode that has been under discussion here now for two or three days, particularly with Doctor Sprague (?), who preceded me on Tuesday, followed by myself on yesterday and continuing to-day. I think if we get that episode and its difficulties out of the way, perhaps we will be in a better position to see whether it does or does not suggest something.

The CHAIRMAN. You spoke of the two powers that it has, the power over discount rates and the power over open-market transactions. You would also include the power of publicity, would you not?

Doctor MILLER. Yes; that can very well be included. I think of that as perhaps something that is incidental to and involved in these others.

Mr. KING. You mean the power of secrecy rather than that of publicity?

Doctor MILLER. That depends on how you look at it.

Mr. STRONG. It strikes me, if we have given the Federal reserve system, or a board, such great powers that men of ordinary human intelligence can not operate them, if we can not direct them to use those powers for certain policies but that they must be left by them for experimental purposes in secrecy, we had better repeal them.

Mr. KING. If you had a committee of Gods, you could confer this power.

Doctor MILLER. Evidently.

(The question of Mr. Strong was here read aloud by the stenographer.)

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Doctor MILLER. Let us leave the latter matter for future discussion. I would say right without any hesitation that these things can not be done by men of ordinary intelligence.

Mr. STRONG. Is it not pretty dangerous to leave such powers in the hands of men who can not use them?

Doctor MILLER. What is the danger?

Mr. STRONG. That they may misuse them.

Doctor MILLER. Have they been misused?

Mr. STRONG. I do not know. You say they have been trying to use them and that they have brought about results contrary to what you expected. Would we not be better off if they did not attempt to use them?

Doctor MILLER. I think we would be very much better off with considerable abridgement of some of them.

Mr. STRONG. What would you suggest?

Doctor MILLER. I would suggest some limitation of the open-market powers, particularly in view of this last episode in which we have the open-market policy, which is a species of direct action on the part of the Federal reserve system, indirectly responsible for what I would call, in the large, a misadventure in Federal reserve policy. I call it a misadventure, because I regard the situation in which we have found ourselves during the last two or three months, if you please, as the outcome of it.

The CHAIRMAN. Would you term it inflation?

Doctor MILLER. No; I would not term it inflation. There is nothing in the field of ordinary business or price movements in the commodity field to indicate that there is anything that is unsound or unhealthy.

The CHAIRMAN. Would you say it was simply inflation of the stock market?

Doctor MILLER. It is a question whether we ought to go that far. We do know that it affected the stock market.

I think I stated here yesterday that I regarded the policy of the Federal reserve system last autumn as having been a provocative factor in the stock market; and inasmuch as, and mainly inasmuch as, and mainly only inasmuch as—speaking now personally—the Congress of the United States and the press of the country and the people of the country have become so much concerned about the activities of the stock market, do I take that as constituting a fact that has got to be reckoned with publicly in the operations of the Federal reserve system during the past six or eight months.

Now, it is a matter upon which I think very able men may well disagree, as to whether or not the excitement, with this unwarranted, this extraordinary speculation in stocks that has gone on in the last six or eight months, is the great national menace that many think it is. It may be. It may not be. I usually try to maintain in myself an attitude of mind that it is none of my business as a member of the Federal Reserve Board. It becomes only a matter of concern to me as a member of the Federal reserve system when there is evidence that the Federal reserve banks through their policies have become, as it were, tied into the situation.

The CHAIRMAN. You mean the 12 banks, or are you including the member banks?

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Doctor MILLER. No.

The CHAIRMAN. The five member banks?

Doctor MILLER. Yes; because we might as well recognize right here, particularly in a period when the movement of gold has been outward instead of inward, that the only method by which the banks of the country can extend their business is by getting credit at the Federal reserve banks; and during the last year, when we have had trade and production of comparative slackness when set alongside of the years 1926 and 1925, as indicated among other things by rates of employment and by amount of money in circulation, the only source of reserve money was the reserve banks, and therefore whatever went on in the way of expansion went on with money borrowed from them. To that extent we were tied into the situation.

The CHAIRMAN. Yes.

Doctor MILLER. And the expectation, intent, the purpose and policy, entirely apart from the Federal reserve system, has been a contributing factor. It has resulted from the policy that money has been made so abundant that, as stated, cheap and abundant money became a provocative factor in the stock market; and to that exent I feel that it is our concern. When they are doing these things with Federal reserve money, then it is the business of the Federal reserve banks to take heed and consider what action may be taken.

But there I think the whole episode illustrates that action in matters of credit policy, as a rule, is either impotent action, or may be injurious action, unless it is action that is taken sufficiently well in advance to protect against the consequences, rather than to undertake to undo them. There is no use in closing the door after the cow has gone out of the stable; and that is too frequently apt to be the case where you have administrative bodies, where the fear of making a mistake may lead to such delays or tardy action, that it really becomes mischievous action.

I think the mischievousness of the open-market policy of the Federal reserve system is, as it has been operated and as I believe it will be operated, that it offers too great a temptation to some one who feels the itch to do something, with the scalpel in his hand, to go in and do something. Usually you find that men who have got creative imagination, who have got force of will, who are animated by the instinct of domination, and that is something you have got to reckon with constantly where you are dealing with matters of money, finance, and credit—right in the Federal reserve system itself this open-market operation offers, to my mind, too big a temptation to use it unnecessarily, and carries the danger, therefore, that it may result in just these difficulties and impasses in which the Federal reserve system has found itself in recent months. I think this shows about what you may expect.

If the attitude of this committee or of the Congress or the public at large is that the Federal reserve system on the whole has given a satisfactory account of itself in the last eight months, leave it alone; but I take it that there is a good deal of concern, and in going into this matter if you are finding out just what it is that has given rise to these conditions I undertake to say that the provocative factor of the open-market operation in Federal reserve policy is an instru-

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ment so effective and so powerful that it has got to be used with the greatest discretion.

Mr. BEEDY. And within what limitations of law, if any?

Doctor MILLER. Now you are asking me, perhaps, a question upon which current opinion ought not to be taken too seriously. My feeling is that the Federal reserve system, like any other central bank, should have these powers—I mean the power to go in and relieve the money market through a policy of purchase at certain times and at certain other times the reverse; but I should say that the exercise of those powers should be occasional, they should be resorted to only under the pressure of an exigency so real or so important that prudence would advise against awaiting the slower action through discount rates. So, therefore, the problem, as I would phrase it, would not be to destroy this power, not to take it away, but to make its exercise subject to certain limitations.

Mr. STRONG. What limitations?

Doctor MILLER. You are asking me questions, Congressman, that are pretty new questions, and I can not answer these things satisfactorily, perhaps. I will give you my best answer.

Mr. STRONG. All right.

Doctor MILLER. I would say that the Federal reserve act itself has already set a pretty good precedent in making action on certain of the unusual, extraordinary powers of the Federal reserve banks subject to the affirmative vote of five members of the Federal Reserve Board. This is true as regards compulsory rediscounting among Federal reserve banks, as regards the suspension of reserve requirements, as regards the reclassification of outlying districts for reserve purposes or of reserve cities, and so on. My opinion is that it ought not to be made too easy to run the risk of inflation either of the security markets or the commodity markets of the country; and, therefore, I would suggest for your consideration that the purchase of securities by Federal reserve banks in the open market should be made subject to the affirmative vote of at least five members of the Federal Reserve Board.

Briefly, I view it this way: That the injection of money into the market in this way is in the nature of the application of force majeure. It is in the nature of a surgical intervention, and I think the consulant board ought to be a clear majority as to its necessity. If there is a serious doubt on the part of a substantial minority, I think that is a good reason for not doing the thing.

The CHAIRMAN. Do you mean a majority of five, or that five should vote? There are seven members now.

Doctor MILLER. We are eight.

Mr. STRONG. You mean five of the seven?

Doctor MILLER. No; five members of the board.

Mr. STRONG. A majority?

Doctor MILLER. Yes. While you are not specifically asking the question, I may add that the Federal Reserve Board ought to be reduced in number.

Mr. BEEDY. You mean, now, that individual banks of the 12 indulge in the open-market operations?

Doctor MILLER. No.

Mr. BEEDY. By what authority do they take any steps?

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Doctor MILLER. They take action under the provisions of the Federal act.

Mr. BEEDY. Under a vote of the Federal Reserve Board?

Doctor MILLER. The language is ambiguous.

Mr. BEEDY. Do they not vote on it?

Doctor MILLER. You know, there is a so-called open-market committee for handling——

Mr. BEEDY. Yes.

Doctor MILLER. That committee consists of five banks which are represented on the committee through their governors.

Mr. BEEDY. A majority of those five determines?

Doctor MILLER. Well, it may be sometimes a majority of one. It may be one that is the majority.

The CHAIRMAN. I would like to ask you a few questions regarding that. As between the open-market transactions and the discount rate, which do you regard as the most essential?

Doctor MILLER. I regard the discount policy as the most potential from the point of view of good operation.

The CHAIRMAN. The use of the discount rate is confined to open-market operations?

Doctor MILLER. Yes.

The CHAIRMAN. I have understood that open-market transactions were used frequently to prepare the market for money, and when it is once prepared, frequently the discount rate follows naturally.

Doctor MILLER. Yes.

The CHAIRMAN. In that connection, also, you agree with the thought that has been expressed before the committee that we are on a gold basis at present?

Doctor MILLER. I should think that language might have some pertinence to what took place in the autumn of last year; as a description of the attitude of the Federal reserve system over a term of years, I think it is too strong.

The CHAIRMAN. You recognize that the Federal reserve movement has a great responsibility, due to the fact that we have this vast amount of gold here, which is largely under the supervision of the system?

Doctor MILLER. Yes.

The CHAIRMAN. To what extent would the changes in the open-market operations affect the discharge of that responsibility that rests on them in the management of this gold?

Doctor MILLER. I think the effect would be good.

The CHAIRMAN. You think it would improve it?

Doctor MILLER. Yes. If you will permit me, I think that open-market operation is an instrument of direct intervention or interference with the money market. It is lying there on a shelf and there is a constant temptation to use it. It is like a magnificent automobile standing there constantly. "Let us use it."

The CHAIRMAN. Now it is a brake on administrative operation?

Doctor MILLER. Yes. But I think wisdom on the part of the Federal reserve system will be shown in making the exercise of that power occasional rather than regular and frequent. That is the conclusion to which I have come; and for that reason I would suggest that any amendment that might be made to the law should be not by changing the power but by making the indications on which

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the power is exercised more definite. As I view it, the open-market policy of the Federal reserve system, reading it together with the credit policy of the last three or four years, has given two situations that might be called inflation, using that word in a loose, conventional sense. One was in the autumn of 1925 and the early part of the year 1926, and the other is this recent period, the autumn of 1927 and going into the year 1928. In each of those cases I regard the open-market policy as having prepared the ground for what developed.

The CHAIRMAN. Yes.

Doctor MILLER. Not simply prepared the ground for the discount policy, but actually resulted in certain conditions. Perhaps "prepared" carries with it too much the impression that some one intended the result. I think these results were all more or less unexpected.

The CHAIRMAN. Do you think the open-market transactions affect the international-exchange situation?

Doctor MILLER. Very greatly; but I have about come to the conclusion that you can not affect the international-exchange situation without affecting the stock market and stock exchange loan situation. The greatest open money market in the country to-day is the call loan market. It is more important than it ever was, and vastly more important than anyone ever thought it could become after the enactment of the Federal reserve act. It is the most available market, the most attractive market, that exists for idle money.

The CHAIRMAN. The installation of the Federal reserve system did away with the so-called loan money market of the stock exchange in New York, and transferred those functions largely into the Federal reserve, with the discount rate, did it not?

Doctor MILLER. How is that?

The CHAIRMAN. I say, what was known as the money-loaning post which had been maintained by the stock exchane in New York was transferred into the Federal reserve system, really? In other words, there is no open money market in New York to-day—call loan money market—like there was before the establishment of the Federal reserve system?

Doctor MILLER. I should say there is an open market for call money.

The CHAIRMAN. Its whole character has been changed, has it not?

Doctor MILLER. What have you in mind?

The CHAIRMAN. Prior to the installation of the Federal reserve there was what was known as the call loan money market, which was a post in the stock exchange?

Doctor MILLER. There is still a money post, or "money desk."

The CHAIRMAN. There still is; but it is influenced largely by the Federal reserve rate?

Doctor MILLER. It is influenced largely by the facts. Under our old system, before the Federal reserve act, there was no method by which you could produce more credit except by the importation of gold or by some operation on the part of the Treasury. There were Treasury operations that relieved various conditions of tension in the money market, or currency strain, that were roughly analogous to our open-market operations. That is, the Treasury went in and bought bonds, or otherwise put new money into the market. Aside

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from the importation of gold, or an operation of that kind, the United States was operating in what I would call a limited and closed market. There was no elasticity; there was no method by which in time of strain new money could be brought into the situation. Now the reserve banks have come into the picture, and as they contribute through discount operations and more immediately through open-market operations, money to the market, the market has become more distinctively an open money market. Anybody from the Atlantic to the Pacific, from Canada to Mexico, who puts his money into the money market to-day, provided the loans are properly handled, knows that he can always get his money out whenever he wants it. Why? Because such a thing as a currency and credit panic can not exist under the Federal reserve system. Its function is to provide these when further provision is necessary.

But the criticism may be made that it has been a little too liberal and generous in its provision, and has been a little bit, through its open-market policy, in the attitude of the nursery maid at times when she moves around among the children and rather pushes the glass of milk into their mouths. That is the sort of thing that I feel should be made less easy.

Mr. STRONG. You think the law, then, could be changed so that it would read for the accommodation of commerce and business or at the will of the Federal Reserve Board?

Doctor MILLER. It is the same thing.

Mr. STRONG. I am afraid it is.

Doctor MILLER. The phrase "accommodation of commerce and business" has always struck me as one of those rare inventions that occur occasionally in American statesmanship. Whoever was the author of that phrase did a magnificent thing. It is great language. The word "accommodation" is susceptible of the wisest interpretation and reaches to the noblest of economic purposes.

Mr. STRONG. Mr. Chairman, the hour of 12 has arrived, and I move you that the hearings be adjourned until to-morrow at 10.30.

(The motion was seconded; and the question being taken, the motion was agreed to and, at 12 o'clock m., the committee adjourned until to-morrow, Friday, May 4, 1928, at 10.30 o'clock a. m.)

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Friday, May 4, 1928.

The committee met at 10.30 o'clock a. m., Hon. Louis T. McFadden (chairman) presiding.

The CHAIRMAN. The committee will come to order. We will resume the hearings on H. R. 11806.

Mr. Wallace, kindly give the reporter your full name and connection.

STATEMENT OF HENRY A. WALLACE, EDITOR WALLACE'S FARMER

Mr. WALLACE. My name is Henry A. Wallace, editor Wallace's Farmer, Des Moines, Iowa. I am also president of the Stable Money League and secretary of the Corn Belt Meat Producers' Association.

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I may say first that I am not at this present time appearing on behalf of the Stable Money League, because, as you people know, the Stable Money League is not committed to any definite plan. I am coming before this committee appearing on behalf of the agricultural interests. The farmers are very much interested in this problem of inflation and deflation, but in a considerably different manner from the people in the towns and cities.

The CHAIRMAN. Do you care to state just what agricultural interests you represent?

Mr. WALLACE. Well, my only official connection is with the Corn Belt Meat Producers' Association, an Iowa organization, and as editor of Wallace's Farmer, which is a farm paper circulating chiefly in the Corn Belt States. We represent peculiarly the corn and hog farmers of the Middle West.

So you see that officially I do not represent any organization like the America Farm Bureau or the Farmers' Union, or anything of that sort. The Corn Belt Meat Producers' Association is an Iowa organization, composed of producers who produce hogs and fatten cattle for the Chicago market.

I wish to state why it is that there is a gradual and growing interest of the farmers in this problem of money. I suppose you are all familiar with the events that arose in connection with the deflation following the Civil War. The farmer became only very slowly interested in that. That was only, of course, on a paper basis, but they were struck with the value of that paper in terms of gold, and the thing did not come home to them in any strong form until the deflation during the 70's, and it took a long time for the education—propaganda, may I say?—and gradually they became very consciously aware of it.

If I can believe my grandfather, the first editor of Wallace's Farmer, the farmers at that time were very well educated on money problems. I remember that in my grandfather's library there were books on bimetallism and free silver, and I know he wrote editorials along that line.

My immediate interest in the problem dates from 1913 or 1914, when one of Irving Fisher's pamphlets came out on the compensated gold dollar, and my grandfather said to me, "You must get interested in this subject."

So, when Irving Fisher and his people held their first meeting in 1921, I believe it was, I attended the meeting and because I was the only agricultural person there they elected me vice president of this association and I have been such ever since.

Well, now, the interest of business men in stable money is much different interest from the farmers. The farming business is a long, slow affair, and a man goes into it as a lifetime proposition. He is not interested in these short-time business cycles which extend, perhaps, two or three years each way. It is a long, slow trend of affairs that interests him. He can withstand those short-time cycles, because he furnishes his own labor; largely, he can depend in some measure on the labor of the women and children, and he can usually tide over the short-time cycle; but that long, slow trend of things is extremely important to him, and it has been a matter of history that after every great war the deflation policy has hit the farming class particularly.

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You read the hearings held by the British committees of the House of Commons on the deflation following the Napoleonic war, and you will find things startingly similar to this situation now. The situation after the Civil War was similar to this situation; the farmers were hit.

There are two factors involved in that. The one is that during that period of deflation farm products do not have their customarily normal pre-war ratio to other products, and the other is the long, slow decline in the purchasing power of the dollar. They are two separate things. The one, dealing with this ratio of farm products to other products, can not be influenced in any way by monetary policy. I think many people in the industrial centers feel that farmers think that monetary policy may have something to do with the price of individual farm products, but that is not the case. Most farmers are not that ignorant; but they realize that this purchasing power of money in general is influenced by monetary policy, and I can say very frankly that some of our more educated farmers are decidedly suspicious that the Federal reserve system may at any time start a further deflation. We are watching their policy with the very greatest interest.

I think more of those same educated people have great confidence in the beneficent effects of the Federal reserve system if properly managed, but if they are going to start a deflation such as took place in 1920 for a time, late 1919, and early 1920, it would cause very grave suffering to our people.

The CHAIRMAN. In that connection, if I may interrupt you with something that is very pertinent to what you have said here and that has been said in these hearings, Dr. John R. Commons, of the University of Wisconsin, made a statement here in which he indicated that through the cooperation now taking place between the Federal reserve system and the banks of issue of other countries of the world, to get them all back on a gold basis, in which movement, it has been pointed out, we are selfishly interested because of the fact that we have this large amount of the world's gold in our custody, it will result, when that process is fully completed, in the lowering of the general price level from the present basis of 150 back to the pre-war basis of 1913 of 100. That is what you are referring to, is it?

Mr. WALLACE. That is what we are afraid of, that that might take place gradually over the period of the next 20 years.

The CHAIRMAN. That statement has been definitely made here before the committee, that that will be the result of a successful termination of the activities that are now being engaged in by the banks of issue of the world, in which our Federal reserve system is, of course, an important factor.

Mr. WALLACE. Yes. It would seem, unless there are startlingly new methods discovered in gold-mining processes and unless there are startling changes in our credit mechanism which will make a dollar of gold support more credit, there will be great danger, almost a certainty, of that happening during the next 20 or 30 years; and I can say, from a political standpoint, that if we do take that long, slow, painful, grinding deflation toward the 1913 price level, the difficulty of farmers in paying interest on their mortgage indebtedness will bring about a political situation somewhat similar to that which existed in the eighties and nineties, of farmers to some extent striking

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out rather blindly in their wrath to find if they can not do something, and not intelligently, perhaps, and this next time they might act more intelligently than that, but in the background there is that thing.

It is so difficult to pay off those mortgages incurred at the high-price level. We in our State to-day have $1,500,000,000 of mortgages against the farm land of the State. Taking all the farm land of the State, it averages between $45 and $50 an acre.

There are many farms where the value is higher than that, but that is the average, and if we have to pay that off in 1913 dollars instead of 1928 dollars, it becomes a very serious burden.

The CHAIRMAN. What is the average value of that land to-day?

Mr. WALLACE. As I remember it, the 1925 census gave it as around $145, and the Bureau of Crop Estimates, which gets out its estimates each March, has reduced it. The trend has been downward since that period. I would suspect that at the present time it is $135.

Mr. LUCE. Are there any figures giving the average life of a mortgage?

Mr. WALLACE. The typical mortgage is taken out for a 5-year period, except in the case of joint-stock land banks and Federal land banks, where they are on an amortization basis of 33 years. They are typically renewed.

This $1,500,000,000 figure has been roughly constant at that point for the last four or five years. It was cut down slightly last year. These figures are from a bulletin put out by the Iowa State Agricultural College at Ames. They show no very great change during the last four or five years.

Mr. LUCE. I am particularly interested in that by reason of the assertions made by Professor Fisher that the contracts average a very brief life. The argument against deflation would therefore not be nearly so strong if the mortgages averaged a comparatively short life, as they ran to 10 or 15 or 20 years on the average before they were taken up.

Mr. WALLACE. An increased amount of the farm mortgages is being refunded on the amortization basis, which gives an average life of around 30 to 40 years.

The farm mortgage is occasioned more by young farmers, I suspect, because the young man is taking over his father's farm and must pay off the other heirs, or because he has been a tenant and is now starting out in business for himself, and it takes him customarily about 30 years to pay off that mortgage before he can really go steadily ahead.

As to how these mortgages on Iowa farms will be paid off at the present time depends to a very large extent on the amount of agricultural prosperity we have. If the surplus disappears and we get off the European market we may be able to pay off the mortgages with a fair degree of rapidity, although the history of the past is that the percentage that the mortgage represents to value has not declined in the Middle West.

Mr. LUCE. There is quite a difference between the total of the mortgages and the turnover?

Mr. WALLACE. Quite a difference.

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Mr. STRONG. That figure is the result of the development of the farms, of improvements and buildings and stock?

Mr. WALLACE. Yes.

Mr. STRONG. And machinery and things they have to buy?

Mr. WALLACE. Yes.

Mr. STRONG. They have to build our country out there just like they built the East.

Mr. WALLACE. We are pretty well through that pioneer period in Iowa at the present time.

Mr. STRONG. That is one reason why the mortgages have gradually increased and not decreased?

Mr. WALLACE. Yes; although since the war there has been a refunding of the short-time obligations into the cheaper-interest form of mortgages.

Mr. STRONG. But if we can get a fair return on our products out there we will commence to pay those off after a while?

Mr. WALLACE. Yes.

I may say that Dr. G. F. Warren, of Cornell University, one of the leading agricultural economists of the country and in no sense a radical—in fact, I consider him very conservative—and in this I disagree with him—feels that the surplus is done away with for the most part, so far as paying an unfavorable price on the pressing things in the next four or five years is concerned, but that the great fear which the farmer has—and he holds this position very firmly and strongly—is the general deflation policy. He feels that if we are on the gold price level in the old sense of the term, and not a managed price level, that the deflation will be such as to cause continuous hardships in the agricultural sections—because we are a great debtor class—for the next 10 or 15 years. That is his opinion.

The CHAIRMAN. In that connection, Doctor Sprague has testified before this committee this week, and he expressed the thought that it would be necessary to continue the management of the gold reserve through the cooperation of the central banks of issue at least over a period of 10 years, because of the possibility that if all of these countries went on the gold basis there might be a dearth of gold, and that therefore it will be necessary to exert a management over that gold during that period of time.

Mr. WALLACE. I rather like the idea of a managed gold affair, provided it does not mean either inflation or deflation, if it is handled with the common sense which has characterized, as a whole, the management of the Federal reserve system during the past five or six years, and I think all thoughtful people will agree to that, that it has been a rather intelligent management, but we are fearful as to the future. We thought we detected during the past years some symptoms on the part of the Federal reserve people indicating that they might want to start a slightly gradual downward trend again.

The CHAIRMAN. Whom do you recognize as the managers in this gold situation?

Mr. WALLACE. Do you mean internationally at the present time?

The CHAIRMAN. Yes.

Mr. WALLACE. At the present time we feel that the Federal reserve system, as a whole, has quite a dominant influence. In saying that I am merely accepting the testimony of people more expert in such

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things than myself, largely European authorities. There are a couple Swedish economists, Ohlin and Cassel, who have made statements along that line, and an Englishman, Mr. McKenna, and also I have been rather led into that belief by a British cotton expert by the name of Todd, who felt that our Federal reserve system did have quite a dominating part in handling the world's gold supply at the present time.

Just who in this country has that dominating part would be a little difficult to say. I rather suspect that that authority may rest with the New York Federal Reserve Bank fully as much as with the Federal Reserve Board here in Washington; but, of course, that is merely a suspicion.

So far as the bill itself is concerned, it seems to me like such a reasonable bill that I am surprised that there should be any opposition to it. I just can not understand the position of the Federal Reserve Board on it. I have not been able to see their position in logical form. As a matter of fact, it seems to be a feeling on their part rather than anything tangible to lay hold of. I have not attended these hearings, but from what has been reported that has been the conclusion I have reached.

The CHAIRMAN. The opinion seems to have been expressed here by at least one member of the board that the board was exercising now without explicit direction the functions that are sought to be conveyed by Congress in this kind of a measure, and they feel it might be unfortunate to give positive directions to the board in exercising these functions.

Mr. STRONG. Might I say, Mr. Chairman, in that regard that the bill only directs them to use their powers for a policy of stabilization; that is, they should use those powers to do what they can toward stabilizing the purchasing power of money. That is what they claim they have been doing. That is what we want them to continue to do. We want that policy maintained and not changed.

Mr. BEEDY. I think the testimony, Mr. Wallace, of Doctor Miller makes it quite clear as to his position at least. He grants the existence of all the powers necessary to do the things which seem to be desired, and concedes that if exercised wisely and at the proper time it would probably accomplish all the purposes sought to be accomplished by the bill. He fears that inasmuch as the men who are intrusted with the management of this great study are merely human, they ought not to be directed by a law to accomplish a result which no one will deny is much to be desired.

I myself feel a good deal as you do. I do not see that there has been offered any real objection to the making of this law, based on logic and reason.

The CHAIRMAN. The governor of the Federal Reserve Bank of New York, Mr. Benjamin Strong, expressed the thought that attention should more properly be directed toward world stabilization of the gold standard, that the important thing in connection with all of this was to get the world back onto a gold-standard basis.

Mr. WALLACE. Perhaps a person should not state suspicions, but it is just as well. We are a little fearful—we have this feeling—that the people who work with money, the bankers, the bond companies, the insurance people, all have an instinctive and unconscious bias

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toward enhancing the purchasing power of money, quite unconscious, perhaps, that the folks that are likely to be on the Federal Reserve Board and in the Federal reserve bank at New York are people likely to have an unconscious bias in that direction just as farm people and manufacturers have an unconscious bias in the direction of decreasing the purchasing power of money or inflation. We feel that there is a little bit of an unconscious bias in both directions, and that the people who are likely to be intrusted with the management of the Federal reserve system, both regional and the board itself, are likely to want to see deflation, and that they would much prefer to have such instructions given 15 years hence when the price is lower rather than now, and we with our bias—we all have bias—in the Middle West, have the other feeling, that it would be better to stabilize this thing right now. Of course, we prefer to hold it where it is now, have the thing come to a head now instead of letting it go ahead and causing continuous unrest over a period of years on the part of the farmers.

The CHAIRMAN. Taking that position as your position, have you given consideration to the possibility of our trade relationships with the other countries of the world, now that they are getting back on an established basis of consumption of manufactured articles, that we might be in a very unfortunate position if our price level is maintained at the present basis in selling our superfluous products to those countries in competition with other intensified manufacturing industries in Germany, England, France, and so forth?

Mr. WALLACE. This occurs to me that England would be very anxious to cooperate with us in stabilizing at a moderately high price level, that France would be equally anxious to do so, and that the Scandinavian countries would be anxious to do so. That would be especially true of England and France, because of the fact that it lessens the burden of paying their Government debts to us if the price level is stabilized relatively high.

The CHAIRMAN. If we stabilize on the present basis, do you give them an advantage in marketing their products throughout the world in competition with ours?

Mr. WALLACE. I must confess that I can not follow that reasoning.

The CHAIRMAN. If our general price level keeps up to the point where it is and the other countries of the world intensify production——

Mr. WALLACE (interposing). You are assuming that they will all be on a gold price level and they will all at that time be on a gold basis?

The CHAIRMAN. Yes. In other words, I discovered in England last February that the manufacturing element of England felt that because they stabilized on a $4.86 basis instead of, say, a $4 basis, they have impeded their industrial recuperation largely.

Mr. WALLACE. That would seem to me to suggest in that case the advisability of our stabilizing on the present high basis—I mean that your statement would suggest that.

The CHAIRMAN. I have wondered in connection with your statement of a moment ago, whether you have given consideration to the possibility of our trade relations being disturbed by stabilizing at a high-price or low-price level here, and what effect it might have on

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the general economic situation, not only in this country but throughout the world.

Mr. WALLACE. I think you have come to the wrong place to look for light, coming to the Middle West, on international trade relationships.

The CHAIRMAN. But the Middle West is extremely interested in that, because you have a surplus production. We are hearing lots about the surplus production from your section of the country now.

Mr. WALLACE. We are extremely interested in it, and would like to have the people here on the Atlantic seaboard, who have had some experience along the line of international relationships, throw some light on just what the effects would be; but I can not see, if we are on a gold basis in these different countries, the influence one way or the other. If you are talking about a managed gold basis, that would be another thing. We are assuming, I think, that we are on a managed gold basis?

The CHAIRMAN. Yes.

Mr. WALLACE. We are going to assume that?

The CHAIRMAN. Yes.

Mr. WALLACE. And therefore we might manage gold in a different way than England would manage gold; is that it?

The CHAIRMAN. That is not entirely determined as yet, as I view it. We are apparently cooperating with the other banks of issue throughout the world, and whether we are taking an independent stand or whether we are cooperating with them to the full extent is not clear to me at this time.

Mr. WALLACE. I suppose the governor of the New York Federal Reserve Bank has as much influence on this as any, but is it not important that those men in their conferences with the French and British and Italian bankers work out gradually a policy which will stabilize affairs at about the present level rather than gradually throwing it on the side of the declining level? And if there were a declaration such as the Strong bill, might it not have some influence on the activities of these men in the direction toward which they would throw their influence? That is merely a question.

Just one word in closing. I feel I have taken too much time.

It seems to me that as you trace the last hundred years or so you will find cycles occurring about 30 years each way, 30 years in our agriculture getting the prices upward and 30 years the other way—roughly that. Apparently you let deflation go on in the normal course of events on the old-fashioned gold idea. You gradually make agriculture a little less attractive.

The CHAIRMAN. You are speaking now of the war periods?

Mr. WALLACE. That is the way they happened to have come. Following the Napoleonic wars you had roughly 30 years, and following the Civil War roughly 30 years, and, perhaps, we have consumed 10 years in this postwar period of agriculture going down, and the currency was managed in both of those preceding cases in a way which gave an advanced purchasing power to the dollar, and in both of those periods they finally forced enough people off of the farms to indicate that the thing had gone too far, and agricultural products went up and the general price went up and we would be again on the upgrade.

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Now, agriculture is interested in those long-time swings, not in the short-time swings concerning which so much of this conversation is about. We are interested in the long-time swing. The farmer is in the business a long time, and I feel it is to the long-time interest of this Nation to have the proper consideration given to these long-time swings just as well as to the short-time business cycles. It is good form nowadays to consider the short-time business cycle, unemployment, and how it can influence policies of various sorts. What we are contending for is that similar consideration be given to the agricultural cycle, which is a much longer affair, and, in my opinion, a much more vital affair to the fundamental welfare of the Nation.

The CHAIRMAN. Do you feel that the power is vested in the Federal reserve operations to influence this situation favorably or unfavorably?

Mr. WALLACE. I feel that the Strong bill would have some favorable influence in this direction and that it would cause knowledge and a much greater understanding than we have now as to just what powers they do have. Of course, it is not clear as to how much ability they do have along this line. We should know more about what these powers are and what they mean to agriculture and to business, and I feel that the Strong bill is a movement in this direction.

STATEMENT OF ANDREW SHEARER

Mr. SHEARER. I am an old farmer—a retired farmer—too old to work. I have made some study of this subject from a farmer's standpoint. I am very much interested in the passage of Mr. Strong's bill.

Mr. STRONG. First, I think you ought to give us your position.

Mr. SHEARER. Well, you did not ask me.

Mr. STRONG. You are the representative of the farm organizations of Kansas?

Mr. SHEARER. I am vice president of the Kansas State Farm Bureau, which is one of the most influential farm organizations in our State and in the Middle West. I am also in part representing the three major farm organizations of Kansas, the Farmers' Union, the Grange, and the Farm Bureau.

I have here some resolutions that were put through those organizations that I would like to have put in the record.

The CHAIRMAN. Without objection, these resolutions will be inserted in the record at this point.

FROM THE MINUTES OF THE MEETING OF THE KANSAS COMMITTEE OF FARM ORGANIZATIONS, HELD AT TOPEKA, OCTOBER 25, 1927

That whereas there has recently been formed an organization known as the Stable Money Association, its object to stabilize the purchasing power of money, and thereby stabilize the general price level; also to prevent the seemingly inevitable recurrence of periods of inflation and deflation with their attendant ills to both investor and producer: Therefore be it

Resolved, That we, the committee permanently organized and representing the major farm organizations of Kansas, hereby indorse the work and aims of the Stable Money Association and agree to convey the ideas involved in securing a stabilized price level to the membership of our several farm organizations in an educational way; and

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Whereas the Strong bill, now pending in Congress (as an amendment to the Federal reserve bank act) seeks to instruct and make it obligatory on the Federal Reserve Board to use all its powers to maintain a stable price level: Be it

Resolved, That we hereby indorse the Strong bill and will encourage any further legislation that may be necessary to the desired end through enlightened public opinion.

Mr. SHEARER. The above-mentioned organizations are the Farmers' Union, the Grange, and the Kansas State Farm Bureau.

RESOLUTION ADOPTED AT THE FIFTY-SEVENTH ANNUAL MEETING OF THE KANSAS STATE BOARD OF AGRICULTURE, JANUARY 11–13, 1928

Whereas agriculture has suffered much in the past and is now suffering from extreme fluctuations of prices and values caused by inflation and deflation of currency and credit, resulting in mortgage foreclosure, bank and business failure, and widespread distress. We, therefore, indorse the effort now being made in Congress to require the Federal Reserve Bank Board to use its powers to maintain a stable price level and to stabilize the purchasing power of money. To that end we indorse the Strong bill now under consideration in Congress.

We instruct that a copy of this resolution be sent to the Kansas delegation in Congress.

Mr. SHEARER. A similar resolution passed the Kansas State Agricultural Council and the Kansas State Farm Bureau annual meeting.

ADOPTED AT NINTH ANNUAL MEETING AMERICAN FARM BUREAU FEDERATION, DECEMBER, 1927

(k) We indorse the effort now being made in Congress to effect a stabilized price level and stable purchasing power of money through additional instructions to the Federal Reserve Board.

Mr. SHEARER. Included in the resolutions are three of our different farm organizations in Kansas, in addition to the three I have mentioned, our State board of agriculture and our agricultural council and livestock associations—six of them in Kansas—and I also have a resolution here that was put through the American Farm Bureau organization at the national meeting in Chicago last December, committing that organization to this measure. I want that in the record.

(The resolutions referred to are as follows:)

RESOLUTION ADOPTED AT THE FIFTEENTH ANNUAL CONVENTION OF THE KANSAS LIVE STOCK ASSOCIATION, WICHITA, KANS., MARCH 9, 1928

We heartily indorse the efforts of Congressman Strong of this State in pending legislation to require the Federal reserve bank system to use its powers as was intended by Congress in the law establishing the reserve bank system.

I notice in your hearings of last session—and I read over a thousand pages of them to see just what you were doing to get a line on you people—and in reading those hearings very patiently and in listening since I have been here, the trend of thought and the trend of discussion has been all in the line of the stock exchange and in the line of dealing with credits and credit paper and foreign exchange and foreign banking, and not a word said, or scarcely a word, in regard to the production of wealth.

I want to speak for the men who are producing the tangible wealth of the country. Without this tangible wealth, without the meat and dairy products, and the cotton and steel and those things, your credit paper would have little value.

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We are producing the elemental things, the vital things, in the business life of America, and I hope that in your discussions you will not lose sight of that fact; that unless production is favored, unless production goes ahead in a prosperous manner, the whole structure falls eventually.

To run the thing to the extreme, suppose that we men of the Middle West who are producing the food should take a notion to stop? Your credit paper would not have much value; and I see one thing that I do not like very well, and that is that the stock exchange in New York has got to be such a large affair that they have even almost quit considering whether the stocks they are dealing in are a paying proposition or not. They seem to have got to a point where they are a business in and of themselves, regardless of production.

The tendency is in that direction, and we think, we men who are producing and who are watching the situation closely for fear of a fall in the price level, that the absorption of so much money or credit by the stock exchange, to the detriment of the industrial interests, is not good for the country. We look at it in that light. They are borrowing and gambling on the ability of corporation to extract profits from the producer and consumer. The American people have become great because they always want the most for the least effort. That has made this Nation great. I do not blame people for wanting a sure thing; but when too many of our people get on the investment side, get on the credit side, and not enough on the production side, why the car of progress may slow down.

Now, about this bill of my friend Strong's. Mr. Strong is my neighbor. I have known him since he was a boy. I have been at times of different political faith from him, but I have been working in these farm organizations in a strictly nonpartisan way, so that I can come here with very good grace as a Democrat and support Mr. Strong's bill and urge this committee that it be reported out.

Now, I will tell you what effect I think it would have. You men know that we have always had panics in this and every other country. All through the past ages, as far back as you can go, we have had panics. We have had recurring panics in the United States. I am old enough to have lived through the reconstruction period after the Civil War and the panic of 1873. We have had recurring panics about every 10 years, and the average business man and farmer have gotten into a fatalistic mood. They regard it as a part of fate that after a while we will have a panic. They say that what goes up must come down, and after a while we will have a panic.

It is hard for them to believe that we have got a new system, this Federal reserve system, through which it is possible to prevent panics. They still do not feel that things are any different; they are still afraid that something will drop unexpectedly.

Now, if this measure could be put through, it would be a wonderful assurance to us men, isolated as we are, scattered on the farms of the United States of America. It would be a wonderful assurance to us that here at last, after so long a time, is a power to prevent panics, to prevent lowering our price level, to prevent ruining our business, which has been done so often.

Now, I notice in your former hearings that Governor Strong especially feared that the average uninformed citizen would expect too much of the board; that they would think that if wheat went

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down, the board ought to bring it up. Mr. Strong made that illustration and, as an experiment, I tried it out in our farm meetings in Kansas. When I introduced those resolutions I tried that out. At first blush there were a number who had not thought about the matter, that did take that view of it—I will admit that—but it only takes a moment's explanation to show them that the Strong bill will not apply to individual items, to wheat as against steel, but that it is for the general price level, to avoid panics in the future, and the farmer immediately understands it. I tried it out on the common citizen, the ordinary farmer of Kansas, and he is no different from any other farmer or other citizen.

I noticed in the hearings that the burden of the talk was fear of inflation. That is natural, as Mr. Wallace said—it is perfectly natural. We all see our own interests clearer than the other one's interest; and you take the salaried class, the fixed-income class, the class who are dealing in credit paper, and they naturally fear inflation. It makes their income worth less.

On the other hand, we who are producers fear deflation. Our fear is for deflation and consequent price reduction, and I want to repeat what Mr. Wallace said, in a little different way, that our business of farming is a long-time business. It takes six years to produce a work horse or mule; it takes five years to produce a milk cow. In our farm rotations, to keep up the fertility of our soil, we frequently plant a crop that there is no money in to bring up the fertility of our soil, so that in a three or four year rotation we have built up our soil and are getting better crops. It is a long-time proposition.

We are very much interested in stability. All we are asking is stability, a stable price level, so that we know when we engage in stock raising that at the end of four or five years, when those cattle are fattened and ready to go on the market, we will not be ruined by a sudden fall in the general level.

Then we are interested for another reason, and that is that our business is out in the open. We have no possible way of combining. I have been in farm organizations for 50 years in Kansas, and we are very little nearer effecting a combination to-day than we were 50 years ago. We men are isolated; we live on isolated farms—one here, one there—dotted all over the United States. Some of us are stockmen, some are grain raisers, some raise cotton, some tobacco, and our interests are varied.

Now, I happen to know personally that at least one of our large manufacturing industries has a managed price. They manage that price. They are nullifying the old law of supply and demand and fitting supply to demand and managing prices. They are not so much subject to inflation and deflation as we are. The industry is centralized and can get together and can agree to maintain a certain price for the goods, and is not a victim of deflation like we farmers would be.

We are out in the open in competition with the world whenever we have a surplus. When we have no surplus we are competing with one another in our home markets. We have no possible means of passing prices up or stabilizing them, only as the Federal Reserve Board and the banking interests will do it for us.

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That is why it becomes vital to us men. That is why I am here. If it were not for that I would not be here.

We are beginning to understand this problem, although you men know that this money question is the least understood of all our public questions. Men are afraid of it, and it takes education to get anything like a comprehension of it.

I want to make a statement rather disagreeing with Doctor Miller, and you men may not agree with me, but I want to make it anyhow, and that is that money is a positive factor. Now, here we are produring wealth in the United States, all kinds of tangible wealth, bread and meat and cotton and tobacco and wool and steel and cloth and lumber—everything. We are producing the wealth, and they tell us that we produce too much. They tell us farmers that we have overproduced. They tell us that that is the reason our prices are low, we have overproduced; and they tell us that the spinning mills of New England have overproduced and that the steel mills have overproduced and that the cotton men have overproduced.

Now, I have lived a long while in the United States, almost 60 years. I have never seen any food thrown in the sea. I have never seen any of it destroyed or burned up, of bread or meat or cotton. It is always consumed.

The truth is that to-day there is a market for everything we can produce—if not in the United States, in Europe. There is a market for all we can produce. It is only a question of price.

It is no use to talk about hunting for markets. The hungry millions, the half-fed millions of Europe and Asia, are grabbing for every bushel of wheat we have got and every pound of meat and every bale of cotton, if they could only buy it. It is a question of price.

It is a big subject, gentlemen, and now this good old United States of America is in a position where the dollar is the determining factor of the price level of the world. We are the dominant nation, financially and otherwise. We are setting the price level in London, Liverpool, Hamburg, Berlin, and Paris. This is a tremendous responsibility, and that is why if this Federal Reserve Board can stabilize things and remain stable it means peace and prosperity, not only in the United States, but in the world; and you men know that when we have a panicky condition and a falling price level, as well as a deflation of currency and credit, it results in disturbance at home, in men thrown out of employment, in bankruptcy, in political rebellions—all of those things result from this.

Every argument is on the side of Mr. Strong. Every argument is for a stable price level and a stable volume of money and credit commensurate with the population and the business we are doing in the United States. Every argument is for it and there is no good argument against it.

I am discouraged with Doctor Miller. I am discouraged that a man of his caliber, a man holding the responsible position he holds and has been holding all these years on the Federal Reserve Board, should sit before us yesterday and say that he doubted if there was any man in the United States wise enough to administer the Federal reserve act. I was discouraged. I would not have said it. I do not believe it. I believe that we have brains and men in the United States

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of America, men of genius and vision who can administer that act and do what was intended for it to do, to provide a sufficient amount of currency and credit for the business of the country and keep our business going on steadily and prosperously.

I want to mention this fact, though it is not exactly related to our subject, that in the United States of America, on account of our higher civilization, we are capable of using bank credit to an extent that no other country does. The tremendous prosperity that we have got, especially in our industrial sections and in the East, is the result of the very extended use of bank credit.

You offer a check to a French peasant and he would not know what it meant. They do not use checks; they want money.

Am I talking too long?

The CHAIRMAN. No, sir; go right ahead.

Mr. SHEARER. I can remember the time in Kansas when we took a load of hogs to town, or 100 bushels of wheat, and we got the money and we rolled it up in a roll and took it home. I can remember the first check book I had, along in the early eighties of the last century, and it was with very great timidity that I put my money in a bank.

I think there is a gentleman here old enough to remember that.

Mr. STEVENSON. I did not get a check book in the early eighties, but I did in the later eighties.

Mr. SHEARER. Now, we check our money and put it in the bank, and the bank multiplies that money by 10 or more. When we issue our Federal reserve money we multiply the gold dollar first by two and a half, and then the bank multiplies it by 10—no wonder we have the prosperity. That is what is making the prosperity.

Mr. BEEDY. Are these Democratic or Republican banks that you are talking about now?

Mr. SHEARER. Banks have no politics; never did have. They are like Jay Gould was in his testimony before a congressional committee. He said that when he was in a Republican district he was a Republican, and that when he was in a Democratic district he was a Democrat, but he was always for Jay Gould. [Laughter.]

That is the way the larger banks are. They have no politics. They are smart enough—they are smarter than us poor devils out on the prairies of Kansas; they do not fall out and quarrel and vote opposite to one another when their vital interests are at stake. They do not do it. It is all right; I am not finding fault with it.

I just wanted to mention that idea, and to say that since we got the Federal reserve act it has been the salvation of the country. There is no question about it; it was the greatest step forward that this Nation ever took since its organization and the adoption of its organic act, the greatest step forward for business. I am very proud of it as a citizen. It has some faults.

I think it has got one radical fault, but I am not in a position to dictate or to be the judge. I think that it was a mistake to give the Federal Reserve Board the power to increase or decrease the volume of currency. If our money is the measure of our mercantile prices, why change the measure? We do not cut an inch off a yardstick; we do not take a little out of a quart measure; we go on with those just the same; but here is our great measure of value that is measuring all the wealth of the United States; that is gauging every

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transaction every day of 120,000,000 of people, and we give the board the power to change the yardstick on us. I think that is a mistake, but we are getting along.

In the distribution of our wealth, I said that our fear was overproduction; in other words, we American people are so smart that we have produced ourselves into trouble.

Mr. BEEDY. That is right.

Mr. SHEARER. Doctor Miller discussed the other day whether you could induce people to eat more food or not. I do not think you can. That is not a vital question, but I will tell you what you can do. You can put the business on such a basis that every man can get all the food he wants, and they do not get it to-day. We suffer from underconsumption, not overproduction.

Right in my own little home town, where we are producing the best kind of corn-fed beef and hogs, and where hundreds of head of fat steers are being fattened around the town, I happened to be talking with a very clean, decent citizen who is a clerk in a store. Last week he told me he could not afford to buy meat but twice or three times a week—right in the middle of where we are raising the meat.

If the industrial interests only knew of the enormous market that is awaiting them in the Middle West if our buying power was restored. I told my friend Strong the other day that in all my travel from Frankfort to Washington, D. C., I had only seen one new barn. My friend Strong remarked, "If you will give me a monopoly of painting all the farm buildings from there to here, I will be a millionaire."

I wonder that the industrial interests do not see what an enormous market there is there.

Now, in this matter of distribution, our railroads are distributing our stuff very nicely now. We are getting splendid railway service. Our telegraph and telephone are getting perfect. The third factor in distribution, viz, money, must be in insufficient supply. Money is the positive factor in distribution. The saturation point in consumer's needs has never been reached. Money in the hands of the consumer is the great distributor. So long as there are unsupplied consumers the cry of overproduction is an admission of the insufficiency of the greatest of all tools of trade, money—and becomes a case of underconsumption.

Fluctuation in the purchasing power of the dollar, either by changes in its volume or quality, is at the bottom of nearly all our economic ills. True, there are nonmonetary causes for varying prices in certain specific lines. Propitious weather may give increased supplies of food and fiber. Labor and time saving inventions may result in increased supplies of certain commodities, but these things are out in the open and known of all men and are to be expected. Also, what is publicly known and understood rarely causes discontent. The unseen and usually unknown shifting of the purchasing power of money always makes trouble, and often those least to blame are made the culprits.

Whether buyer or seller, creditor or debtor, some one is always wronged by instability of the dollar. That is why this initial step toward stabilization provided for in the Strong bill becomes highly important.

As I said before, we farmers fear deflation. We have reasons to believe that it is the policy of the moneyed interests to gradually

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increase the purchasing power of the dollar, with a correspondent reduction of the general price level. It wouldn't make such a great difference to farmers were it not for the tremendous load of debt they are carrying. A lowered price level makes it harder to pay debts and other fixed charges. In fact, debts are increased to the amount of the price reduction. Most of farm indebtedness was contracted in low-powered dollars with a high price level. Now we must pay back higher-powered dollars on a lower price level. This really constitutes the much-discussed farm problem, and were it possible to bring about conditions whereby farmers could meet their obligations with the same powered dollars they borrowed, there wouldn't be much left of the farm problem. The great fluctuation in the dollar has made our trouble. That is why even at the present lowered price level we are for the Strong bill, to, if possible, prevent further deflation.

The CHAIRMAN. What is the price of meat in your town?

Mr. SHEARER. The price of beef?

The CHAIRMAN. You say that this young man was not able to buy meat.

Mr. SHEARER. The best steak costs me 35 cents a pound and ordinary round steak 25 and 30 cents.

Mr. BEEDY. What do you mean by the "best steak"—sirloin?

Mr. SHEARER. Yes.

Mr. STEVENSON. Those fellows are not "hollering" for a lower price, then, are they—the fellows who are selling that steak?

Mr. SHEARER. Just at present it so happens that in the circle of things the men who are raising beef cattle are doing quite well. They are on a paying basis.

Mr. STEVENSON. What you would like to do is to stabilize them, so that they would stay there?

Mr. SHEARER. Yes.

Mr. STEVENSON. Would that not stabilize the clerk, so that he would stay in the same place?

Mr. SHEARER. Now, this money on credit——

Mr. BEEDY (interposing). What do you say to that?

Mr. STEVENSON. Would not that stabilize that clerk in the same place to two steaks a week?

Mr. SHEARER. No price stabilization is general. There would still be a variation in items.

Money is the great, vital, positive factor in distribution. Governor Strong was inclined to say that it was not and that there were times when currency would come back and was not wanted. But I will tell you that whenever production—that is, the production of wealth, either in manufacturing or farming—is profitable money soon goes into it—the production of food, the production of steel, whenever it is profitable money goes into it. When it is unprofitable money goes into securities, as it is doing now.

Our business is unprofitable, and money is not going into it. Our land is lower in price than it was in 1914.

Mr. BEEDY. I want to call your attention, apropos of something you said, that some of our greatest problems are in distribution, to this, that this is what happens to a pound of beefsteak between Kansas City or your town and Washington, D. C. You pay 35 cents

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a pound for T-bone steak. I pay 70 cents a pound for it. In the meantime, since this left Kansas City and the railroads have put on their transportation costs and the middleman has had his part, as well as the retailer, you see what that costs me on my table.

Mr. SHEARER. That is your job, not ours.

Mr. BEEDY. It is everybody's job—this problem of distribution.

Mr. SHEARER. Our job is to produce it. Your job is to get it as cheap as you can. I do not want that laid on the farmers.

Mr. BEEDY. I am not trying to.

M. SHEARER. I would like to tell you this about your beefsteak, which I am giving to you as a fact: They have established a system now, which has started in the principal cattle markets—Kansas City, Omaha, and Chicago—of grading meat. They have first, second, and third grades. All the meat is inspected by the Government and stamped.

I went into our butcher shop last week. I was thinking about this very thing. I said, "Have you any graded meat?" He said, "No; I could not afford to buy it."

You are buying graded meat, first-grade meat. In my little town it would cost me 50 cents, probably, for second grade, or a little less. I buy meat that was inspected as wholesome meat and healthy meat, but it is below the first three grades.

Mr. BEEDY. This steak that I referred to is steak that we say is from corn-fed cattle.

Mr. SHEARER. Certainly; but there are grades of corn-fed cattle.

I wish you would inquire, for your own satisfaction, the next time you buy steak, what grade it is, and look at the brand on it. You will see a blue brand stamped on it. It does not go by first, second, and third; it goes by "prime"—I can not remember the grades. You watch it, and if it is prime or first class it will be way up. That means meat that is nicely mixed, that has been fed a long time. That means young meat, from a yearling, very tender and juicy, and the necessary amount of fat mixed in, and absolutely clear as to disease. That is what it means.

Mr. STRONG. Let me say that you do not get that here at 70 cents a pound.

Mr. STEVENSON. Now, speaking of that matter, of the price of meats, I have seen in this committee, and so has Mr. McFadden—I do not know whether Judge Brand was here or not—but he was on the committee—where we had exhibits of bills that were paid, of 33 cents apiece net for a lamb. They would ship the lambs, and they got 33 cents apiece net for them, and at the same time they had a bill of fare, right here in our own cafe, in which two lamb chops cost 60 cents, and the price received by the farmer was just equal to one chop and a tenth.

Since then, of course, matters have swung the other way; but it would not have been safe to have stabilized the lamb business at that time, would it?

Mr. SHEARER. No.

Mr. STRONG. And we do not want to go back there.

Mr. STEVENSON. I do not either.

Mr. SHEARER. I have a great deal I could say, but I am not going to say it. This is a very large subject.

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I want to make the statement again that money is the positive factor in distribution. If you have goods and have not money to move them, they lie on the shelves; our cattle remain in the food lots.

Money is a positive factor, and I wish that there could be some way of keeping our money west of the river from reaching New York. We need it all. I have lived there for almost 60 years, west of the Missouri River, and our big job is to keep money west of the river to do business with. Most of the time we have not enough, and we have to borrow it from the East, and pay them high interest for it. They have got ways of getting it from us.

This is our big job, and we are glad when you men make appropriations to build roads out in our country or to put up Federal buildings or to make navigable our streams—anything to bring money from the East, so that we can go on doing business without continuing to borrow money.

It is a big job, this thing of keeping money away from the money centers. We are interested in that, but that is aside from the question, and I am going to quit talking just by repeating that I hope you men will report this bill out favorably. It will be received favorably by the great business interests and the farmers of the Middle West and all over the United States; and let it get on the calendar, to be printed and debated, because it is a matter of education.

I do not expect this bill to pass at this session, but we must begin educating the people along this line so that they will understand the matter and be able to act intelligently about it.

Just a word as to the way of finding the "index number" used in determining the general price level. I feel sure it is true that many of our larger manufacturing industries have managed prices independent of supply and demand or of the purchasing power of the dollar. Why should they be given a rating alongside of commodities which are open to competition and subject to the vicissitudes of a variable dollar? It can not be a true "index number" unless some allowance is made for manipulated prices.

I thank you for listening to me.

Mr. STEVENSON. I will say to you that I have enjoyed your address very much, and I am glad to see that you are not the extreme optimist that some people are that come and ask for legislation that they expect to have passed immediately.

The CHAIRMAN. The committee will adjourn until 10.30 o'clock Tuesday morning.

(Whereupon, at 12 o'clock noon, the committee adjourned until Tuesday morning, May 8, 1927, at 10.30 o'clock a. m.)

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Tuesday, May 8, 1928.

The committee met at 10.30 o'clock a. m., Hon. Louis T. McFadden (chairman) presiding.

The CHAIRMAN. The committee will come to order.

Doctor Miller, do you remember where you left off the other day?

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would be to pursue such a policy as would even out those lines, would it not?

Doctor MILLER. No. I would say, in answer to your question, but looking at Mr. Strong, and having in mind doubtless some one or two reserve-bank officers who may have influenced him in drawing his bill, that one of the commonest mistakes, when people talk about stabilizing price level, is to imply that it means stabilizing money rates. I have occassionally seen something in reports of the open-market committee to the effect that stable money rates, in relation also to stable business conditions, prices, and so forth, should be the objective of a certain policy.

Now, the only method, supposing that the thing is at all practicable, by which ordinarily prices could be stabilized would be by variable money rates. In other words, when the flow of credit gets to be too rapid, and prices tend to rise in terms of the quantity theory and the concept of this bill, the way to pull them back is by running money rates up and checking borrowing, thus reducing the volume of money in use.

Similarly, in terms of the conception of credit price stabilization, when things are running down, when prices are going off and you want to start a reverse movement with a view of coming nearer to stability, you cheapen the cost of money so as to induce borrowing and raise the price level.

Mr. BEEDY. On your chart, the lines which present the most violent fluctuations are found under "Money Rates in New York" and "Money Rates in the Principal Countries," but I notice the lines indicating "Loans" and "Investments" are steadily rising from 1922 to the beginning of 1928, while the line denominated "All Other Loans" and which you say may be grouped under the head of commercial loans, is fairly steady. In other words, as the rates of money rise and fall in big cities, the loans that are made on investments seem to take advantage of them and present quite a violent change, while industry in general does not seem to avail itself of these violent fluctuations, and that line is fairly even, there being no great rises or declines.

Doctor MILLER. Here [indicating on chart] is 1927, and this represents the volume of borrowing for commercial accounts.

Mr. KING. When you say "this" and point to the chart, it does not mean anything when we come to read the record.

Mr. BEEDY. He is referring to this line, indicating "All Other Loans."

Doctor MILLER. Yes; on the chart marked "Money-Market Factors." This line "All other loans" shows no marked changes during the year 1927; it moves on a level not appreciably different from 1926. In the latter part of the year it would show, I think, a decline.

Is that correct, Mr. Riefler?

Mr. RIEFLER. A slight decline.

Doctor MILLER. Notwithstanding the fact that the Federal reserve system pursued a policy of easing money, first through purchases of United States securities. This black line, the heavy black line, "U. S. Securities," shows about mid year the beginning of this policy of purchasing securities, and you will notice how the curve rises.

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Mr. STRONG. That may be a very good argument; rather a manufactured one, I think.

Mr. KING. It is very good.

Mr. STRONG. But in the prior hearings it was quite generally stated that the Federal reserve system had been fairly successful in bringing about stabilization in the last three or four years. The purpose of this bill is only to direct a continuation of this policy by the use of all the powers they have, not to direct just what you shall do with the powers you have, but that the powers you have shall be directed toward stabilization, leaving you a direction as to study and research as to what might be best to do in the future.

Doctor MILLER. Well, if you read the bill as a whole, Mr. Congressman, beginning with paragraph (h), where it uses positive language, a command is issued to the Federal reserve system. It says in effect: "Use all your powers to promote or accomplish certain purposes."

Mr. STRONG. To promote them.

Doctor MILLER. Let me go ahead. It says in effect, "Use all your powers." That is the language of command.

Mr. STRONG. Yes.

Doctor MILLER. It then says, in effect, "Well, anyhow, do it so far as it is practicable to promote these ends by monetary policy."

Mr. STRONG. Certainly; use all of your powers toward stabilization as far as it may be accomplished by monetary policy.

Doctor MILLER. You are already beginning to doubt and hedge. You issue a command to begin with, but your later language shows that there is a doubt in your mind as to whether what you command to be done can be done, by saying, "Do it as far as it is practicable." Then, in a later paragraph you add still further to the doubt by saying, "Well, anyhow, go and investigate and find out what you can do."

Mr. STRONG. That is unfair, because there is no doubt in my mind that the language you refer to has been dictated and suggested by members of the Federal reserve system.

Doctor MILLER. I regret to say that I do not think it is a very creditable exhibition of their understanding of the seriousness of this whole matter.

Mr. STRONG. Their objections are that we should not have a positive direction, for fear the people will misunderstand and think that we can do all these things and blame us if we do not. Therefore, they said, "Please change the bill, Mr. Strong, so that you only direct the use of these powers toward a policy of stabilization as far as the monetary policy can accomplish it," and I said, "Very well; if that is your wish, I will so change the bill."

It is not that I am having any doubt as to the way the powers of the Federal reserve shall be used.

Doctor MILLER. But they appear to have, and are therefore protecting themselves at once by qualifying the command and at the same time getting a charter to go ahead and exercise certain experimental liberties, if you please.

Mr. STRONG. That is what you are doing, anyhow.

Doctor MILLER. I am trying to show that a little less of that sort of thing would probably give us a more satisfactory result in the Federal reserve system.

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Mr. STRONG. I think that is true. That is what I do not want you to do, to experiment, but to proceed with these powers toward the policy of stabilization.

Doctor MILLER. I know what you want to have done; but very frequently the way to get it is not the direct way or not the way that assumes that a resolution or instruction will do it.

Mr. STRONG. Do you mean to say that the way to get it is not to direct that they shall use these powers toward that policy?

Doctor MILLER. No; I do not say that the powers shall not be used.

Mr. KING. I want to make a protest, that the gentleman from Kansas has referred to the fact that a member of the Federal Reserve Board has changed the reading of this bill.

Mr. STRONG. I did not say the board. I said "system."

Mr. KING. While they have almost every power on earth they are not infallible.

Mr. STRONG. I said the Federal reserve system. Some of these amendments were made after a conference with the members of the board and of the Federal reserve system.

Doctor MILLER. The Federal reserve system is a pretty big organization. There are many persons in it. We have a considerable number of amateur economists, and from my point of view they constitute one of its dangerous elements.

Mr. STRONG. I agree with you.

Doctor MILLER. There are altogether too many in and around it for the good of the system, and there has been some influx into the Federal reserve mind of half-thought-out ideas—notions almost metaphysical in their character. These have penetrated the minds of some of the operators of the Federal reserve system.

Mr. STRONG. That is just what I am afraid of.

Doctor MILLER. And I venture to say that some of the men whom you have consulted do not know what this is all about. These are high-sounding and captivating words you are using in your proposed amendment.

Mr. STRONG. Of course, one of them has been Governor Strong.

Doctor MILLER. Of course, he is a very able man. But when it comes to economic insight and understanding, and when it comes to a program of economic statesmanship such as this bill contemplates—the most novel, the most untried, the most difficult—it calls for the exercise of power of analysis, of power of foresight, that is very unusual in any group of men anywhere, no matter what their experience or training.

Mr. STRONG. Do you mean to say that for the past three or four years the Federal Reserve Board has not been trying to use their powers for stabilization?

Doctor MILLER. I do not know it.

Mr. STRONG. Why do you employ these economists to prepare these charts for you if you are not trying to reach a policy of stabilization?

Doctor MILLER. I might simply repeat what I explained in great detail before this committee two years ago, and what is explained in considerable detail in the 1923 annual report of the Federal Reserve Board, which is a fundamental document in the Federal reserve system as then understood and conceived. It contains a

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point-blank declaration against the price level as a guide to credit policy, with some of the reasons for it.

It also contains an affirmative statement how Federal reserve credit procedure is being developed. I question whether you can find a more competent statement of the fundamentals of modern reserve banking policy.

Mr. KING. What report is that?

Doctor MILLER. The Tenth Annual Report of the Federal Reserve Board.

Mr. STRONG. And yet when members of the board and of the system have come before this committee they have always brought their charts, the basis of which has been a price level of some kind, or indicating the price level.

Doctor MILLER. I am afraid you are not acquainted with——

Mr. STRONG (interposing). I am very well acquainted. I have sat here for two or three years around this table and heard them.

Doctor MILLER. Here is a book containing 24 charts which are a part of the operating equipment of the Federal reserve system.

Mr. STRONG. I made my statement because when the members of the Federal Reserve Board and system have come before this committee they have always brought charts indicating price levels.

Doctor MILLER. Have they brought charts indicating anything else?

Mr. STRONG. Oh, yes; but all trying to reach a period of stability, trying to show where there were fluctuations one way or the other.

Doctor MILLER. Fluctuations of what?

Mr. STRONG. Of the levels they were discussing; and they have always indicated that they preferred to have a stable level.

Mr. BEEDY. What percentage of the charts showed fluctuations in price levels?

Mr. STRONG. I would say three-fourths of them; half of them, anyway.

Mr. BEEDY. Most of them, I think, showed fluctuations in volume of money and credits.

Mr. STRONG. That is showing the price level of money.

Doctor MILLER. Is that what it means to you?

Mr. STRONG. I think it means that to any ordinary man. I do not think I am so deficient in the study of this subject.

Doctor MILLER. I am not raising any question as to competency or deficiency. You are saying that that is what it means to you. It may mean a great deal to somebody else that is different.

Mr. STRONG. That may be.

Mr. KING. Were you here when Governor Harding was the head of the board? When he appeared we had the room filled with charts.

Mr. STRONG. And so has everybody else who has appeared before the committee from the system. But I want to make a further statement, that Governor Strong is only one of those whom I have consulted. You will remember I was before the board with Governor Harding, and we discussed various amendments at the time.

Doctor MILLER. I do not question that you may have gotten the impression that this or that group of officers of the Federal Reserve Board or of the Federal reserve system may agree with you, and I do not say that these men are not able, very able men, but on this par-

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ticular subject I do not know that they understand just what they are about.

Furthermore, it is human that on a subject with which a man is not particularly familiar the last man that talks with him is very apt to influence his mind. I would say that this bill was very cleverly and very brilliantly drawn to accomplish that purpose. I do not say that that was your purpose, but it is drawn, I would say, in language of convenient vagueness.

Mr. STRONG. Now, go ahead with your testimony.

Doctor MILLER. What do you want me to talk about?

Mr. STRONG. The bill.

Doctor MILLER. What part of the bill?

Mr. STRONG. There is publicity to be discussed, and, after that, the studies.

Doctor MILLER. Yes; but I want to finish up on paragraph (h), which is the heart of the bill.

The CHAIRMAN. Before you do that, I would like to have you discuss these charts that you have here, because, as I understand it, these charts are a history of past happenings, which have a bearing on the decisions which the board makes or, at least, certain members of the board rely on them to govern the decisions they make. I think it is an important part of the operation.

Doctor MILLER. Mr. Congressman Strong, this is a chart that I have had prepared for my personal use, and it always stands on a table opposite my working desk. You will notice that it has no price curve on it.

The CHAIRMAN. Without objection, this chart will be inserted in the record at this point. It is headed, "Money Market Factors."

Mr. STRONG. But the chart does show the stableness or unstableness of the various money rates and bank credits.

Doctor MILLER. Exactly.

Mr. STRONG. And it purports to show brokers' loans. It shows that you are studying how you reach a stable situation.

Doctor MILLER. Where is the steadiness in that chart?

Mr. STRONG. There is not any; and that is the reason you have that, to point to the unsteadiness of it.

Mr. BEEDY. I direct your attention to the line, Mr. Strong, in the center column, between the figures 10 and 5, which is fairly steady It is called "All other lines."

Doctor MILLER. No; "All other loans." That is a statement that is constructed from the reports of some 650 or 700 of the largest banks of the country that make a report every week to the Federal Reserve Board as to their condition.

Mr. BEEDY. Not members of the system?

Doctor MILLER. Oh, yes; they are members. They are the largest members in the reserve cities, and so on. They are the large banks, and they make a report weekly of the leading items in their condition. The line that is marked "All other loans," you can roughly identify in your own mind as meaning commercial loans; that is, lending to borrowers for commercial, agricultural, industrial, and similar operations.

Now, of course, the striking thing in that chart, Mr. Strong, is the fluctuation in these various curves, great fluctuations.

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Mr. STRONG. Certainly.

Doctor MILLER. They are up and down. To my mind, from a strictly interpretative point of view, the main interest arises the moment you find that curves which behave in a certain way in relationship to one another under ordinary conditions, begin to behave differently when you get a different set of conditions. They then begin to cut through one another in one direction or another. In brief, when you have a curve that for a long period of time has been moving above another curve, later on it moves below it, that is an indication that something is out of joint.

Now, do you care to go into these charts? I do not know just what you would like. I have referred a good deal to the period of the last eight or nine months.

The CHAIRMAN. The thing I am interested in, Doctor Miller, which I think is important in connection with these things, particularly as regards the decisions that the Federal Reserve Board makes, is what goes into the mill that comes out in the form of a decision issued by the Federal Reserve Board. These charts are apparently one of the guides. In other words, for instance, by way of definite illustration, take the decision which was made last summer when the discount rate was changed and we entered into this new era to which you are referring. Will you just tell us briefly how that matter was brought to the Federal Reserve Board and what the influences were that went into the final determination to bring about the lowering of the discount rate, etc. In other words, the testimony before this committee is that you members of the Federal Reserve Board arrived at individual opinions and that you arrive at those opinions based on such information as is before you. It may be a condition of the weather; it may be a condition of charts; it may be a condition of business; it may be a suggestion made from this source or that source, all culminating in a decision which is of tremendous importance to this country.

Now, I would like, if possible, for you to just visualize, if you please, a decision similar to that which was arrived at last summer.

Doctor MILLER. You are asking me not only a difficult question but a question impossible for me to answer. All I can do is to give you my best impressions. I think it is a most difficult thing to know what is another man's mind when he makes a decision.

The CHAIRMAN. Perhaps I can clarify that by asking this: Where did the suggestion come from that caused this decision of the change in rates last summer?

Doctor MILLER. Well, you will recall that last summer the three largest central banks in Europe had sent representatives over to this country. As I remember, there was the governor of the Bank of England, Mr. Montague Norman; the president of the German Reichsbank, Mr. Hjalmer Schacht; and Professor Rist, deputy governor of the Banque de France.

I think these gentlemen were in conference with officials of the Federal Reserve Bank of New York, or some of them, at any rate, and possibly with the directors. I am not advised as to these details, so that it may well be that what I am stating, on the basis of mere impression or hearsay, is not very accurate.

After, I should say, a period of a week or two, they appeared in Washington for the better part of a day. They came down, I think,

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the evening of one day, and were the guests of the Governor of the Federal Reserve Board at a luncheon the following day, and they left that afternoon for New York.

The CHAIRMAN. Were the members of the board present at this luncheon?

Doctor MILLER. Oh, yes; it was given by the governor of the board for the purpose of bringing all together.

The CHAIRMAN. Was it a social affair, or were matters of importance discussed?

Doctor MILLER. I would say it was mainly a social affair. Personally, I had had a long conversation with Doctor Schacht alone before the luncheon, and also one of considerable length with Professor Rist. After the luncheon I began a conversation with Mr. Norman, which was joined in by the other foreign representatives and, as I remember, by Governor Strong and perhaps one or two other officers of the Federal Reserve Bank of New York.

The CHAIRMAN. Was that a formal meeting of the board? Were minutes taken?

Doctor MILLER. No.

The CHAIRMAN. It was just an informal discussion of the matters that they had been discussing in New York?

Doctor MILLER. Well, I assume so.

The CHAIRMAN. No definite statement was made of that, however?

Doctor MILLER. No. I assumed that the purpose of the visit here was largely in the nature of a courtesy visit.

The CHAIRMAN. Was there a representative of the Federal Reserve Bank of New York present at the luncheon?

Doctor MILLER. Oh, yes; two representatives of the New York bank, as I remember. It was quite a large party, including Assistant Secretaries of the Treasury and State Department and a number of other persons in official life here. It was mainly a social occasion. As I remember, I was the only member of the Federal Reserve Board asked to say anything, and what I said was in the nature of generalities. The heads of these banks also spoke in terms of generalities. As a conference the meeting did not mean very much, and I was left with a feeling after the luncheon adjourned that it was—well, not very satisfactory.

Mr. KING. Was the menu satisfactory?

Doctor MILLER. I mean that these gentlemen had been here and had said nothing in particular, and nothing in particular had been said to them.

Mr. KING. What did they want?

Doctor MILLER. Well, Mr. Congressman, that is sometimes a very difficult thing to find out. I wanted to find that out, and, as already stated, had talked with two of these gentlemen separately in my office. They were very candid in answers to questions. I wanted to have a talk with Mr. Norman, and, as I say, we both stayed behind after luncheon and were then joined by the other foreign representatives and two or three of the officials of the New York bank. But I was the only member of the Federal Reserve Board. The conclusion that I drew—not that this was said, but it was a conclusion I drew—was that these gentlemen were all pretty much concerned for one reason or another with the way in which the gold standard was then working. That was not said by anybody, but that was my read-

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ing of the mind of each one of these gentlemen. They were therefore desirous of seeing an easy money market in New York and low rates, which would deter gold from moving from Europe to this country, and, possibly, stimulate a transfer of balances from New York to London, and, possibly, even lead an outward movement of gold. That would be very much in the interest of the international money situation which then existed.

The CHAIRMAN. Do subsequent events indicate to you that there was an understanding between these gentlemen representing the German Reichsbank, the Bank of France, and the Bank of England, with the New York Federal Reserve Bank at that meeting?

Doctor MILLER. An understanding among these men themselves? You mean among the foreign representatives?

The CHAIRMAN. Or was there a decision arrived at on the part of the Federal Reserve Bank of New York to bring about such a situation?

Doctor MILLER. I can not testify on that as a witness as to a fact.

Mr. BEEDY. The chairman's question is, Do subsequent events indicate to your mind that there was some unnderstanding arrived at between the representatives of these foreign banks and the Federal Reserve Board or the New York Federal Reserve Bank?

Doctor MILLER. Well, I would say in answer to that question, yes; especially as between these gentlemen and the New York Federal Reserve Bank.

Mr. BEEDY. You say that such an arrangement was not reported to the Federal Reserve Board formally?

Doctor MILLER. No. I would say it was not a part of the conversations held at the time they were in Washington as guests of the Governor of the Federal Reserve Board.

Mr. BEEDY. Was it subsequently reported by the Federal Reserve Bank of New York to the board?

Doctor MILLER. I am testifying here now at some disadvatage, because I left Washington about a week after the meeting there, but let me say parenthetically, Mr. Beedy, with respect to your question, because these things are all of record——

Mr. BEEDY (interposing). You started to give us some information. You said "Later on——"

Doctor MILLER. Later on there came a meeting of the open market policy committee, investment policy committee, of the Federal reserve system, to which and by which certain recommendations were made. As I remember them—though I have not a copy of the report—in substance the committee recommended that there be made purchases of securities in the open market for system account; in brief, that money be put into the market. I am not exactly sure about this, but my recollection is that about $80,000,000 of securities were purchased in August consistent with this plan. The policy was made operative early in August, and, if I remember rightly in connection with that meeting, there was reference to the desirability of a lowering of discount rates. Indeed, I suppose that any rational account of Federal reserve policy at that time would state that it was doubtless intended or expected by the authors of the program, that the purchasing of securities should and would prepare the ground, so to speak, for a modification of the Federal reserve discount rate,

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and, as a matter of course, of open-market money rates, including the call rate.

The CHAIRMAN. Might I ask here if there was any conference between the open-markets committee and these bankers from abroad whom we have referred to?

Doctor MILLER. Certainly not as a committee, so far as I am aware. They may have met them as individuals or possibly as a group, but not as a committee; no.

The CHAIRMAN. But apparently as a result of the discussion which took place, the open-markets committee responded to the suggestion which was made either in the conference in New York or here or somewhere while these gentlemen were here in connection with carrying out their views as regards open-market transactions and the lowering of the discount rate.

Doctor MILLER. Yes; I do not know whose idea it was. It may have been an idea that was simultaneously entertained by several of these men. My own belief is that the directors of the New York bank had for sometime been looking in that direction, and it may have been that it was because of this that the visit occurred. I do not know whether the original suggestion was presented from the other side; it may have been. About all that I would say, on the basis of my impression, is that the idea was very welcome on the other side. It was distinctly a time in which there was a cooperative spirit at work, a feeling that for one reason or another, and perhaps a variety of reasons, an easing of conditions was desirable.

Mr. KING. What medium of exchange do you usually use between those fellows that came across and the institutions that you speak about?

Doctor MILLER. What do you mean?

Mr. KING. I mean the open-market operations committee.

Doctor MILLER. What do you mean by "medium of exchange"?

Mr. KING. I do not mean "medium of exchange." I mean "medium of communication." How did they get these ideas into their heads?

Doctor MILLER. Sit around and talk about it.

Mr. STRONG. At a social dinner, I would say.

Mr. BEEDY. He has said that individuals of this committee——

Mr. STRONG (interposing). I appreciate that.

Doctor MILLER. I suppose that Doctor Schacht was in my office with me alone for about an hour and a half. I think I knew his mind pretty well, because I was struck with his singular candor and also his remarkable ability. He is far and away the ablest central banker that I know anywhere in the world, a man of commanding ability and solidity and with a minimum of illusionism in his mental make-up as a practical administrator.

Having talked with him at length, the thing that rather surprised me was that the things that appeared to come out of this visit later did not seem to fall in with the impressions I picked up from him as to his attitude, and subsequent reflection has led me to think that probably he stood somewhat apart, possibly, on some of these matters.

I do recall this particularly, because it falls in now, as it fell in then, with my own view as to what should be the official attitude of the Federal reserve system as regards the international situation. I

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remember asking "Doctor Schacht, what would you like in our arrangements if you could have anything you wanted from the Federal reserve system; would you like a reduction of the discount rate?"

He said, "No; that is a matter that you must determine for yourselves. What we want is that your discount rate, that your money rates, shall be truly adjusted to your conditions. Then we shall have something that we can work to, that I can work to in the administration of the Reichsbank."

In brief, he wanted a true money rate in the world's leading market so that he might have it as a guide. He said, "It is a hindrance to me——"

The CHAIRMAN. I got the impression, Doctor Miller——

Mr. BEEDY (interposing). "Hindrance to me" to what?

Doctor MILLER. "Hindrance to me if you make a rate"—I am using my own language, because I can not recall definitely what language he used—"that is artificial and subsequently have got to correct it." He said, "I shall not know then how to direct my course." I have often wished that I might sit down and talk with Doctor Schacht for an hour or two now and see what his feeling now is. He told me in that connection, "The greatest difficulty I have had in controlling the situation in Germany is the fact that money spills in from the outside and thus neutralizes my efforts at internal regulation and control."

The CHAIRMAN. What I started to say when Mr. Beedy interrupted me was this: You have outlined here negotiations of very great importance.

Doctor MILLER. I would not call them negotiations.

The CHAIRMAN. Well, a conference.

Doctor MILLER. Well, I would say conversations. I think that is the proper word.

The CHAIRMAN. Well, as a result of negotiations or this conference or casual conversations, something of a very definite character resulted?

Doctor MILLER. Yes.

The CHAIRMAN. A change of policy on the part of our whole financial system, which has resulted in one of the most unusual situations that has ever confronted this country financially. Now, this apparently took place by informal discussions, both in the Federal Reserve Bank of New York and in Washington. It seems to me that a matter of that importance, even if it was discussed informally, should have been discussed and made a matter of record in the Federal Reserve Board in Washington and nowhere else.

Doctor MILLER. I agree with you.

Mr. BEEDY. We would all agree to that, I guess.

With reference to this chart here that you have set up, the noticeable thing about these lines is the upward trend and then the sudden falling, and you set it before you in order that you may derive some conclusion as to the policy which you could recommend, for instance, to the Federal Reserve Board, do you not, with respect to rediscount rates?

Doctor MILLER. Yes.

Mr. BEEDY. And in studying those lines and in arriving at the conclusion which you would like to recommend as to policy, your desire

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Initially, about mid year, when this pronounced rise begins, the Federal reserve system, through its open-market operations, decided to go into the market and buy securities. Later on, in order to offset gold exports, it continued purchasing, so that it went on right through to the latter part of the year. You have a pronounced rise here [indicating on chart]. We will insert the figures in the record later on.

Mr. RIEFLER. The total security holdings increased from about $300,000,000 in May to about $600,000,000 in December.

The CHAIRMAN. Of 1927?

Mr. RIEFLER. Yes.

The CHAIRMAN. You are referring now to the reserve-bank credit chart?

Doctor MILLER. To the reserve-bank credit chart, precisely.

Now, if you will be good enough to look at the chart marked "Money Rates in New York," in order to see what happened in regard to money rates, you will see that in 1927, a little after mid year, the rediscount rate, which is represented by the red line marked "Federal Reserve Rate," dropped from 4 per cent to 3½ per cent. You will notice almost simultaneously that the green line, which is the line marked "Call Money," drops. Call money cheapens almost simultaneously with the drop in the discount rate. You will also find that the acceptance rate declines, while commercial paper goes down about a quarter of 1 per cent, drops a little. The main influence exerted by the change of discount rate, the main result of the policy adopted, was to lower the call rate.

Now, as to the lowering of the discount rate, let us see what peculiar combination of conditions existed at that time, although it may not have been clear then. That combination of conditions introduced into the whole speculative situation the element of cheaper money; in fact, we may say cheap money.

What effect did the low money rate have upon borrowing for other than commercial purposes? Well, Mr. Beedy has called attention to the rise of these two curves, the one marked "Investments" and the other "Loans on Securities." They both show a considerable rise during the second half of the year 1927.

Now, if you turn to the curve on this chart marked "Brokers' Loans" you will find that the rise is almost perpendicular.

In other words, the brokers' loans rise was the factor that was pulling up the security-loan curve. That shows here [indicating on chart] and follows the reduction of money rates, following the rediscount rate change, and the injection into the market by purchase of securities of a very considerable volume of new basic Federal reserve credit. I think those things go together.

Mr. BEEDY. All of which has what, if any, effect on prices of commodities?

Doctor MILLER. Before getting to that let me say that this was all more or less in the interest of what I have called briefly the international situation, and our own interests so far as the international situation has certain American reflexes. This low acceptance rate, for example, which you find in the latter part of the year 1927 (chart, Money Rates in New York), undoubtedly drew a volume of the financing of our exports by the use of American acceptance credits of probably $300,000,000 in excess of what we might call normal.

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I think I explained the other day that the financing of the movement of commodities between countries is cheaper in proportion to the extent that an importing country can buy the currency of the country from which it is importing cheaper. The effect of our low American rates was to raise sterling exchange, to raise sterling exchange from about $4.85 to $4.87⅞. In other words, our policy tended to increase the value of the pound by diminishing the value of the dollar as compared with the pound. The result was that importers in England, or anywhere in Europe, who were financing themselves through London, directly or indirectly, who wanted American dollars would find that they could get more dollars and cents, so to speak, for their pounds as the result of Federal reserve policy followed through the autumn than was the case hitherto or than otherwise would have been the case.

Mr. STEAGALL. Putting it in the language of the layman bluntly, what happened was that they made money a little cheaper?

Doctor MILLER. Yes; exactly.

Mr. STRONG. Made our money a little cheaper.

Mr. STEAGALL. That is a better way of expressing it.

Doctor MILLER. Exactly. I do not want to complicate the presentation too much, but if we turn to the international situation we find that the spread between money rates in the United States and Great Britain became wider after this new policy was adopted, so that it had the effect of diminishing shipments of gold to the United States; on the contrary, stimulating a movement of gold to Europe, where it would command a better current return. There are a considerable number of American banks that have funds that they shift from one market to another or from one class of investments to another, according to the return they can expect to get that actually make transfers to London, and it was those transfers that called, in part, for shipments of gold to cover their transfers.

In brief the operation was this: They sold gold credits in New York for sterling bills or sterling balances in London.

Mr. STRONG. Doctor Miller, I understand from your statement that you do not agree with or approve of the change of policy that was made by the Federal reserve system after the visit of the foreign bankers?

Doctor MILLER. That is correct.

Mr. STRONG. Then would it not have been a good thing if there had been a direction that those powers given to the Federal reserve system should be used for continued stabilization of the purchasing power of the American dollar rather than to be influenced by the interest of Europe?

Doctor MILLER. Well, I take exception to the term "influenced."

Mr. STRONG. You would, but I just wanted to get that answered.

Doctor MILLER. I would say that there is no such thing as stabilizing the American dollar without stabilizing every other gold currency. They are tied together by the gold standard.

Mr. STRONG. Then you approve of our efforts to stabilize Europe?

Doctor MILLER. I disapprove in toto of any mechanical formula in banking.

Mr. STRONG. I agree with you.

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Doctor MILLER. Let me explain what I meant when I said I disapproved of that policy. We are dealing here with conditions, not theories. My belief was, and I so expressed it at the time, that the policy of easy and cheap money would undoubtedly stimulate speculative activity in this country. My feeling was that it probably would go to such excess that we would have to pay for the cheap money that was created in the latter part of the year 1927 by dear money in 1928. So far as the requirements of the commercial situation are concerned, it appears that we would have profited more by cheaper money in 1928 than in 1927. We would not have suffered appreciably, in my judgment, from money a little less cheap in 1927 than it was made through the intervention of the Federal reserve policy.

The CHAIRMAN. Now, getting back to these conferences with the foreign bankers who were here and the change of policy last August, I want to put into the record at this point a statement by the Federal Reserve Bank of New York on the gold movement for 1927–28, which appears on page 2728 of the Financial Chronicle of May 5, 1928, and call your attention to the fact in that statement that the net loss to this country in gold since September, 1927, is $345,000,000. That covers this period of time, and I would like to ask you whether or not that exportation of gold is the result of the policy established back in August, 1927.

(The statement referred to is as follows:)

FEDERAL RESERVE BANK OF NEW YORK ON GOLD MOVEMENT DURING APRIL—NET LOSS TO COUNTRY SINCE SEPTEMBER $345,000,000

In reviewing the gold movement, the Federal Reserve Bank of New York, in its May 1 Monthly Review, says:

The gold-export movement continued during April, with total shipments of about $94,800,000. Imports totaled about $3,800,000, and there was a net release of approximately $45,700,000 from earmark during the month, so that the net gold loss for the month was about $45,300,000. This makes the net loss to the country about $345,000,000 since the beginning of the export movement in September.

The export movements to Argentina and Brazil and the shipments of earmarked gold to France continued during April; further exports to Italy and Uruguay were made; and the strength of sterling exchange led to another small export of gold to England. The shipment of about $5,000,000 of gold received in February from Russia and refused by the assay office was transferred by the consignors to Germany. The only important import movement was the receipt of $3,400,000 from Greece.

The destination of the largest shipments from New York during April and the total amounts sent to those countries since September 1 last are given in the following table:

	April 28, 1928 [1]	September 1, 1927, to April 28, 1928 [1]
Argentina	$3,500,000	$117,090,000
Brazil	1,680,000	54,994,000
France	71,741,000	132,540,000
Germany	[2] 5,353,000	[2] 26,881,000
Italy	6,000,000	12,000,000
United Kingdom	1,465,000	11,033,000
Uruguay	3,000,000	11,000,000

[1] April figures preliminary, covering Port of New York only.
[2] Including $5,201,000 previously received from Russia.

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The monthly changes in the country's stock of gold in consequence of exports, imports, and earmarking transactions during 1927 and the first four months of 1928 are given below:

Gain or loss to gold stock

Year and month	Through imports or exports	Through earmarking	Total
1927			
January	+$44,000,000	+$20,000,000	+$64,000,000
February	+20,000,000	+3,000,000	+23,000,000
March	+11,000,000	−2,000,000	+9,000,000
April	+12,000,000	−1,000,000	+11,000,000
May	+32,000,000	−95,000,000	−63,000,000
June	+13,000,000	−1,000,000	+12,000,000
July	+9,000,000		+9,000,000
August	+6,000,000	−2,000,000	+4,000,000
September	−11,000,000	−9,000,0000	−20,000,000
October	−9,000,000	−25,000,000	−34,000,000
November	−53,000,000	−40,000,000	−93,000,000
December	−68,000,000	−8,000,000	−76,000,000
Total	+6,000,000	−160,000,000	−154,000,000
1928			
January	−14,000,000	+6,000,000	−8,000,000
February	−11,000,000	+3,000,000	−8,000,000
March	−95,000,000	+36,000,000	−59,000,000
April	−[1] 91,000,000	+[1] 46,000,000	−[1] 45,000,000
Total	−[1] 211,000,000	+[1] 91,000,000	−[1] 120,000,000

[1] Preliminary.

Doctor MILLER. I would say, in answer to your question, that that is in part true, but not wholly so. Part of the gold that we have lost is gold that foreign governments, notably France, have been accumulating here for some time. They are exporting it now.

The CHAIRMAN. This statement, I will say to you, shows the earmarking of that gold for the different months of 1927.

Doctor MILLER. But the total figure includes, I think, gold withdrawn either for exportation or for earmarking; that it, the form of statement put out regards the gold as lost; that is, for the time being, to the American credit system when it is earmarked and set apart as the property of some foreign government.

The CHAIRMAN. It is impounded and in storage. It is out of our system just as much as if it were out of the country.

Doctor MILLER. Yes.

The CHAIRMAN. In connection with these conferences which took place and which subsequently resulted in definite action, you referred to conferences in New York and conferences or a luncheon in Washington. I would like to ask you to put in the record the names of the people who were here from abroad at this luncheon in Washington—in fact, all who attended that luncheon.

Doctor MILLER. I will do the best I can. I think I can give you approximately the gentlemen here from abroad. I have already given you the names of Mr. Norman, of the Bank of England; Doctor Schacht, of the Reichsbank; and Mr. Rist, deputy governor of the Banque de France. There was also present one of the younger men from the Bank of France. I think he was in charge of statistical work, and in part also acted as a sort of interpreter. I do not recall that there were any others among the foreign guests at that luncheon.

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Mr. KING. This was at the New York luncheon?

Doctor MILLER. No; in Washington. I think all members of the Federal Reserve Board were present. Possibly there may have been some member absent. That I do not recall.

My impression is that the Undersecretary of the Treasury, Mr. Ogden Mills, was there, and the Assistant Secretary of the Treasury, Mr. Schuneman; also two or three men from the State Department. There were some members of the Federal Reserve Board staff, and Mr. Warren, of the foreign department of the Federal Reserve Bank of New York.

The CHAIRMAN. Who else was here from the Federal Reserve Bank of New York?

Doctor MILLER. I think Mr. Harrison, deputy governor of the Federal Reserve Bank of New York, was there.

The CHAIRMAN. Neither Doctor Burgess nor Governor Strong were present?

Doctor MILLER. Oh, yes; Governor Strong was present. I think Mr. Burgess was also present, but of that I am not positive.

The CHAIRMAN. Let me ask you something else, Doctor. This conference, of course, with these foreign bankers did not just happen. The prominent bankers from Germany, France, and England came here at whose suggestion?

Doctor MILLER. I can not answer that. You will recall that at the time, or, rather, two or three months earlier, a situation had been created that was distinctly embarrassing to London by reason of the impending withdrawal of a certain amount of gold which had been recovered by France and that had originally been shipped and deposited in the Bank of England by the French Government as security for a war credit. I presume the really provocative thing in this whole situation was the indication that there was getting to be some tension of mind in Europe because of the fact that France was beginning to put her house in order for a return to the gold standard. And there was some danger that the thing that had been predicted by a good many people in the preceding two or three years would happen, namely, that as Europe went further and further in the direction of the restoration of the gold standard there might result a scramble for gold and a possible scarcity of gold, with restricting effects upon credit. The situation was one, therefore, that seemed to call for some moderating influence, some moderating influence in the monetary affairs of these different countries. The most natural place to take their troubles was to this country, where existed the leading gold market of the world and where, so to speak, the most disinterested advice and help could be given.

That is my view of what probably lay at the bottom of this thing.

Mr. KING. Who was the moving spirit that understood that situation and got these people together?

Doctor MILLER. That is a detail with which I am not familiar.

Mr. KING. That is immaterial?

Doctor MILLER. I am not particularly interested, because there is nothing here that is per se objectionable. I want to say that I would think it as a whole a better thing if members of the Federal Reserve Board would make contacts with foreign bankers and know what was in their minds, for it becomes a factor in our problems.

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Mr. STEAGALL. All that you say is interesting, but it is a little bit aside from the question propounded by Mr. McFadden. He asked the question as to who was responsible for this meeting.

Doctor MILLER. I can not answer that. I suppose that it would eventually come to this, that these men got together over there or otherwise conferred with one another and then cabled Governor Strong, "We would like to come over and have a talk with you." In that case you would say the meeting was at their instance.

Mr. STRONG. Would it not be fair to say that the fellows who wanted the gold were the ones who instigated the meeting?

Doctor MILLER. They came over here. That is as much as I know as a matter of fact. Beyond that I can throw no light on it.

Mr. STRONG. They came, they banqueted, they talked, and they got the gold.

Mr. BEEDY. The answer to the question is that he does not know who was the moving spirit in getting them over here.

Doctor MILLER. Yes.

Mr. BEEDY. I would like to get back to the bill.

Doctor MILLER. I can not let your expression stay in the record, Mr. Strong, without a protest, because it carries with it a sinister suggestion.

Mr. STRONG. Not sinister, but based on the facts.

Doctor MILLER. Well, what is the fact?

Mr. STRONG. The fact is that they came over, they had a meeting, they banqueted, they talked, they got the Federal Reserve Board to lower the discount rate, to make the purchases in the open market, and they got the gold.

Doctor MILLER. Well, now, if I took that view of the matter, if I used the words you have used, I would say that it was pretty clearly demonstrated why your bill should not be enacted.

Mr. STRONG. I know you would say that, but I think that if we used this power to take care of our own standard of value, our own dollar——

Doctor MILLER (interposing). But you have said that these gentlemen did all these objectionable things. If they can do all these things with the Federal reserve system, that is a good reason——

Mr. STRONG (interposing). For stabilizing the American dollar first?

Doctor MILLER. Who is going to do the stabilizing?

Mr. STRONG. The Federal Reserve Board, instead of trying to stabilize Europe first.

Doctor MILLER. What guarantee, or what warrant, have you for expecting the Federal Reserve Board, taking your view, your own words as to this recent performance, to give a more competent account of itself in the future? If these gentlemen did these things you charge, why will they not do them in the future?

Mr. STRONG. That is the reason I want to direct them to stabilize the American dollar first, not to stabilize Europe first, but America first.

Doctor MILLER. Let me say here parenthetically, because while it has no bearing upon the problem, it may have at least a bearing upon your statement——

Mr. STRONG. Never mind my statement. I can take care of it.

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Doctor MILLER. I mean in this committee. I do not know whether Gustave Cassel is in this country now.

Doctor COMMONS. Yes; he is. I should like to see this committee invite him to be here.

Doctor MILLER. I have just received an invitation to meet him at what you call a banquet here, a dinner at the home of the Swedish minister.

Mr. STRONG. I am going to be there.

Doctor MILLER. You know, Gustave Cassel is, among Europeans, perhaps the foremost proponent of the stabilization theory of central bank operation. He has also been a very persistent and very sharp and aggressive critic of the Federal reserve system. He does not think that we have always done very well. Unless we do better and show a warmer heart toward Europe, he thinks that things are going to go pretty hard in Europe in the future.

Well, since you are going to meet him and I am going to meet him, perhaps we will have a nice exchange there.

Mr. STRONG. Have a nice dinner.

Doctor MILLER. At any rate, from the point of view that we were discussing here a moment ago, I am merely now trying to convict you of inconsistency.

Mr. STRONG. I know; but you are not going to convict me.

Doctor MILLER. Here is an eminent man coming here, and there are other eminent men that will come. Others have come who are very adroit in knowing how to approach the folk who make up the personnel of the Federal Reserve Board.

Mr. STRONG. With the one exception.

Doctor MILLER. For the most part we are innocent of European psychology. What warrant have you, therefore, that they won't use this thing to improve their conditions if, as you think, they can influence us so easily?

Mr. STRONG. I am only talking about the things brought up in your statement this morning to which you said you were opposed.

Doctor MILLER. Yes; I was opposed, and I am candid enough—I am respectful enough of the imponderable forces in all of these situations to say at this moment that I do not know which would have proved to be the correct course, the one that was followed or——

Mr. STEAGALL. Is it true that that action stabilized the European dollar and demoralized or upset ours? Is it not true that whatever change took place affected the two?

Doctor MILLER. It did affect the two.

Mr. STEAGALL. One one way and one the other?

Doctor MILLER. Yes; that is what it was intended to do.

Mr. STEAGALL. So it could not accurately be said that that action stabilized the European dollar?

Doctor MILLER. It was not intended to stabilize the European currency so much as to improve the exchanges, to raise them.

The CHAIRMAN. And relieve a very delicate situation.

Doctor MILLER. And relieve a very delicate situation.

Now, I think anyone who undertakes to deal competently with the problems of Federal reserve policy has got to have guiding convictions as regards certain situations; otherwise he is flotsam and jetsam, at the mercy of whatever influence is at work.

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Personally, I am on principle opposed to artificial money conditions. To my mind, they are one of the most unfortunate things that can happen, and many of the most serious conditions that we have gotton into have come from just that sort of thing.

Mr. STRONG. What would you say is a natural rate?

Doctor MILLER. One that is pretty carefully adjusted to actual conditions, where you do not undertake to force and create conditions. I would say, for illustration, that the 3½ per cent rate was an artificially low rate and it has brought in its cycle the present higher rates; and that, in itself, is an undesirable condition.

Mr. STRONG. I would like to get one thing through my mind, referring to your chart there. The changed policy of the Federal Reserve Board in the open-market operations, and the lowering of the discount rate, tended, as I take it, to increase loans and investments and resulted in the violent increase of brokers' loans, but was not accompanied by a corresponding rise in other loans for business. Well, now, was anything done or any policy adopted or any action taken by the Federal Reserve Board to hinder the use of cheap money to increase the brokers' loans?

Doctor MILLER. There is no method known to the Federal reserve.

Mr. STRONG. You remember that Doctor Sprague suggested the method of adopting the English system.

Doctor MILLER. Yes.

Mr. STRONG. Two remedies were suggested, one to adopt the English system to force the lending to be in a loan for at least seven days and to pay interest for that time, in order to prevent borrowing sums of money one day and returning them the next and only paying interest for one day, and then his other proposition was to inquire into the purposes for which the money was to be borrowed.

Could either one of those remedies have been used?

Doctor MILLER. I think the first one would be worthless. I think it would produce just the opposite result from that intended.

Mr. STRONG. Why?

Doctor MILLER. Because a bank being limited to borrowing for a 7-days' minimum would see to it that it kept its borrowed money invested for the whole seven days and there would be no other place that it could with certainty go with that money than the call-loan market.

Mr. STRONG. But would that not be a check when they wanted to furnish money for speculative loans? Suppose that a man came in and said that he would like to get money for a couple of days to be used in the open market. They would say, "But we have to borrow that money for seven days." Would that not be a check upon it?

Doctor MILLER. It does not work that way. The call-loan market is the most impersonal thing in the money market. The bank borrows at a reserve bank, and that is notably true in the big cities, and, of course, especially true in New York City, because it finds its reserves depleted and needs to restore them. Being a central reserve city, the New York member bank is required to keep a balance of 13 per cent against its demand liabilities.

Mr. STRONG. Do you think the other remedy of Doctor Sprague's would be of any value?

Doctor MILLER. I think, Mr. Congressman, that the most essential thing in the operation of the Federal reserve bank at this juncture is

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the development of some technique by which a restraint can be exercised over banks that are indebted to the Federal reserve bank when they are lending in the call loan market. That is my opinion and that is the opinion I expressed here two years ago.

Now, the interesting thing in an inquiry into the Federal reserve system and its operation is why it is not done. It will be said by some that it can not be done; it will be said by others that it does not need to be done, that there is no evidence that the banks are borrowing for the purpose of reloaning the proceedings in the call-loan market. There is some basis for a statement of that kind if you are looking directly for, we will say, a culprit, but there is no basis for it if you are looking for an explanation of a condition that obtains.

Only a few days ago in a Federal reserve conference this question of whether the member banks were not borrowing for making call loans came up. Well, they do not come in, as Mr. Strong implies, and say, "I want to get $10,000,000 to lend in the call market."

Mr. STRONG. Of course, I know that.

Doctor MILLER. The president of the bank may not even know that his bank is short in its reserve account at the Federal reserve bank at Boston or New York because of call loans.

What happens may be this: That a member bank is engaged in a vast volume of business of great variety; that it has a great mass of commercial business. It may find that its commercial borrowers come in and want more credit. It may have at the same time a considerable amount of funds invested in the call-loan market. What it may do under those circumstances is not to go to the call market and take money out in order to meet the demands of its commercial customers. It may instead go to the Federal reserve bank and borrow; and what I think I have on several occasions tried to make clear is that it will be more likely to do this when the call rate is high and the Federal reserve discount rate is low. Therefore one of the dangers, one of the risks always taken under such conditions, is the steady maintenance or even accumulation of funds in the call-loan market.

Now, some of our reserve governors, when we were discussing this thing, said that a particular bank is "in" to-day $10,000,000, $20,000,000, or $30,000,000, and then is "out" to-morrow, and some other bank is in the reserve bank as a borrower. That is what might be expected. The load is being shifted all around. But the figures will indicate that the total volume is growing. And if you seek to find where the reserve system ties into the situation is, you will find it in the expanded discounts of the Federal reserve system or, under other conditions, in expanded open-market purchases.

What has been going on recently is that the Federal reserve system has been pursuing a policy of sales of securities with a view to bringing pressure to bear upon the central money market. That pressure, in my judgment, is succeeding, and the evidence is that call money has gone to 5 per cent, has even touched, on occasions, 6 per cent. But that 6 per cent rate is, so to speak, a call to the interior of the country to send its money to New York if it has any, and the result is that the interior money in New York City in the call market threatens to cut commercial loans at home.

The CHAIRMAN. You were discussing a few moments ago this suggestion of Doctor Sprague's in connection with 7-day money as a

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possible check as applied to the New York market. There is not very much difference between the total amount of brokers' loans and the deposits in New York banks. There are legal-reserve requirements in connection with the deposits in the New York banks. In other words, it is a deposit of money belonging to the country banks, or that part of it that is loaned by the country banks on the market, and the same thing would apply to industry.

Doctor MILLER. Unless they loaned it.

The CHAIRMAN. Supposing that the reserve law were changed in that respect and that New York banks were forced to keep a reserve against the total amount of brokers' loans; would not that have a tendency to check the situation?

Doctor MILLER. In effect, I think, if I understand your question, that it does that now. When a New York bank makes a loan to anybody, but in a specific case a broker, it takes his note with collateral and gives him a credit on its books. It creates, in other words, a demand liability against itself and against that it must immediately carry a reserve of 13 per cent.

The CHAIRMAN. That is true; but when these brokers' loans accumulate the New York banks know that overnight they may be called on to supply the money to liquidate all those loans that are made when they hold money from outside of New York City, and they have an assurance now that if that call is made they can go into the Federal reserve and get the necessary funds.

Doctor MILLER. They have the assurance, but I think they feel——

The CHAIRMAN. They have eligible securities from the applicants to take care of just that situation.

Doctor MILLER. Government securities.

The CHAIRMAN. And they can go into the Federal reserve bank and get whatever funds are necessary to take care of the sudden call of the amount on brokers' loans held outside of New York City.

Doctor MILLER. That is true.

The CHAIRMAN. My question to you was whether or not it would have a tendency to check that if we required a legal reserve requirement against those loans the same as is required against deposits?

Doctor MILLER. Well, wherever you have a loan you have a deposit. Your loan is always offset by a corresponding item on the liability side of the ledger. That is the deposit item.

The CHAIRMAN. In other words, look at it this way: If it were not for the fact that around the corner is the Federal reserve bank, to which the big banks in New York that have the responsibility of furnishing the money to discharge those loans in case they were called on to do so can go, those big banks in New York City would take a different attitude in regard to brokers' loans than they do now, because they would have to find themselves the money with which to liquidate those loans. As it is now, the Federal reserve bank, being around the corner, is furnishing a source of relief which works to the advantage of the continuance of the brokers' loans.

Doctor MILLER. Yes; no doubt about that.

Mr. BEEDY. In other words, you are calling attention to one of the weak spots in the Federal reserve system?

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The CHAIRMAN. I am calling attention to the assistance which the present operation of the Federal reserve system gives to the continuance of the brokers' loan situation.

Mr. STEAGALL. Everybody would not agree as to whether it is an evil or a weakness in the Federal reserve system now. If I can prosper and have a fine car and a nice home and plenty of servants and a trip abroad, I do not care if some gambler down here lives a little better than he has been living. That will not hurt me.

Mr. BEEDY. Before the committee adjourns, I would like to have this fact go into the record as pertinent to the observations made here as indicated in the chart resulting from the cheapening of money in the mid year of 1927, namely, the pronounced rise in the line indicating loans and investments and the pronounced check in the line indicating broker's loans. You will recollect that I asked the question as to what is the effect, if any, on prices. I note in these Federal reserve charts—and this is chart 16 in this little pamphlet which you have here, the chart used by the Federal reserve system—that beginning mid year, we will say, the line begins to rise in this chart denominated "Wholesale prices" as prepared by the Bureau of Labor, based on the prices of 550 commodities, and that the chart shows an abrupt rise in the line indicating the amount of reserve-bank credits, plus gold stock and reserve-bank credit, from which might be drawn the conclusion that with this cheapening of money all the member reserve banks began to participate in this extension of credit, and that as the result of this cheap money there is some reflection of it indicated in not a pronounced rise by any means, but an appreciable rise in the wholesale prices of the 550 commodities.

Doctor MILLER. That would depend. I think a consistently incorrigible stabilizationist would say this proves it was done and can be done.

Mr. BEEDY. I am not that, but I am an impartial student of the problems incident to the consideration of this Strong bill, and I think we ought to have all of these elements in here.

Doctor MILLER. When you put those alongside one another it is a pretty easy thing to conclude that the change in the one is the cause of the change in the other. But if you go into detail and see what groups of commodities have moved in price, you will find it is particularly those that are the products of the soil and for which price are made in the world market.

The CHAIRMAN. I want to suggest that the committee adjourn now to meet to-morrow morning at 10.30.

(Whereupon, at 12.45 o'clock p. m., an adjournment was taken until Wednesday morning, May 9, 1928, at 10.30 o'clock a. m.)

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Wednesday, May 9, 1928.

Following the consideration of other business, the committee resumed hearings on H. R. 11806, Hon. Louis T. McFadden (chairman) presiding.

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The CHAIRMAN. Now we will proceed with the hearings on H. R. 11806.

Mr. Miller, of the Federal Reserve Board, will resume his testimony.

STATEMENT OF DR. ADOLPH C. MILLER, MEMBER FEDERAL RESERVE BOARD—Resumed

Doctor MILLER. Mr. Chairman, yesterday's hearing and, I think, one or two of the hearings last week concerned themselves very largely with a review of Federal reserve policy and operations and their effects during the past nine months. Yesterday's hearing took on the character not simply of an inquiry but of an inquisition, so to speak—a disposition to get something in the nature of a close look-in with respect to the open-market operations and policies of the Federal reserve system.

Personally I think that is not only proper but, I think, likely to be profitable and enlightening to the committee and to others who are really interested in the manner in which, humanly speaking, the Federal reserve system operates.

Now, I think I have stated once or twice in connection with these discussions that I have not always been in sympathy with the policies that the Federal reserve system has followed in recent years. More particularly is that true with respect to its open-market policy and operations. And I have felt an embarrassment, a certain personal embarrassment, in my desire to meet candidly and frankly the questions of members of the committee and at the same time maintain an attitude of loyalty toward my colleagues on the Federal Reserve Board and officers of the Federal reserve banks with whom I have not always been in agreement.

But I feel that where a committee of Congress evinces the interest that this committee has, not only in connection with the particular bill that has given rise to these hearings but with reference to the general operation of the Federal reserve system, that every help should be given, and I am therefore prompted to make the suggestion, Mr. Chairman, that your committee ask the Federal Reserve Board to send you a complete file of documents containing the reports of the open-market committee to the Federal Reserve Board since the inception of the committee in April, 1923, the preliminary memoranda prepared in connection with those reports, and complete records of the action that the board has taken from its minutes.

I am under the impression that it will be seen as inquiries into the Federal reserve system go on that the very heart of its more recent credit policy lies in the open-market operation. I can see, as these hearings have progressed, that that is a thing to which, in one way or another, we always come back.

I think it will remain a mystery to you until you have all of the facts before you. I think you will never be in a position to legislate intelligently until you have that full understanding that will come only when you have all the documents before you which will disclose exactly what is going on, how it has taken place, and then estimate the wisdom of the operation by the resulting effects of the policy.

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Mr. STRONG. Should we not also have the reasons given for the change of policy at the time it was made, so that, in studying the question, we could see how it worked out?

Doctor MILLER. I think you are thinking of something a little different.

Mr. STRONG. No; I think I understand.

Mr. BEEDY. Change of what policy?

Mr. STRONG. Open-market operations.

Doctor MILLER. You will get it.

The CHAIRMAN. The Doctor has suggested that we have the minutes which show the determinations of the board.

Mr. STRONG. What I wondered was, does that record give us the reasons why?

Doctor MILLER. It will give you all there is, and from that you can judge, for instance, whether that is sufficient.

Mr. STRONG. Does it give the reasons that prompted the board to act in the change of policy toward open-market operations?

Doctor MILLER. I would reply to that that is in the nature of an inference or a conclusion.

Mr. STRONG. It is not in the record.

Mr. LETTS. You are speaking of certain memoranda of the committee, and those, I take it, are directed to the board and would contain some of these reasons that Mr. Strong is inquiring about.

Doctor MILLER. You will have everything.

I am particularly moved in making this suggestion because of the surprise, which I think was quite natural, expressed by the chairman yesterday that there was no record of what went on last year on the occasion of the visit of three of the central bankers of Europe.

The CHAIRMAN. The reason I raised that question was that if determinations are made in a casual conference like that, which determinations govern the action of the Federal Reserve Board, it ought to be understood.

Doctor MILLER. No determinations were made at that conference.

The CHAIRMAN. But as a result of that conference, evidently.

Doctor MILLER. There, again, I should say that that is a matter of inference and conclusion, and I think that the only way to clarify a situation of this kind is that you should have before you all that there is in black and white and you can then see just what the modus operandi is, wherein it is incomplete, and you can then, if you want to, inquire why it is not more complete. In these matters I think it very undesirable for a board or any governmental agency to rest under the thought that there is a mystery about its proceedings or any withholding of information. I think there is some mystery in the public mind. I am a devotee of not only candor in these matters, but publicity at the earliest possible moment. (On these matters I want to get ahead of my critics.) I think the best course for the committee is to ask for the complete records. They should be a matter of interest to the committee and a matter of considerable public interest. While I have pondered and hesitated a good deal in making this suggestion, I think on the whole that in the long run great good will come out of it and the good will compensate a thousandfold for any immediate embarrassment, and I think it will save a lot of time spent in your hearings in feeling around for something that can best be found in the records.

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The CHAIRMAN. The chair is ready to entertain a motion to carry out the suggestion of Governor Miller.

Mr. STRONG. I move, Mr. Chairman, that the chairman of this committee ask the Federal Reserve Board to furnish the details and information referred to by Doctor Miller.

Mr. BEEDY. I second that motion.

(The question was put and the motion was agreed to.)

Doctor MILLER. Now, what is your desire?

The CHAIRMAN. Have you finished the detailed discussion of the bill?

Doctor MILLER. No; I have not.

The CHAIRMAN. We should be very glad to have you proceed in your own way. I might say to you that when you have finished that, Doctor Commons has a few questions, and I imagine Mr. Strong has some that he will want to ask you after that has been completed; and, if it is your desire, I understand that Doctor Commons is willing to be questioned by you.

Doctor MILLER. He suggested that, and if the committee thinks it desirable, well and good.

The discussions in the hearings thus far have confined themselves pretty much to paragraph (h), and I rather think it would be better, if members of the committee have any questions they want to put to me with regard to paragraph (h), that that be done before we go on to paragraph (i), which is on a different subject, and on which I might want to say quite a little.

The CHAIRMAN. I wanted to ask you this, Doctor Miller: Are you entirely in accord with the policy being pursued now of cooperation with the banks of issue in regard to getting the world back, or these countries with which we are collaborating, to a gold basis, standard gold basis?

Doctor MILLER. I am not enthusiastic about it, not always happy about it. Considering our unique positions as a creditor nation, and considering our gold position, which is without precedent in the history of finance, we have an obvious obligation and that obligation entails a pretty large and serious responsibility for the Federal reserve banks particularly. But I have never shared the feeling that we should be overzealous in extending our hand and in undertaking to suggest to any country or group of countries or any section of the world what they should do.

The CHAIRMAN. That statement leads me to call your attention to this recent conference in Paris, with which you are familiar, at which Mr. Goldenweiser, director of research of the Federal Reserve Board, is present, and Doctor Burgess, the assistant Federal reserve agent of the Federal Reserve Bank of New York, who are apparently in consultation with the representatives of the other banks of issue with which we are collaborating, and the reports of which conference indicate a closer working arrangement, apparently, with the approval or semiapproval of the Federal reserve system because of the fact that these two important men are present, indicating that closer working arrangements are being brought about. One of the press notices I had in mind indicated that Doctor Burgess was to be the liaison officer between the Federal Reserve Bank of New York, or the Federal reserve system, and these other banks of issue, and other men

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were being appointed by the various banks of issue to collaborate with us in working out a closer arrangement.

Is that done with the approval of the Federal Reserve Board?

Doctor MILLER. Well, the presence of Doctor Burgess and Doctor Goldenweiser is with the knowledge and approval of the board. By that I mean approval in a legal sense. Doctor Burgess, you know, is in the Federal reserve agents' department of the Federal Reserve Bank of New York, and Doctor Goldenweiser is the head of the Federal Reserve Board's own division of research and statistics.

My recollection is that the original invitation came both to the reserve bank and to the Federal Reserve Board to be represented in that conference, but of that detail I am uncertain. The Federal Reserve Bank of New York indicated its opinion that it might be well to be represented in that conference by Mr. Burgess, who is primarily concerned with the statistical work of the bank, and I think the thought here was that it would be well for the board to have one of its representatives there so as to give our representation a little broader base.

There was some discussion as to the propriety of it. I am obliged to say again that I was opposed to it. I want to say, however, that I think it is easy to exaggerate the importance of this conference. These men were summoned there for the purpose of comparing the statistical work and reporting services, what you might call the general information service, set up by these different banks. They have all been very much interested in the character of the work done in our Federal reserve system. That work goes far beyond anything that any European bank has ever contemplated hitherto. I think they feel in part that the rather happy results that they think we have achieved here in recent years may be largely traceable to the intelligent guidance as to credit policy that we derived from this statistical work, and it would appear that they are trying to take a leaf out of our book.

The CHAIRMAN. Further indication of this close-working cooperation was indicated in press notices when I was in London in December of the arrival in London of Walter Stewart, who was formerly the economist of the Federal Reserve Board and who is supposed to be there in some capacity, either representing the Federal reserve bank or collaborating with the Bank of England, and another indication that Blackett, who had been in India, was to come to New York as representing the Bank of England and collaborate with the operations of the Federal reserve there—all indicating an apparent plan of cooperation.

Doctor MILLER. A mental rapprochement, a sort of getting together of minds.

Mr. LETTS. What was the date of that conference?

Doctor MILLER. Which conference?

Mr. LETTS. That conference you just spoke of.

Doctor MILLER. I think it was in April of this year, was it not, Mr. Perry?

Mr. PERRY. April 7, I think.

Doctor MILLER. Just a month or so ago.

Let me say, because no one is more interested in promoting research and a scientific basis for credit policy in the Federal reserve system

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than I am, that you may be surprised when I say that I was not favorably inclined toward this participation.

My knowledge of Europe and Europeans goes back to my student days. There are apparently few Americans who make their first acquaintance with Europe in their maturity who are practically well equipped to deal with Europeans in any kind of conferences, and I am only too well aware that a conference may nominally be for one purpose and actually prepare the ground out of which quite a different crop will develop in the future.

I am inclined to think, to use Mark Twain's phrase, that we have had a good many American "Innocents Abroad" since the war; and when we go abroad I want to see the United States, particularly the Federal reserve system, represented by men who know their way around and who know what it is all about.

These are matters that touch the human equation, and out of them very frequently come results such as are not in contemplation at the time.

So that, generally speaking, I want to know not merely what a conference of this kind is called for but what is probably the main motive behind it.

The CHAIRMAN. Who called this particular conference, Doctor Miller?

Doctor MILLER. My recollection is that the invitation was sent out by the Bank of France, but I am not positive as to that.

Governor YOUNG. It was the League of Nations, Doctor.

Doctor MILLER. The League of Nations called it?

Governor YOUNG. Yes; sent the invitation.

Doctor MILLER. Did the League of Nations itself send the invitations? I had forgotten that. Well, the situation is a little more serious, then, than I thought. (Laughter.)

Yes, I do recall, and my recollection is that either something that I read or something that occurred to me in some way caused me to tie this conference in with the Genoa meeting of 1922 and the so-called Genoa resolutions.

It comes back to me still more now. I recall a visit from one of the directors of the Bank of England—I think it was Sir Otto Niemeyer. Do you recall when it was?

Governor YOUNG. It was this spring.

Doctor MILLER. I think it was in the late winter, probably.

Governor YOUNG. I would say January or February.

Doctor MILLER. January or February of this year.

I remember that I picked up from conversation with him, not from anything he specifically said, certain impressions that I formed of what might be in his mind, and especially as he had been a rather conspicuous and enthusiastic figure in the financial work of the League of Nations—to the effect that many were still in a frame of mind abroad where they wanted to get back to the Genoa resolutions. That led me to connect it up with this proposal for a statistical and economic conference this spring under the auspices of the Bank of France, and I drew the conclusion that we would better keep out of it. We had nothing particular to gain, and probably nothing particular to contribute of value to ourselves.

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The CHAIRMAN. I would like to insert in the record here a statement appearing in the Journal of Commerce during the last few days, which I have not a copy of but which I will give to the reporter, and which is a press notice, apparently, of the meeting which was held in Paris.

Doctor MILLER. When did you see this, this morning or yesterday?

The CHAIRMAN. Just a few days ago.

(The article referred to is as follows:)

PLAN FOR EXCHANGE OF CENTRAL BANKS' STATISTICS ADOPTED—PARIS CONFERENCE LEADS TO AGREEMENT FOR COOPERATION—LIAISON OFFICER FOR EACH BANK PROPOSED—ALSO DEVELOP PLANS FOR STANDARDIZATION OF DATA—MORE PUBLICITY LIKELY ABROAD

A plan for effective cooperation among central banks in exchanging information and developing adequate economic and financial statistics was effected at the conference held in Paris in the latter part of April by the economists of these institutions.

The heart of the plan adopted by the economists, who conferred together for nearly two weeks, was the appointment in each central bank of an officer who is to act as its liaison with other central banks. This man will be responsible for prearranging and dispatching to each central bank the banking and other financial statistics for his country which will be of aid to the other banks. Arrangements were made also for adopting uniform standards and forms in which the statistics are to be made available.

The second important feature of the plan involved the development of complete statistical departments in each central bank to be devoted to the gathering of the data for the use of the bank and the other banks. In this direction the American delegates are understood to have contributed a number of important ideas. The Federal Reserve Bank of New York was represented by Randolph W. Burgess, assistant Federal reserve agent, who is expected to be appointed liaison officer for the bank in exchanging statistics with other banks. The Federal Reserve Board was represented by E. A. Goldenweiser, director of the division of analysis and statistics.

The eventual material result of the work of the conference is expected to be a more adequate system of gathering statistics in each important European country for use in guiding their monetary and credit policies. In the second place, it is expected that an increasing amount of publicity for this data will be secured in the future, so that eventually each important central bank may publish in periodical form data similar to that appearing in our own Federal Reserve Bulletin. At present such data is generally considered crucially confidential by most European central-banking institutions.

Most of the sessions of the central-bank economists were closed, but it is known here that questions of policy were for the most part left alone, the discussion generally dealing with the gathering and presentation of data rather than its ultimate interpretation. However, opportunity was presented for private discussion among a number of the delegates of all questions of a financial nature bearing on the international situation, and the exchange of ideas which took place is expected to further a cooperative policy among the central banks.

Following the conference the American delegates visited the central banks of Germany and England, at which they were able to begin immediately a study of the needs of these banks for data from this country as well as to aid in making data that will hereafter be exchanged by these banks more uniform. Doctor Burgess is expected back here by the end of the present week.

Doctor MILLER. Let me add what I think is of some importance, perhaps, in connection with matters that will be covered in other cases, and it has a bearing upon the major idea of this stabilization bill.

If I were a proponent of this bill, if I were sold to it as a thing that was economically feasible and administratively practicable, I should be inclined to put it forward as a plan to establish Federal reserve credit administration upon a scientific basis. Administra-

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tively thereby, to my mind, hangs one of its greatest dangers, and it connects up immediately with the matter that the chairman's questions have brought to our attention.

The more scientific you undertake to make Federal reserve administration, whether in the case of the Federal reserve banks or in the case of the Federal Reserve Board, the more dependent you make the men who are officially charged with the administration upon their so-called expert advisers. The more you make them trust the findings, the views, the conclusions, and the judgment of others the less they will use their own native judgment, however strong it may be.

And I could well believe, though I do not know that there is at this moment the slightest basis, either in fact or in anyone's intention, that if the wise men of the European banks– and by "wise" I mean wise in the understanding of human nature—wanted by a subtle, not easily detectable method, as it were, to capture the mind of the Federal reserve system no matter method, perhaps no less objectionable method, and possibly in the long run no more effective method could be found than by laying a foundation for some sort of a rapprochement between the expert services of these various banks; in brief, set up a sort of college of augers.

The CHAIRMAN. In other words, you are likening that to the present conference in Paris?

Doctor MILLER. Yes. I am a great believer in experts when you know how to use them, but you want to know pretty well who your expert is and what your own capacity to maintain independence of judgment in the presence of your expert. And that becomes particularly true when other experts are involved. It makes a great deal of difference whose expert a particular expert is. And the expert, so called, in these matters is most apt to be a man of scholastic training and scholastic habit, and as a rule the better he is as a scientist the less aware he will be as a man of what is going on, what is happening. So that you run into certain dangers.

My belief is that in these matters the less you frame yourself in by constructing an elaborate paraphernalia of experts, the more likely you are to be successful in what you do.

Mr. STRONG. Doctor Miller, I am rather at sea in what you are getting at. Do you mean that the Federal Reserve Board does not need any expert advice, or, if they receive it, are not able to digest it independently and handle it properly; are liable to be misled?

Doctor MILLER. I heartily believe we should have experts, but I think you want to be very, very careful not to erect a Frankenstein.

Mr. STRONG. Is it not for the Federal Reserve Board to be very, very careful? Is not that the kind of men we have on the board, that will be very careful?

Doctor MILLER. I say that they should be, and therefore I am particularly concerned in connection with the chairman's inquiry that there be a constant awareness of the dangers, and you are very frequently caught before you know it unless you are very watchful.

Mr. STRONG. I would hate to have to write in this bill advice to the Federal Reserve Board how to use their experts.

Doctor MILLER. No; but the more emphasis you put upon those things, the more you push the board in directions, perhaps, in which the board will go slowly, while it is free to use its own judgment,

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instead of rapidly. For instance, to make the matter specific, right in this publicity section of the bill, do you know what interpretation I would put on it?

Mr. STRONG. No.

Doctor MILLER. I believe in publicity, but I think this particular section is a vicious one, because I do not think it correctly visions what would probably happen.

Let me read this section—

Whenever any decision as to policies is made or whenever any action is taken by the Federal reserve system tending to affect the aforesaid purposes of this amendment—

That is, affects the purpose as set forth in paragraph (h)—

such decision or action and reasons therefor—

Not the reasons therefor, but reasons therefor. What kind of reasons?—

shall be thereafter published by the governor of the Federal Reserve Board at such time, place, and in such detail.

Now, tie back the reasons—

as may be deemed by him to be most effective in furthering such purposes.

That is, reasons are to be given that will further the purposes of this act.

Propaganda—the invasion of the hired sophist into the Federal reserve system; that is what this means to me.

You will introduce into the Federal reserve system some men who will give reasons, which reasons may or may not be the true ones for the action taken. The test of their value is to be whether or not they tie in with stabilizing industry, commerce, employment, the dollar, etc.

Now, I do not mean for one moment, Mr. Congressman, to imply that that is what is in your mind. Somewhere I have heard or read that the word "the" was stricken out here; for what reason I do not know, but I should say right there that you have got an illustration, if this amendment were enacted into law, of what I conceive to be already a danger that hangs around the Federal reserve system.

I used advisedly the expression, "the invasion of the hired sophist." A man will be hired to state reasons. In this particular case he will be hired to state reasons that will play up the idea of credit as a factor in the stability of agriculture, commerce, employment, prices, and so on.

Mr. BEEDY. I would like to ask right here if the word "the" was in some draft and has been stricken out; and if so, by whom?

Mr. STRONG. The amendments that I proposed in making my introductory remarks when these hearings started were amendments suggested to me by members of the Federal Reserve Board and officials of the Federal reserve system at the time of my conference with them; I do not remember the date, but it was the date that I made my remarks upon the floor of the House. We had a two-hour conference in the morning and in the afternoon.

The CHAIRMAN. Do you mean this year?

Mr. STRONG. Yes; and as a result of that conference the amendments were suggested which I suggested to the committee when the hearings opened.

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Mr. BEEDY. My question was whether the word "the" was in there before "reasons," and has been stricken out, and, if so, by whom or by whose suggestion.

Mr. STEVENSON. The bill that was introduced should be read and he can refer to that and see if it was there.

Mr. STRONG. One suggestion was to strike out the word "all." These were suggestions made at the conference with the board and officers of the Federal reserve system, and, in paragraph (h), after the word "system," add "in addition to the purposes expressed in the title of the Federal reserve act of 1913," and strike out the word "all" in that line.

Beginning at line 7, add "promote the," and change the word "maintain" to "maintenance," and add the word "of," so that it will read "promote the maintenance of a stable gold standard."

In line 9, after the word "stable," add the word "average," and in line 8, after the word "of," add "average of."

Those amendments that I have just read were suggested at that conference, and I would like to say that paragraph (h) is not in the original language in which I prepared the bill. The purpose of paragraph (h) was to meet a great deal of criticism that I have found as to the need of publicity.

Doctor MILLER. You are thinking of (i) now?

Mr. STRONG. Oh, yes; the publicity section. I want to say that I have put the publicity section in the bill because I found quite a general demand in the correspondence which I had, and which embraced hundreds of letters, for a publicity section. Various financiers and men connected with banking said that they ought to know when the Federal reserve system intended to change its policies and why. I first wrote that into the bill. When I came into conference with the officers of the Federal reserve system, with Governor Young, himself, and other members of the board, they suggested that a publicity section should be in it but that it had to be written very carefully; that if the reason for a change in policy were given out at some crucial moment in the management of the Federal reserve system, more harm might be done than good and it should be written very carefully, so I tried to provide that the publicity should be given after the change of policy was taken and at such time and place as the governor of the Federal Reserve Board thought best.

Mr. BEEDY. And, instead of "the" reasons——

Mr. STRONG. I took out the word "the" and put in "reasons therefor." The reason I used the plural was because it was suggested that the members of the Federal Reserve Board might not agree and one might have one reason for changing a policy and another one another reason, and that therefore all the reasons might best be given by the governor when he goes at the publicity end of it. So this section was written to meet the views of those who consulted with me on the Federal Reserve Board, and I certainly did my best to get all the cooperation from the board I could.

Mr. BEEDY. What I want to say is not any reflection upon you, but I think this is the most astounding disclosure that has yet been made, that you have attempted to put in here a publicity section, the aim and purpose of which originally, of course, was to give to the public honest information on any changes of policy by the board, and that

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you have been advised by somebody in the board to so modify its original wording as now to give us a section which would hoodwink the public by furnishing it some kinds of reasons which would conform to the purpose of this bill to withhold from the public the reasons which prompted the change in policy.

Mr. STRONG. I think, Brother Beedy, that that is rather unfair, because I am certain that that was not the case.

Mr. BEEDY. I do not think that is unfair at all. I submit it to the committee that that is the fact which now is presented to this committee.

Mr. STRONG. Before you submit it to them, let us have the facts.

Mr. STEVENSON. Should not the word "all" take the place of "the"?

Mr. BEEDY. All the reasons.

Mr. STRONG. I am perfectly willing. I expected that the committee in executive session would adopt the amendments that they desired, but I think that I ought to give the facts, so that you will not suspect the motives. I am positive that the members of the Federal reserve system who suggested these changes were not inclined to hoodwink the public. They simply said that if at some period in the management of the Federal reserve system they decided that it was necessary to change the policy, and printed the reasons at that time, it might do more harm than good. Then they said that the reasons should be given thereafter; and I said this: That if, after they changed their policy, they then gave the reasons why they did it, when next they changed the policy the public would feel that they probably had some good reason and that the public would be advised at the proper time and the board would have in a greater degree the confidence of the public. Then the suggestion was made with respect to the word "the." I had it "the reason," and they said, "Well, then, the members of the Federal reserve system might not agree; they might have different reasons. Would it not be best to make all the reasons public?"

So I took out the word "the" and made the word "reason" plural, so that it would read "and reasons therefor," not meaning to camouflage the public, but to give them the reasons that prompted the Federal Reserve Board to change the policy.

Mr. BEEDY. "All the reasons" would make it perfectly clear.

Mr. STRONG. I think that would be a very proper amendment, and if no proper reason is shown why it should not be, it ought to be accepted.

Mr. LETTS. Whether or not you make that change depends on what you are trying to do.

Mr. STRONG. I am trying to advise the public.

Mr. LETTS. What you are trying to do is in the language itself. It is very clearly stated that it shall be discretionary, deemed by him to be most effective in furthering such purposes.

Mr. BEEDY. The whole wording leaves——

Mr. LETTS (interposing). It sounds like propaganda.

Mr. BEEDY. The whole wording of this section leaves it to the party intrusted with carrying it out to frame it up just as he thinks it ought to be framed.

Mr. STRONG. That was not the intention.

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Mr. STEAGALL. I do not think Brother Strong added much to it when he changed that language.

Mr. STRONG. My purpose was to advise the public, in due and proper time, so as not to hurt the policy that they were trying to promote for reasons that caused the Federal Reserve Board to change the policy. I think the public has a right to know that. If you gentlemen have any language that will better express the idea, let us have it, but this language has been suggested to me by men whom I believe want to operate the Federal reserve system in the best interests of the country.

Mr. LETTS. This language certainly leaves it in the discretion of the Governor of the Federal Reserve Board to determine what, in his mind, will be the most effective way of giving this information to the public.

Mr. STEVENSON. To further the purposes of the act.

Mr. BLACK. It seems that it is sufficient for the Federal Reserve Board to give out a statement of what it has done. You take a Member of Congress, for example. We are called upon to vote upon extremely important legislation from time to time, and suppose you would compel us to state in the Congressional Record the reasons why we cast our vote as we did. The responsibility is ours; we have to stand by it.

Mr. STRONG. We do put in the Record the reasons why we pass the legislation.

Mr. BLACK. We are not compelled to state them at length in the Record; we may or we may not.

Mr. STRONG. Every committee that makes a report to Congress on a bill files a report saying why the legislation is necessary.

Mr. STEAGALL. You do not require them to give the reasons; you tell the board to give reasons at such time and place and in such detail as the governor may deem most effective in furthering such purposes. When you get through with all that range of construction, there are not enough lawyers in Washington to tell what he is required to do, whether you add the "the" in there or "all," or leave it just as it is.

Mr. STRONG. I think I have stated to this committee repeatedly that in drawing this bill I tried to meet the objections of the Federal Reserve Board and of the officers of the Federal reserve system. I anticipate that when we get into executive session we will probably change it after we have had these hearings in such a way as to do the things that we determine is necessary to be done after a study of the question.

The CHAIRMAN. You have evidence before the committee to the effect that the board is opposed to this amendment.

Mr. STRONG. Certainly.

The CHAIRMAN. You are not adopting their suggestion here?

Mr. STRONG. After I met all their objections, I find that they come in here and are opposed to it. That is one of the wonders——

Mr. STEAGALL. I do not find any fault with you; and I think myself that Brother Beedy is a little bit hard on you to say that that would hoodwink anybody, because this thing did not mean anything before that.

Mr. BEEDY. I suggest that we go on with the hearings. I was only going to say, for one, that when we go into executive session I will never vote to report this section out.

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Mr. STRONG. I think I will join you.

Mr. BEEDY. My friend Strong has put something in here that will ruin the bill. Of course, the word "all" is absolutely necessary. If you say "the reasons," that will mean all the reasons.

Mr. LETTS. If we have the information, it ought to be given at once and not at such time and place and in such detail as the governor of the Federal Reserve Board may think proper.

Mr. STRONG. We will try to fix that up after we have had these hearings.

The CHAIRMAN. Doctor Miller, if you can get your thoughts together, we will be glad to hear you some more.

Doctor MILLER. I think that the problem raised by this paragraph (i), as to what can be done through legislation to promote a more definitely official and organized publicity in connection with the important decisions of the Federal reserve system is one that is most worth the attention of the committee in connection with this bill.

Mr. STRONG. Could I suggest, Doctor, along that line, that you suggest to us what language——

Doctor MILLER (interposing). I will do that presently, but I want to state the problem before I undertake to offer a solution, because it is by no means a simple problem. The pros and cons are pretty closely balanced.

When I was before this committee two years ago my recollection is that the chairman of the committee asked me some questions along this line. I believe at that time I stated that it would be in my judgment inadvisable to require a published official statement in connection with the important actions or decisions taken by the Federal Reserve Board. That was my judgment——

Mr. STRONG. I think we ought to have the attention of the members of the committee. It is pretty hard for a witness to testify under these circumstances.

Mr. STEAGALL. We were discussing publicity on the side.

Mr. STRONG. The doctor is trying to get your attention.

Mr. STEAGALL. He has already had mine.

Doctor MILLER. That was my judgment at the time. It did not represent a deliberate opinion upon a question that I had had an opportunity to turn over in my mind, and, as I recall, the chief reason I gave at that time was this, and it still constitutes one of the main difficulties, to my mind, in any publicity requirement in the Federal reserve system.

It is the simple fact that, I think, we have all experienced, that a man may have very excellent judgment and yet have no skill or capacity in the statement of reasons for his conclusion or judgment. I am not a lawyer, but I did study jurisprudence at one time, and there are lawyers here who will possibly recall that it has been said of some of the greatest of the chief justices of England that they were great justices but very poor in giving the reasons or grounds for their decisions.

Now, if that be true in the case of the law, where the jurist is a man who is highly trained for the exercise of his professional duties, it is likely to be very much truer in the case of a board the membership of which is chosen haphazardly, from here and there, and from no profession which presumably has given him skill in

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understanding his own thought processes or skill in stating the true reasons, the actual reasons, that have led him to a conclusion.

The CHAIRMAN. Is not this a fact, also, if you will pardon an interruption there, that when statements like that are issued, editorial writers, financial writers, will draw different conclusions from the same statement?

Doctor MILLER. They may.

The CHAIRMAN. And, by interpreting those statements, they try to support their own views.

Doctor MILLER. That is true.

Mr. STEAGALL. It is also true that in the expression of reasons you would fall somewhat in the hands of your experts again.

Doctor MILLER. May I go on and finish this statement? I am analyzing this thing and trying to show what there is in it in the way of good and why I have, on the whole, reached the conclusion that we would better write into the Federal reserve act a publicity clause.

Now, I would say as a general proposition—and I am a man of years; I have had a great variety of human contacts, quite a variety of experience—that the rarest and the most difficult thing in the world to get is reasoned action. More frequently what is called "reasoned action" is action with the invention of reasons afterwards for public consumption, and it is precisely that sort of thing I have in mind when I say I am anxious to protect the Federal reserve from the invasion of the hired sophist, the man who is hired to dress up the action of the Federal Reserve Board or system for public consumption.

That constitutes a very real danger. Your sophist may be the man who, by reason of the fact that reasons have got to be given, will eventually capture the mind of the Federal Reserve Board, not with any intention on his part or because of any weakness on their part, but because the necessities of the situation are such that something has got to be said.

I repeat that it does not follow that a man's judgment is poor because he can not give reasons.

On the other hand——

Mr. STRONG. Doctor——

Doctor MILLER. Do not stop me from agreeing with you. I am just about to slide across the line into your territory.

Mr. STRONG. All right; come on over.

Doctor MILLER. On the other hand, I think what Mr. Strong has said, to the effect that there is a constant and a rather growing and insistent demand for information on the part of the public, on the part of the business public, and on the part of the banking public, that in some instances there is a feeling that the action of the Federal reserve system in important matter of credit policy has an arbitrary character about it, because the rationale of its action is not clear. That I think could be said, and has been said, more particularly with respect to open-market operations, which are of a somewhat different character in their manifestation, from a change in the discount rate. That is an overt act. When we raise or lower the rate we do it openly. Everybody can see it, even though we do not tell the reasons for it. But the open-market operation by comparison is subtle, it is invisible, and it may not be detected by many that anything

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is going on until it has been going on for some time. It therefore savors of a covert operation concerning which there is some feeling of dissatisfaction, particularly the feeling that it is arbitrary in character.

Now, I am inclined to think a public administrative body like the Federal Reserve Board set up in connection with the operation of these banks, more particularly, as I conceive it, for the purpose of giving to the general public assurance that the action of these banks is public in character (by the requirement that important actions shall be submitted to the Federal Reserve Board and have the approval of that board before they become effective), must take the public into its confidence with regard to the basis of its policies.

My belief, however slowly I have come to this conclusion, is that the action of a body like the Federal Reserve Board, in order to be good action, has got to be action which is accompanied by good and sufficient reasons. In brief, I am rather inclined, as I look back over the experience of the last four or five years, to believe that if the Federal Reserve Board had been under the legal obligation to give a statement of the reasons for its action in important matters of credit policy, we probably would have had better action, because the board, I think, in that case would have been more deliberate and might not in all cases have taken the action it did, because it would perhaps have reached the conclusion that it could not, after all, give good and sufficient reasons for such action.

Mr. STRONG. Well——

Doctor MILLER. Let me go on.

Mr. STRONG. All right; go on.

Doctor MILLER. I also want to say this, that even though this paragraph were rewritten (and I will suggest a revision of it presently), I anticipate that we might have considerable difficulty for a period of perhaps 1, 2, or 3 years. I do not for one moment deceive myself as to the difficulty the board would find in pooling its reasons, as it were, and drawing a conclusion by majority vote as to the reasons which tied in with action taken. But I am convinced, after mature reflection on the matter, that in the long run the balance of benefits will far outweigh the difficulties and the objections to where a board has got to give reasons for its actions; its action in order to be good public action, has got to be action based on reasons that in the long run and on the whole the public will approve as good reasons. The educative effect on the board itself is not the least of the important effects that would result from it. I believe also, especially if the same requirement were made of the banks, that such a requirement would be bound in time to raise the standard of qualification for service in the Federal reserve system.

In brief, we have got to have in the banks and in the board—let us say in the Federal reserve system at large—men of the mental stature requisite to state the reasons for their actions. In stating the reasons they will gradually develop not only in the Federal reserve system but outside, what might be called the rationale of Federal reserve policy. It will, therefore, give one of the best guarantees that the development of the banks and Federal reserve policy will be orderly and progressive, that the system will devise, as it has already in part,

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a method of procedure that in the course of a few years will become more definitely recognized as such; that will, Mr. Strong, I venture to say, go so far beyond what you have in contemplation here in paragraph (h) that you yourself will accept it as, on the whole, a good solution of those problems in Federal reserve administration that you have so much at heart.

Mr. STEAGALL. If this law should pass and the Federal Reserve Board should find itself in difficulty in assigning reasons for any action taken, I want to suggest that they might apply to the gentlemen before the committee, with a reasonable hope of success.

Mr. STRONG. May I ask you one or two questions? Just to return to plain, ordinary English language, do you think that the public is entitled to know why the Federal Reserve Board changed its policy with reference to the discount rate or open-market operations?

Doctor MILLER. I do certainly as to the former. As to the latter, I might want to make a reservation.

Mr. STRONG. I do not just get you. Do you or do you not think that the members of the Federal Reserve Board have the intelligence to give the reasons that prompted them in their action?

Doctor MILLER. I have tried to state what I conceive to be the difficulties.

Mr. STRONG. I see.

Doctor MILLER. What I think would eventually come about.

Mr. STRONG. I have proceeded upon the idea that we had members on the Federal Reserve Board that possessed that intelligence.

Doctor MILLER. It is not a question of whether they have or have not. You are asking for one of the most difficult things you can ask of any administrative body.

Mr. BEEDY. I do not think anything the doctor said reflects upon the intelligence of the present board.

Mr. STRONG. I wanted to get his opinion.

Doctor MILLER. I am giving you my opinion and my idea as to what ought to be done to bring this paragraph into satisfactory shape. I am trying to tell you that I am for publicity, but I want it to be real publicity. I do not want anything factious and sophistical about it, and so I would revise it somewhat as follows:

When any position is taken by the Federal Reserve Board—

There is no such entity as the Federal reserve system; that is merely a convenient administrative phrase. Change it to read:

Whenever any position is taken by the Federal Reserve Board as to changes in discount rates—

I want to reserve for further reflection whether or not I would include here open-market operations, and therefore you will kindly regard this as a tentative proposal—do I make myself clear?

Mr. BEEDY. Yes; but surely, from what you have just said, one would draw the conclusion that the prompt necessity was for publicity as to reasons in the open-market policy.

Doctor MILLER. I will come to that, and then recall an answer I made to a question the other day. I think where you are dealing with a piece of machinery which is a part of a whole, you can hardly deal with one part without knowledge of what you are going to do with

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the rest, so I will hang open-market operations up for the time being. But certainly as to discount rates—

Such decision and action, together with the reasons therefor, shall be published by the governor of the Federal Reserve Board.

What does that mean?

Mr. STRONG. Would you mean immediately?

Doctor MILLER. When the action is published, the reasons should be given immediately. Unless that view is entertained, I should say have no publicity. Do not have canned publicity, do not have manufactured publicity. The only thing to my mind that is vital, if you are going to have publicity, is that at the time action is taken the reasons should be stated.

In practice, how might this work out, particularly if the law carried with it an amendment of similar import requiring the board of directors of the Federal reserve banks, when they take action on the discount rate, also to state their reasons; or, even if in the absence of such a specific amendment, the board whenever it had before it questions of discount rate would administratively call upon the Federal reserve banks, when they established discount rates, also to give a statement of their reasons.

Informally the governor of the board has already done that. I do not think I am stating anything that is improper. He has asked, I think very properly and very profitably, of the chairman of the Federal reserve bank of this place or that place, where they have taken action to change their rate, for a statement of reasons, and he has developed some very interesting statements.

Now, I can conceive that the board might very well approve of an increase in the rate in this bank or decrease in that bank, and adopt as its reasons the reasons stated by that bank when it transmitted its action. If it did not adopt those reasons, then the board would have, as it were, to find its own separate reasons and state them, provided it took action.

That is the way that I conceive the thing might operate. As a matter of opinion, I think that if last summer, when the Federal reserve banks began reducing their rates to 3½ per cent, a statement of reasons from the point of view of the board and the banks that took that action, good reasons, had been given—and the banks had acted on what they believed to be good, sufficient, convincing reasons—the whole situation now might be very much better than it is. I think the public would have been in a better position to cooperate with the Federal reserve system and the other banks.

The reasons in this instance, as frequently happens in such matters, began to filter out very slowly to this group and that group, and it is not until very recently that they had percolated through to general knowledge. In fact, I have been asked within the last few weeks by men who I supposed were in a position to pick up these things promptly what was the real reason that led the Federal reserve system to reduce discount rates last summer.

It is only less than a month ago that a very large money dealer in the New York market asked me if it was really true that it was reduced in the interest of the international situation. I told him it was. He said, "I think if the market had generally known that it would not have been quite so quick in going in to pick up the cheap and easy money that was created as a part of that policy."

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So I am inclined to think that if a body like the Federal Reserve Board acts on good reasons, which are stated it is likely to elicit the cooperation of the community or of sections of it in the accomplishment of its purposes; or, at any rate, if there is any interference with the successful development and accomplishment of its purposes it is in better position at least, I think, if it suspend the policy or is forced to change its policy.

I think that one of the difficulties the Federal reserve system is in at the present time—and there are evidences of restiveness right up here in the Capitol and in the press—is that a confusion of mind exists with reference to what is going on in the Federal reserve system, and has been during the last 8 or 10 months. Anyone who is a student of these matters, or who is enough interested in them to take the time to look up the public records of the Federal Reserve Board, can find the facts. Pretty much if not most of them, in one way or another or at one time or another, have or will come out, partly in the Federal Reserve Bulletin, which is the monthly organ of the Federal Reserve Board, partly in the board's annual report and partly in the occasional weekly statements or special statements that may for one reason or another be issued.

But I am of the opinion that that is not sufficient, from the very fact that there is so much guessing, so much questioning as to what all these recent changes have been about.

I had a visit yesterday afternoon from a New York banker who said, "Why is there so much mystery about gold movements?"

I said, "What mystery do you refer to?"

"Well," he said, "we get figures of shipments, but there seems to be a great mystery regarding the earmarking of gold. Why not publish the earmarked gold just as you do the gold that actually leaves the country?"

Here is a man of great intelligence, occupying one of the foremost positions in the banking community of New York City, and he wants publicity with respect to that subject.

I told him I thought that if he followed the published documents of the Federal Reserve Bank of New York and of the Federal Reserve Board—to wit, its bulletin—he would find this out.

"Well," he said, "I find it out after the event. Why can not a statement be made at the time it takes place?"

He said, "I happen to know of two considerable earmarkings made in New York in the last week." One of the particular items he referred to happened to be new to me. It was a bit of last-minute information.

His opinion was that that ought to be known, and if it were known he thought we would get better cooperation, more intelligent cooperation, at any rate.

I am inclined to think that, with all the difficulties that the administration of a well-drawn publicity section would undoubtedly bring with it, on balance the benefits would considerably outweigh the disadvantages.

The CHAIRMAN. As a matter of fact, prognosticators and economists who study the trends of the times are embarrassed now because of lack of information as to the elements entering into the situation to change the normal flow of events.

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Doctor MILLER. Yes; and I would not be too much influenced by them. The prognosticators, or certain classes of them, are of the opinion that the Federal reserve, so to speak, makes the financial and economic weather. They are illusionists.

(At this point, following an informal discussion as to what further hearings will be had on the bill under consideration, the committee adjourned, to meet Thursday, May 10, 1928, at 10.30 o'clock a. m., to consider another matter.)

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Tuesday, May 15, 1928.

The committee resumed hearings on H. R. 11806 at 10.30 o'clock a. m., Hon. Louis T. McFadden (chairman) presiding.

The CHAIRMAN. The committee will come to order.

This is a continuance of the hearings on the Strong stabilization bill. Dr. Adolph C. Miller, a member of the Federal Reserve Board, is here.

Doctor, have you any further statement that you want to make this morning?

STATEMENT OF DR. ADOLPH C. MILLER, MEMBER FEDERAL RESERVE BOARD

Doctor MILLER. Mr. Strong and I have been having a sort of an informal conference this morning, and some allusion having been made to the paragraph of his bill which provides for investigations, perhaps I should say something about that.

With reference to the so-called section 28A of H. R. 11806, which provides for studies and investigations of various subjects related to the operation of the Federal reserve system, I will say in a general way that, of course, I am thoroughly sympathetic with work of that character. A great deal is now being done by the Federal reserve in the field of the economics of credit, banking, exchange, prices, production, trade, and related matters.

The criticism I would make of this paragraph as a whole is that it ties in the investigation authorized a little too closely with the specific "stabilization" purposes of the bill. With that in mind, I would suggest that the section be redrafted as follows:

"The Federal Reserve Board is hereby directed"—

I think you should keep the responsibility definitely in the hands of the board and not place it with the banks. There will be plenty of work done by the banks even if the instruction goes to the board.

I would suggest the omission of the word "authorized," because the board is already within its authority in undertaking work of this character and its use may raise some question as to whether the board is on solid ground in making studies not specifically authorized by congressional statute.

Mr. STRONG. It is a matter of the use of funds.

Doctor MILLER. Yes.

Mr. STRONG. That is the reason the word "authorized" was used.

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Doctor MILLER. We are now doing a great deal under the authority we have assumed we have under the terms of the Federal reserve act as it is.

The CHAIRMAN. Is there any duplication of work that the board is doing, that is being done by the several banks?

Doctor MILLER. I think it would be better to question the Director of Research on that matter. I would say some duplication, yes; but not of a wasteful kind. Sometimes questions of this kind can be profitably approached by two different groups of people, even though nominally the problem is the same. Their approach may be different and results also be different.

I would suggest that the section be amended to read as follows:

The Federal Reserve Board is directed to make and to continue investigations and studies of the following subjects.

I would cut out:

For the guidance of the system's policies, at least to the extent and in the manner prescribed in paragraphs 1, 2, 3, 4, and 5 of this section, and to such further extent as they may deem to be desirable.

I would then leave paragraph 1 of this section stand as it is.

I think I would be content with paragraph 2.

Paragraphs 3, 4, and 5, in my judgment, would better be omitted.

Mr. STRONG. Why?

Doctor MILLER. I do not think that they are particularly germane to the operation of the Federal reserve system, and I do not think that the subjects on the whole are such as can be very well handled by the kind of investigating organization the Federal reserve has or should set up. They are a little bit vague and far-reaching.

Mr. STRONG. Do you not think some investigation and study might very profitably be made of index numbers?

Doctor MILLER. That will be done and is being done anyhow.

Mr. STRONG. But we are drawing a bill here directing the study——

Doctor MILLER (interposing). You want to draw your bill to accomplish something not now being accomplished, or to get a better accomplishment.

Mr. STRONG. But you do not always know just what you are working toward, you know. That is the reason I put it in the bill. It was suggested to me that no index number was perfect, of course, and at times a lot of information is necessary, and I yielded to the suggestion of including in this investigation a study of index numbers.

Doctor MILLER. Yes. As I have said, studies of this kind are constantly being made.

You have in your paragraph 5 one or two additional clauses which give, as it were, a purpose or slant to these price investigations. Let me read the paragraph.

Studies—

Of existing or proposed index numbers of prices or other measures of the purchasing power of money, which are used or might be used, singly or in combination, by the Federal reserve system as a guide in executing its policies.

Mr. STRONG. Having laid down that this policy shall be toward the stabilization of the purchasing power of the dollar, then what can be attained in price-index numbers that would be helpful?

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Doctor MILLER. I am proposing this because, as you know, perhaps better than anybody around the table here (and as has been brought out in previous hearings), that my whole attitude toward the bill is that it would be regrettable if paragraph (h) were enacted. That paragraph contemplates a legislative formulation of the objectives toward which Federal reserve policy should work. I am now trying to see what parts I would retain of your bill if those parts of it that I have objected to were omitted.

Mr. STRONG. Let me ask you a very frank question. Congress having given these tremendous powers to the Federal Reserve Board undirected, do you not think that the Congress, on behalf of the people, ought to lay down a policy toward which these powers shall be used?

Doctor MILLER. Well, now, I am going to answer just as candidly as I can.

I would say, first, that the powers of the Federal reserve system at the present time, as defined in the Federal reserve act, are not without legislative indication of the line or direction in which they are to be exercised. I regard the statement which occurs in section 14 of the Federal reserve act in connection with the board's power to determine discount rates, to the effect that such "rates shall be fixed with a view of accommodating commerce and business," as giving about as good an indication of the whole complex of considerations and factors to be reckoned with by the Federal reserve system in charting its credit policy as you can get. The word "accommodation" is one that can be weighted with as big a meaning as the men who are chosen to administer the act are capable of conceiving.

Mr. STRONG. We might have a Federal Reserve Board that, when you had a period of inflation, the bankers would come to and say, "The law says that you shall accommodate business and commerce. We want more money, even though we are using it to inflate, and we have got the eligible paper. Now, comply with the law and accommodate us."

You might have a board which would say, "That is the law; go ahead with the inflation."

Doctor MILLER. You might equally have a board or banks that, when the first insidious indications of inflationary developments were in progress, would say that the maintenance of unduly low discount rates in situations of that kind is not the "accommodation" of business within the meaning of the act, no matter what some bankers or business men might say or wish to the contrary, and that, therefore, under the charter of the authority given it by the Federal reserve act would go ahead and put some restraint upon the flow of credit from the Federal reserve banks so as to insure that this credit actually accommodated business instead of merely accommodating somebody's wishes.

Mr. STRONG. If you direct your judgment in the right direction, well and good.

Doctor MILLER. I would say that some of the things you have in mind actually are in the minds of the Federal reserve system as an appropriate part of the content of the word used in the existing statute, to wit, "accommodation." I would say that you do not accommodate commerce and business when you see banking develop-

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ments in process that are going to create economic instability, if Federal reserve action can prevent their development.

Mr. STRONG. But I do not want to accommodate them if that is leading up toward inflation that will bring trouble later on.

Doctor MILLER. Yes; and by the same token, I think I myself would be inclined to say that if the Federal reserve system, by an error of judgment, by inadvertence or even negligence, if you please, did not quickly enough detect what was in process in credit and business development to chart its course correctly and in consequence a situation of the kind that we roughly call inflation developed, I would say it would then not be true accommodation if, when it woke up to the realities of the situation later, it suddenly tried to undo its error by pursuing a policy of violent restriction of credit. Accommodation, to my mind, means that credit policy must at all times and in all circumstances be adjusted to facts and conditions as they happen to be.

Mr. STRONG. That is what I want; that is this bill.

Doctor MILLER. Well, it is in the act now, I should say. It is, however, a matter that I recognize may be debatable. I referred to it only because I wanted to make clear why I was proposing certain omissions in your section 28 here with regard to investigations.

To my mind there is a great deal that can be done in the way of investigation that will in time enable us to know more than anybody knows at the present time as to just what is practicable and not practicable in the fields of, broadly speaking, central and reserve bank policy, in relation to prices, industry, employment, and so forth. We need to know a great deal more in my judgment than we do now before we can improve upon the present guiding principle contained in the Federal reserve act.

I would like to see retained in an amendment so much of a "direction" to make investigations as would justify the Federal reserve in expending the money necessary to provide an ample foundation.

Mr. STRONG. Just one suggestion in defense of paragraph (5) on page 4, and then I will not bother you with further questions or interruptions. If the policy of the stabilization of the purchasing power of money is to be the goal toward which the Federal reserve system is to be directed in the use of its powers, then the system of the measurement of the purchasing power of money is one of the questions to be studied.

Doctor MILLER. Certainly.

Mr. STRONG. And the measurement of the purchasing power of money is that which the money will buy in commodities in general, meaning index numbers, and it has been pointed out to me that there is no perfect index number and they do not know at all times what is best to use. Therefore, I put in the bill a direction for the study of existing and proposed index numbers; that is all.

Doctor MILLER. I would see no objection whatever to taking out the part of paragraph (5) reading—

> proposed index numbers of prices or other measures of the purchasing power of money—

and putting it in as an additional item in paragraph (1). To my mind, it is already covered in item (c) of paragraph (1), which

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speaks of the general level of commodity prices. You can not have a study of the general level of commodity prices without going into the whole matter of index-number devices. That is the problem—how to get at the general level of prices, what is the most competent form of index.

However, I merely mention this, Mr. Congressman, to indicate that I am thoroughly sympathetic with the enlargement of the investigative work of the Federal Reserve Board, and would only add the suggestion that in anything that might be adopted by the committee those phrases and clauses that seem to tie up the investigation with the particular purpose of your proposed amendment be omitted so that it may commend itself to those who are not yet sold to the idea of using credit and monetary policy for the purposes of stabilizing, etc. I would like to see more research work done, even if your general amendment is not adopted. I think the matter might best be covered not by an amendment to the Federal reserve act but by a joint resolution of Congress specifically directing the Federal Reserve Board with regard to such work.

Mr. LUCE. All of them, Doctor?

Doctor MILLER. No. I would say paragraphs (1) and (2), with the inclusion in paragraph (1) of the item mentioned in paragraph (5), and with the inclusion of a further item, say, (f), in paragraph (1), reading as follows—

and of existing or proposed index numbers of prices or other measures of the purchasing power of money.

That is now a part of paragraph (5).

Mr. LUCE. I would like to discuss this with you a little, if I may.

These three paragraphs interest me more than anything else in the bill. I have, for a score of years, been convinced that the subject matter of those three paragraphs is the most important consideration to which the Congress may address itself. I think it has more to do with the happiness and prosperity of mankind than any other subject before Congress. It faces us practically at every turn.

Just a trivial illustration. I came down this morning in the street car. In a seat adjoining was a good samaritan who was telling a stranger in town about all the wonderful things along Pennsylvania Avenue, and we came to the Southern Railway Building, and he said, if I remember his figures correctly, that before the war this could have been bought for $1,200,000 and is now going to cost over $2,000,000.

He ignored the fact entirely of the change in the purchasing power of money, that that of itself would have changed that $1,200,000 to $1,800,000. That is only a side light.

A more practical thing, the Welch bill, which occupies the columns of the Washington papers at the moment, has that factor in it, that changes the salaries to correspond with the changes in the value of the purchasing power of money, and that is the most important factor in it, and yet it is being wholly ignored in the considerations before Congress and in the newspapers.

Our calendars are full of salary bills in which this is an important factor. Furthermore, the economic literature of the day attaches, if my judgment is correct, more importance to the problem here involved than to any other now confronting the world.

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Within 48 hours I have read what Doctor Cassel, I think it was, has said about his expectations as to the failure of gold to meet the needs of the world inside of 20 years, the diminishing supply of gold and the necessity of making new arrangements to meet the situation that will confront us if nothing is done in the way of preparing for a managed currency.

Now, when the economists seems to think that this is the most important problem now facing mankind, and when in our daily work it is a constant factor, are we not justified, some of us, in the hope that some agency of the Government may be directed to compile the statistical data necessary for wise legislation?

You may, in reply, if I may anticipate what you would say—you may think that the Federal Reserve Board is not the agency to do it, but where would we turn for this except to the chief financial agency of the Government?

The Bureau of Labor Statistics has been doing this thing after a fashion for many years, but its figures are not those of recognized—I will not say experts, because I do not want to cast any slur upon the bureau, but I think we all take the figures we find in the reports of the labor statistics with a grain of salt, with some uncertainty as to whether they are thorough and adequate. I know that their figures about unemployment, printed from month to month, are greatly at variance with those printed in the current papers, the reports of the American Federation of Labor, etc., and I have my doubts whether the Bureau of Labor Statistics is the best qualified agency to compile this all-important information.

I can not follow you, Doctor, in the suggestion that there is anything dangerous in acquiring knowledge.

Doctor MILLER. There is no objection from my point of view to acquiring knowledge. On the contrary, I think the more knowledge we have, if it is actual knowledge and is pertinent to the problems the Federal Reserve Board has to deal with, the better off we shall be.

My objection to certain of these paragraphs, e. g., to this paragraph 3, is that you are dealing with matters that are physical in substance; any conclusive as to their future must be largely speculative or, if you please, even metaphysical.

For instance, here is one of the things that the Federal Reserve Board would be directed to undertake—

> The study of the effect upon the purchasing power of the dollar or changes in the supply of and demand for gold, either actual or prospective.

I have the greatest respect for the eminent economist whose name you just mentioned, Prof. Gustav Cassel. He may be right in his forecast of a scarcity of gold in the future, say 10 years from now, in connection with the growing demand for gold, both for monetary and nonmonetary use. He warns against threatened deflation under the gold standard.

There is no method by which the Federal Reserve Board, no matter how competent the men grouped together into an organization for the study of the future effects of the gold standard could resolve that doubt.

An eminent South African professor, Robert Lehfeldt, who died six or eight months ago and who lived close to the mines, a very eminent scholar, takes direct issue with Professor Cassel's forecast

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and in a very elaborate study of the subject, buttressed at every point by an array of facts, has reached the conclusion that the thing that we need to protect ourselves against by central banking policy in the future is gold inflation. The thing that he fears is that under a gold standard, not tempered, we will say, by discretionary management, we are more likely to have an inflation than a deflation.

These are things which relate to the future. No body of men can be clairvoyant enough, even though it has an official mandate to go ahead and equip itsef for the undertaking, to say what is going to happen.

Now, let me follow it up, if I may, Mr. Congressman.

When one's mind gets to working with intangibles it may reach a point where it feels that it can perhaps resolve the uncertainties. One may say that the mass of evidence points to the almost certain scarcity of gold in the future. That point reached, it is very difficult to dissociate the policy compartment of one's mind, so to speak, from what may in fact be little more than a guess.

Competent administrative judgment has got to be based upon an appraisement of facts that are determinable and an approximation of facts more or less conjectural. If, for instance, I believed at this moment, if I had an active conviction, that the menace that was hanging over the world was a scarcity of gold, unquestionably that conviction would influence my mind in the decisions I have to reach in connection with Federal reserve policy. Similarly if I believed the contrary. Frequently though a "fact" that is not capable of establishment by scientific process may give a sense of direction to the mind which is more or less uncontrollable.

My thought about these matters relating to the future of gold, etc., is that we shall find out about them in the usual course, and we shall probably find out soon enough. I am talking now when I say "we" of the Federal reserve system and of the country and Congress, so far as they are particularly interested in the way in which new problems as they arise are handled by the Federal reserve.

If there should be good reason for expecting a scarcity of gold in the future, and therefore a slow, gradual, but nevertheless real and injurious restriction of credit threatened in consequence, we shall not only sense its approach but sense it, in my judgment, in time to take such necessary moderating action as is practicable by Federal reserve policy.

When I appeared before this committee, I think two years ago this very time, shortly after the gold standard had been set in operation in Germany and in Great Britain, I felt a little apprehension myself as to the possible effects the rapid restoration of the gold standard in one country after another might have upon the adequacy of the supply of gold in the future. But more particularly what I was fearful of was that there might be an imaginary scarcity when there was actually no real scarcity. My reason for that fear was that suspicions of that kind had developed in the past, notably in the decade from 1870 to 1880, when, somewhat as now, after a period of currency disorganization in a great many countries, they were moving rapidly toward either the adoption or the restoration of the gold standard. There then developed for a period of years a real anxiety, something that was called a "scare," as to whether there was going to be enough gold to go around.

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Mr. LUCE. But, Doctor, we would be derelict in our duty, it seems to me, to pursue your policy of waiting. We owe in this country nearly $20,000,000,000 of public debt. We are confronted at the door with the issue of whether we shall retire the payment of that debt. It is a vital political issue with us now, and involved in that issue is the question whether it is better for us to hasten the payment of the debt while the dollar is at its present level or retire the payment of the debt when we may have to pay it, as we did after the Civil War, in two or three times the amount of the purchasing power of our dollar to-day.

Now, that is only one of the various problems that the mind can hardly grasp in the size of the figures that are involved in this problem here before us now of whether we are going to attempt to keep the level of the purchasing power where it is.

Now, you suggest that there be a further accumulation of experience. It happens that last night I was reading Doctor Burgess's book on the Federal reserve system. I had about one-third finished it, but I had read enough to see that that book is just crammed with the proofs that this system is now trying to read the future from the past. Diagram after diagram—and here is one right before us—is of no earthly value unless it is a basis for attempting to judge what ought to be done in order that we may act intelligently, prudently, and wisely.

Now, for the life of me I can not understand why you demur at getting more information to carry out the purpose which is now one of the chief purposes of your work.

Doctor MILLER. I do not demur at getting more information. I want just as much information as can be obtained, but there are certain of these subjects upon which the information is not obtainable by investigation. Fortuitous circumstance may be the decisive factor.

When one speaks about the actual present supply of gold, of course that is a definite, ascertainable, statistical fact. That is just production statistics published in the Federal Reserve Bulletin. That is determinable, historic, fact. But when it comes to the prospective supply, either for next year or 10 years hence, who knows?

The CHAIRMAN. Doctor Burgess has said that in 10 years the natural growth of our credit requirements here will take up all the gold we have in this country.

Doctor MILLER. That has been said.

The CHAIRMAN. I might also add that we have in these hearings the statement of Doctor Lafelt, to whom Doctor Miller just referred; and I would like also to state for the benefit of the committee that Doctor Gustav Cassel, whom Mr. Luce referred to, will appear before the committee on next Friday morning at 10.30. He has very kindly consented to come before the committee and make a statement on this very matter.

Mr. LUCE. You point out that Doctor Cassel and Mr. Lafelt are at opposite extremes, and of course it is impossible for us to determine with any accuracy which man is right, but does it follow that we should make no attempt to determine and, if possible, adjust our financial system in some way so that in either case disaster may not follow?

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Doctor MILLER. I can only repeat that whether the Congress should enact a bill retaining this paragraph or not, the Federal Reserve Board will keep on thinking about this problem, as it has been doing without congressional instruction.

My objection to the bill is that the thinking of the board is made official thinking and thinking upon which, if you please, by referring to section 28B, it is obliged to report its conclusions from time to time and at least annually. The board would be obliged to report annually whether it thought there is impending an actual scarcity or a superfluity of gold. It would have to erect a conjecture into a conclusion, the best presumption that could be made within the limits of human fallibility as to what the future gold supply and gold demand are going to be, and to tell it officially under this set of provisions here.

Now, it is perfectly conceivable a very competent investigative organization might be set up and carry on for the next 5 years which would reach the conclusion that there is ground for apprehending that within 10 years the gold supply of the world will fall short of what is necessary to maintain, we will say, using Mr. Congressman Strong's favorite phrase, the price level upon a stable basis. Within two or three years after that, with a change in the organization, and so forth, it might be found that an equally competent group of men would come to the conclusion that there is no basis for anxiety.

It might easily turn out that the board confronted at that juncture with the predicament that, having made a public declaration in an earlier report, under the inspiration of its scientific organization, that there was threatening a scarcity of gold, would hesitate to counter that previous conclusion.

Where one is dealing with problems that are so indeterminable, so conjectural in their character, it is not advisable to think aloud publicly or to speak officially unnecessarily. Of course, everyone who deals with such things has got to form opinions, but he ought to maintain, in my judgment, such flexibility of mind as not to hesitate to change an opinion. And it should not be made difficult for him to change his opinion if new facts warrant it. In other words, he might feel this year that there is a good deal of material at hand that looks as is the world were coming into a period of gold shortage. Two years hence he ought to be perfectly free to say to himself, "I was mistaken."

Mr. LUCE. We are all fallible; but you demur at official thinking, while it is our duty here as Members of the House to engage in official acting.

This afternoon the Senate is going to continue its discussion of whether there shall be a reduction in the tax level of $200,000,000 to $225,000,000 or $290,000,000. There is a difference of $70,000,000 a year in the tax level, which will inevitably determine whether the debt shall be reduced by $70,000,000, more or less, and within a week every member of this committee must vote on that question. One great political party says, "Reduce the taxes, but do not pay your debt as rapidly." The other political party says, "Do not reduce your taxes and pay as much on your debt as you can."

Now, what is there obnoxious, when we must act, in telling our experts that they must help us think?

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Mr. STEAGALL. I want to say parenthetically right there to the gentleman that he is not accurate in his reference to the two parties with reference to tax reduction. Both parties want tax reduction, but one wants to give it to one set and the other to another.

Mr. LUCE. But there is a difference in the total of $70,000,000.

Mr. STEAGALL. But it can not be stated that one party wants to pay everything that exists on the debt and the other does not. That is not an accurate statement. I am sure the gentleman does not want to put an inaccurate statement in the record, although it is beside the issue.

Mr. LUCE. Whether I have righly read the political signs of the times or not, and possibly I have misconstrued the political aspects of the situation——

Mr. STEAGALL. So far as this discussion is concerned, your contention is absolutely all right, but in its details it was not entirely accurate.

Mr. LUCE. I am simply trying to bring out that Congress is composed of 531 men, and very few of them have had any economic training and must in large measure rely upon the information furnished to them and in considerable measure upon the advice given to them by the experts in these most important questions before Congress of taxes and the debt, and there is allied with them the future price level in its bearing upon the obligations of the United States and upon individuals.

I know of no agency in the Government that is so well equipped and so well trained as yours to furnish us the facts upon which, so far as you can get them, we must act. I do not expect you to do the impossible; I do not expect you to be clairvoyants and read the future. If any of us could do that, we would be millionaires overnight; but the whole scheme of your conduct, of your system, now is to attempt to serve the interests of the country by information and such action as you can take based upon your estimate of what the future is going to bring forth.

Why should we not turn to you, rather than to anybody else, to help us?

Doctor MILLER. I think, if you want information upon these subjects, if you feel it is really obtainable, the Federal reserve system is, on the whole, the best situated of any governmental agency to make the necessary studies.

I do not know that I have anything to add beyond what I have already said, except this: I think most men who are dealing with policy matters are very apt, if certain things begin to lodge in their mind as facts which are not actually determined or determinable facts, to see things differently and possibly less truly and competently than they otherwise would.

I always have this in the back of my mind: It is my general attitude that in matters of credit and banking policy, as a reliable guide to an administrative body, you can place more reliance in the gold standard than in any set of devices or formulæ that can be invented as a substitute.

I think Doctor Commons would probably agree that we had before the war, on the whole, a tolerably stable price level. There was occasional criticism that over a period of years there was a slow but nevertheless steady and perceptible rise of prices. Opinions differed

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as to whether the resulting hardship to the creditor was or was not offset by the resulting stimulus to business enterprise and to industry.

In my judgment, it must be a very wise man who undertakes with any degree of confidence to express a broad social judgment in this matter. We are all very apt, I think, to identify the public interest with what happens to be either our private interests, or those of the group with which we are most chiefly identified. It is well known by the economic historian that the world has in times of gold inflation in the past sometimes experienced the greatest stimulus to the broadening of the spirit of industrial enterprise and to economic development and productivity, even though such inflations have brought with them a certain amount of maladjustment, and, even, if you please, social injustice by disturbing relationships between debtors and creditors whose relations extended over considerable periods.

So that I felt a certain revolt—it is temperamental in part, in part it is based upon observation and in part upon my reading of history—against what I would call legislative prescriptions that proceed from a more or less static conception of society.

We are not living in a static world; certainly not yet in the United States. I am inclined to think that as long as we live in a world that is susceptible to a wide range of new responses, as our American world is, and one in which we invite and solicit, desire, and expect change, we are bound to have elements of instability which will be absolutely beyond control.

If you want a perfectly stabilized economic society, then you have got to get a static human nature. As long as we live in a world in which there are many men who dare to think and plan and imagine and risk their fortunes in undertaking new ventures—and this is true of the modern world as a whole and preeminently true of our own country—you are not going to have stability.

I would suggest that if the committee really wanted to prosecute this inquiry to a point where it would become fully illuminating, that it would be well worth while to review the last three years and inquire what has produced such instability of prices as we have had in this period. What has produced such instability of employment as is the subject of not only criticism at the moment but even of controversy as to its extent? What has produced good years and bad years in the last four or five years in agriculture and in commerce?

Now, I venture to say that among the responsible factors you would find that the pressure, so to speak, or, rather, let me pluralize it, the pressures put upon the American captain of industry by the new hazards that business enterprise and undertaking has had to face as the result of all of the post-war uncertainties, have led to developments in the technique of business and industrial management, in the scope of industrial organization, that have resulted in putting American business and enterprise ahead to a position it probably would not have reached in the ordinary course in less than 25 years.

What has provoked it? Many things. In part, the high wages of labor that were left by the war. I remember, and I think you gentlemen will all recall, that one of the most common things we heard after the armistice in 1918, was that the first thing to be done was to liquidate labor.

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Labor, however, was not liquidated; it would not be liquidated, and the history of past inflations similar to the one we had in 1919–20 inflations, during and following a period of war, pretty generally shows that labor does not liquidate, that it is one of the surest and solidist gainers from the inflation war brings, that it tenaciously holds to the abnormal wage level attained under war conditions, and that this is particularly true where labor is as well organized as it is in several countries and in our own, where its position has been strengthened by a statute restrictive of immigration.

Now, then, what happened? The American business man was up against a condition. His labor costs were increased. In order to keep his total costs down he had to invent new sources of efficiency. He did it. It is one of his great achievements. It is one of the wonders that European observers come here to see. But in the process of doing it we find, according to the statistics of the Bureau of Labor and of the National Industrial Conference Board, that American factory productivity has been increased from 20 to 30 per cent in many lines, with the result that there are fewer men to-day engaged in many of these industries turning out a bigger product than was the case three or four years ago.

Now, then, what does this mean from the point of view that we are discussing here? It means that industry, business, in undertaking to save and stabilize itself, has brought about at least a temporary instability in the condition of labor within those particular industries.

From my point of view, that is a very regrettable result for the laborer who is displaced and obliged to find a new connection. But I think it is more less inseparable from a state of society, so to speak, in which there is continuous and rapid progress in industry.

The great question, to my mind, is whether the instability that you and I regret as such is not really inseparable from a highly competitive industrial society. I do not think you can get away from it, and I am afraid that in the attempt to, as it were, control it through a monetary-policy device of the kind set up in this bill you will either accomplish nothing, or if you succeed, you will succeed only by actually putting at times a strait-jacket upon the forces of growth that inhere in the American industrial system.

Mr. LUCE. The problems you have just been discussing, important problems, are covered by paragraph (4), which refers to stabilization of agriculture, industry, commerce, etc. My inquiry had been meant to be addressed particularly to the factor covered by paragraph (3).

Now, let me recall to you just hastily half a dozen very important happenings in this country, the panic of 1818, due to the inflation of currency by the creation of State banks; the panic of 1837, having much the same cause; the panic of 1857, due to the discovery of gold in California, in part at any rate; the panic of 1873, also a financial problem; the development of the Populist and Greenback Parties following the resumption of specie payments; and the campaign for the election of Mr. Bryan in 1896, the most fiercely fought campaign in all my own political experience.

These are but the high lights which indicate that in the past this very problem that we are facing here has at intervals been paramount in our public life, of the greatest concern to all of those who

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are in public life, and of immeasurable importance to the comfort and happiness of the great masses of our people.

Why should not we see by study if we can not lessen the likelihood of a repetition of the Populist and Greenback agitation, of the bimetallist agitation? We can handle the banks perhaps adequately with our Federal Reserve Board and will not have a repetition of the circumstances that brought on the panics of 1818, 1837, and 1857, but we have done nothing as yet to remove the conditions that brought about the political and commercial troubles following the Civil War.

Those are not things to be minimized, in my judgment; they are not things to be called academic; they are problems that are here facing us. Shall we do nothing about it?

Doctor MILLER. Well, you are getting into the general purposes of the bill in raising those questions.

I would say that the upsets you refer to were in the nature of cataclysms. Following the World War, the particular impulse that had given rise to the ideas and plans contemplated in this bill was the disorganization of the currency, the disturbances of price levels—and I call them revolutionary in scope and character—that grew out of the last war.

The difficulties experienced in 1857 were probably an inevitable aftermath of the gold discoveries in California and Australia about the middle of the century. The panic of 1857 was the last phase of the wonderful development of industry and enterprise that either coincided with the period of the gold discoveries or was, as I believe, occasioned by them. On the whole, and regarding the matter from the point of view of national economy, the crisis was a small price to pay for the enormous growth in the productive power of the Western World and the improvement in the economic condition of the masses or the people in the Western World, which on the whole occurred.

I do not think, should we ever be precipitated into another great war, that anything you could ever write into a statute would stop us from doing the things thought necessary in order to put through the Government's financial program. Laws of this kind—of most kinds—are not made for the exceptional situations of national emergency, but for the more ordinary conditions, and if we were in a great World War again, and were under pressure to provide not twenty-five or thirty billions but seventy-five or one hundred billions in order to take care of war needs, and Congress for one reason or another would not tax or could not tax, I fancy that the Federal reserve printing presses would be set to work again at high speed. It would not govern its actions by price levels or by considerations of present and future production or scarcity of gold.

"Inter arma, leges silent."

So that, from my point of view, the objection to your proposal is that, firstly, it orders an investigation that gets great official importance from the fact that it has got to be the subject of at least an annual report to Congress.

Secondly, included in the scope of the proposed gold investigation is the prospective as well as the actual demand and supply of gold. Underlying that proposal, I think, must be the belief that somehow or other there is a potency in the Federal reserve that actually can

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control what economists sometimes call secular movements of prices, which means the long-period swings of prices.

Personally, I have the gravest doubts as to whether that can be done. I think the most that any mechanism like the Federal reserve system can do with regard to these factors of instability is limited to those that are, generally speaking, confined within a comparatively short period of time—swings that modern economists are very apt to describe as cyclical as against those which are secular—short-period trends as against long-period.

I think you have stretched the possibilties of the Federal reserve system, so to speak, beyond the nth degree when you include these long-period movements that take, perhaps, a generation or half a generation at least to develop and work their full effects. I agree with you that they are deplorable in many ways, but to my mind they are deplorable for the same reason that the Mississippi floods are deplorable, and yet the rains from heaven can not be regulated or controlled.

The CHAIRMAN. In that connection, under the management of gold as exercised by the Federal Reserve Board here to-day, they can send out of this country large amounts of gold——

Mr. STRONG. And recall them.

The CHAIRMAN. And recall them. That would have an appreciable effect, would it not, on long-time prices?

Doctor MILLER. No.

The CHAIRMAN. On the long-time cycles. If gold plays the part in this whole situation that has been indicated here before this committee, certainly the management of gold on the part of the Federal reserve authorities would have an effect.

Doctor MILLER. On the long-time trend?

The CHAIRMAN. Yes.

Doctor MILLER. No; I doubt that very much.

The CHAIRMAN. Supposing half a billion dollars of gold were shipped out of the country and remained out of this country; it certainly would have an effect, would it not?

Doctor MILLER. Well, I think you are to a certain extent taking your conclusion for granted when you say the gold would remain out of the country. Let us see how gold is shipped out of any country.

The CHAIRMAN. I am speaking of the management of gold.

Doctor MILLER. I am speaking of it, too; at least, I am thinking of it. There are cases, such as we have had particularly in the last few years, where gold has gone out of this country because countries like Germany and Italy and France actually want gold for the purposes of carrying through monetary reforms. They are going back onto a gold basis, and in order to achieve their purpose they must have gold. Therefore they come to the world's greatest gold market and they arrange for specific gold loans. They mean, when they come here, to take gold from us; that is the commodity they want. Those loans may be 10, 15, 20, or 25 year loans. They, however, in all cases have a definite maturity and they carry interest which makes this a pretty expensive convenience or necessity for these several countries.

That is one way in which gold goes. France has been drawing gold most abundantly in the last few months as a part of its policy of monetary restoration.

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Let me add before I leave this subject that a country that wants gold in order to reform its currency will go where it can get the gold cheapest, if it can be sure of getting it at all, in the amounts that it requires. It is probable that, of the many countries that have been borrowers of gold for monetary restoration purposes in the last year, some have come here because the rate at which they could borrow was lower, we will say, than in England. They go to the cheapest market where they can get the gold, just as the buyer of wheat and cotton will go to the cheapest market in which he can get the cotton in the amount he requires. If England had been a cheaper market, as it was very apt to be before the war, nations that wanted to borrow gold for monetary purposes would go to London. But not so recently. New York has been the cheaper market. The rate of interest is apt to be the controlling factor.

Now, in addition to gold movements occurring in this way there are certain funds, so to speak, in the nature of an international short-term loan fund. It consists, we will say, of balances of one kind and another that can be shifted from one market to another, from one country to another. They also will be shifted more or less in accordance with changes in relative money or discount rates. It is probably true, though the figures are not available for an accurate statement, that low money rates in this country last autumn stimulated the transfer of international balances to the London market, where the rate was higher.

Now, we have seen that, whether as a sequence of the policies that were adopted by the Federal reserve system last summer or whether from other causes independent in their character, money rates have latterly tended upward in this country so that they are now pretty nearly equal to the London rates.

The CHAIRMAN. Let me ask you there what effect the reduction of the public debt by a billion dollars has on money rates?

Doctor MILLER. It has a very important temporary effect.

The CHAIRMAN. I refer to the fact that during the past year the public debt has been reduced a billion dollars in a flush money market, and you were speaking the other day of the effect of open-market operations on the money market. Take the various Treasury transactions in connection with bond purchases and sinking-fund purchases; do they have a similar effect on the money and stock market?

Doctor MILLER. They do when they buy.

The CHAIRMAN. Suppose that those purposes are synchronized with the operations of the Federal reserve and its open-market operations?

Doctor MILLER. There is a constant disposition not to work at cross-purposes, but to let the Treasury's program, whenever it is practicable, work in with the Federal reserve's.

The CHAIRMAN. Have you or the board made a study of the effect on the economic situation and the money market of the continued reduction of, say, a billion dollars a year of the public debt?

Doctor MILLER. No; no systematic study. It is always dealt with as a factor in our current discussions and conclusions. Of course, what is done is this, and I doubt whether you could get very far. The Treasury collects taxes, mainly income and corporation taxes. It pays off the debt to the extent of $1,000,000,000 a year, we will say. Presumably the recipients of the paid-up debt, the holders of the

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bonds that are redeemed, are those who belong primarily to what we would call the investing class. If, in other words, a billion dollars of Government obligations were paid off in the course of a year, we might assume that perhaps 75 per cent of those obligations were held by people who belong to the investing class. When they receive their money from the Treasury they will probably turn around immediately and seek to reinvest, in which case there would be by that amount an augmentation of the demand for investments; there would be an addition to the supply of investment capital.

If they had not been paid off—in other words, if the income taxes requisite to finance our annual requirements were less by a billion dollars—the probability is that those who are large contributors to the income tax would use the money not taken from them to make investments.

The CHAIRMAN. Would you go so far as to say that in the reinvestment of the proceeds of a billion-dollar debt reduction that that fund might be used for the purpose of increasing brokers' loans?

Doctor MILLER. Yes.

Mr. WINGO. Is there any doubt about that? Is not that one thing that is agreed on? At least, all of the articles I have been reading in the financial papers are to the effect that that is one factor that absolutely negatives the efforts of the board to check brokers' loans, that for several years we have been putting $1,000,000,000 of new money into the investment market by the retirement of the public debt. The one article I read the other day was predicting a continued bull market, for the reason that Mr. Mellon's theory and desire to continue a rapid reduction of the public debt evidently was going to prevail and that as long as the Government did counteract the open-market operations of the Federal Reserve Board by retiring a billion dollars a year of Government securities you would continue to get an easy money market and a flushed stock market.

Do you not think we all agree on that?

Doctor MILLER. I would say that in the analysis of that matter you would have to pay a great deal of attention to the source whence the Government derived the revenue it used to reduce the debt.

Mr. WINGO. The presumption is that the source will continue the same as it has over the last few years.

Doctor MILLER. By the source I mean the contributors.

Mr. WINGO. I say that the contribution over a given period of years, with the securities distributed, is practically permanent now, because the shift has taken place. The presumption is, and most of the writers proceed upon the theory, that for the last few years this effect has taken place, notwithstanding the fact that the securities have been shifted from the temporary holders as a result of Liberty loan campaigns into the hands of the permanent investing class, and that in spite of the presumptions to which you referred, if they had not paid their taxes for the purpose of retiring these bonds that they would have used those funds to go into the investment market, the experience of the last few years has negatived that theory, and this writer that I was reading said it was fair to presume that the effect would continue to be the same and we would continue to have a cheap money market so long as we continued a million dollar reduction in debt.

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The CHAIRMAN. But you referred to the sources from which this money comes. One source is taxes, the other is customs, and the other is from the railroads and others to whom the Government has made loans. Of course, during the past year or two there have been large recoveries in the way of the repayment of loans made to the railroads and various others.

Doctor MILLER. And we get some foreign payments, too.

The CHAIRMAN. And we get some foreign payments. That would not have the same effect on the situation as would the use of the money that we received from taxes or customs, would it?

Doctor MILLER. No; it would not.

Mr. LUCE. Possibly there is one factor that ought to be mentioned here in connection with the other things, that the reduction of the debt by canceling a billion dollars of paper, if we may assume it did balance in that way, has by so much reduced the basis for loans that were made on that paper, and it is just as broad as it is long.

Doctor MILLER. Well, I do not think we have suffered from that. The time may come when that would prove to be an embarrassment.

Mr. LUCE. I did not mean it as an embarrassment, but I meant it as an offsetting consideration to the one which Mr. Wingo has referred to.

Mr. WINGO. There is another factor, and that is the effect of the interest charged on the Treasury.

Mr. LUCE. Yes.

Mr. WINGO. My point was this, that with the experience of the last few years, it is reasonable to presume that if the reductions continued the same, the appreciable effect upon the market would be the same. Of course, it must be noted that there may be a failure of some of the sources of funds to reduce the tax, like these special payments that have come in and that will mean an appreciable decline in the volume of reduction of debt in the next few years, even if your tax rate and income remain the same.

Doctor MILLER. I would say if I were going to study that subject, that I would want to analyze the sources of revenues of the Government and see to what extent they were derived from, let us say, essentially the same class of contributors. I would call it broadly the investment and saving class on a large scale and the creditors of the Government. I think we have several new factors in our whole economic situation in the last 10 years that, to a certain extent, differentiate it very sharply from anything we have ever known before or that has ever existed anywhere else.

The CHAIRMAN. My reference to this deft reduction has nothing to do with the merits or the wisdom of that reduction, but as to the effect that a reduction of $1,000,000,000 would have on our economic and money market situation, and whether or not that was actually the throwing in to an already flush money market of a billion dollars' worth of additional funds would it or would it not tend to accelerate speculation in securities?

Doctor MILLER. I think it is undoubtedly a very considerable, but transitory, factor of disturbance.

The CHAIRMAN. I appreciate the thought of Mr. Luce, that this is a very propitious time for us to reduce the public debt as rapidly as possible because of the purchasing power of the dollar at this

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time, and I can also realize in that connection that the present question of a raise of salaries of Government employees is not a raise in salary but an adjustment to the purchasing power of the dollar.

Mr. WINGO. Will not the acceleration of the reduction of the public debt have an appreciable effect upon the purchasing power of the dollar, and may meet the other factor coming back to which Mr. Luce referred?

The CHAIRMAN. I think that is very pertinent.

Mr. LUCE. Does this all not bring out, Doctor, that somebody ought to study this thing?

Doctor MILLER. They are studying it. I am perfectly agreeable myself to it going on. I think we have perhaps consumed too much time in the discussion of an item that I felt would better be left out of the bill than be pro forma included in the specific directions given to the Reserve Board. But I do not think it is a matter of such great importance.

Mr. LUCE. Possibly, as a mere matter of technique, it is not, but it strikes me we have reached the very nub of the whole problem before us when we are discussing this particular question. It seems to me the most important phase of the whole situation.

Mr. WINGO. I can not help but wonder, I will say to the gentleman, that if we were to do this, to give this mandate, and the board sat down and tried to carry out what we suggested, these investigations, whether they would not say, "The general fundamentals we can agree on; we can agree on what laws exist. The law of supply and demand is one of them."

But the difficulty we would have is not ascertaining what the fixed laws of economics and finance are but what would be the circumstances that would surround the operation of those loans and the effect they are going to have upon the purchasing power of the dollar, and then they will proceed to say, "We have to study and try to anticipate what will be the policy of Congress, whether it will or not rapidly reduce the public debt, whether or not the troubles in China will precipitate such a burning up of commodities and how far the war there will go, and what effect it will have upon the operation of supply and demand in the commodity market," and then you will set your forces to work to try to predict and tell each Congress that "if you do so and so, if you will reduce the public debt so much, then we think it will affect the purchasing power of the dollar so much."

I am inclined to think that that would have great value, provided the legislative body would treat with any degree of respect the prognostications and recommendations which the board made.

Doctor MILLER. Mr. Chairman, let me ask a question here. Is it contemplated that Doctor Commons will conduct an inquiry of me before I am dismissed?

Mr. STRONG. That is the understanding, when you have reached a suitable place in your remarks.

Doctor MILLER. The discussion has ranged over a pretty broad field here recently in connection with Mr. Luce's questions. You know, to my mind one of the great considerations to bear in mind in connection with any currency, banking, and monetary legislation is the liability of these things to inject themselves into politics. The "money

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question," as we use the phrase in this country, as we have used it over a period of 50 years, means not an economic question but a political question. However it originates, it becomes such because people, for one reason or another, get excited or disturbed about its effect on them and take opposite sides and then it injects itself into political and party discussions.

I would say that on the whole one of the incidental but yet very important merits of the gold standard is that it carries with it a greater promise of keeping the money question out of politics than any other. That is the reason why I constantly come back to the position I have taken in these hearings. I would hold to this position even if I felt that indications were favorable to the practicability of a price-level stabilization program being effectively promoted and accomplished by the Federal reserve system. I want to see what the now generally restored gold standard is going to show itself to be in operation for the next five years or so before entertaining any proposal in the nature of a radical departure from it. If it proves competent on the whole to give the world as good results as it did before the war for a period of 15 or 20 years, my disposition would be to say it is part of wisdom to keep legislative hands off. I am satisfied in my own mind that clauses and phrases and language of the kind used in this proposed bill will give rise in their application and administration to new political issues should the bill be enacted into law.

Mr. Strong. After all, Doctor Miller, is not the only purpose of the act to direct a continuance of that policy that we feel has been fairly well carried out and that all sound men want to see continued to be carried out?

Doctor Miller. Well, I had in mind, when I asked the chairman the question whether Doctor Commons was going to question me, whether it was still the intention of the committee to go into these details. In that connection I think my reasons will come out.

Before we part company, I want to say that I feel that the gold standard, on the whole, will be the major controlling principle in the operation of the Federal reserve system in the near future. Let us wait and see how the gold standard works within the next few years.

When I say the gold standard, I do not mean a blind adherence to the old principles of operation. I would expect it to be tempered in its application now and then, here and there, by a very informed discretion and at time with a certain degree of courageous interference. On the whole I think we will be better off in our monetary affairs if we have something that is, so to speak, above expected and intended interference by an administrative agency like the Federal Reserve Board, than if we have something that is specifically subject and intended to be specifically subject to interference, and that not only over short periods, but also over long periods, and all according to the judgment of the Federal reserve authorities and in obedience to an instruction from Congress.

Mr. Strong. I do not quite get you when you talk about departing from a gold standard. The purpose of this, as stated in the preamble, is to promote the maintenance of a stable gold standard.

Doctor Miller. A stable gold standard is something that the world has never known.

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Mr. STRONG. Of course, a gold standard can be unstable. If we have a gold standard at all we ought to strive to have a stable gold standard.

Doctor MILLER. The moment you prescribe a stable gold standard you are in effect already abandoning the gold standard and substituting in its place a dollar standard based on gold; and it is a dollar that is subject to other influences than those which affect the value of money under the unimpeded operation of the simple gold standard. It means that you are, as it were, bringing into the picture in a very prominent way the judgment of men and management as against the fortuitous circumstances of nature affecting gold production, the interplay of money market, and so on.

Mr. STRONG. I think the purchasing power of our dollar should be maintained as a stable purchasing unit, and that that should be the aim of this Government even though the value of gold may appreciate or depreciate.

Doctor MILLER. I would not differ from you there, but I would like to see it demonstrated——

Mr. STRONG. That is the purpose of the study.

Doctor MILLER (continuing). Otherwise than as a venture in speculative economics that there is good ground for expecting that we will have greater economic stability or price stability, or other forms of stability, under the operation of this new scheme than we have had in the past under the gold standard.

Mr. STRONG. This is not a new scheme, but a measure to direct the continuance of what you gentlemen have been stating with a great deal of pride you have been doing for the past three or four years.

Doctor MILLER. If we have said that, we have taken a great deal of credit that is not due us. But this touches matters of fact and detail that I hope will be brought out later.

Mr. STRONG. Before we adjourn I would like to make this observation for the record: That I think the disturbing factor of war is not going in the future so to wreck our financial situation and our economic situation as the past war did, because I think the 4,000,000 men and their relatives and families that participated in this war are going to see to it that the next war will not be a money-making war; it will not be a war where the war contractors will be allowed to make a great deal of money while the men are fighting for the Nation. I think there will be a drafting of all of the faculties and all of the resources of this Government, instead of just drafting man power, and, if we do that, we will not emerge from the next war with a lot of profit-taking and debts as we did from this war.

Mr. GOODWIN. Why limit that to the 4,000,000 men and their families?

Mr. STRONG. I said their families and relatives. I think there is a very settled conviction on the part of the people of this country that the next war will be a war in which all the resources of this country will be drafted, and, if we do that, we will not emerge from it with the conditions that we have from the past war.

The CHAIRMAN. We will adjourn until to-morrow morning at 10.30.

(Whereupon, at 12.20 o'clock p. m., an adjournment was taken until Wednesday morning, May 16, 1928, at 10.30 o'clock a. m.)

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HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Wednesday, May 16, 1928.

The committee met at 10.30 o'clock a. m., Hon. Louis T. McFadden (chairman) presiding.

The CHAIRMAN. The committee will come to order to continue the hearings on H. R. 11806.

Under the arrangement as heretofore stated, Doctor Commons desires to ask certain questions of Dr. Adolph C. Miller, of the Federal Reserve Board.

Doctor Commons, will you proceed now?

STATEMENT OF DR. ADOLPH C. MILLER, MEMBER FEDERAL RESERVE BOARD—Resumed

Doctor COMMONS. Doctor Miller, you made a reference to what you considered the theory back of this bill, which you indicated was the theory you used to teach as a professor of economics.

What I want to do is to inquire into the methods by which you and the board learn by experience when you take up the statistical material and then apply it to certain episodes. I have in mind especially the period of 1922–23, when, it seems to me, the Federal Reserve Board could be said to have been the most successful during its career in handling the situation, but I would like to know what would be your statement of that theory underlying this bill, and I take it that the theory you used to teach is what is called the quantity theory of money?

Doctor MILLER. I suppose what you really have in mind is to find out why I have qualified my adhesion to it. or abandoned it, or whatever you please?

Doctor COMMONS. That is it.

Doctor MILLER. That would be a pretty long story, and I am not sure, even if I took the full time, that I could tell you all that has led me to this feeling of doubt as to its validity as a working or guiding principle in bank administration.

I think I would say this, Doctor Commons, first that I have been very much impressed with the more recent work done by economists, notably in our country, in the field of economics of credit, prices, banking, business cycles, and related matters. All these studies have seemed to me pretty clearly to have thrown much light on the mechanism of credit, the price system, how prices are made, how prices are changed, how, in the presence of more or less common factors, the prices of different commodities change differently or react differently to the same or a closely similar stimulus.

Let me repeat that we do not know nearly as much with regard to the behavior of prices as was assumed in the days when I was taught the quantity theory of money and prices and in the days when I myself taught what I had been taught.

Now, in part I think that is due, as is the case with most shifts in the emphasis or reformulations of economic theory, to an actual change in economic conditions.

If I were to undertake to say what I thought the important changes were, I should put them perhaps under a few heads, the two

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most important of which would be, first, the diminished dependence, more especially in our country, of current business, trade, and industry upon current banking accommodations.

I would say, particularly in our country, that the nexus between the volume of activity in trade and industry and the volume of banking accommodation is a less close one than it was in the days when Mill formulated the quantity theory of money and in the succeeding generation or two, when it was the currently accepted theory in Great Britain and in our own country.

I think possibly, as your questions go on, it may be worth while to return to this.

Doctor COMMONS. I was thinking about the opposing theory which used to be called the commodity theory.

Doctor MILLER. I do not know anything about it; I have no theory to offer. I am not here to offer a theory; I am here to find one.

Doctor COMMONS. Why did you, in those days, reject the commodity theory—in your teaching days?

Doctor MILLER. I do not think I ever really faced the question that way. I do not think it made enough impression upon me to attract me.

Doctor COMMONS. Would this be a correct statement of the two theories, that, according to the quantity theory an increase or decrease in the supply of money and credit would cause a change in the price level?

Doctor MILLER. That was the assumption.

Doctor COMMONS. Now, the commodity theory says that an increase in the activity of business creates a demand for credit, and therefore the volume of credit increases; that is, we have gotten away from the time when gold was the main instrument, so that the commodity theory, as I understand it, was a demand theory, demand for money, and the quantity theory was the supply of money. The two conflicted.

Doctor MILLER. I would say there was no conflict there.

Doctor COMMONS. There is no conflict?

Doctor MILLER. I would say there is the same kind of conflict as you may say there is between the two opposing blades of a pair of scissors. The conflict, or contact, is what makes the scissors; they are working against one another.

Doctor COMMONS. You would say that that is now the prevailing idea of economists?

Doctor MILLER. What?

Doctor COMMONS. That there is no conflict between the two; that the two operate together?

Doctor MILLER. I do not know. I will tell you frankly that even in the days when—I should say in the early nineties—we had a revival of an acute interest in money and price phenomena, and men were expected to take sides either by proclaiming their faith in the validity of the quantity thereof or against it; it never really made much of an appeal to me, and it does not now. I feel that, taking that as a touchstone or test of a man's economic faith—it does not mean very much to me. Personally I would suppose that no man would deny that changes of conditions affecting the supply of money and credit have an important bearing upon price changes. I would also

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suppose that any man who really looks at the facts and at history would say that the actual quantity of credit, the volume of credit, and of money in use will depend upon men's disposition to use credit and money; that if they do not want it it exercises no effect. If they want it, and can not get it, then the fact that they can not get it, if you please, exercises an effect. If there is any money available for which there is no imperative demand at a certain price, it is conceivable that the lending power might induce some use of it through cheapening the price, but I suppose even under the quantity theory it must be recognized that it takes two to make a price.

The one item in the quantity theory that always seemed to me of importance was contributed by John Stuart Mill when he said that credit influences prices only when it is used as a means of payment or purchase. It is not the potential volume of credit, but the credit that is used, and credit is used only as there is somebody who wants credit for use, so that I should say that, in explaining the changes in the volume of credit, you have to take into account those influences that act upon the appetite for credit—in other words, that influence the demand.

But I want to go further on this very point and set myself squarely with you. It is a long time since I have had occasion to concern myself with the niceties of theoretical formulation in economics, but I think one thing that I carried away with me is a permanent distrust and prejudice against the use of the words "cause" and "causation" in economic theory, and the whole problem to me is one in the balance of more or less interacting and counteracting forces.

Doctor COMMONS. How would the demand for credit arise? It would arise from the expectations of business men. They demand credit now for 30, 40, or 60 days ahead. They are looking forward to two things, the volume of commodities and the price of those commodities. Is not that where the demand originates? It is their expectations?

Doctor MILLER. I should say primarily upon their expectations as to whether to hazard safely an investment in the production or the purchase for sale of commodities with the expectation of at least a certain rate of return on their investment. The profit is what they are after.

Doctor COMMONS. Would not that resolve itself into two things, the future volume of business, we will say, or trade, or employment, and the future price that they expect to receive?

Doctor MILLER. Either one, or both.

Doctor COMMONS. So that the demand is always in the form of expectation on the part of the business man of cheaper prices and volume of business?

Doctor MILLER. Yes.

Doctor COMMONS. And the supply is in the nature of the volume of credit or money that is forthcoming now, in the present, to meet those expectations?

Doctor MILLER. Well, I will let that pass without challenge, although I would state it differently.

Doctor COMMONS. I wanted to apply that to the statistical investigation that I presume you are largely responsible for inaugurating, which, I take it, you looked upon as an aid to gauging these future forces, to prophesy what was going to happen.

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You spoke of three things that guided you—experience, experiment, and judgment. Now, what do you mean by judgment?

Doctor MILLER. Of course, you are aware that psychologists will tell you that the judgment process is the most difficult one to analyze and describe.

By judgment as I use it in discussions of this kind I mean most frequently what I would call the judgment of degree. I think most commonly men who have good abilities will agree upon what might be called the qualitative analysis of any situation. They will agree upon a specification of the factors that enter into a given situation, but when it comes to their evaluation, to saying that this is 5 or 10 per cent responsible, this is 3 per cent, or 17 per cent, and so forth, they may differ. In other words, you are then dealing with forces that are imponderable, immeasurable, except by what I call the process of judgment.

Into that goes your experience, your scientific and intellectual equipment, your imagination, your capacity to sense things. It is what makes the difference frequently between a man of great capacity in business and another of lesser capacity.

Now, of course, into the judgment frequently enter many factors that are at least in an approximate sense measurable. A good deal of the scientific apparatus of the laboratory in medicine or in the Federal reserve is set up for the purpose of ascertaining, if you please, the knowable quantities so as to reduce those that are incapable of exact determination or perhaps even of approximate determination and which therefore have got to be referred to the judgment of an individual or a group of individuals who have to take the responsibility for acting.

Let me go perhaps a little step further here. You have asked about this term. I would say that judgment, as I can conceive of it in relation to such matters as Federal reserve administration, also implies the power to select the factors of difference in a different situation from which you have previously dealt with. In other words, you might give the proper valuation to 10 or 12 different factors in this situation. Some of those perhaps have got to get a different appraisement in a different situation; therefore good judgment means that you also sense what are the factors in the latest situation that have gained in relative importance, and which, therefore, in the language of our index number making, we describe as a different weighing. I should say it is knowledge of how to weigh these factors, as well as what the factors are, and to free yourself from valuations which you have attributed to them in the past.

Doctor COMMONS. Well, then, according to that, good judgment always looks toward the future effects of any action that you may now take.

Doctor MILLER. Action always looks toward the future, and judgment, as I see it, is for the purpose of action.

Doctor COMMONS. You would not call that a cause-and-effect relation? You do something now, say open market and discount, with the idea that in the future it will have certain effects. Now, your idea is that that factor to which you have for the time being given the greatest importance will work out toward a certain result in the future. That is about what judgment means, then; it means

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forecasting or predicting what the effects will be of your present action.

Doctor MILLER. Well, of course, that narrows it. I should say if you carried that out it would be rather a definition of judgment working ideally or perfectly. Actually we very blindly have to use our judgment upon what has happened in the immediate past.

Doctor COMMONS. Is not that experience and experiment?

Doctor MILLER. I am not talking about experience; I am talking about what has happened in the immediate past, and therefore great errors of judgment are very apt to be made. For instance, if the price of cotton is good this year because there has been a shortage of the crop, it is very likely to have the effect of inducing the planting of more cotton for the next crop than the reverse. Men are apt to be influenced by their most recent experience in what they do as regards the future, so that when you speak of judgment as directing itself always to the future I should say that is when the judgment is clearly to be rated as good judgment, as ripe judgment.

Doctor COMMONS. Well, my idea of that would be to say in either case, whether you make a good forecast or a poor one, it is judgment.

Doctor MILLER. Yes; whether you have selected a good basis or a bad basis for determining what your line of conduct or action will be, in either case it is judgment; you had to take an attitude. I myself would not use the word "forecast."

Doctor COMMONS. Prediction?

Doctor MILLER. Oh, no.

Doctor COMMONS. You are balancing up many factors which you think will happen in the future?

Doctor MILLER. You are taking cognizance of a great many regarding whose bearing you know with such a degree of approximation that you do not need to be in any great uncertainty as regards them.

Doctor COMMONS. Then combining all of those complex factors which you have to deal with, you have to weigh them each to see what is going to be the predominant factor and what will be, not its effects but consequences?

Doctor MILLER. Yes.

Doctor COMMONS. Of course, you can understand that what I am driving at——

Doctor MILLER (interposing). I am not quite sure yet.

Doctor COMMONS (continuing). Is that if you are looking forward to a stabilization of the price level would there be any different exercise of judgment than when you disregard the future price level?

Doctor MILLER. Please restate that question.

Doctor COMMONS. I will put it this way: When you presented your charts the other day of the credit mechanism you called attention to the fact that there were no prices on those charts, which might lead one to reach the conclusion that you did not pay any attention to the expected effect on prices. You do not mean to be understood that way, do you? You take into account future price moves, do you not?

Doctor MILLER. Yes. You are addressing your question to me now personally, I assume?

Doctor COMMONS. Yes; from that explanation of how you used those charts.

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Doctor MILLER. Yes; sometimes to a very slight degree; sometimes to a pretty considerable degree; and sometimes I would feel that the changes in the price level were a very important and essential indicator, and that would be when I felt that the situation warranted an increased weighting of that factor, and at other times I would be disposed to pay practically no attention to it. I would not pay much attention to it now, for instance, in the determination of a question that came before the Federal Reserve Board to raise or lower discount rates, to put into the market or take out of the market two or three hundred million dollars.

Doctor COMMONS. If this bill were enacted into law you would be required to take into account your expectations, the effect of what you do upon price movements, would you not?

Doctor MILLER. It would contemplate that, undoubtedly.

Doctor COMMONS. A matter which you do not now consider of importance except as conditions change?

Doctor MILLER. Personally I consider it of importance when it is important, in my judgment. When it is not important I do not pay much attention to it.

Doctor COMMONS. You use your judgment to tell which is important?

Doctor MILLER. Exactly.

Doctor COMMONS. And if Congress proposed to say that you shall use your judgment to determine that prices are important——

Doctor MILLER (interposing). Always important; uniformly important.

Doctor COMMONS. So that your judgment under such a guidance will probably be somewhat different from what it is now, when you do not necessarily——

Doctor MILLER (interposing). It ought to be, if one is, at my age, capable of refashioning his mental processes to fit the requirements of a legislative mandate. I do not know to what extent that is possible.

Doctor COMMONS. Personally I believe you could fit yourself very well into this bill.

Now I want to ask you about the statistical charts which you have developed as an aid to what I would call this prediction or judgment of what is going to happen. As I understand it, those statistical compilations were not begun until about in 1922—September, 1922—when Mr. Stewart came to the research and analysis division?

Doctor MILLER. They were begun earlier, but the more active development and the publication of results came in 1922.

Doctor COMMONS. What do you mean by more active development? More prompt development?

Doctor MILLER. No; I meant more concentrated study of various groups of data thought to be relevant to the effective handling of credit problems by our division of research.

Let me just refresh my recollection. My recollection is, Doctor Goldenweiser, that we began some of these in 1919, that in 1920 they were carried on, and in 1921 we were pretty active?

Doctor GOLDENWEISER. I think so.

Doctor MILLER. But they did not come to fruition, so to speak, until a large amount of preliminary work had been done, and they did not appear in publication until the early part of 1923. If I

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remember rightly, it was about the early part of 1923 that we began to publish certain charts and recast the form of our monthly review of business conditions.

Doctor GOLDENWEISER. Yes, sir.

Doctor COMMONS. My own recollection from reading the bulletins is that in about February or March, 1923, you began a rather analytical discussion of these various movements indicated by index numbers. Taking production, you had evidently then compiled some indexes of production.

Doctor MILLER. That is correct.

Doctor COMMONS. And of trade and of employment and of pay rolls. Those were outside of the control of the Federal reserve system and they were indexes of expected future demand for credit. That is the way they are treated in your bulletin. So I take it that the first time you really had adequate statistics on which to base your judgment was about January, February, or March, 1923?

Doctor MILLER. I just want to say that my silence does not indicate that I should not want to qualify the word "adequate."

Doctor COMMONS. You do not think they are yet adequate?

Doctor MILLER. I do not think they ever can be adequate.

Doctor COMMONS. But they are based on an economic analysis of many factors which you have to weigh, and you try to put them all on a comparable basis of index numbers. If you see one moving up and another in another direction, you form some idea as to what is the probable future movement.

Now, I notice that you published at that time a chart on price statistics. You had your own index number of prices, 101 commodities, and published in 1923 a summary of the way in which that was compiled and analyzed it by domestic and export and import, all reduced to index number. You kept that up until—the last publication of it I can find is December, 1925, appearing later in the February bulletin. Why did you discontinue that index number?

Doctor MILLER. Why did we, Doctor Goldenweiser? Let me ask Doctor Goldenweiser about that.

Doctor GOLDENWEISER. The reason we discontinued it is that we decided that the Bureau of Labor Statistics index, being a more comprehensive index, was adequate for our purposes. What the board had intended by starting its own index number was comparing the price movements in different countries, and the idea was that by selecting some of the leading commodities and having approximately the same commodities in the different countries you would have a better basis of comparison. After experiments and after many of the countries had returned to the gold standard we decided that the index that was best adapted for domestic measurement was also the best index for international comparisons. During that same period Canada and England and Japan had all improved their index numbers and we decided it was not up to us any longer to compile index numbers for those countries, and the index number for the United States, which had been compiled for the purpose of comparison with those. fell by the wayside along with those others, because we decided that we could use the 404 commodity index of the Bureau of Labor Sta-

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tistics and the figures the board of trade had, etc., and they would furnish the best basis for international prices.

Doctor COMMONS. What I want to know——

Doctor MILLER (interposing). You want to know why publication of a price chart was discontinued in the bulletin; is not that so? Not the specific price curves that the Federal Reserve Board itself had been constructing, but why the price chart disappeared?

Doctor COMMONS. I will put it this way. The Bureau of Labor and the board of trade did not publish their statistics in an analytical form such as you evidently started out to do. That is, you distinguished export prices, import, domestic, and so on, and had your separate index numbers for those different prices.

Doctor GOLDENWEISER. The answer to that, somewhat in detail, Mr. Commons, is that these people also analyzed prices, although they did not analyze them in the same way we did. We found that the import and export classification was not a satisfactory classification, because the imports in this country applied to only a few commodities and the export group was very much dominated by the price of cotton, and we found we would not get any additional light out of them. The official foreign indexes are also grouped; the grouping of the board of trade, for instance, is shown on page 350 of the bulletin for May. It includes the food and nonfood products and then the industrial products under certain other groups, and we found by actual experiment that these groupings that they were making were more significant than our groupings, in which the exports and imports seemed the most significant but turned out not to be. The other grouping we had was into raw materials, semifinished products, and finished products, and we found that this grouping did not work out; that it was too complicated and that there were difficulties in definition, and all the work we did in trying to make use of those figures turned out to unsuccessful; so we decided that we were no longer justified in spending money on those compilations when they were not yielding any results.

Doctor COMMONS. The point I am getting at is this: I have taken your chart and I have analyzed the index number and divided it into exports and imports and the general average, and I find that since 1919, when there was a rise in prices, the export and import prices rose much faster than the general level, and when there was a full in prices, the same happened. This is what I gathered from your charts up to as long as I continued it.

From that I would draw this inference——

The CHAIRMAN. Can we not identify this chart so as to have it in the record?

Doctor COMMONS. This is a chart of wholesale prices, having three curves, one being of commodities, of the Federal Reserve Board, and later of the Bureau of Labor; the second being exported goods; and the third being imported goods, with the index numbers of each. (Chart, commons; whole prices, p. 278.)

The CHAIRMAN. Without objection, this chart will be inserted in the record at this point. We will call it the chart headed "Wholesale prices, 1913, equals 100, covering the years 1919 to 1928." The clerk will insert the proper number, to more properly identify it.

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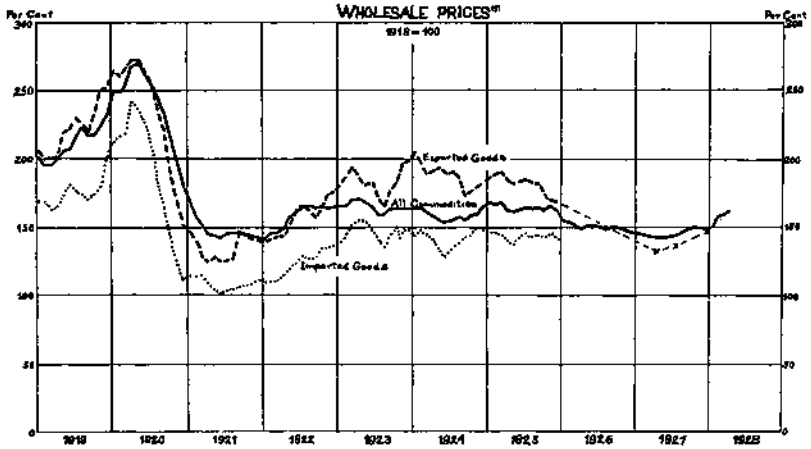
(The chart referred to is as follows:)



(1) Federal Reserve Board's index numbers for the period 1919 to 1925, inclusive. All commodities: 1926 and 1927 from the Bureau of Labor Statistics, first four months of 1928, relative changes from the Analist. Exported goods for April, July, and December, 1927, computed by Professor Commons.

Doctor COMMONS. While we had knowledge of those price movements analyzed in that way, it indicated that our foreign trade, export and import, was more sensitive, quickly responded to changes which I would call changes in monetary credit, or it might be cyclical changes, but they responded more rapidly, so that if you would try to figure out the effect of credit and currency on prices you would, if I am correct on that, first look to its effect on the export and import prices. There is where it first showed its effect, and by that export rising index it pulled the average up more than it otherwise would have done. Of course, the weight of those, reduced to export, is about 10 per cent, and the import is about 5 per cent, leaving the rest 85 per cent.

Doctor MILLER. Well, now, Doctor Commons, I have not studied this chart, obviously, but my approach to it would be altogether different. I would say, particularly as regards the exports, that what I would look for is to see when the prices rose, inasmuch as exports, particularly in the year when the price curve rises here, are made up mainly of agricultural staples. You take your line here [indicating on chart] and you find that it inclines sharply upward.

Doctor GOLDENWEISER. It would closely follow the curve of cotton prices.

Doctor MILLER. Here is your all-commodity price index. We have not an export line here, but you will notice the all-commodity index goes up in 1924, and goes up further in the early months of 1925.

Doctor GOLDENWEISER. This is the chart of wholesale prices which is in the record, both in my testimony and Doctor Commons's testimony. It shows the price index for all commodities, cotton, grains, and livestock.

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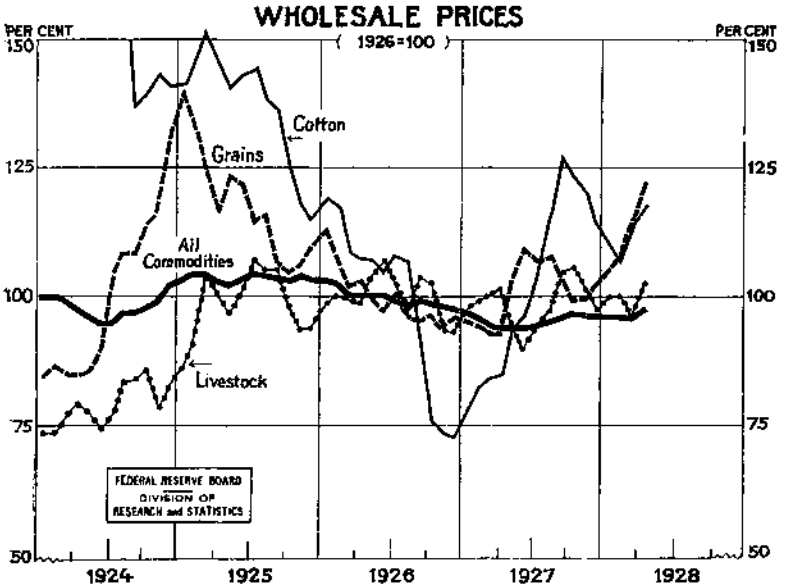

Doctor MILLER. I would suggest at this point, in case this chart goes into the record now or is referred to, in view of the fact that we have here a chart contributed by Doctor Commons, that these charts be marked "Federal Reserve Board," so that they can be distinguished from one another.

The CHAIRMAN. The clerk will make note of that so that there will be no confusion as to the origin of these two charts.

Doctor MILLER. You see, in 1927 there is a very sharp rise in the price of cotton. I can not say offhand—perhaps you can, Mr. Goldenweiser—about approximately what the ratio of the value of cotton exports is to our exports during the autumn months.

Doctor GOLDENWEISER. I should say about 25 per cent.

Doctor MILLER. So you see it will pull up prices of export commodities very materially. We had the same general movement, though in a less pronounced degree, with regard to grain. We know last year was a good grain year.

Back in 1924, we had a very pronounced upward movement in the price curve for grain. We know that that was due, firstly, to the short crops in Europe. The autumn of 1924 was a bad wheat year in Europe, and the establishment of credits in this market enabled the European consumer and the purchaser to get our goods and pay those prices. Approximately the same is true of cotton. So that I would say that, with regard to the exports, the primary factor of variation is the state of the European or outer world demand, the state of our crops, and the resulting prices. Credit also comes into it; it came into it strikingly in 1924.

Mr. WINGO. I think this chart should reappear in the record right at the beginning of this statement.

Mr. GOLDENWEISER. We can very well have it reinserted.

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The CHAIRMAN. Without objection, this chart of the Federal Reserve Board, of wholesale prices, will be inserted at this point in the record.

Mr. WINGO. No; at the beginning of this explanation the doctor has made.

Doctor COMMONS. Now, you attributed that change in these export prices mainly to crop conditions, apparently.

Doctor MILLER. I say that that was the physical factor over which nobody had any control. No central banking policy, no device, could alter that fact.

Doctor COMMONS. By what discount rate or money rate do you assist these foreign exports? Is it the bankers' acceptances?

Doctor MILLER. The rate on the bankers' acceptance has a very important influence in facilitating the financing of our exports by American credit. In certain situations probably it has also an effect in effecting the volume of certain of our agricultural exports that Europe can profitably import. In other words, it would affect the attitude of a speculative buyer in Europe, either of cotton or corn or some other commodities.

Doctor COMMONS. I notice in your chart here, that in 1924 you reduced——

Doctor MILLER. What chart?

Doctor COMMONS. "Money rates in New York."

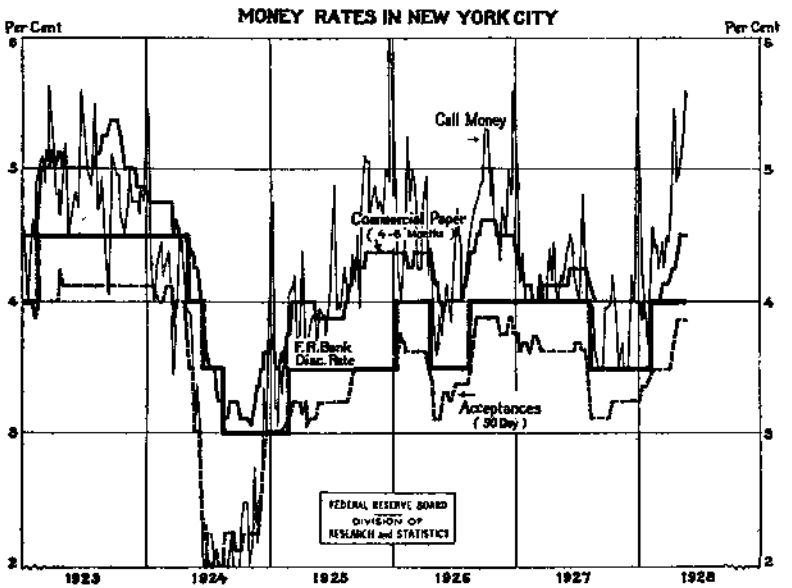
The CHAIRMAN. Is that in the record?

Doctor GOLDENWEISER. I do not know.

Doctor MILLER. My impression is that it went in the other day. You know that this chart has one additional line, the call-money rate.

The CHAIRMAN. Without objection, this new chart, "Money rates in New York," will be inserted at this point, a Federal Reserve Board chart.

(The chart referred to is reproduced below.)



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Doctor COMMONS. I notice the acceptance rate makes an extraordinary spread from what is called the bank discount rate in 1924. It drops down to 2 per cent, whereas the discount rate on commercial paper is 3 per cent.

Now, would that facilitate the furnishing of credit to Europe through bankers' acceptances? Would it cooperate, in other words, in helping raise the prices of exports and imports?

Doctor MILLER. I do not answer your last question because——

Doctor COMMONS. You do not know?

Doctor MILLER. I do not know, and, from my point of view, it is an approach at the wrong end, but that does not mean that you may not be right. I would say it is a factor in the cost of importation of American products. Now, to the extent that Europe will take more grain when she can import it at a little less cost by reason of the fact that credits for financing it can be arranged in the New York money market, at a lower rate than the current rate in London—to that extent it may do what? It may result in a brisker demand in this market, in which case the price would be higher, or it might result in the importation of a larger amount which would be sold in Europe at an existing price.

I do not believe there is any method by which you can tell, particularly in the case of commodities like grain and cotton, whether a revision in the cost of financing through a lower acceptance rate, either in New York or London or anywhere else, is going to raise the price or simply increase the amount taken at a given price.

I do not know as it would be worth while, Doctor Commons, except as you want to pursue this particular thing, to introduce into the discussion here the terms "elasticity" and "inelasticity" of demand, but we do know from studies that have been made that there are certain commodities the consumption of which is very quickly stimulated by a reduction of price. The same commodities will be those in which there is a contraction in the amount that will be taken the moment the price shows a disposition to go up.

Mr. BEEDY. Those commodities are notably what?

Doctor MILLER. Those commodities, the commodities whose consumption would change quickly with a change of price, belong to the group of what we might call articles of optional consumption, and notably the luxuries.

It is probably true that if the price of automobiles to-day could by reason of some superorganization be cut in half it would get response in the increased use of automobiles.

On the other hand, if the price of a loaf of bread were cut to 2 cents it is doubtful whether there would be any notable increase in the consumption of bread. We eat as much bread as we eat, irrespective of the price.

In general, it may be said, in answer to your question, Mr. Beedy, that the higher the well-being of any community, the less responsive is the demand for what we call articles of necessity. Everybody has all of those he wants anyhow and he is not going to get more because they are cheap.

So that, to sum up, I do not believe that you can draw any conclusion there that is of much value, except as you start with your conclusion in your interpretation or analysis of facts.

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Doctor COMMONS. That leads me to ask a question which bears upon the way in which a change in the discount rate affects the market. It is quite evident that a change of 1 per cent in the discount rate has very little change in the cost of production, is it not? It is an insignficant change in the cost of production. If we depended upon the discount rate to raise or lower the costs of production of goods, we would have a factor there which would not be more than, say, 1 per cent of the total cost of production, using cost in the sense of outgo for production.

So that if that is so, then the discount rate would have no effect whatever. You could change it 1, 2, or 3 per cent in considering the amount of bills payable and receivable as compared with the total costs of production, and you would find that it was of very slight effect if you base your argument on the cost principle. You must base the influence of the discount rate which you emphasized greatly here upon some other principle rather than cost.

Doctor MILLER. What would you like me to answer?

Doctor COMMONS. My idea is that it has an important bearing on the expectations of business men. It determines whether they are going to increase or decrease their commodities or raise their prices. It looks to the future.

Doctor MILLER. Now, when you refer to the important bearing on expectations, do you refer to the expectation of the attitude of the Federal reserve system, or because it influences the cost at which they can obtain money?

Doctor COMMONS. I would say that in so far as it influences the cost, in the sense of cost of production, it has no influence, no appreciable influence, but in so far as, say, a raise in the discount rate would lead business men to be cautious about commitments, about expected prices and expected volume of business, then a change in the discount rate might have tremendous effect.

Doctor MILLER. You think that effect is mainly sentimental or psychological?

Doctor COMMONS. What they call psychological, and that means nothing more or less than expectations. That is what psychology means in this case. It influences their expectations as to how much they are going to produce, how much they are going to sell, and with reference to being paid for it in the future.

Doctor MILLER. Well, is that really your view, Doctor Commons?

Doctor COMMONS. I am trying to find out whether it is yours.

Doctor MILLER. That is what I want to know, if you are trying to develop my point of view.

Doctor COMMONS. I want to develop your point of view on how you analyze these changes in the discount rate as to their effect upon the market, in quantities and prices.

Doctor MILLER. Well, we do not analyze the discount rate. We make the discount rate, so that is a factor controlled by the Federal reserve system.

What we do analyze are factors that bear upon and therefore give some indication of whether or no there should be a change, and, if so, whether that change should be an increase or a diminution, or, in certain contingencies, whether there should be any change.

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Now, I would say, taking one of the periods that you have referred to here, the earliest one, namely, 1924, when the acceptance rate of the Federal reserve banks ran as low as 2 per cent, I think, and I think the same is true of the call rate——

Doctor GOLDENWEISER. That is right.

Doctor MILLER. You asked why those rates were so low. The acceptance rate was falling steadily throughout the first half of the year 1924. It began to show a tendency to rise in the third quarter of 1924, and the rise was rapid in the last quarter or the last two months of 1924.

The year 1924, as a whole, was a dull year in American trade. I do not think you want to stop to verify that point by reference to these charts, but I think we all remember it sufficiently as a dull year. The acceptance rate was running down, and so were other rates in the first half of the year, because we were getting an extremely large importation of gold.

Do you know approximately what the gold imports were?

Doctor GOLDENWEISER. $200,000,000 of gold in the first six months.

Doctor MILLER. That was at a time when the demand for credit was very slack and when trade was running down.

Now, the turn came in the autumn of the year, and it came primarily, I should say, with short harvests in Europe, and therefore an increased demand for American farm products and also with a considerable volume of foreign financing. The first of the outstanding years in which foreign loans were placed in the American market was the year 1924, in the second half of that year.

Now, under those circumstances it may well be asked, What kind of a discount or credit policy was indicated for the Federal reserve system? The year opened with a 4½ per cent discount rate, and in April or May it dropped to 4 per cent, then 3½ per cent, and late in July or early in August it went to 3 per cent in New York.

At the time when the rate went to 3 per cent it was a debatable question whether or not it was advisable. My own opinion at the time was that it was advisable for a variety of reasons, even though there were different reasons for believing that it could not safely be left at 3 per cent for a very long interval.

Now, I say that I think it was advisable. I am speaking now purely personally, because I have said here a good many times that you may know what is in your mind, particularly when you are referring to a past situation, but you can not be sure that you know what is in the minds of others. The view I have entertained since 1922–23 was that in the incipient stages of a business recovery a low rate may exercise a stimulating effect, that when that effect is in process and has gone approximately near the limits of safety it is not advisable to leave your rate low but to begin to apply a little pressure in order to make it less easy for commitments, perhaps, of an undesirable character to be taken on.

Now, what happened was that the rate went to 3 per cent in, I think, August, 1924. The latter part of the year 1924 was one of distinct business recovery. A distinct good feeling existed in the country, and that feeling registered itself, as I recall, among other things, in the first pronounced upward swing in the stock market since the brief spurt in the early part of the year 1923. There was

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getting to be pronounced evidence of this sort of thing that we have been recently complaining of in this country, an active stock market with a steady rise of quotations.

The rate continued at the 3 per cent level until about February, 1925—is that correct, Doctor Goldenweiser?

Doctor GOLDENWEISER. Yes.

Doctor MILLER. It was then advanced in the New York bank to 3½ per cent. In the meantime open-market rates were moving up. The call rate was going up, the commercial-paper rate was going up, the acceptance rate was going up, and money was in demand. It was in demand because of active securities speculation and because of more active trade, and it seemed advisable to test out the situation by the application of a higher rate, and there were some accompanying sales of securities in the market at that time.

Doctor GOLDENWEISER. The period you were discussing was the first couple of months of 1925, and there were considerable sales of securities.

Doctor COMMONS. I am speaking of 1924. You bought securities during 1924.

Doctor GOLDENWEISER. In the early part of 1924 there were very large purchases of securities.

Doctor COMMONS. What was the increased volume of securities in 1924?

Doctor GOLDENWEISER. $500,000,000. We started at about $100,000,000, and went up to about $600,000,000.

Doctor MILLER. Does that represent simply the total of United States securities, or the special investment account?

Doctor GOLDENWEISER. This is the total.

Doctor MILLER. Yes. Approximately, at the maximum, there were $600,000,000 in the portfolio of Government securities.

Doctor COMMONS. That was at the end. Toward August, what was it? At that point there was about $600,000,000?

Doctor GOLDENWEISER. $540,000,000.

Doctor COMMONS. And in January how much?

Doctor GOLDENWEISER. About $120,000,000.

Doctor COMMONS. So that your increased purchases were $500,000,000?

Doctor GOLDENWEISER. Close to that; yes.

Doctor COMMONS. You have a working principle which you have mentioned in your former testimony, and I find it in Governor Strong's testimony and also in your report, that you need to multiply by 10 in order to find the increase in bank credit, of an increase in securities—that is to say, if you increased the securities by $500,000,000, it would work out, on the principle of 1 to 10, if you increased the bank credit of the country ten times, that it would be $5,000,000,000. Would that ratio apply to that situation?

Doctor MILLER. It certainly would not.

Doctor COMMONS. What is the reason for that?

Doctor MILLER. The reason is that a good deal of that money was used to pay off rediscounts. It simply meant that the reserve credit that was afloat in the country was open-market credit instead of rediscount credit.

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Doctor COMMONS. How do you figure that ratio of 1 to 10? Does it always remain 1 to 10, and what are the conditions which cause it to change?

Doctor MILLER. It is subject to a variety of factors, one of which is the nature of the increased credit that is being used, and also the character of the member-bank liabilities which give rise to the need of more reserve. When you have, as we have had in recent years, notably in the years 1925–26, a relatively great increase in so-called time deposits which under the law require a reserve of only 3 per cent, obviously a given volume of reserve credit on the books of the member banks will sustain a far larger volume of credit on the part of the member banks than when the credit in the member-bank liabilities is not time deposits but demand deposits, which require a reserve in the so-called country banks of 7 per cent, of 10 per cent in the reserve city banks, and 13 per cent in the central reserve city banks.

Also, the requirement of currency is a most important factor and when the member banks borrow from the Federal reserve banks in order to get currency the ratio is practically 1 to 1. In order to get a dollar of currency, they have to put up a dollar of paper.

Doctor COMMONS. That would be also true when they are paying off their indebtedness, would it not?

Doctor MILLER. Yes; or when they are borrowing, in order to get gold for exportation, they have to give dollar for dollar.

Doctor COMMONS. So that it might have increased, instead of, say, $500,000,000, multiplied by 10, which would be $5,000,000,000, to something less than that, only five times as much.

Doctor MILLER. When you are saying, it might have, what do you mean?

Doctor COMMONS. I mean the bank credit.

Doctor MILLER. I would say nothing could have happened in the year 1924 different from what actually did happen. We are not in a vacuum with respect to that year.

Doctor COMMONS. I wanted to get what your statistics showed as to the augmentation of bank credit in use.

Doctor GOLDENWEISER. The total volume of reserve bank credit did not increase at all during the year 1924 as a whole.

Doctor COMMONS. That is because the debts were paid off?

The CHAIRMAN. You made a reference there a moment ago to open-market credit. What is the difference between open-market credit and general credit?

Doctor MILLER. As I use the term, it is an elliptical term for indicating reserve bank credit that is in the market by virtue of the fact that the reserve bank itself has put it in the market through the purchase of Government securities. By the alternative method, credit comes into the market at the instance of the member bank, which goes to the reserve bank with its paper and has it rediscounted. It is largely a question as to who takes the initiative. In the open-market operation, the Federal reserve bank takes the initiative.

The CHAIRMAN. That clarifies it.

Doctor COMMONS. I had a different meaning of open-market rate of interest as distinguished from the discount rate of interest.

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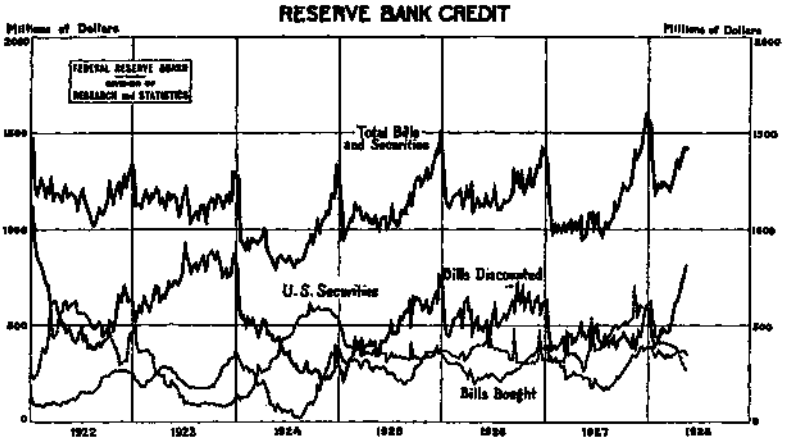
Doctor MILLER. The open-market rate of interest?

Doctor COMMONS. I thought you meant the four or six months commercial rate.

Doctor MILLER. No; I am talking about the method by which this money that was put into the market in the first six or seven months of the year 1924 effected a redistribution of the assets of the Federal reserve banks when it came into the market and was deposited with the member banks. The member banks did not use it to expand their business, but to pay off their indebtedness to the reserve banks, and so you see that the line there [indicating on chart] which represents rediscounts goes down as the United States securities go up.

The CHAIRMAN. So that the record may show clearly, the witness is now using the chart of the Federal Reserve Board called, "Volume of reserve bank credit." Without objection, this will be inserted in the record at this point.

(The chart referred to is as follows:)



Mr. BEEDY. You are referring to the chart showing the volume of Federal bank credit?

Doctor MILLER. Doctor Goldenweiser has that chart there. The upper line indicates the total amount of reserve-bank credit in the market, and there was no pronounced movement there within the trend of the curve during the first half of the year. When you come to the second half of the year you get a different situation.

Doctor GOLDENWEISER. There was a big decrease in the first part of the year.

Doctor MILLER. That is purely seasonal.

Doctor GOLDENWEISER. It was also due to the very large imports of gold that were taking place at that time.

Doctor MILLER. I think the point of view of Doctor Commons's inquiry is that you get those kinds of movements—in other words, if you take the first six months of 1924 as a whole and compare them with 1922 and 1923, you get no very pronounced change in the total volume. You get up and down movements, but there is nothing conspicuously different in the actual volume of Federal reserve bank credit outstanding.

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Doctor COMMONS. He brought out another figure, of member-bank credits.

Doctor GOLDENWEISER. Yes. This was all member banks; this is the chart of all member-bank credit.

Doctor COMMONS. For 1924?

Doctor GOLDENWEISER. Yes.

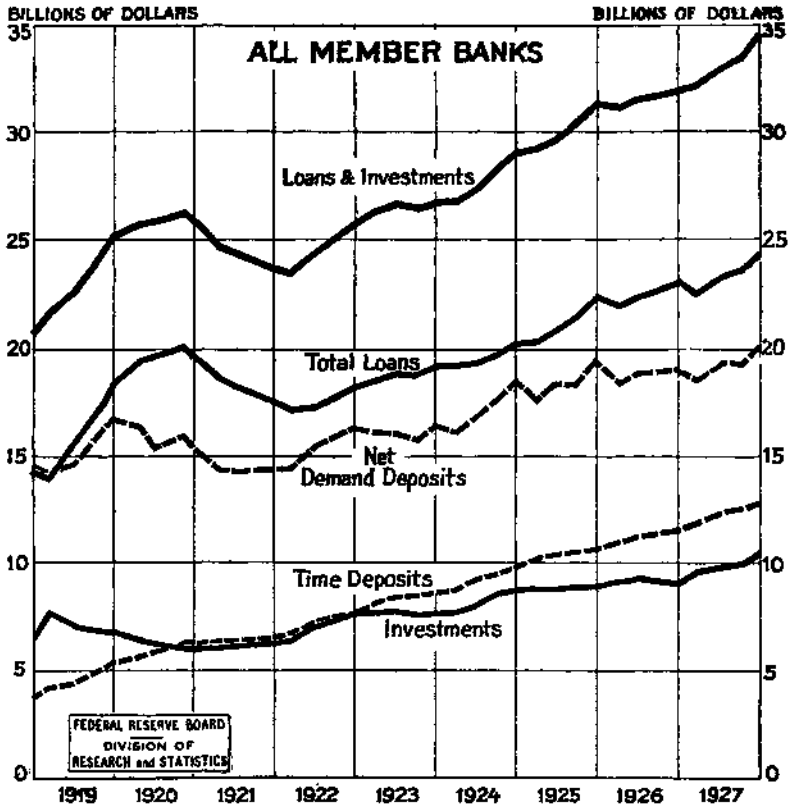
Doctor COMMONS. How much did that rise during the period?

Doctor GOLDENWEISER. In the latter part of 1924——

Doctor MILLER (interposing). Let us keep the first part of 1924, when we were putting money into the market, separate. That is an episode in itself.

The CHAIRMAN. The chart now inserted into the record is entitled "All-Member Banks." Without objection that will be inserted at this point.

(The chart referred to is printed below.)



Doctor MILLER. I would say, Doctor Commons, that the first striking thing in that chart for the year 1924 is that during approximately the first half of the year, despite the fact that the Federal reserve banks at that time were steadily putting money into the market by open-market purchases of securities——

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Doctor COMMONS (interposing). Did it begin in the first part of the year?

I see, by looking at the chart of reserve-bank credit, that they began putting money into the market in January, and continued to buy securities until August.

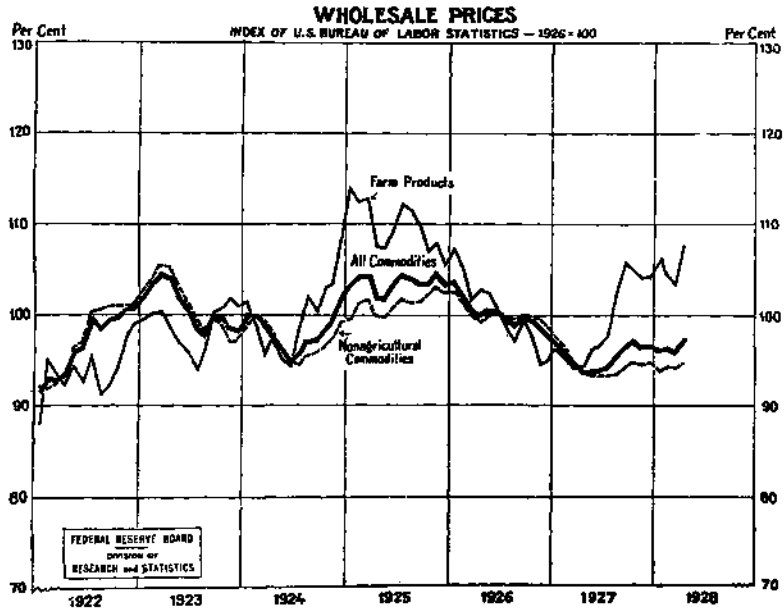
Doctor MILLER. Yes; and at that time we were apparently getting no marked response in the total loans and investments of member banks, and in part the reason for that is that they were using the money to reduce their rediscounts at reserve banks. You see, the first six or seven months of the year 1924 was a time of almost unprecedented gold imports. Those imports of gold were exerting the same sort of general influence upon the situation of the member banks and on the money market as the purchases of securities by the reserve bank. They were in part used to reduce their rediscounts. They exerted no pronounced effect upon the upward movement of loans and discounts.

Now, Doctor Goldenweiser, please get your price chart.

Doctor GOLDENWEISER. Prices also were not going up.

The CHAIRMAN. The chart now inserted in the record is entitled "Wholesale Prices." It shows the price index for all commodities, farm products, and nonagricultural commodities.

(The chart referred to is printed below.)



Doctor MILLER. Now, what I would like to call attention to is that at the time when the Federal reserve bank was pursuing a policy of open-market purchases in greater volume than it ever did before, or, I think, has since, when gold imports attained a magnitude of approximately $200,000,000 or more in the first half of the year, and when the rediscount rate was being lowered, there appeared to be no re-

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sponse in the borrowings of the public. There is no reflection of the increase in the loans and investments of all the member banks and no response in the movement of prices; in fact, at the time when we were pursuing the most liberal money policy we had up to that time prices were steadily running down.

Doctor COMMONS. That is to say, there were three forces—gold imports, purchasing of securities, and a low money rate?

Doctor MILLER. Exactly.

Doctor COMMONS. All of which would make for easy money, and yet prices continued to fall?

Doctor MILLER. And yet prices continued to fall at the time when this was in process.

Doctor COMMONS. How long, in your experience, have you figured out that it takes for these processes to filter through until they reach the stock market and the export market and the price market?

Doctor MILLER. I wish you would figure that for us.

Doctor COMMONS. I figure it very plainly here, that, beginning in July, 1924, prices had started up. I have not the stock prices. I presume they started up earlier and faster. Prices started up from about 95 and went up to about 105, about 10 per cent or 11 per cent, apparently a steady process, when business was dull and a falling off of gold imports and open-market purchases and a lowered rate to 3 per cent, which was, of course, lower than you ever had it before at any time, had no effect until something from the outside started things up, which seems to have been about the middle of July, 1924. That may have been some foreign situation. You say that the foreigners began borrowing a billion dollars.

Doctor MILLER. That was later in the year.

Doctor COMMONS. That would not have had any effect on this?

Doctor MILLER. It had an effect later in the year, undoubtedly.

Doctor GOLDENWEISER. The world shortage of wheat was the cause.

Doctor COMMONS. It may be another nonmonetary cause.

Doctor MILLER. When you have a period of fairly prolonged dullness in trade, it is inevitable that there is going to be sooner or later a revival, and that revival will show itself in the movement of prices. It may be the upward movement of prices that produced the revival; it may be the signal that the consumer wants more goods; it may be an indication that the producer is willing to face the hazards of resuming, but whatever may be the combination of causes. I should say that they became active in the latter part of the year 1924, and it may have been that the immediate cause was the increased demand for farm products and the buying in this country by Europe because of the favorable terms upon which they could get credits here.

Doctor COMMONS. The rate of interest was very low, so they could float their securities in this country and borrow more money.

So, putting it in your own terms, does it not come out this way, that when business is dull you can not push things, you can not crowd things, but meanwhile you can enormously increase the possibilities; that is, you can increase the gold imports, just taking that period?

The CHAIRMAN. You are speaking now of the action of the Federal Reserve Board?

Doctor COMMONS. Yes; I am thinking now partly of the action of the Federal Reserve Board. There are two things the Federal Re-

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serve Board controls—open market and the low rates of discount. As to the gold imports, I do not know. Would you say the Federal Reserve Board controls that or not?

Doctor MILLER. The money rates control that in normal times and, to the extent that the Federal reserve is a factor in the money rate, it can control it. In 1924 the world was not yet on a gold standard, gold movements were not free and were not so responsive to money rates.

Doctor COMMONS. It was also during the early half of 1924 that you kept piling partly gold from abroad, partly open-market purchases, and the very low rate of discount, and it had no effect. Now, if you should take the time factor into account, we should hardly expect any of these forces to operate coincidentally, should we? We would have to have a time interval, and that time interval apparently comes from some industry that starts up or something that starts the demand. Then all of your Federal-reserve policy, all of your accumulations of easy money, begin to concentrate on that nonmonetary factor, which you say is the demand side, and you have an easy market which they can immediately take hold of, so you have practically there one of the most rapid rises of prices, and if you take the export prices you will find that they rose about the same as all domestic prices.

I think that this analysis follows exactly the answer you made to Congressman King the other day, in which you said that in a dull time no low rate of interest will help anything. I would say also no gold imports would help and no open-market purchases would help, and, when things are going down, everybody is pessimistic. But you also say that when the things do start up then you can stimulate the start by having these low rates and these open-market purchases, but you have to wait until that time comes.

Is not that entirely consistent with the theory you——

Doctor MILLER (interposing). I would not object to that statement.

Doctor COMMONS. It comes under the head of what you call time limits?

Doctor MILLER. Yes.

Doctor COMMONS. If there is a dull season here and you know that low, easy money is not going to help, yet if by timely action preceding that you prepare the way and get an easy money market, then when the time comes that demand will absorb it and you will have this increase in price. Of course, there was a great increase in the volume of production at that time, as your figures also show. Would you say, then, if you took into account the time factor or time limits, if you planned in advance at the proper time your discount rates and your open-market rates in the prospect of some event that is going to happen, which you know always will happen—you know there will be seasonal upturns of industry and all that—if you have prepared for that, you can by that means effect a demand for credit along with the return of business activity—that is, you can stimulate the demand?

Doctor MILLER. Stimulate the use.

Doctor COMMONS. Yes; stimulate the use.

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Doctor MILLER. Yes; by making your credit cheaper at the time when business wants credit and wants to borrow. If it does not want it, you get no appreciable response.

Doctor COMMONS. You have got to wait.

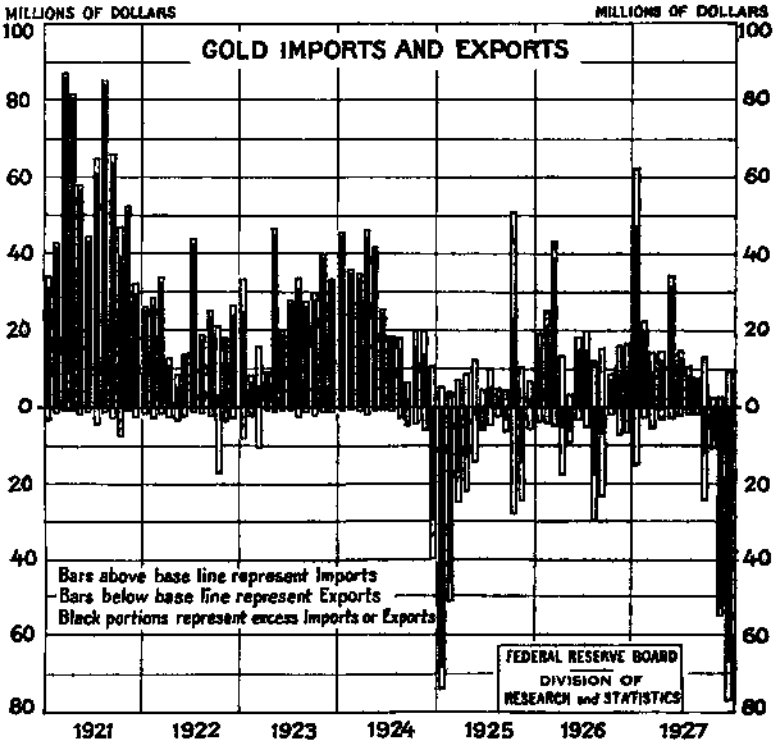
Doctor MILLER. There must be an appetite for credit before you can affect the consumption of credit by your rate.

Doctor COMMONS. It is just like feeding my hogs. I can go out and fill the tank with plenty of provender, but if the hogs are not hungry they won't eat it. So you can fill the market with money, and if the market has not any expectations or boost it won't take it, but when it does take it it will take it very fast. You may have a rapid rise of prices.

I would like to go on with the period of 1922–23 in order to get this thing down to a quantitative basis. We have just so far talked qualitatively, not quantitatively, and it appears that in 1922–23 you used the same instruments you talked about here with very great success.

I should like to analyze the different factors of 1922–23. First, the net gold imports from September, 1920, to March, 1923, I figured out to be $1,120,000,000.

Doctor GOLDENWEISER. That sounds as if it were correct; 1920 is not on this chart, but there were two or three months of heavy gold imports during the latter part of 1920.



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Doctor COMMONS. But we had net exports prior to September, 1920; then we began to have an accumulation of net imports, which I figured during that time, up to March of 1923, was $1,120,000,000. Now, on top of that, during that same period, you first started in to buy securities—what year was that?

Doctor GOLDENWEISER. 1922, you mean?

Doctor COMMONS. The first part, up until May, 1922, you were buying securities. How much in securities were bought during that year? Was that the low point?

Doctor GOLDENWEISER. This is about the low point, yes; close to the low point.

Doctor COMMONS. Apparently the buying of securities early in 1922 had no effect. It simply enabled the member banks to pay their debts to the Federal reserve system, so you would say that the security buying would not have any effect—would that be the way you would interpret it?

Doctor MILLER. Yes; I would say it simply changed the name of the credit.

Doctor COMMONS. Now, from May, 1922, when the open market committee began operating—May or June, 1922—and began selling securities, until the middle of 1923, how much was sold?

Doctor GOLDENWEISER. About $500,000,000.

Doctor COMMONS. I would like to follow that up in relation to 1922 prices. This is the way I find it: That beginning in January, 1922, up until April, 1923, prices arose from about 138 to about——

Doctor GOLDENWEISER. One fifty-nine.

Doctor COMMONS. That was an increase of about how much?

Doctor GOLDENWEISER. About 15 per cent.

Doctor COMMONS. Now, we had a discount rate there of what?

Doctor GOLDENWEISER. The discount rate at New York was 4 per cent during most of that period.

Doctor COMMONS. Now, we had then a rise of prices beginning in 1922—going up very rapidly.

Doctor MILLER. What part of the year?

Doctor COMMONS. The beginning of 1922.

Doctor GOLDENWEISER. January, 1922, was the postwar low point.

Doctor COMMONS. That is to say, 1921 was the year of depression, and business started up in January, 1922. As you doubtless remember at that time a great many people became alarmed at the rapid rate at which prices were advancing in 1922 and 1923, and they predicted that there was a recurrence of the inflation of 1919. In fact, at a certain period their prices were rising more rapidly than they had risen in 1919.

What would be the counteracting effects by which, as a reserve system, you would attempt to check that rise of prices?

Doctor MILLER. Well, I should say that, taking the period as a whole, the Federal reserve did not undertake to check that rise in prices, on the theory that that rise in prices was due to certain economic factors that inevitably would and should be permitted to work out their effects in price changes. We were emerging from

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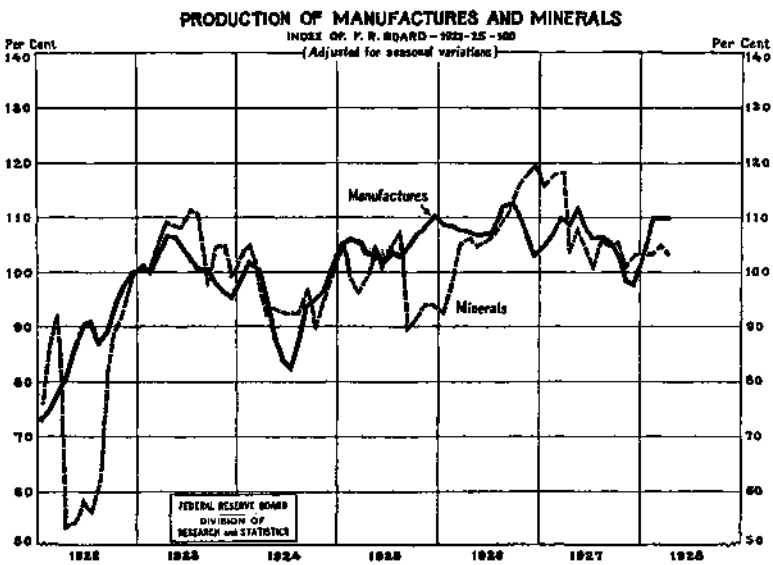
a period of acute depression. Business was at a low ebb. Goods were in short supply, and a rise of prices as interpreted by the Federal reserve would be the signal that the consumer was beginning to show a disposition to consume, and we had concurrently an upward movement of prices and an upward movement of production and trade.

The CHAIRMAN. The chart that is now introduced is called "Production of manufactures and minerals."

The chart referred to is printed below.)



Doctor MILLER. Prices were rising from the low level of 1921, both the curve marked "Manufactures" and the curve marked "Minerals."

Doctor COMMONS. May I answer there that your index of industrial production shows that the physical volume of industrial production rose from about 74 in January, 1922, to about 107 in April or May, 1923. That would be an increase in the physical volume of production of about from 74 to 107.

Doctor GOLDENWEISER. That is about 50 per cent.

Doctor MILLER. That is a very pronounced increase.

Doctor COMMONS. Now, if you take your pay rolls, they showed an increase in 1922——

The CHAIRMAN. The chart that is now introduced is "Factory employment and pay rolls."

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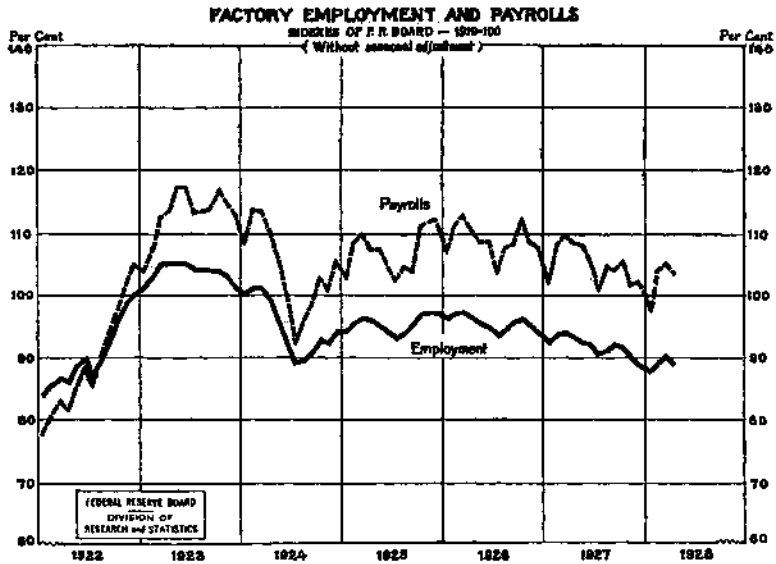
(The chart referred to is printed below.)



Doctor COMMONS. That increased how much?

Doctor MILLER. From under 80 to about 120. That is also 50 per cent.

Doctor COMMONS. Now, employment increased——

Doctor GOLDENWEISER. From about 83 to about 104, about 25 per cent.

Mr. BEEDY. From January, 1922, to when?

Doctor GOLDENWEISER. From January, 1922, to about May, 1923.

Doctor COMMONS. Now, I understand from reading the bulletin of that period, 1923, that it was considered by the Federal Reserve Board that there was no inflation because there were still people unemployed, because production had not reached its normal, saying there were 3,000,000 or 4,000,000 people out of employment in 1921. They had to be absorbed into industry, and it was not until about March or April, 1923, on the basis of the statistics you had, that you could infer that production and employment had about reached full production and full employment.

Doctor MILLER. Yes; we will let it go at that, and that the rise of prices had about exhausted its effects on the activity of the productive agencies of the country, and that the movement had approximately reached its end or was about to.

Doctor COMMONS. That was on the basis of such statistics as you had been compiling at that time. Well, then, this alarm that was felt by the public generally about that increase in prices did not alarm you because you felt that it had not gone far enough yet—that is, in January and February—to stabilize production?

Doctor MILLER. I would not, of course, use those terms——

Doctor COMMONS. Stabilize employment?

Doctor MILLER. We were not thinking of stabilization at all. If we had been thinking of stabilization, I think we might have put

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the brakes on this movement and either checked or destroyed the first considerable spasm of recovery after the depression of 1921.

Doctor COMMONS. How would you put the brakes on?

Doctor MILLER. By a very severe contraction of credits.

Doctor COMMONS. You would have contracted credits by what methods?

Doctor MILLER. By any method available.

Doctor COMMONS. Discount rate?

Doctor MILLER. Discount rate.

Doctor COMMONS. You would have raised the discount rate?

Doctor MILLER. Also by more energetic sales to the open market. We still had a considerable volume of securities that could have been sold to the market.

Doctor COMMONS. You were selling them?

Doctor MILLER. By very gradual degrees, merely to feel out the situation, without, however, any definite commitment that the situation was one that needed firm restrain and control.

In other words, I would say that the policy of the Federal reserve at that time was one of concern, but it did not propose to get alarmed because of the expression of alarm in the public press and in certain scientific business reviews, unless it found that conditions pretty definitely warranted it.

I would say only because we are talking here in connection with a legislative proposal, that attaches particular importance to the price curve, that the significance of this particular episode is that the Federal reserve, to the extent it gave a good performance at that time, gave it because it was not concerned with stability of prices. Prices were moving rapidly upward, but I think the judgment of the Federal reserve may be properly said to have amounted to about this, that it did not interpret that upward movement of prices as inflationary in character, because close tab on the situation showed that while prices were moving upward, so was production and trade, and sooner or later production would overtake the rise of prices, demand would be satisfied, and prices in turn would trend downward, and, as a matter of fact, I think they did beginning about mid year, 1923.

Mr. WINGO. Do you recall whether or not the board realized that that upward movement had about spent its force?

Doctor MILLER. Yes; I think it was our view in April that the movement had about spent its force. If we could go back now, or if we knew then what we know now, my own disposition would be to say that the Federal reserve might even have dispensed with the slight precautionary operations that it then engaged in, to wit, an advance of the discount rate in New York, I think in March of 1923.

The CHAIRMAN. I notice this, Doctor Miller, that following the activities of the board in the spring of 1923, the wholesale price level went down until, say, September of 1923, to about 97 or 98, which was followed by some irregularity later on in the year and in the early part of 1924, but in midsummer of 1924 the wholesale price level reached the low point of about 95. Was that lowering to that point of 95 the direct result of the activities that were taken by the Federal Reserve Board in the early part of 1923?

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Doctor MILLER. I would say emphatically no; emphatically no. I would say that prices were down at that time primarily because they went up so high in the previous period and that the whole movement of prices in this period was one toward the ascertainment of a new level. The prices themselves were, so to speak, finding their new level.

The CHAIRMAN. So any actions of the Federal Reserve Board taken in 1923 were not reflected in that movement of low prices of 95 in 1924?

Doctor MILLER. I would not want to go so far as to say that. They were a factor, but, I should say, mainly a psychological factor. The very existence of the Federal reserve, the assurance that there was a reservoir that could be drawn upon for credit in case of increased credit needs, acted as a moderating and steadying influence, and rates also had a minor effect.

The CHAIRMAN. When the wholesale prices reached that low point of 95 in midsummer of 1924, there was an immediate upturn. What part did the Federal reserve management have in that?

Doctor MILLER. In the upturn?

The CHAIRMAN. Yes. Just what occurred in the management of the Federal Reserve Board at that point, when the general wholesale price level reached the point of 95?

Doctor MILLER. You mean, in reaching the low point?

The CHAIRMAN. At that point when the wholesale price level reached 95, what did the Federal Reserve Board do, if anything?

Doctor MILLER. The Federal Reserve Board was easing the situation at the time the price level was descending. The price level was descending in the first half of the year 1924. That was the time when the Federal reserve was pursuing definitely a policy of easing the situation, not for the purpose primarily of restraining the fall of prices. That was undertaken from an entirely different set of considerations. Nevertheless, if it had been its policy to try to direct its credit policy toward an influence on the movement of prices, the easing of the money market at this time would have shown, I think, no immediate effects on price movements.

After midyear of 1924 prices began to rise. At about the same time the credit policy of the Federal reserve shows the application of some pressure on the situation.

Doctor GOLDENWEISER. You are referring to the period of 1925?

Doctor MILLER. 1924. The Federal reserve began to sell securities toward the end of the year 1924.

In brief, I would say its attitude was one of exercising some pressure. In the meantime prices were going up.

Now, here is a question, Doctor Commons, that I think we have already covered—to what extent the credit that was available by reason of large gold imports in the first half of 1924 and by the liberal credit policy of the Federal reserve system was responsible for the movement of prices that went on later in the year.

Doctor COMMONS. You said that the fall in 1924 was due to reaction of what had occurred in 1923. Do you say that the price level in April and May, 1923, had gone too high?

Doctor MILLER. No.

Doctor COMMONS. What do you mean by "reaction"?

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Doctor MILLER. I mean that prices went up because of shortages of supplies.

Doctor COMMONS. In 1923?

Doctor MILLER. Yes. The whole productive machinery of the country was speeded up to the highest point, I think, that was ever registered previous to 1926. The consumer demand could not keep up with the producing capacity, and therefore it was inevitable that goods should come on the market in greater amount than could be taken off, except at a lower price level.

That is what I mean by saying that the decline of prices in 1924 was a reaction.

Doctor COMMONS. If that is true, you should have applied pressure earlier than you actually did in 1922 and 1923 in order to keep that production from going up to the 1923 peak?

Doctor MILLER. I can not follow you there, and I can not grant it.

Doctor COMMONS. If you had foreseen that 1923 would bring you overproduction, then you should have applied it earlier and more experimentally, as we were speaking a moment ago.

Doctor MILLER. I do not think it would have made any difference. I think if we had, these prices would have risen even higher.

The CHAIRMAN. I am going to suggest, as it is 20 minutes to 1, the committee recess until to-morrow morning at 10.30.

(Whereupon, at 12.40 o'clock p. m., an adjournment was taken until Thursday, May 17, 1928, at 10.30 o'clock a. m.)

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Thursday, May 17, 1928.

The committee met at 10.30 o'clock a. m., pursuant to adjournment, Hon. Louis T. McFadden (chairman) presiding.

The CHAIRMAN. The committee will come to order. We will resume the hearings on H. R. 11806. If you gentlemen can remember where you left off, we will be very glad to have you proceed.

STATEMENT OF DR. ADOLPH C. MILLER—Continued

Doctor COMMONS. I think, Mr. Chairman and Mr. Miller, that I was trying to bring out the comparison between the 1919 and 1920 operations and the 1922 and 1923 operations, to see what, you might say, the Federal reserve system learned by experience in those two events. I do not know whether you have a chart here of the price movements back to 1919.

Doctor GOLDENWEISER. I am afraid I have not the 1919 chart today. I brought one that goes back to 1921.

Doctor COMMONS. I want the 1919.

Doctor GOLDENWEISER. I have not one for months that far back. I have one by years. Will that do?

Doctor MILLER. Do you want one covering the years 1919 and 1920?

Doctor COMMONS. Yes. The computations from the Bureau of Labor indicate that the wholesale price level rose from 201 in April, 1919, up to 249.

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Doctor GOLDENWEISER. I have the chart covering that here.

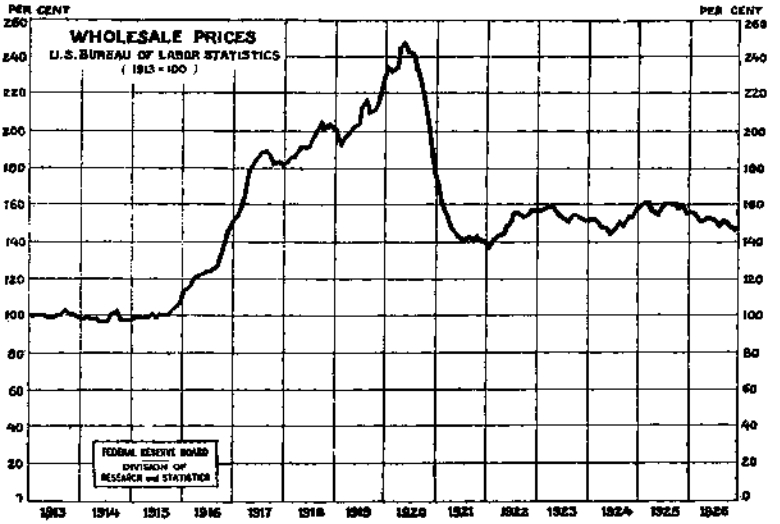
Doctor COMMONS. And, according to the Federal reserve bulletin, the corresponding movement was from 195 to 269, which would show that the two estimates did not move quite the same. There was an average 25 per cent increase according to the Bureau of Labor, and a much larger increase as shown by the Federal reserve bulletin.

In the period of 1922 we had a rise in prices of—I think we figured it out the other day——

The CHAIRMAN. Do you want to put this chart in the record?

Doctor COMMONS. I prefer the one from 1919.

Doctor GOLDENWEISER. I will have one put in going back to 1919. I do not have it here, but I will put it in the record. It is on the 1913 base and covers the years 1913–1926.



Doctor COMMONS. Now, there are certain monetary and credit policies, and there are nonmonetary business situations. The question I want to raise, Mr. Miller, is: What is the difference between those two circumstances which in 1919 and 1920 caused prices to go up 25 to 40 per cent; that is, from the beginning of 1919 to 1920?

Doctor MILLER. What caused prices to rise 25 to 40 per cent from 1919 to 1920, and what per cent in the second period?

Doctor COMMONS. About 15 per cent.

Doctor GOLDENWEISER. From 138 in January, 1922, to 159 in May, 1923. That is about 15 per cent.

Doctor MILLER. My answer would be, nobody knows.

Doctor COMMONS. Now, let us take the operations that were occurring at that time. I will analyze them partly. In the first part of 1919 the Government was lending money to Europe up until about April. That would increase the purchasing power of Europe. From that time on until, we will say, the early part of 1920, the banks in this country were lending on short-term paper to Europe to the extent of nearly $4,000,000,000. The estimates have been made. I figure that it was about three and three-quarters up to $4,000,000,000.

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Now, that would augment the purchasing power of Europe for American commodities, would it not?

Doctor MILLER. Yes.

Doctor COMMONS. So that during that year, 1919–1920, Europe had a purchasing power originating in America, first by Government loans and then by bank loans, of about $5,000,000,000, which had increased their purchasing power.

Mr. GOLDSBOROUGH. Was that all utilized?

Doctor COMMONS. It probably was. This four billion of bank loans to Europe would be in what form; partly bankers' acceptances?

Doctor MILLER. Yes. I do not think that would constitute the most important part of it. I am at something of a disadvantage in discussing this in detail, because it has not been in my mind for a long time. But, as I recall, it was in part a direct credit, or loans made by our Government to European governments. In that case it would be a credit in American banks. That is, our Government, which issued the Victory loan in the spring of 1919, and was bringing out issues of short-dated securities throughout the whole of the year, would use the proceeds in part to grant credits to the European governments. My impression is that those aggregated about two and one-half billion in 1919.

Doctor GOLDENWEISER. I think that was approximately the figure.

Doctor MILLER. In addition, it was assumed by many of our leading exporters, particularly of foodstuffs, that because of the depleted stocks of Europe there would be a very heavy demand for American breadstuffs, pork products, and so on; and there were enormous masses of pork products particularly that were sent to Europe on consignment and financed by American credit, partly in the shape of domestic acceptances and in other cases by foreign acceptances. By foreign acceptances I mean acceptances by American banks, but against export transactions. There were direct expenditures in Europe. If I remember rightly, something like two hundred millions in gold was taken from Germany, from the Reichsbank, and was used in part payment for foods and other needed materials that went into Germany.

As to other loans, I would have to refresh myself by looking back at the record.

Doctor COMMONS. If the Government loaned two and one-half billion, and if this estimate of what the banks loaned, four billion, is correct, that would be about six and one-half billions?

Doctor MILLER. I would say that would be an exaggerated figure.

Doctor GOLDENWEISER. I think so.

Doctor MILLER. Very grossly exaggerated.

Doctor COMMONS. What would you put it at; about five billion? I have in mind the estimate—you are familiar with it, I think—that was made by B. M. Anderson in the Chase Bulletin, where he put it during that period at three billion seven hundred million.

Doctor GOLDENWEISER. That figure is controversial.

Doctor COMMONS. Then the Government loans were two and one-half billion?

Doctor GOLDENWEISER. Perhaps.

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Doctor COMMONS. Am I correct in saying that that four and one-half billion of increased purchasing power was given to Europe on the indebtedness to America?

Doctor MILLER. Nobody can say whether that is correct or incorrect. I think all we can say for the purpose of the discussion is, let it be taken as a basis for whatever conclusion you want to draw from it. But I would at once say that if the validity of your conclusion depends upon the accuracy of that figure, your conclusion would be subject to——

Doctor COMMONS. Investigations?

Doctor MILLER. Yes. It probably could not be determined, either. Those facts are not ascertainable at this date. They were not then ascertainable.

Doctor GOLDENWEISER. There is a good deal of duplication, Mr. Commons, because the estimate of what the banks had included bank balances, and some of those balances were created through loans secured from the Government.

Doctor COMMONS. I see your point.

Doctor GOLDENWEISER. So there is a good deal of duplication.

Doctor COMMONS. Any how, there was a large amount, four billion three and one-half billion, or whatever it was. It increased the purchasing power of Europe, and it was based on credits which they obtained in America. Now, that would be one reason for increasing the level of prices, especially our export prices, would it not?

Doctor MILLER. I should say it was a factor in the actual increase of prices that then took place. I mean we are now dealing with an actual situation, are we not?

Doctor COMMONS. Yes.

Doctor MILLER. Not with an imaginary one.

Doctor COMMONS. No.

Doctor MILLER. In that actual situation it was a factor.

Doctor COMMONS. Now, at the same time, during 1919, we exported large quantities of gold. You mentioned a transfer in Europe; but our exportation of gold during that period, I figure, was nearly $400,000,000.

Doctor GOLDENWEISER. That is correct; yes.

Doctor MILLER. The net figure.

Doctor COMMONS. The net figure was nearly $300,000,000. Now, what would be the effect of that $300,000,000 of gold going to Europe?

Doctor MILLER. My recollection is that it did not go to Europe.

Doctor GOLDENWEISER. No.

Doctor MILLER. It went to South America, to Japan, and to other countries that had gold credits here.

Doctor COMMONS. So you would not count that as increasing the purchasing power of Europe in any way?

Doctor MILLER. Not at all.

Doctor COMMONS. It would, however, require the American banks to borrow at Federal reserve banks, would it not?

Doctor MILLER. To the extent that it had not been previously earmarked. I do not know about that. Some of the gold was earmarked, was it not?

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Doctor GOLDENWEISER. I think not, Doctor Miller. A large part of it was an Argentine credit, but it was not earmarked.

Doctor COMMONS. But it went from the American banks to Argentina or other countries?

Doctor GOLDENWEISER. Yes.

Doctor COMMONS. So those American banks that shipped gold would have been compelled, according to their condition, to borrow?

Doctor GOLDENWEISER. Yes.

Doctor COMMONS. Have you the figure there, during that year, of the increased borrowings by the member banks of the reserve system?

Doctor GOLDENWEISER. During 1919 they increased about six hundred millions. I have the figures here of the total borrowings of member banks.

Doctor COMMONS. What was the increase from the beginning of 1919 up to May or June, 1920?

Doctor GOLDENWEISER. They increased from about $1,600,000,000 to about $2,500,000,000, an increase of about $900,000,000.

Doctor COMMONS. That increased the debt of member banks to the reserve system about $900,000,000. Now, those borrowings may have been of a different character, but I figure that the bulk of them was Government collateral; that is, most of that borrowing was done on the basis of Government collateral.

Doctor MILLER. I think that is probably true. Have you the classifications there?

Doctor GOLDENWEISER. Yes; I have the figures here. As it happens, it was not so. I mean, there was no increase during the period in the borrowings on Government collateral, and practically the entire increase was in borrowings other than on Government collateral.

Doctor COMMONS. I have here a chart that I put in recently, Doctor Miller, and it shows the increased Government collateral, followed by the increased eligible paper, showing that in 1919 about 97 per cent of the total borrowing was on Government collateral.

Doctor MILLER. I think you must be using the same term in different senses.

Doctor COMMONS. How do you figure it?

Doctor GOLDENWEISER. I think it is this way, Doctor Commons: It is true that a large proportion of the borrowings in the beginning of 1919 were on Government collateral. Out of a total of $1,600,000,000, $1,350,000,000 was on Government collateral. This was a period, however, during which the increased additional borrowing was not on Government collateral; so that when you speak of the increase during this period it was in loans other than on Government collateral; this class of loans increased from $250,000,000 in January, 1919, to $1,150,000,000 in June, 1920.

Doctor COMMONS. That is the commercial paper and eligible paper?

Doctor GOLDENWEISER. Yes. The growth in that period was not on Government collateral.

Doctor COMMONS. I think that if you examine this you will find that it corresponds with what I have. Here [indicating] I have the

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increase on Government collateral. This is 1919. There was really a falling off in other collateral. (Chart, Commons; Federal reserve bank holdings of bills discounted, p. 77.)

Doctor GOLDENWEISER. Yes.

Doctor COMMONS. Then the Government collateral fell, and the other greatly increased.

Doctor GOLDENWEISER. Yes.

Doctor COMMONS. So that if you average it up, this [indicating] being the total, it is composed of those two.

Doctor GOLDENWEISER. Yes. Your chart is evidently based on the same figures.

Doctor COMMONS. Now, at that time you had two rates of discount on paper secured by Government collateral. Have you your money rates for 1919?

Doctor GOLDENWEISER. I believe that the Government collateral rates were 4 and 4¼ per cent in the early part of the year.

The CHAIRMAN. Let me suggest that inasmuch as you are referring to various charts, it is going to be almost impossible for anyone to understand this testimony unless these charts are properly inserted. The committee will have to rely on the witnesses to insert at the proper points in these hearings a statement as to these charts that they are referring to.

Doctor COMMONS. This is chart 2 of my testimony, which I introduced. It shows that the rate on Government collateral in 1919 was 4¼.

Doctor MILLER. At what point?

Doctor COMMONS. During thee-quarters of the year 1919; and that the rate on eligible paper was 4¾.

The rate on Government collateral was raised in 1918 to 4¼, and that continued until about October, 1919, and at the corresponding dates the rate on industrial or commercial paper was 4¾. It kept that difference until along in 1921, when the two rates were consolidated, and the differential at the peak of 1920 was 1 per cent. That is to say, on eligible paper, commercial paper, it was 7 per cent, but on Government paper it was only 6 per cent.

Doctor MILLER. In New York?

Doctor COMMONS. Yes; in New York.

Now, the question is would 4¼ per cent, which represented, I should say, 90 per cent of the borrowings, have been a low rate at that time? Would you consider that a low rate?

Doctor MILLER. I would consider them both low.

Doctor COMMONS. What is your standard of measuring a high or low rate?

Doctor MILLER. The rate of growth of borrowing under a given rate and the use that is made of the proceeds of the credit obtained from the reserve bank.

Doctor COMMONS. Apparently, then, you would compare it with the rate that the banks charge their customers?

Doctor MILLER. Not primarily.

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Doctor COMMONS. Have you the banks' commercial rates in New York at that period?

Doctor GOLDENWEISER. During most of 1919 they were about 6 per cent.

Doctor COMMONS. They could borrow at 4¼ and lend to their customers at 6 per cent. Would that be the standard by which you would measure it?

Doctor MILLER. Not alone; no.

Doctor COMMONS. What else would you use?

Doctor MILLER. What you need to know is why people are bidding for money and what they are doing with the money?

Doctor COMMONS. Yes.

Doctor MILLER. If you bring into the picture at this point a chart showing the movement of trade and production, it will develop, I think, pretty clearly that this increase of credit was not validating itself, economically speaking, by any commensurate effects in increased productivity in trade; in other words; that it was inflationary in character. If it had been a real contribution to the increased productivity of the country, it would have been, I will not say unobjectionable but certainly less objectionable, and would have carried with it the same degree of danger.

Doctor COMMONS. You do not have your production charts running back to 1919?

Doctor MILLER. I think so.

Doctor COMMONS Those published here do not go back to 1919.

Doctor GOLDENWEISER. No.

Doctor COMMONS. Did you in 1919 have data on that question?

Doctor MILLER. Nothing that was of a valid character. You have one chart here, have you not, on production, prices, and credit?

Doctor GOLDENWEISER. Yes.

Doctor MILLER. No; we had nothing that was anything more than crude and fragmentary.

Doctor COMMONS. Can you figure out from 1919 to 1920 what was the increase in production?

Doctor GOLDENWEISER. From 1919 to 1920 there was a slight increase in production.

Doctor MILLER. Let us interpret this a little more broadly. In 1919 there was really no increase in production.

Doctor COMMONS. Just a moment. This chart is to be inserted.

The CHAIRMAN. Without objection, the chart will be placed in the record at this point.

Mr. STRONG. Referring to the chart entitled "Production, prices, and credit"?

Doctor MILLER. Yes, sir.

Doctor MILLER. One of the lines on this chart shows the movement of output in manufactures. My reading of that, for purposes of a general discussion, is that the year 1919 shows no appreciable increase in the volume of production. My best guess would be that on the whole, if you average the year, you get a slightly downward

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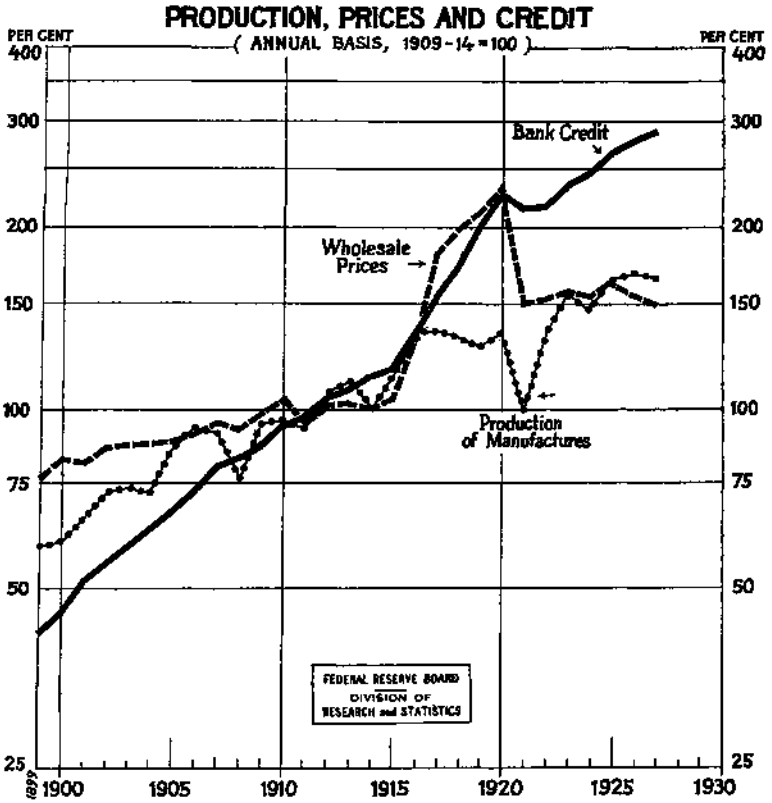
trend. Certainly there is no pronounced change. On the other hand, there is a pronounced growth of bank credit. There is a marked upward rise in prices, and I suspect this is what you are after, Doctor Commons.

Doctor COMMONS. Yes.

Doctor MILLER. So I will anticipate you. It was the more rapid increase of bank credit than of production, or the rapid increase of bank credit with a practically unchanging output of industry, that lifted the wholesale price curve.

Doctor COMMONS. Then that is what you would call inflation?

Doctor MILLER. That is what I would call inflation.



Doctor COMMONS. Inflation is not a rise of prices merely if it is accompanied with a corresponding increased employment and an increased production of trade. But if prices rise at a point when everybody is employed and when they can not possibly increase production any more, then the rise above that you would take to be inflation?

Doctor MILLER. I would exclude some of your "ifs" there. It does not matter what the cause may be; if you have an increased credit that moves without a response in production, you then have a rise of prices that is unmistakably due to the fact that credit is increasing at a more rapid rate than production, whatever may be the cause why production does not increase.

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The CHAIRMAN. And this period that you are speaking of now, of 1919 and 1920, is just such a period, as I understand?

Doctor MILLER. Yes; I should say 1919 particularly, and just the early part of 1920.

The CHAIRMAN. Now, as to this excess amount of bank credit, how is that loosened? How is that put into effect?

Doctor MILLER. There was increased borrowing from the reserve banks. That supplied the base of this whole credit expansion.

The CHAIRMAN. Then the member banks, through their borrowings at Federal reserve banks, were responsible for that loosening of an excess amount of credit?

Doctor MILLER. Yes, sir.

The CHAIRMAN. What prompted that? Was it the high price for money? Was the fact that you could borrow at the reserve banks at a low rate and loan it at a high rate conducive to that?

Doctor MILLER. It was due in part to the fact that our so-called war expenses were still going on. The Government was still borrowing, even though the war was over. A large part of those borrowings were financed in 1919, as in prior years, by an expansion of bank credit which reflected itself into an expansion of Federal reserve credit.

The CHAIRMAN. The point that I was getting at was this: Was that done for the purpose of making money or was it done for the purpose of relieving a situation?

Doctor MILLER. From the point of view of the bank, it was done for the purpose of making money; but the bank could make money only as there was an acute demand for credit on the part of borrowers. What actually took place in that year is a long story, but I would say, having in mind your question particularly, Mr. Chairman, that the war being over, and there being a disposition for people to lay aside their self-imposed war-time restrictions, and the Government relaxing also at the same time many of its controls—for instance, the War Trade Board, the War Industries Board, and the like—there was a desire to consume and to buy, and there was real bidding in the market for goods. That bidding went to a point where it soon set in operation speculative buying, speculation in inventories for the rise; and that in part was what gave rise both to the borrowing and to the rise of prices. Men were speculating in commodities then, as they are speculating in securities now.

The CHAIRMAN. Then borrowing on the part of member banks at that time was largely on Government-secured obligations, was it not?

Doctor MILLER. Mr. Goldenweiser has just given the figures. I should say it was almost half and half, was it not, when we got into 1920?

Doctor GOLDENWEISER. Yes. The increased borrowing over what they had at the beginning of 1919 was not on Government obligations.

Doctor COMMONS. Mr. Goldenweiser, I would like to have you check up on that, because my figures show a great increase on Government collateral and a falling off in commercial paper.

Doctor GOLDENWEISER. In the early part of 1919?

Doctor COMMONS. Yes; in the early part of 1919. The increase on commercial paper started in then, and reached its peak in the latter part of 1920.

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Doctor GOLDENWEISER. I think that is correct. From January to May, 1919, borrowing on Government collateral increased rapidly.

Doctor COMMONS. So that it was mainly, I would say 90 or 95 per cent, on Government collateral.

The CHAIRMAN. Here is one other question I want to ask in that connection. The rate of interest, I understand, is lower on Government-secured borrowings than on commercial paper?

Doctor MILLER. It was then.

The CHAIRMAN. Is that the general rule?

Doctor MILLER. No, sir.

The CHAIRMAN. There is no special rate?

Doctor MILLER. Rates are uniform as between so-called Government-secured paper and commercial paper.

The CHAIRMAN. Is there any difference between a straight loan secured by Government securities and a repurchase agreement? Is there a different rate of interest on repurchase agreements?

Doctor MILLER. Not in New York. I think there are possibly one or two of the banks which have at times made a slight differential. I think Chicago has at times; whether she still does it or not, I do not know. But that is an inconsequential part of their business. Do you happen to know about that, Mr. Goldenweiser?

Doctor GOLDENWEISER. It has been one-eighth of 1 per cent at times.

The CHAIRMAN. The same as rediscounts?

Doctor GOLDENWEISER. Yes.

Doctor COMMONS. If I may refer to this chart again, I figured out the ratio of Governments to others, and it runs around 50. In the last few months it has gone up to 95.

Doctor MILLER. What does 95 mean?

Doctor COMMONS. Ninety-five per cent of the total borrowings.

Doctor MILLER. The total borrowings from reserve banks?

Doctor COMMONS. Yes. This is in this chart 2 of mine, and I think that might be checked up.

The CHAIRMAN. I would like to get this straight; this borrowing on Government securities, by particularly the large member banks, which are the ones that largely go into these big credit movements with their loans. That is the usual method, is it not, for the large banks in getting loans from the Federal reserve now—using Government-secured loans, or entering into repurchase agreements?

Doctor MILLER. There is not much of that.

The CHAIRMAN. Not much of the repurchase?

Doctor MILLER. No.

The CHAIRMAN. But that method is available, of course, if they want to resort to it?

Doctor MILLER. It is available. When you talk of Government securities, it is a negligible item.

Doctor GOLDENWEISER. Member banks rarely obtain funds from the Federal reserve banks on repurchase agreements.

Doctor MILLER. I think if you look at any of our recent statements they will show a rather small amount.

Doctor GOLDENWEISER. Very small.

The CHAIRMAN. In other words, the big banks, who have to respond to these quick movements, and who act as the buffer for with-

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drawals by country banks and others occasionally, find it to their advantage to carry large blocks of Government securities to be used for the purpose of loans at the Federal reserve bank at a moment's notice?

Doctor MILLER. I would amend that statement, Mr. Chairman, by saying that as a matter of general policy they do carry considerable holdings of Government securities. I think they would do that as a part of good banking policy, quite irrespective of any thought they might have of using these as a basis of borrowings from the reserve banks. Having them, they constitute a most convenient form for short borrowings. That is, instead of getting together a great portfolio of commercial paper, if they want to borrow $5,000,000, they take $5,000,000 of Government securities and send them along as collateral to the reserve bank; or, as the thing works out in practice, they have large amounts of these Government securities actually in storage in the reserve banks, do they not, Mr. Goldenweiser?

Doctor GOLDENWEISER. Yes.

Doctor MILLER. So that the reserve bank, as it were, has the collateral right there. The transaction, therefore, is mechanically a very simple one.

The CHAIRMAN. The borrowing, then, is made available through the Federal reserve banks, who also act as custodians of Government securities?

Doctor MILLER. Yes.

The CHAIRMAN. So that their access has been accelerated?

Doctor MILLER. Simplified.

The CHAIRMAN. Yes; simplified. And, as I understand you, that class of borrowings is not favored by a lower rate over other rediscounts?

Doctor MILLER. I do not think it has been since 1920.

Doctor GOLDENWEISER. Certainly not since 1921.

The CHAIRMAN. But in 1919 and 1920 there was a lower rate?

Doctor MILLER. There was. There was the so-called differential.

The CHAIRMAN. Inasmuch as bonds of public utilities, railroads, and that class are not eligible as a basis for rediscount or as security for loans through the Federal reserve bank, is it a good policy, do you think, for the Federal reserve banks to continue to grant loans or rediscounts on the basis of Government securities?

Doctor MILLER. You are opening up a pretty big question there.

The CHAIRMAN. I realize that.

Doctor MILLER. Personally I would rather be disposed not to think particularly well of this form of borrowing from Federal reserve banks. It is not clear just what it does that is objectionable, but I am inclined to think that in certain cases it facilitates very large borrowings from Federal reserve banks by banks that are not primarily engaged in commercial lending, and it makes it a little bit easier, therefore, to draw money from Federal reserve banks for general financing purposes or other purposes that I think are not strictly germane to the use of Federal reserve credit; and in practice it has developed that while the so-called Government-secured member-bank loan is a 15-day loan, the borrowing may be for a single day.

The CHAIRMAN. It does permit the financing by member banks of these underwriting houses of investment securities to an extent that otherwise might not be possible?

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Doctor MILLER. It certainly would not be quite as easy; and if all of the paper brought for purposes of establishing credit at the reserve bank had to be commercial credit, at any rate you would have that test, that the bank that is borrowing is also engaged in making commercial loans, at least to the extent of the amount of the commercial paper that it brings there. I do not know that you could reach even a very loose opinion as to how much it would affect the situation. But I am inclined to think that we have, on the whole, made access to the facilities of the Federal reserve system by amendments in recent years a little bit too easy. The arrangement has no particular merit, except from the point of view of the convenience of the large borrowing member banks, and it might have been considerably better if Federal reserve credit could not be tapped quite so easily.

The CHAIRMAN. Doctor Commons, I beg your pardon for asking these questions. There is one more that I want to ask that has reference to the previous question.

Doctor COMMONS. May I ask something on this same question?

The CHAIRMAN. Yes.

Doctor COMMONS. Feeling, as you do, that it possibly facilitates borrowing which does not go into commerce but goes into the loan market or something of that kind, why would it not be a feasible experiment for the system to reverse the process that they had in the early days, where they charged a lower rate on loans secured by Government collateral than they did on eligible paper, and now charge a higher rate on loans secured by Government collateral as against eligible paper? Might not that be a technical device already within your power which would tend to check that easy flow of credit outside of commercial paper?

Doctor MILLER. It would be unpopular.

The CHAIRMAN. Doctor, have you or the board given consideration to the fixing of different rates on money to use for different purposes; in other words, a classification on a different basis of different uses to which money is to be put?

Doctor MILLER. Of course it will not do for any member of the Federal reserve system to admit that Federal reserve credit can be used for any purpose but one, to wit, what is broadly called a business purpose; that is, commerce, agriculture, and industry—short-time borrowing. In fact, from the point of view, I think, of the Federal reserve act, and at least the traditional interpretation put on that act by the Federal Reserve Board, that is the only legitimate purpose for the use of Federal reserve credit.

The CHAIRMAN. It is a pretty well-established fact, however, that the Federal reserve member banks have discovered a method of using the Federal reserve funds, either through rediscounts or borrowings, to obviate that very thing.

Doctor MILLER. I want to be perfectly fair about that. I would say that by a process of inference you can reach that conclusion. It is not so easy, in the course of the ordinary operation of a Federal reserve bank, to say when a member bank borrows, "Are you borrowing for the purpose of lending this for uses that are not contemplated by the Federal reserve act?" It goes into a common pool, and it is not always easy to identify that particular credit and say it has gone

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into, we will say, stock-exchange loans, or into security loans that are facilitating the promotion of some new organization, or that it has gone into real-estate loans, or for some other purpose. That question has often been discussed in Federal reserve conferences. It was recently. I think it is when we look back and see what has taken place and find that there has been a great growth of security loans, a great growth of brokers' loans, a slight growth of commercial loans, no increase in currency, no importation of gold, but a growth of Federal reserve credit, that the conclusion is justified that that increase of Federal reserve credit has been the basis upon which this expansion of member-bank loans, mainly security loans, has taken place. But it is not easy to detect that in its incipient stages.

The CHAIRMAN. An analysis of the portfolios of these banks that are located in close proximity to the transactions such as you have referred to, I am sure will reflect a changed condition over that which existed in 1913, just prior to the organization of the Federal reserve.

Doctor MILLER. Yes.

The CHAIRMAN. In other words, these institutions located in close proximity to the transactions that we are discussing now have found it to their advantage to make themselves very liquid, or have in their portfolios the class of securities that are most readily available for loans or borrowings from the Federal reserve banks, so that the facilities for easy movement of credit are at hand.

Doctor MILLER. Yes, sir.

The CHAIRMAN. Now, through the organization of the Federal reserve that has been possible. I realize, of course, as you men do, how hard it is to analyze the use to which a dollar of borrowings from the bank is to be put; but it is an important part of the consideration.

Doctor MILLER. Yes. I think it is a most important part and one that I think is capable of development and improvement. I think there is a problem in the technique of Federal reserve bank operation there that from my point of view ought to have more attention, because I think it is possible to devise a method that is not meddlesome or inquisitorial or objectionable from any reasonable point of view, that would give some check upon what might be called ungoverned borrowing for purposes that are pretty remote from the Federal reserve act.

Mr. STEAGALL. But, Doctor Miller, could there be any ungoverned borrowing in the Federal reserve system or from Federal reserve banks? Does not the law fix limitations, and is not the kind of paper to which you refer noneligible?

Doctor MILLER. No; it is not. It is eligible.

Mr. STEAGALL. All of it?

Doctor MILLER. We are referring now specifically—at least that is what I have in mind—to the so-called member-bank loans for not over 15 days, with Government securities as collateral.

Mr. STEAGALL. Yes; I understand that.

Doctor MILLER. That is eligible.

Mr. STEAGALL. But what I mean is this: The paper that they offer you, of course, is eligible; but when it comes to dealing with paper which is noneligible, the Federal reserve could not take it?

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Doctor MILLER. No, sir.

Mr. STEAGALL. And therefore, as I understand the situation, that could not be said to be ungoverned borrowing. I think that is a little further than you would want to go, if I understand the situation.

Doctor MILLER. When I use the term "ungoverned," I do not mean ungoverned by the Federal reserve act, but ungoverned by, we will say, the Federal reserve bank; and perhaps the word "ungoverned" is not quite the proper word.

Mr. STEAGALL. I do not see how it could be called ungoverned. except in the sense that it is ungoverned by the will of the Federal Reserve Board or the will of somebody other than those in charge of the particular bank that wants to engage in that kind of business.

Doctor MILLER. By "those in charge of the particular bank" you mean in charge of a particular borrowing bank?

Mr. STEAGALL. Yes.

Doctor MILLER. I use your term, and I will say ungoverned by the will of the Federal Reserve Board and the will of the Federal reserve bank that is supplying the credit. In other words, it is not part of the practice of the Federal reserve banks, if a member bank comes in, and especially in these cases that the chairman has in mind in the larger centers, and borrows $1,000,000 or $5,000,000, to ask, before it receives the paper, "What are you doing with this money? Why are you borrowing? Before we loan this to you we want to satisfy ourselves that the use you are going to make of it is a use contemplated by the Federal reserve act."

Mr. STEAGALL. Doctor Miller, I am just a little bit old-fashioned and I am just feeling my way in this situation in so far as any view I might have is concerned. I am largely governed and influenced by men like yourself, in whose judgment I have great confidence. Where would we land if we started with the policy of having a board limited to a certain number of men with high authority to censor, superintend, and control the activities of the various and numerous banks throughout the country and indirectly control the policies of each of those banks? I am just wondering how far we will get when we start on that road.

Doctor MILLER. I am not prepared to say that it is impossible to devise an administrative rule that will enable us to test the country's economic need of credit from the Federal reserve system.

Mr. STEAGALL. Why not let the country itself have a little say in determining this?

The CHAIRMAN. May I suggest right there that the Secretary of the Treasury has, in his last two or three annual reports, called attention to the growing tendency of investment securities getting into the Federal reserve system, and pointing it out as a dangerous tendency.

Mr. STEAGALL. Yes; I think that is true, and I should like to see it remedied whenever there is danger of evil results coming from it, but I am thinking of the principle involved in the policy of having a board of a limited number of men directing it and ordered by the law to exercise power so far-reaching.

Doctor MILLER. I think there that possibly you exaggerate the situation. If something such as you have been criticizing——

Mr. STEAGALL. I do not mean to criticize; I am simply trying to inquire.

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Doctor MILLER. If the situation that you have been inquiring about were one that actually existed, you have 12 Federal reserve banks that actually, through their officers and directors, have got to perform this job of satisfying themselves as to the uses their member banks are making of reserve-bank credit.

Mr. STEAGALL. And I grant you that the tendency to which I refer, and the benefits, of which there may be some doubt—I am not prepared to say—I grant you that the tendency is curtailed somewhat, or at least any possible objection to it is curtailed by the fact that you have the 12 Federal reserve banks located in the different communities of the country and more or less in touch, of course, with peculiar conditions in those communities.

Doctor MILLER. There are 25 branches also.

Mr. STEAGALL. But the fact remains that in large measure the policies of those banks are influenced to a great extent by the one board in Washington; and I am not saying that in a spirit of criticism against the board; I do not mean it in that way, but I am just thinking of the vast power involved in a policy underlying legislation. I am just trying to think out loud about it.

Doctor MILLER. I think it constitutes one of the most pressing and one of the most difficult problems.

Mr. STEAGALL. I think it does.

The CHAIRMAN. Now, Doctor Commons, I beg your pardon; go ahead with your questions.

Doctor COMMONS. In this situation in 1919, apparently, according to your statement, the demand for credit arose from two sources, first this four or five billions that Europe borrowed in this country and then the domestic demand greatly increased, so that the rate in New York on the commercial loans was about 8 per cent; yet you were at the same time discounting their paper when secured by bankers' paper, and not the eligible paper at all, except about 5 or 10 per cent, but the bankers' borrowings secured by Government collateral at about 4¼ per cent. You said that that was a low rate, considering all those other circumstances. Would it have been a high rate if the Federal reserve bank had raised that rate up to, say, 7 per cent?

Doctor MILLER. When?

Doctor COMMONS. In 1919.

Doctor MILLER. 1919 was a year of 12 months.

Doctor COMMONS. I will say the middle of 1919.

Doctor MILLER. The middle of 1919 would have been the beginning of July.

Doctor COMMONS. Yes.

Doctor MILLER. I do not recall at this moment whether the Victory loan payments were out of the way.

Doctor GOLDENWEISER. No; not until November.

Doctor MILLER. Not until November. I do not consider it would have been advisable to establish a rate of 7 per cent on any class of paper in the middle of 1919. I think it would have been advisable to establish a rate of 5 per cent about the 1st of September, 1919. I choose that particular date because the public debt reached its maximum on the 30th of August; that is, the Government was no longer in the market for more new money, though it did a large amount, as it still does, of refinancing.

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Doctor COMMONS. You kept the rate down there in order not to accommodate business but in order to accommodate the Treasury in floating securities?

Doctor MILLER. The rate was down, and it was left down or left without very much change until the end of January, 1920.

Doctor COMMONS. Supposing there was no pressure by the Government at that time and you did not allow that differential in favor of Government securities and they put the commercial rate up to, say, 6 per cent in the middle of 1919. I must use an "if" here, because it is the only way I can eliminate the Government influence from your consideration. If they put the rate up to 5 or 6 or even 8 per cent, nearly to the amount all your commercial banks were receiving on their loans, would there have been that expansion of credit?

Doctor MILLER. Well, I just can not entertain the thought that any competent body of men would have contemplated the establishment of a rate as high as 8 per cent in the middle of 1919. I would rather rephrase it as follows: If the Federal reserve system could have and had reached the conclusion in the middle of 1919 that, unless it undertook to get an effective control of the credit situation, there would ensue an expansion of credit, the consequences of which would be injurious, it would have gone to whatever length was necessary. My own belief is, if that had been its attitude, it would not have been necessary to go so high as the rates you have in mind.

Look at the middle of 1919 on the chart. About half of the expansion of credit in 1919 occurred in the first six months, and the other half in the last six months. In the first six months the item of Government loans was a very large one. I should say that probably a fairly moderate increase of rates, from your point of view, would have been adequate. When you speak of an 8 per cent rate you refer to something that has never yet occurred in the reserve system.

Doctor COMMONS. You were compelled to do that in 1920, when your ratio got low; but supposing you had done it a year before the time you actually did it, or six months before—that is, there was no timely action then—then would you not say, no matter for what cause, so far as it affects prices, that it was that delay in starting to raise the rates which contributed to this inflation in 1920?

Doctor MILLER. Yes.

Doctor COMMONS. You could not estimate how much, but you could have experimented. If 5 per cent was not enough, you could have raised it to 6 per cent, could you not?

Doctor MILLER. Yes.

Doctor COMMONS. Now, what indications had you in 1919 as to whether production had reached its maximum?

Doctor MILLER. We had no indication that was worth very much, if anything. I should say that, turning the tables a little bit on you, that the economists of the country and the statisticians had been singularly remiss in not waking up to a service they could render until the Federal Reserve Board stimulated them to a little activity when it was groping around for a statistical basis upon which it could proceed in formulating its credit policy. We did not know; we were guessing.

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Doctor COMMONS. But in that year my observation was that in June and July everybody was employed. It was a scramble to get high wages and it was not increasing production, and that is the principle, as I understand it, with which you correlate the rise of prices with the conditions that you do not have control of. That is to say, if employment and production are increasing by an increasing amount of credit, then that would not be inflation, so my information about it as I observed it at the time traveling over the country and visiting many factories was that the maximum of production had been reached in the middle of 1919. Everybody was employed; the laborers were able to command three or four times the wages then that they ordinarily command, so that if you had operated then as you did in 1923, upon the principle that as long as industry had not yet reached its proper proportion, you would probably have taken action in the middle of 1919. That would be the inference I would draw.

Doctor MILLER. Well, assuming the field had been as clear for independent action on the part of the Federal reserve system in 1919 as it was in 1923. We were still under the influence of war psychology. The Government was still a very large borrower.

Doctor COMMONS. Apart from the Government; if you had been free from Government influence——

Doctor MILLER. If we had been free from Government influence of any character, and free also from the national psychology of the moment—and I want to recall very definitely, because we forget these things, that I think as late as March, 1919, there was set up, under the auspices of the Department of Commerce a so-called industrial board. The particular function of that board, as I recall, was to stabilize—I think that that word was used—the transition from the war-time economic and industrial situation to the postwar, particularly against the expected collapse of prices. The general assumption was, I think, that there was going to be a great collapse of industry in 1919. That was in the atmosphere, I think, Doctor Commons, pretty well into midyear. If you will turn back and read the economic history of the times, you will find that in connection with this industrial board that I have alluded to, the membership of which consisted of some very eminent men, who had been here temporarily in Washington in connection with various war boards, the conclusion was reached that we must moderate the peace-time descent of industry by equipping it with a parachute.

Doctor COMMONS. Which meant a low rate of discount.

Comparing that with 1923, there was in 1923, in May or April, a situation where you had reached the position where a further increase in prices would have been inflationary in the sense in which you used the word.

Doctor MILLER. I think I would say, and I am answering you now on the basis of subsequent information and impressions, and not contemporaneous ones; I think I would say the general situation in 1923 was not favorable to an inflationary or a dangerous inflationary development. Agriculture was flat, very flat. There was no real recuperation of agriculture as yet in sight, and without that I am inclined to think that inflation was also not in sight.

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Doctor COMMONS. I have reference to this question, that the prices rose 15 per cent and employment was increased until about everybody that was willing to work was employed, not as to anything else that would operate, but just that correlation between prices and contraction. There was no indication, as I gather from your monthly reports, that the price had been risen beyond what was necessary to bring industry up to, say, a normal capacity, employment, and contraction.

Doctor MILLER. Yes; I would put that a little differently. I am thinking now of what I actually did think at the time, which was this, that consumer demand had overtaken production and consequently there was a rise of prices, but the evidence derived from our trade and employment and production charts pretty clearly indicated that production was making rapid strides so that in due course it would catch up with the increased consumer demand, and at that point we would have reached, so to speak, a new landing place and prices would have reached a new point, and then it would have to be redetermined in accordance with new conditions, whether they were going to move upward or on a level or downward.

Doctor COMMONS. In 1923, as contrasted with 1919, you carried on open-market operations. During 1922–23 you were selling securities. The open-market instrument did not appear in 1919. It was purely a discount policy then, a low discount policy?

Doctor MILLER. That is correct.

Doctor COMMONS. Now, then, you began selling securities in June, 1922, and continued selling them in very large amounts up to 1923?

Doctor MILLER. Summer of 1923.

Doctor COMMONS. Will you say that that had no influence at all in checking the rise of prices?

Doctor MILLER. Let use see the chart showing reserve-bank holdings of United States securities and bills discounted.

Doctor COMMONS. The question is, Did the open-market sales have any effect whatever in checking the increase in prices in 1922 and 1923?

Doctor MILLER. You will observe, Doctor Commons, that the line marked "United States securities" descends pretty steadily, with no interruption in the first half of the year 1923.

Doctor COMMONS. From about May, 1922, to about the middle of 1923?

Doctor MILLER. Well, in the latter part of 1923; you see, it goes down and then goes up.

Doctor COMMONS. At that point; yes. I bring it up, then, to 1923. That is the knowledge you had about that time?

Doctor MILLER. Yes; but as that line declined—in other words, as the holdings of securities diminished, the bills discounted—the credit obtained from the reserve bank by means of bills discounted went up, so that the effect, I should say, and the justification—or, rather, let me say the motivation of the policy of selling open-market securities at that time was to apply some sort of a test to the urgency of the needs for the existing volume of Federal reserve credit; and the test seemed to indicate that when the burden was shifted on to the member banks, even though there was an increase in discount rate,

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they actually came in and borrowed, so that you have, taking the year 1923 as a whole, and looking to the upper line—the heavy black line marked "Total bills and securities"—a fairly uniform trend for the year.

Doctor COMMONS. Begin back a little further—1922. The price increase began, as I think, in 1922, did it not?

Doctor MILLER. Yes. It began at the third week of 1922, as I remember it. The prices touched their bottom at the end of the year 1921, and then the movement was upward.

Doctor COMMONS. Was gold coming into the country at that time?

Doctor MILLER. Yes.

Doctor COMMONS. So that those sales seemed to offset the gold imports?

Doctor MILLER. Yes.

Doctor COMMONS. And the borrowings partly augmented the credits in 1922, up to the beginning of 1923; that is, the total bills and securities was augmented from $1,000,000,000 to, say, $1,300,000,000. The rise of prices was going on from 1922 up to April, 1923.

Doctor GOLDENWEISER. Yes.

The CHAIRMAN. Might I suggest that, if it is agreeable, we will shortly adjourn until 2.30 this afternoon.

Just before we adjourn I want to call the attention of the committee to an editorial that appears in the Journal of Commerce of New York. This paper is edited by H. Parker Willis, who was formerly secretary of the Federal Reserve Board and was one of those men who was actively engaged in the writing of the Federal reserve act.

Inasmuch as this editorial refers to matters which are pending before this committee, I am going to read this.

It is headed "International Bank Tinkering." [Reading:]

[Thursday, May 17, 1928]

INTERNATIONAL BANK TINKERING

Once again it is announced that there is to be a meeting of the heads of central banks, this time in a foreign country. Those who are "scheduled" to participate are the governors of the banks of France, Germany, and England, and also, it is reported, the executive head of one of the Federal reserve banks. The announcement comes opportunely, just at a time when testimony on the part of a member of the Federal Reserve Board before the House Banking and Currency Committee has brought out the real nature of the deliberations of this same bankers' conference when it met in New York last summer and afterwards went to Washington for a brief discussion or "interchange of ideas" with the members of the Reserve Board. What is now planned appears to be a continuation of the meeting of last summer.

According to the official statement now definitely on file before the Banking and Currency Committee, last summer's conference was devoted largely to a consideration of discount rates. The foreign bankers desired to have a cut in our local discount rate here in the United States in order that they might more easily accumulate capital and gold in their markets, so they came to the United States and discussed the matter with one of the reserve banks. The subject was then informally talked over with the Reserve Board, no "record meeting" being held, according to the testimony now furnished. Thereafter a cut in discount rates was initiated at eastern reserve banks, and then the board was wrought upon by these same banking influences to the extent that it finally ordered the interior banks to cut their rate. Thus was inaugurated a general

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reduction of rates and period of "easy money" all over the country which powerfully accelerated the movement of funds into the stock market and furthered an inflationary condition all around.

These are the facts as ascertained through authentic public statements, and the question now is what will be our attitude toward the next bankers' conference? Are we sending to that conference a delegate representing the Federal Reserve Board and system who is authorized to act for and commit the banking resources of this country to such policy or policies as may be deemed best? In times past the Federal Reserve Board has denied that it has given any such roving commission to any member of the system and has asserted positively that it reserved its own power to do as it saw fit and as circumstances dictated.

It is also of fundamental importance to know by what theory, if any, the reserve system, and for that matter the central banking organizations, are being guided in their effort to control or manipulate discount rates. It is not long since members of the Reserve Board were in the habit of categorically denying in public their belief that the discount rate had any relation to the price level or could or should be used to control its movements. On the other hand, the author of one of the stabilization bills before Congress has lately, in a public statement issued to the press, asserted that he is informed by the head of one of the reserve banks that the latter does believe in this use of the discount rate and is endeavoring experimentally to apply it in that way. To the same source of authority is ascribed by some the assertion that changes in the discount rate should never be employed for the purpose of restricting the growth of speculative or other movements but should be used entirely for the purpose of stabilizing or controlling the prices of commodities. If there has been an actual change in the policy of the reserve system, why should it not be truthfully announced to the public? It is only in that way that a fair idea can be formed by the community of what is actually going on in its own banking system.

Ever since our Federal reserve system was formed it has suffered steadily from back-stairs influences and behind-the-doors conferences. These conferences were first aimed at the destruction of the authority of the board itself and gave rise to the famous "council of governors," whose doings never got into the newspapers much but came so close to disrupting the whole system that Governor Harding, then at the head of the Reserve Board, had to break up the council by main force. The effort to establish a subterraneons authority in the reserve system has continued and has at times taken form as an alliance between the Treasury Department and one or two of the reserve banks, the department giving orders directly to these reserve banks and practically leaving the board aside as a kind of fifth wheel. In short, this phase of our reserve banking system is not working very well and needs modification. The reason for giving it special attention at the present moment is found in the recurrence of secret conferences of an international nature, at which we are represented by apparently unauthorized persons, with bad subsequent results in our domestic financial economy.

Ought not this matter to be given a thorough clearing up before Congress adjourns, if possible.

The CHAIRMAN. In that connection I would like to ask Doctor Miller, of the Federal Reserve Board, the same question that Mr. Willis has asked here:

Are we sending to that conference a delegate representing the Federal Reserve Board and the system who is authorized to act for and commit the banking resources of this country to such a policy or policies as may be deemed best?

Doctor MILLER. I know nothing about it, Mr. Chairman. I do not know whether there is any conference that is in contemplation. Certainly the Federal Reserve Board has sent nobody. As far as I know, nobody has gone. All that I have heard in connection with the matter is what is derived from the public press. Officially I know nothing about it; actually I know nothing about it. Whether anybody has gone or is on the water or going, I know simply as a matter of newspaper statement.

The CHAIRMAN. Another question is asked: By what theory, if any, the reserve system, and, for that matter, the central banking

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organizations, are being guided in their effort to control or manipulate discount rates?

Doctor MILLER. You are addressing that to me as a question?

The CHAIRMAN. Yes.

Doctor MILLER. I am not quite clear that I know what that means, "by what system." Do they mean by what system of conferences?

Mr. STRONG. International conferences.

The CHAIRMAN. I will quote this from the editorial:

> It is also of fundamental importance to know by what theory, if any, the reserve system, and, for that matter, the central banking organizations, are being guided in their effort to control or manipulate discount rates.

Meaning, of course, that at this conference, apparently the subject of discount rates will be a part of the discussion.

Doctor MILLER. Well, the statement there, of course, assumes a degree of knowledge which the editor may or may not have. It assumes that a group of men are getting together for the purpose of "manipulating" discount rates. That may or may not be the case; I do not know; but, in any case, I would be inclined to say that pretty strong language is being used in the term "manipulation."

I have this feeling, Mr. Chairman: The matter of conferences between the heads of central European banks and officers of the Federal reserve banks has been made the subject of reference two or three times in the course of these hearings. I think it is clear, from what I have said, that I have not personally been in the fullest sympathy with some of the things that have been undertaken or the way in which they have been undertaken, but I feel that if the committee is interested in the details in connection with that phase of Federal reserve bank operation, it is only fair to those who have been actively identified with those operations that they be your first source of information and your main source.

If, then, the committee feels that the subject is one of such importance as to merit further investigation, I should be very willing to be summoned here as a witness to explain my position, but I am not really in a position to answer some of these questions on the basis of positive information, and therefore I am afraid this record would look as though I was either pleading my ignorance or using my ignorance to construct a case against those of my colleagues, or officers of the reserve banks, or the reserve banks themselves, that have been actually the sponsors for the program or the action taken by the Federal reserve banks.

So that I feel, as a matter of simple justice to everybody in interest and in order to really get the information that you want and need, that it is not desirable that this subject should be made the matter of occasional reference, but should be a matter of systematic inquiry.

I am inclined to think that there is a great deal there that might well be the subject of methodical inquiry by the committee. I think that some good would come from it, but I doubt whether it could well come from these occasional inquiries addressed to me in connection with these matters.

Personally I am at your disposal. I want to answer candidly everything I can, but I do not want to be in a position where my candor may perhaps lend itself subsequently to a different construction.

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The CHAIRMAN. I might say at this point that Governor Strong, of the Federal Reserve Bank of New York, has appeared before this committee and has made statements here in connection with Federal reserve operations and their contacts with foreign banks of issue. There is already in the testimony in these hearings much information on this particular subject.

These conferences that are referred to in this editorial are important conferences affecting the Federal reserve system. It is pertinent to note that apparently these conferences are proceeding independently of the Federal Reserve Board and are being carried out independently by the management of one or more of the Federal reserve banks composing a part of the Federal reserve system.

Mr. GOLDSBOROUGH. Did it not state in this editorial, however, that there was a lowering of discount rates among the eastern banks as the result of this international conference? Is not that stated in the editorial, Mr. Chairman?

The CHAIRMAN. Doctor Miller, who is now a witness before the committee, stated to the committee that the change in discount rates occurred after a conference of the heads of these international banks which took place in New York and Washington.

Mr. GOLDSBOROUGH. Well, is not the Federal Reserve Board responsible for that change in the rediscount rates which occurred as a result of the conference between the heads of the central banks of Europe and the head of the New York Federal Reserve Bank?

The CHAIRMAN. Doctor Miller is a member of the Federal Reserve Board, and he can perhaps answer that better than I can.

Mr. GOLDSBOROUGH. The purpose of my making the inquiry was your statement, Mr. Chairman, which you had put in the record and which, as I understood it, was that this work which was being done by officials of the Federal reserve banks was being done independently of the Federal Reserve Board.

The CHAIRMAN. I assume that that was the case from the statement Doctor Miller made here a few moments ago. It seems to me that these important conferences with the other banks of issue of the important countries of the world should be authorized by or at least known to the Federal Reserve Board before they are entered into.

Mr. GOLDSBOROUGH. Did not the Federal Reserve Board have any connection with the change in the rediscount rates due to the conferences?

Doctor MILLER. There can be no change in discount rates except with the approval of the Federal Reserve Board.

Mr. GOLDSBOROUGH. And that was done as a result of the conferences which were mentioned here?

Doctor MILLER. It followed them, and it is my understanding that it was involved in conclusions that grew out of the conversations and interchanges that occurred in connection with the visit of European bankers here last summer, but let me say that if it is the disposition of the committee to want to go into it, I know very little about what took place. I can speak only as to what I did and not as to what others may have done.

Mr. GOLDSBOROUGH. The situation in this country now, as I understand it, is that the public has absolutely gone wild on the subject of speculation, and that it is due more than anything else to the action

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of the Federal reserve banks in refusing to gradually raise their rediscount rates at the time when this wild speculation was evidently beginning, and it would be very interesting to me to know just why the Federal Reserve Board did not check that very apparent tendency at the proper time, which has now gotten away from everybody.

Doctor MILLER. When was it apparent?

Mr. GOLDSBOROUGH. It has been apparent for two years.

Doctor MILLER. You are talking in new dimensions.

Mr. GOLDSBOROUGH. You asked when it was apparent, and I said for two years.

Doctor MILLER. When you asked the question, I supposed you had in mind this most recent phase of it.

Mr. GOLDSBOROUGH. Oh, no.

Doctor MILLER. I quite agree with you, though I think, if I were in the privileged position of an outsider, I would be inclined to suspend judgment, final judgment, upon the developments that have been in progress in this country in the last four years until the whole chapter is written out. I am not at all convinced that we have not been going through a revolution in American business that may mean that we have got to reappraise a great many things in new terms. So that if I were in a position where I could forthwith indulge this privilege of an outsider I would want to see what the thing was going to eventually include.

It has been my consistent position, as a member of the Federal Reserve Board for a period of almost four years, that we were in danger of sowing the wind ultimately to reap the whirlwind, and I have not felt easy and comfortable about it.

Mr. GOLDSBOROUGH. There have been efforts made by certain members of this committee—in other words, there have been hearings here every year since 1922 on this question of stabilization and the effort to try to avert just what is about to happen, and my contention always was before the committee that unless we had some automatic process by which credit could be controlled, the pressure of business would overcome the will of the Federal reserve system and that it absolutely would get beyond control.

It has always been my theory that no set of men could possibly control the pressure of big business when it portrayed a condition when any appreciable raising of the discount rates would probably cause a panic or some terrible business calamity.

That has been my theory, and it was under that theory that I introduced the Fisher bill, which would produce, it seems to me, an automatic control of the situation.

The CHAIRMAN. I want to state here that what has been said in the statement I made is no attempt on my part to criticize any governor of any of the Federal reserve banks participating in the conference referred to, but, realizing the importance of these conferences to the management of the Federal reserve system and this country, it has seemed to me important that the Federal Reserve Board should have knowledge of and authorize such conferences, and it is a matter of some surprise to us to find that no such authorization has been given. I do not know, except from the newspaper reports, as apparently Doctor Miller does not know, that a conference is about to take place to which the editorial in the Journal of Commerce has

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referred. The cooperation of our Federal reserve system with the banks of issue of the other countries of the world I regard as of extreme importance; in fact, I do not think there is any other function that is more important at the present time than that cooperation, but when it is entered into it seems to me as if it ought to be entered into with the fullest knowledge and after due and deliberate consideration of matters that are to be discussed.

Mr. STEAGALL. I want to ask you this question. There may have been discussion of it in my absence, because, unfortunately, I have not been able to attend all of these hearings.

At one time the Federal reserve banks were committed to certain loans in Europe. What is the status of the relations of our banks now with the European situation in that connection?

Doctor MILLER. I would have to refresh myself on that. These were in the nature of credits, or arrangements for credits.

Mr. STEAGALL. Yes. At one time we were told that there was an agreement made with the Bank of England by which, upon request or demand, we were to loan them $200,000,000.

Doctor MILLER. Up to $200,000,000.

Mr. STEAGALL. I am not sure that I remember all the details of that arrangement, but somewhere in some way I was informed, or got the impression, that there were other loans of similar nature; and I would just like, if you can, to have you give us the information in that connection and let it go in the record.

Doctor MILLER. Do you want me to give you my offhand impression?

Mr. STEAGALL. Offhand, and if it is not entirely correct you may change it when you go over the record.

Doctor MILLER. Please check me, Doctor Goldenweiser, where I am not correct.

I think the first central bank credit arrangement that followed that made in 1925 with the Bank of England was the credit arranged on behalf of the National Bank of Belgium.

Would you like to have the amount?

Mr. STEAGALL. Yes; if you have it.

Doctor MILLER. The maximum amount of that was $10,000,000, and it ran for a period of 12 months.

The next one was with the Central Bank of Poland. That ran in amount of $5,250,000. I think that credit is still alive.

The CHAIRMAN. These credits were arranged through the purchase of bills?

Doctor MILLER. These credits I am now describing, for the Banks of Belgium and Poland, were different from the credit arrangement with the Bank of England. They contemplated purchase of bills.

The next one was on behalf of the Bank of Italy for $15,000,000. That credit is still alive.

The CHAIRMAN. That was in participation with the banks of issue?

Doctor MILLER. Yes.

The CHAIRMAN. And that was the arrangement for the purchase of bills?

Doctor MILLER. Yes; and there is one that has been under discussion, but not consummated.

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Mr. STEAGALL. Does that cover the entire list of transactions?

Doctor MILLER. I think so. I think there have been informal suggestions that others might come along, but this, I think, exhausts the list of cases where credits actually have been arranged.

Mr. STEAGALL. What is the present status of the arrangement with the Bank of England?

Doctor MILLER. It has expired.

Mr. STEAGALL. What were the total committals under these arrangements to which you referred—something like $300,000,000?

Doctor MILLER. Not as much as that. Some expired before others began.

Mr. STEAGALL. Do you know just what transactions the governor of the Bank of England was having with the United States and our investors at the time that our banks were committed to this loan to them?

Doctor MILLER. I do not quite get you.

Mr. STEAGALL. I am wondering what other borrowings they were negotiating for contemporaneously with the agreement made with our banks.

Doctor MILLER. Well, you may have forgotten, Mr. Congressman, that part of the general arrangements that included the credit of $200,000,000 from the reserve system to the Bank of England also included credit arranged by private bankers for $100,000,000.

Mr. STEAGALL. That is what I was getting up to. I wanted that information from you, because I was not sure just where I got it.

The CHAIRMAN. I will say to the gentleman that it was put into the record by Governor Strong, of the Federal Reserve Bank of New York.

Mr. STEAGALL. I am testifying from my recollection of that, but my memory is not entirely clear about it. So our committal of an amount of $200,000,000 was substantially a contemporaneous transaction with that by which the Morgan banks loaned to the Bank of England $100,000,000?

Doctor MILLER. As a matter of fact, I think neither credit was ever availed of.

Mr. STEAGALL. How was this loan to be handled through our banks? Was it not an arrangement with the 12 Federal reserve banks?

Doctor MILLER. They were to participate; that is, they were to be given the opportunity of participating.

Mr. STEAGALL. I want to ask you one question aside from what we have been talking about. In sitting here listening to this discussion and thinking of this legislation and the obligations and duties that would be put upon the Federal Reserve Board, this inquiry has occurred to me, which is largely one of policy: I want to ask you what you think of the idea of providing for a member of the Federal Reserve Board from each of the 12 Federal reserve districts, my thought being, of course, primarly that you would have on that board at all times a representative of each district presenting the views and approaching questions arising before the board from the viewpoint of his environment and the people of his particular district.

Doctor MILLER. Of course, you now get that from the Federal advisory council. Each district sends a member, and they are meeting in Washington to-day.

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Mr. STEAGALL. How are they selected?

Doctor MILLER. By the Federal reserve banks.

Mr. STEAGALL. I am speaking now of having members of the board representing the different districts.

Doctor MILLER. I have thought of that a great deal. My judgment on that is that you would get the best results from such an agency as the Federal Reserve Board; or, let me put it this way, if the Federal Reserve Board is to perform under the Federal reserve system the function that it has always been my belief it was set up to perform, you would most nearly get that result if the membership of the board consisted of only five members with no ex officio representation.

Mr. STEAGALL. I am thinking not only of having every section being able to have its needs properly understood by the board, but also have in mind the diffusion, the spreading of those vast powers conferred upon the Federal Reserve Board, if it may be done without any injury to efficient management.

Doctor MILLER. Well, my expectation would be that if you had a board consisting of 12 men, it would be tantamount to a small legislative assembly in which each member would be disposed to regard himself as a representative of and for the particular Federal reserve district from which he was appointed.

Mr. STEAGALL. It was not my thought that any suggestion of that kind would be in the legislation at all, but that by an enlargement of the board you would incidentally get a viewpoint presented coming from each particular section, not that that would be controlling——

Doctor MILLER (interposing). It is my belief that with an enlargement of the board you would get such a division of responsibility that you would find that your board would lack capacity for constructive leadership and initiative such as I think the chairman has in mind in some of the questions he has put to me. I think if that is what is desired, and I believe that is necessary if the Federal reserve system is to function to the best advantage of the country, it can be gotten only through concentrating responsibility by reduction of membership.

You must not forget that the Federal Reserve Board is peculiarly a policy board—a board that is dealing with matters of policy. That involves a good deal of concentration, of attention, and continuity of interest, patient evaluation of facts and statistics, acquaintance with conditions, all of which, as brought out here in the testimony yesterday, eventually present the problems that call for the exercise of a broad vision, discretion, and judgment.

It means, therefore, that if you are to get the best results, each individual member of the board, in my judgment, has got to keep himself in such a mental condition as he would have to if he alone were responsible for the action taken by the board; as if he were a single individual invested with that discretion.

Mr. STEAGALL. The Bible says that in a multiplicity of counsel there is wisdom. I am wondering whether, where there is such a vast power to be exercised, it would not bring together a wider range of information and wider expression of interest and sympathy, and if it would not bring into the council chamber certain other elements of deliberation, possibly resulting in compromises of opinions at times but promoting conservatism of action that would be desirable.

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Doctor MILLER. That would depend on the membership of the board. It might work out that way at certain times, and at other times it might, perhaps be an obstruction to action. I think it would seldom work so as to give, through the agency of the Federal Reserve Board, a sense of direction to the Federal reserve system.

Mr. STEAGALL. I think I have your answer on that, and I want to ask you one other question. You referred to the ex officio membership of the board. That has been a question that has been running through my mind, as to whether the board should not have been entirely independent in that regard. I would like to hear your views on that and your reasons for the though you expressed a moment ago.

Doctor MILLER. I think my reasons are pretty well implied in what I said.

Mr. STEAGALL. I guess that is true, but I am wondering if you might want to enlarge upon it.

Doctor MILLER. I am not thinking of any particular persons when I speak of this. The relations on the whole, with the different gentlemen who have been Secretaries of the Treasury have been very agreeable, but I have observed over and over again that where you have a member of the board who is weighted with other very serious responsibilities and who is an occasional member, therefore, he is brought in at a time when the active membership of the board, those who have no other job, have been thinking on a problem for a long time and been living with it. As has happened on several occasions, perhaps you have a divided board or close to it and the deciding vote, or the decisive influence, may be one or other or both of the ex officio members. That, I think, is something that is inevitable under the present set-up.

You may also have to deal with this, and that applies more particularly to the Secretary of the Treasury, because that is one of the greatest positions of the Government, a position that carries a great prestige, particularly to the membership of the Federal reserve system, that it may well happen that if you have members of the Federal Reserve Board who are on the margin of doubt as to how to act, that doubt might be resolved by a disposition to be in step with the thought of the Secretary of the Treasury.

Mr. STEAGALL. It had been my thought that, out of the necessities of the situation, no man whose first obligations and duties are involved in the administration of some great office and responsibility other than that of membership on the Federal Reserve Board could devote to the work of the Federal Reserve Board that persistent and continuing effort that is indispensable to the healthiest efficiency.

Doctor MILLER. Yes; and there are other reasons, but I think these are enough, perhaps, for the present.

Mr. GOLDSBOROUGH. Mr. Chairman, may I insert in the record a speech I made before the Bankers' Association of the State of Maryland at Atlantic City on May 6, 1924, having to do with the rediscount policy of the Federal reserve system and also its open-market operations, and also an address made by Mr. Reginald McKenna, president of the Midland Bank, before the stockholders of the Bank of England on January 28, 1928, on the same subject?

The CHAIRMAN. Without objection, those two speeches will be inserted in the record at this point.

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(The addresses referred to are printed below:)

STABILIZATION OF MONEY

Speech of Hon. T. Alan Goldsborough, of Maryland, Delivered Before the Maryland State Bankers' Association on May 6, 1924

Mr. Chairman and gentlemen of the Maryland State Bankers' Association, in the course of these remarks I hope you will not be forced to feel about me as a woman felt who met a friend she had not seen for several years, and who said to her:

"Your husband does not knock you about as he used to do, eh?"

"No, sir," the woman answered.

"I am mighty glad to hear it. After all, his heart is in the right place."

"Oh, yes, sir; his heart's in the right place, and the rest of his body, too. He is in jail."

I trust also you will not be as careful to show this feeling as was Mrs. Maloney when she was brought before the magistrate for an assault on Policeman Casey. She had been unusually attentive throughout the proceedings, and now the judge was summing up the evidence.

"The evidence shows, Mrs. Maloney," he began, "that you threw a stone at Policeman Casey."

"It shows more than that, your honor," interrupted Mrs. Maloney. "It shows that Oi hit him."

When I was asked to address this distinguished body of representative Marylanders the question naturally arose as to what I could say which would be of interest and possibly of some service. Years ago in Caroline County, when I was a boy, we had only one bank, and the offering of a promissory note to that institution for discount was done with the humility proper in the asking of a great favor, while the board of directors in discounting that note, which, by the way, had to be protected by indorsements representing many times the amount asked for, deported themselves as if they were a charitable organization bestowing from their own individual resources largess to the benighted multitude. This is no longer the condition. With 10 banks in the county, each bidding for business, the danger now, in so far as there is danger, is toward too great laxity in loaning the funds of these banks. What has happened in Caroline County is typical of what has happened in the other counties of Maryland and in Baltimore City, is typical of what has happened in all the older communities through the length and breadth of the United States, and is typical of that spirit of democracy which is the result of a vastly increased average intelligence, enlightenment, and education, and which, in its spread not only throughout our own great people but the people of the world, is so great a part of the hope of the future.

It is extremely difficult to segregate basic human necessities and single out any given one or two as of paramount importance, but, based not only upon preconceived notion but upon what I believe has been a patient investigation, I have reached the conclusion that there are at least two fundamental human problems that our people are now prepared to consider and solve—the abolition of war and the stabilization of money. It is of this last I would speak.

My grandfather was a country doctor, and in 1885, as a very small boy, I began to drive with him constantly, except when I was in school. In those days the farmer had no hours; the farmer's wife had no hours. They worked from the time they could see the morning until daylight down at night, and as a class they were always poor. This fact was driven home to me because time and again when it was necessary for the family doctor to make some sort of a collection in order to live he found that after the interest and bonus on the bill of sale had been paid and the interest and part of the principal on the fertilizer note and the taxes and insurance attended to there was nothing left for the doctor; and a great many times, instead of making a collection, he "lightened his wallet," to him who was less well off than he. I wondered about this condition. I tried to think why it was that these people whose work was never done were always poor. Afterwards, with a broadening view, I wondered why it was that the average of those with things to sell were at such a great disadvantage relatively with those who had money to sell. About the time I

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graduated from college in 1899 I noticed a change. Those with things to sell had gradually begun to prosper and those with money to sell gradually began to do not so well, and finally I reached the conclusion that from my earliest recollection until near the beginning of the century the investor and the man with a fixed income appeared to be always in a gradually better position, while the small business man, and especially the producer—having in mind the farmer—was constantly going back; and that since the beginning of the century and up to 1914 the position was exactly reversed, although the farmer, for other reasons, has always occupied a relatively unfavorable position. Finally, it appeared to me that various social phenomena had resulted and were resulting from these varying conditions. The gradual fall in prices from 1873 to 1896 culminated in the Bryan free-silver campaign, which, if successful, would have resulted and was intended to result in the paying of debts with cheap money; that is, in the partial repudiation of obligations.

In the period from 1896 to 1914 we heard no more about free silver, but a wave of unrest began to spread among those with a fixed income; the clerk, the school-teacher, the salaried man of every class began to feel with ever-increasing pressure the gradual rise in the cost of living. Labor unions were formed, strikes became uncommon, radical legislation of all sorts was offered in Congress; some of it was passed. We began to hear of capital as distinguished from labor and labor as distinguished from capital, as if our people occupied two armed camps, each battling against the other. And then the World War came on. Providentially, just prior to that time the Federal reserve act was passed, which increased potential credit many times. We have seen the period of inflation in 1919 and 1920 with general commodity prices rising to about two and one-fourth times what they were in 1914; and then the collapse of the latter part of 1921 and 1922, and the conservative, careful period of 1923.

What does it all mean, and is there any solution after we find out what it all means? When I went to Congress in 1921, with some opportunity to investigate these things which I had been wondering about for so long, I began to mull around, and one day in the Bureau of Labor Statistics I was shown a curve of prices based on the bureau's index number, and as I ran my finger along the line of falling prices from 1873 to 1896 and of rising prices from 1896 to 1914 I began to see why it was that the first period was one of prosperity for the man of fixed income, the mortgagee, and the bondholder, and why the last period was one of relative prosperity for the producer, the business man, and the stockholder, each period causing social misunderstanding, unrest, and misery to that part of our people not on the right side of the price trend. Now, there was a reason, of course, for these long periods of rising and falling prices, and remembering that we were on a gold basis it then occurred to me that gold began to be produced in South Africa and the Klondike just about 1896. By this time it seemed there was a little light just ahead and that the foundation of our changing economic conditions had been either a scarcity or a plentitude of gold. And now what is the answer?

Careful economists tell us that there is a constant equation between the volume of production and its turnover and the volume of money and credits and their turnover (of course, I am speaking roughly), so that in order to preserve their relative positions of debtor and creditor, mortgagor and mortgagee, bondholder and stockholder, seller of goods and seller of money a means should be devised to preserve this ratio so that the volume of money and credit will expand only in the same proportion as production and turnover expands and contracts as production and turnover subsides. In the March number of Harper's Magazine there is an article entitled "Stabilizing the dollar," which analyzes this subject in every satisfactory way, and which, incidentally, spoke favorably of certain legislation now pending in Congress and introduced by me. I mention this fact as indicating two things: First, that the stabilization of purchasing power is becoming a matter of public interest; and second, that I am discussing a question in the solution of which I am attempting to assist in a practical way. In the Bureau of Labor Statistics, in Washington, there is kept an index number of wholesale price levels made up of a composite of something over 400 commodities, each weighed in accordance with what experience has shown to be its relative market importance. The standard from which conclusions are now drawn is the average price level of 1914. The present price level relative to 1914 is about 161. The legislation

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referred to and now pending in Congress contemplates starting with the general price level at the time when the proposed legislation becomes law and afterwards maintain approximately that price level by means which I will indicate in a few moments. In the meantime I want to make it perfectly clear, of course, that there is no attempt in this legislation to control the price level of individual commodities. They will move in accordance with the law of supply and demand, but the purpose is to keep the average the same, so that the value of money in an aggregate of the general commodities which it will buy will not appreciably change. In other words, while flour and eggs and butter and chickens and meat and sugar and coffee will individually vary in price, the filled market basket made up of these different commodities can always be purchased with the same amount of money. And right here let me say that when the general price level is kept constant, when there is an automatic restraint against inflation and its consequent deflation and collapse, the tendency of individual prices to change will be immeasurably reduced, because the unhealthy economic conditions, the result of these abnormal periods, is the chief cause of the sudden rise and collapse of the price of any given commodity.

How can we keep this index number constant? How can we prevent periods of inflation succeeding periods of business expansion, culminating in periods of speculation and ending in periods of collapse? The quantity theory of money has been recognized as essentially sound by practically all economists for more than a century. Illustrating by reducing the theory to its simplest form, if the total volume of commodities consists of 20 bushels of wheat and wheat is only traded in by the use of money, and the total volume of money is $20, as long as all that wheat is being traded in and all that money is in circulation wheat will be worth $1 a bushel. If, under the same conditions, there are $40 in circulation, wheat will be worth $2 a bushel; if, with 20 bushels of wheat and $20 in money $10 of that money is withheld from circulation and all other conditions are as stated in the first previous illustration, wheat will be worth 50 cents a bushel; if, on the other hand, one-half of that wheat is being withheld from the market and there is only a turnover in 10 bushels of the wheat, other conditions remaining as in the first illustration, wheat will be worth $2 a bushel. Or, expressed in the generalization mentioned heretofore in these remarks, there is a constant ratio between the volume of production and turnover and the volume of money and credits and their circulation. So that if your index number of general price levels remains constant, you are assured that your volume of money and credits are expanding only in proportion as production and turnover expands—that is, only in proportion to the legitimate needs of business—and you can be assured that when you restrain the rise of the index number you are restraining credits beyond the legitimate necessities of business, you are restraining unhealthy and abnormal production, and you are restraining business expansion within wholesome limits and stopping in its inception overproduction, waste, speculation, and collapse.

The basis of our monetary system is gold; our entire credit structure is based on gold. Now, let's assume that all the gold is withdrawn from circulation, gold certificates being substituted; and let's assume that we start with a reserve of $1,000,000 in gold at the present number of grains of pure gold in the dollar, and that the index number goes up 1 per cent, indicating that our money and credit structure is expanding more rapidly than our production and turnover. If we then increase the theoretical gold content in a dollar by 1 per cent, we have reduced our gold reserve from $1,000,000 to $990,000 and the possibilities of our credit structure by 1 per cent, which in turn tends to reestablish the normal ratio between production and turnover on one side and money and credit in circulation on the other.

Without going into the details of the proposed legislation, the above illustrations will serve to indicate its theory. Now, the question arises, Is such legislation possible at this time? The law requires us to maintain our gold reserves at 40 per cent. We now have about 82 per cent, and in order to make this plan feasible without unduly weighing the dollar it will be necessary to legislate for a required gold reserve of about 70. It is, therefore, difficult to have passed such legislation at this time, but in the various discussions concerning stabilization caused by this proposed legislation various alternatives have been suggested, such as a legislative direction by Congress to the Federal Reserve Board to have raised rediscount rates in the Federal reserve banks

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when the index number is rising and reduce them when the index number is falling and in that way tend on the one hand to discourage unhealthy expansion and on the other hand to make money easy when business is not so good and thus tend to stimulate it. Another proposal is legislation requiring the Federal Reserve Board to have the reserve banks put securities on the market and thus tend to draw money from active circulation when the index number is rising and to buy them up and thus put money in circulation for business when the index number is falling.

In considering the necessity of legislation, let us go over for a minute what happened in 1923. At that time the mental attitude of the country regarding economic conditions was the attitude of a people who had just been through a period of unhealthy inflation and drastic and stupefying deflation and corresponded to the way people feel about a war just after the war is over. We would never have wars if people kept in the same frame of mind they are in just after one is over. In 1923 we were cautious, not because we are habitually wise enough to be cautious, but because and only because we had just had our lesson. Various banks in their monthly letters during 1923 gave reminders of the disasters of 1920; the monthly letters of the National City Bank of New York, for example, one of the most widely read of economic bulletins, in January advised business men to operate with caution. In February it remarked that business men "are following conservative policies and showing little inclination to become extended, which is the part of wisdom in present conditions." In March it warned its readers that every upward movement is in danger of running away. In April it again called attention to the danger of inflation. "The industries of the country," it declared, "are already working practically at capacity or to the limit of the labor supply. Under this condition they can not use more credit to advantage."

These warnings are typical of the state of mind of bankers in the early months of 1923. In February and March, 1923, the reserve banks of New York, Boston, and San Francisco raised their rediscount rates. Due in part to this action, interest rates of commercial banks rose in February and again in March, rates rates on call loans on 60 to 90 day paper and on 4 to 6 months paper being all higher in March than in any month of the previous year. Raising of money rates was followed promptly by curbing of the upward movement of prices and overproduction. Not so generally understood is the fact that the open-market operations of the Federal reserve banks in the first half of 1923 tended to curb the involuntary movement and in the second half of the year tended to sustain business on its new level. Early in January the Federal reserve banks held open-market acceptances and United States securities to the value of $734,000,000. These they reduced steadily throughout the period of incipient business boom. By July the total holdings were less than $300,000,000. Between October 17 and the end of the year, however, the holdings increased from about three hundred million to four hundred and seventy-three million dollars. Thus the open-market operations took money out of general circulation at a time when, according to our indices, money in circulation was increasing faster than the volumes of trade, and later in the year when these same guides began to point in the other direction the open-market operations put more money into circulation. We were cautious in 1923 because we had had a recent lesson. We will be less cautious as time goes by, and in a very short time when credit begins to be demanded all over the country for developments of all sorts the Federal Reserve Board, without express legislative authority, will not be able to restrain a period of inflation greater, probably, than any we have ever known. In 1920, with our gold reserve down to 43.4 per cent, the index number was 226, or two and one-fourth times higher than in 1914. In 1922, with a reserve percentage of 77.9, the index number fell to 149. With the present reserve percentage of 82 per cent, the index number of wholesale prices is about 160, so that a determined demand for credit based on our gold reserve could pull our reserve percentage down to 45, probably, before it could be stopped. The index number would rise to around 300, which would mean prices higher than this country has ever seen, and which would result in an economic collapse greater than that of 1921 and 1922. This problem, my friends, is on the very verge of being solved, but we can't wait too long. As I said before, human memory is short. Unless our obligations as a world power and a leader of civilization are fulfilled shortly, the gradual abolition of war never can be achieved until

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the lessons of the next war direct the human mind to the solution of the problem, and unless we have promptly some legislation looking to real scientific monetary stability, it will be too late until the next so-called business cycle has left in its wake its dreadful toll of economic waste, misery, and human despair.

I, personally, am an optimist. When I compare conditions now with what they were 30 years ago I see tillage where there was swamp; I find sewers taking the place of unhealthy, insanitary conditions; I find the people willing to spend thousands of dollars a year to build roads to lighten the human burden and to draw the city, the town, and the country ever closer together; I find the body of the child taken care of in a manner undreamed of 30 years ago; and I see a public endeavor to surround with the beneficence of education every class from the highest to the lowest; and if you and I live out the normal span of our lives I have no doubt whatever that we will look back and wonder why we were ever short-sighted enough to allow a condition of constantly changing money value to exist without making the necessary changes in our system. A problem like the one we are discussing to-day is a problem of democracy, a democracy which is one in fact and not one in name only; a democracy which demands that that which one has accumulated by his industry and his endeavor shall not be taken away from him because of a fall in the value of the medium of exchange, and that the results of human toil shall not be dissipated and the toiler left in his despair because of an increase in the value of the medium of exchange.

In the course of some litigation several years ago a certain prominent manufacturer said during his cross-examination that he knew nothing of history and didn't recognize the value of such knowledge. This was either an ill-considered statement or else was the result of the kind of practical success along a given line which creates in some minds the obsession that they are blessed with all wisdom, an obsession which interferes with the process of reflection.

In an address delivered at the University of Michigan in April, 1911, on the study of ancient literature the Hon. James Bryce, then ambassador to this country from Great Britain, had this to say concerning the study of history:

"We can conjecture the future only from what we know of the past; that is to say, from what we know of human nature and the processes by which it and human institutions change. One who knows only his own country and people does not really know them, because it is only by knowing something of other countries and their peoples that he can tell which characteristics of his own people are normal, generally present in all peoples, and which are peculiar to his own. So likewise he who knows only his own time does not really know it, for he can not distinguish between characteristics that are transient and those that are permanent. This is the main use of history besides, of course, the pleasure which all knowledge gives. To know what we are we must know how we came to be what we are, and must realize that we shall before long pass into something different."

The lessons of history teach of the cycle, inevitable, under our present monetary system—expansion, inflation, speculation, collapse, slow recovery. Stabilization, restraining expansion at the point of overproduction and consequent inflation, is not only an economic problem the solution of which people are ready to undertake, but is clearly a direct problem of civilization involving self-restraint and mental and spiritual elevation.

The great body of bankers, representing as they do much of the best thought of our communities, are bound to be conservative in the sense that they shrink from political nostrums and fundamentally unsound economic proposals, but pure conservatism is alike offensive to them, as it means stagnation and a refusal to note the march of civilization.

In the language of Edward G. Ryan, the great Wisconsin lawyer and judge:

"Pure conservatism is always wrong; civilization is never fixed. No Joshua has power to stay the course of the human mind. Change is the necessity of human history, progress the duty of the human race. Pure conservatism has no place in the annals of mankind. It concedes the past, but denies the future. It worships the actual, but anathematizes the possible. Its creed is the present because it is the present. It holds with Pope that whatever is, is right. It is the bigot of the present, without sympathy with the past or prophecy of the future. Content where it finds itself, pure conservatism sits down by the way-

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side, while the march of civilization passes by and presses on to the promised land of the future, guided on its dark way by faith in the destiny of man as by a pillar of fire."

Speech of the Right Hon. Reginald McKenna Before the Directors of the Bank of England, January 28, 1928

To-day I shall turn to ask you to consider the present position of gold as an international standard of value.

Nearly three years have elapsed since the pound sterling was reestablished on the gold basis, and most of the important currencies are now stabilized in relation to gold. This general reversion to gold gives the appearance of a return to pre-war conditions in matters of credit and currency, but if we look further into the question we shall find that there has been a remarkable change. The development of central-bank policy in the United States has shown that, while gold may be retained as a medium for making international payments, it can be deprived of its function as the ultimate standard of value. How this came about, the stages through which American policy has passed, and the meaning of the conclusion deserve our close attention.

CONDITIONS BEFORE THE WAR

Let me begin by reminding you of the conditions before the war. At that time the central banks adopted a purely passive attitude with regard to the control of credit, allowing the movement of gold into or out of a country to regulate the internal supply of money. If gold flowed in freely, credit and currency expanded; if more credit was created than was required to support the current growth of business, prices rose.

If gold flowed out, credit and currency contracted; the growth of business was checked and prices showed a tendency to fall. It followed from this that the current course of world prices was determined by the supply of monetary gold. This does not mean that other causes, such as improved methods of production and communication, do not affect the price level, but these only come into play over more extended periods of time.

This passivity of the central banks probably arose from the peculiar structure of the British central banking system. London was then the unchallenged financial center and free gold market of the world. In addition, Britain, as the world's principal creditor, was the main source of supply of new capital, and international trade was for the greater part financed by sterling bills. These various factors taken together constituted London the point through which a surplus or scarcity of gold made its influence felt, and the British price level was the medium through which gold operated on the price levels of all other countries.

PRIMARY RESERVE SMALL

Under the British central banking system only a small part of the country's total gold holding was available to meet demand. So small, indeed, was the primary reserve in relation to the demands which might possibly be made upon it, that the principal aim of our central bank policy was to protect it from withdrawals of gold, even when these were really of quite moderate dimensions in relation to the total stock in the country. The movement of gold became a matter of the utmost importance, and the means of counteracting its influence on the supply of money and the course of prices hardly existed. In these circumstances there was little scope for the formulation or exercise of conscious policy, and the principles of central bank credit control remained undeveloped, if not unknown.

The first authoritative suggestion that gold movements need not have predominant importance in the control of credit and currency appeared in the recommendations of the international economic conference held at Genoa in 1922. The financial commission appointed at that conference, perhaps the most important of its kind that has been held, were deeply impressed by the danger of a gold shortage. As advised by most of the leading authorities, the commission took the view that a scarcity was to be looked for in the absence of any unforeseen developments in production.

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AIM TO ECONOMIZE GOLD

They were alarmed at the prospect of the supply of gold to the principal trading countries of the world becoming inadequate to provide for such an expansion of credit and currency as would be needed to meet the requirements of growing trade. Accordingly the commission's recommendations were aimed at economizing the use of gold, and one of their main suggestions was that instead of reverting to the pre-war system, under which each country held its own gold stock, gold exchange standards should be adopted by most countries, leaving only a few to hold the ultimate metallic reserves for the entire world.

The purpose of the conference in propounding measures to economize gold was undeniably sound, and it is a matter of regret that the suggestions for the adoption of gold-exchange standards have been widely departed from. The proposal, it is true, was at first incorporated in a modified form in schemes of reorganization in many parts of the world, particularly in central Europe and South America, but, unfortunately, the system has come to be regarded as merely a step on the road to a full gold standard. Already many countries actually on a gold-exchange standard are unprofitably using their foreign assets in the purchase of gold reserves.

The eager desire to accumulate metallic reserves is no doubt prompted by the recollection of pre-war practice and ignores our more recent experience that, even in a gold-standard country, gold need no longer be the controlling factor in the supply of money. This brings me to the example of the United States, and I shall endeavor to outline the stages along which that country has moved in its progress from the pre-war to post-war conceptions of monetary policy. If, however, the successive proceedings of the American central reserve banks are to be fully understood, we must continually bear in mind a general proposition which lies at the root of monetary theory and to which I have referred on several previous occasions.

REGULATION OF SUPPLY

Stated in the briefest terms, the proposition is that every central bank purchase and every loan by a central bank increases the cash resources of the other banks and provides the basis for an expansion in the volume of credit, or, in other words, of money; while every sale by a central bank or repayment of a central bank loan reduces bank cash and restricts the supply of money. This proposition holds true whatever the central bank may purchase or sell, whether it buys or disposes of gold, bills, securities, or any other asset. From this it follows that central banks possess the power to regulate the supply of money irrespective of gold movements. According to their view of trade requirements they may, if they choose, wholly or partially offset, a purchase of gold by a sale of other assets or a sale of gold by a purchase of assets.

MONETARY POLICY OF UNITED STATES

Obviously this power has always been inherent in a central bank system, and, apart from its ordinary day-to-day business, the Bank of England used from time to time in pre-war days to make purchases and sales of assets other than gold. But such transactions were undertaken only as an auxiliary to bank-rate policy, which was itself determined by actual and potential movements of gold. Purchases and sales of gold were alone regarded as the effective control of the volume of bank cash and consequently of the supply of money.

I come now to the story of the recent development of monetary policy in the United States. In consequence of the enormous accumulation of gold, coupled with movements into and out of the country on a scale which, if left uncontrolled, would have proved disastrous to the stability of the American price level, the attention of the reserve banks was forcibly directed to their controlling powers. Beginning with only a partial use, in the course of time they have learned to utilize these powers to the full. All the stages in the development of American practice can be seen in the 13 years since 1914, which I divide into five periods. Each of these is marked by distinctive gold movements, and I propose to show how the resulting problems have been successively dealt with.

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The first period runs from the outbreak of the war to the middle of 1919, covers the beginning of the great westward flow of gold to America. All the incoming gold, amounting on balance to over 1,000 million dollars, was purchased by the Federal reserve banks, and following pre-war practice was allowed to become the basis of additional credit.

REMOVAL OF EMBARGO

As if this were not enough, the central institutions created a further basis of credit by discounting bills for member banks for very large sums, and thus the ground was laid for the vast expansion of credit which actually occurred. The demands for credit on this inflationary basis were insatiable. No sufficient measures for counteracting the effect of the incoming gold had yet been adopted and inflation ran a free course.

The second period runs from the middle of 1919, when the war-time embargo on gold export was removed, to the late summer of the following year. During this period dollar balances owned by South American and Far Eastern countries were withdrawn in gold, and America lost a net amount of nearly $400,000,000. The export demand was met by the reserve banks, but it should be noted that the sale of this gold did not permanently deplete bank cash. Under the influence of the current inflation the reserve banks continued freely to discount bills and buy earning assets to such an extent that the supply of bank cash was considerably increased and an enlarged basis was provided for further credit inflation.

BANK CASH IS INCREASED

My third period covers more than four years and extends from the summer of 1920 to the last month of 1924. This period was marked by continuous imports of gold, and already in the early years we perceive a growing anxiety on the part of the central banking authorities with regard to the inflow. They realized that if the gold were allowed to function to the fullest extent it would lead to a further expansion of credit and a perpetuation of the evils of inflation. They determined, therefore, as far as possible, to deprive the incoming gold of its credit-creating capacity until the demands of trade should call for a larger credit basis.

The period I am now reviewing falls naturally into two parts: In the first the gold was neutralized; in the second it was allowed to form new bank cash. In the first two years, which covered the liquidation following the postwar boom, $1,000,000,000 of gold were imported and bought by the reserve banks. The immediate effect of the purchases was to increase bank cash, but the whole of this increase was used by the member banks to pay off maturing bills held by the central banks, and on balance the volume of bank cash was unchanged.

During this time policy was at work. The gold was absorbed by the reserve banks and held by them in place of discounted bills. This process of acquiring gold in lieu of interest-bearing assets was expensive and severely curtailed the income of the reserve banks. But their object had been achieved. The effect of the inflowing gold had been nullified in accordance with the dictates of policy, and pre-war practice was in process of abandonment as unsuitable to the novel conditions confronting the American authorities.

BANKS TRANSFER TO TREASURY

During the second half of the period the inflowing gold was treated in an entirely different manner. Industry was recovering from the slump, trade was in process of development, and the banks were being called upon for larger supplies of money. The necessary credit expansion could only be effected upon a broadening basis of bank cash, and the incoming gold was utilized for this purpose. It was paid into the reserve banks, and some of it was allowed to form a permanent addition to member banks' reserves.

So insistent was the demand for money that bank cash was also provided by reserve bank purchases of securities and other earning assets, the result of the increase in bank cash being an expansion of nearly $8,000,000,000 in the deposits of all the banks in the country. Incidentally, it should be noted that the reserve banks did not themselves retain the incoming gold, but handed it

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over to the Treasury, receiving in exchange gold certificates, which they put into circulation in place of Federal reserve notes.

We now come to the fourth period, which, in contrast with that preceding it, was characterized by an outflow of gold. Between December, 1924, and the end of 1925, $150,000,000 of gold were exported from the United States. The whole of this amount was sold by the reserve banks, which did not, however, allow bank cash to contract. As gold was withdrawn the volume of bank cash was maintained by the acquisition of earning assets, so that, notwithstanding the outflow of gold, credit was actually increased in response to the needs of business. At the same time the position of the reserve banks was improved by the attainment of a higher proportion of earning assets.

My last period covers the 22 months to November, 1927, during which gold again flowed into the United States, though the movement was of relatively small dimensions as compared with previous years. The direction of the flow was by no means constant and was complicated in the later months by earmarkings and releases on foreign account; but whether the movement was temporarily inward or outward, the reserve banks continued to ignore it in pursuing their credit policy.

DEVELOPMENTS SINCE 1920

I will now summarize the developments in the years since 1920, the period during which the reserve bank credit policy has been most actively in operation. On balance, $1,700,000,000 of gold have been imported into the United States. Over one-half of this amount has been absorbed into the Federal reserve banks, while the remainder has been taken by the Treasury as backing for gold certificates which have gone into circulation in the place of Federal reserve notes. Of the total import only one-third on balance has been allowed to form new bank cash. Throughout the entire period, whether gold was flowing in or out, the central banks have been careful, as far as possible, to regulate the supply of bank cash in accordance with the needs of business. Trade has expanded rapidly and has been accompanied by a growth in bank deposits amounting in the aggregate to $15,000,000,000, an increase of 40 per cent. Meanwhile, the almost uninterrupted prosperity enjoyed by America has been attended by a large measure of stability in the price level.

Here we find ourselves face to face with a definite test of success or failure in monetary policy. Temporary booms can always be obtained by inflationary methods, but it is certain that prosperity on a sound and lasting basis can not be secured except on a fairly steady price level. It must be remembered that, whether we are on a gold or any other standard, the direction in which the price level moves is immediately determined by the volume of money, as modified by its rate of turnover, in relation to the volume of business.

ANENT PURCHASING POWER

If the supplies of money increased beyond the requirements of business, prices tend to rise; if, on the other hand, the supplies of money are inadequate, prices fall. The relation between money supplies and business requirements, viewed in its effect upon the price level, should then be the first care of the central banking authority, and we find on an examination of American statistics for recent years that movements in the price levels upward or downward have never been allowed to proceed far. We must therefore conclude that the monetary authorities have met with a high degree of success in the formulation and execution of their policy. This they have done under conditions of great difficulty, brought about by gold movements of unprecedented magnitude.

It is necessary now to observe the bearing of the American monetary policy on the operation of the gold standard. To-day, as before the war, the price of gold in America is fixed, and we are apt to assume that the value of gold continues to govern the value of the dollar. But such an assumption is no longer correct. While an ounce of gold can always be exchanged for a definite number of dollars, the value of the ounce will depend upon what these dollars will buy, and this, in turn, will obviously depend upon the American price level. If the price level in America fluctuated according to the movements of gold, the purchasing power or value of the dollar would still depend, as it did formerly, upon the value of gold. But we know that this is not so. As I have just shown, the American price level is not affected by gold movements, but is controlled by the policy of the reserve banks in expanding or contracting credit. It fol-

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lows, therefore, that it is not the value of gold in America which determines the value of the dollar, but the value of the dollar which determines the value of gold.

The mechanism by which the dollar governs the external value of gold is obvious. If the price level outside America should rise in consequence of an increase in the supply of gold, America would absorb the surplus gold; if, on the other hand, the external price level should fall in consequence of a shortage of gold, America would supply the deficiency. The movement of gold would continue until the price levels inside and outside America were brought once more into equilibrium. Although gold is still the nominal basis of most currencies, the real determinant of movements in the general world level of prices is thus the purchasing power of the dollar. The conclusion, therefore, is forced upon us that in a very real sense the world is on a dollar standard.

Such is the position as I see it to-day, and I am naturally led to ask how long it is likely to continue? America is able to control the world price level because of two conditions. In the first place her gold stocks are so great that she can afford to lose large quantities without running any risk of the gold reserve falling below the legal minimum; in the second place, her central banking system is so constituted that, given her great wealth, she can absorb large quantities of gold and at the same time deprive it of its credit-creating powers. In a word, America is rich enough either to lose gold or to gain it. She holds now one-half the total monetary gold of the world.

Moreover, her creditor position constitutes a permanent magnet for gold. Her debtors must pay, and, if they can find no other way, they must pay in gold.

The only condition, as far as I can judge, under which America might be drained of her gold surplus is that she should continuously make foreign loans beyond her true capacity to lend. That she will lend excessively at times is quite probable—there are indications, indeed, that she has done so recently; it is by no means an uncommon practice with ourselves, but that she should overlend so heavily as to make a serious inroad into her surplus gold seems to me very unlikely. I conclude that as long as conditions remain at all similar to those we know to-day America will be able to pursue her credit policy without regard to gold movements, and to maintain control over the world level of prices.

WIDE FIELD FOR INQUIRY

Let me repeat that I speak of conditions as I see them to-day. Taking a view of the world as a whole it is evident that a great advance has been made since the time when gold was the main determinant of the direction of the price level. But we have still some way to go before we attain full understanding of the principles upon which the volume of credit should be regulated in relation to business demands. We know that the proper control of credit by the central bank in any country is a very important factor in trade prosperity, and that a guiding principle in the exercise of this control should be the maintenance of a stable level of prices.

But this is not all; there is still a wide field for inquiry on both the practical and theoretical sides. Unfortunately, however, the dearth of statistical information is a grave difficulty in the way of investigation. Individual banks can not do much; it is useless for them to publish more than the customary details at present disclosed in their periodic statements, since no sound generalization can be deduced from banking figures unless they relate to the banks as a whole. Cooperation between all the banks, including the central bank, in publishing the statistics required by scientific students, would help us materially in the solution of some of the problems of credit control.

The CHAIRMAN. Now, I am going to suggest that we recess until 2.30.

(Whereupon, at 12.20 o'clock p. m., a recess was taken until 2.30 o'clock p. m.)

AFTER RECESS

2.30 O'CLOCK P. M.

The CHAIRMAN. The committee will come to order. Doctor Commons, you may proceed.

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STATEMENT OF DR. ADOLPH C. MILLER—Resumed

Doctor COMMONS. In comparing these two periods that we were talking about—1919 and 1923—it appears in the first period that you did not exercise or did not utilize the power of open-market investments; that there was at the same time a great demand for credit, large loans abroad, and a general feeling of scarcity; that the reserve policy then made use, we might say, of the discount rate in a negative fashion—it did not raise the rate; it left it where it was, and that stimulated rapidly the rise of prices during 1919, and then in 1922 and 1923 we had a very rapid rise of prices, beginning in January, even more rapidly than they had in 1919, and that was accompanied by a purchase of securities that coincided, or the purchase of securities began a little earlier and reached in May, 1922, an augmentation of about $400,000,000. At the same time there was an increase in gold imports, and there was a very great lowering of the rate of interest, which came down to a point about where it had been in 1919.

So I may say that that rise in prices up to the middle of 1922 was coincident with those three what we may call expansive instruments of the reserve system.

Then, in May, 1922, they began selling securities, selling even more than they had purchased. The gold imports were still continuing on a small scale, and the increase in prices slowed up, having arisen from 138 to 155, which was coincident with the beginning of sales of securities.

From May, 1922, to April, 1923, the price level arose from 155 to 159, showing that for some reason the increase of prices had been slowed up. Then in February, 1923, the rate of interest was rather equalized; the New York rate was raised slightly in the latter part of February.

Then, accompanying that, there was a very large amount of publicity given out; and caution, along in March and April, about the dangers of inflation, given out in various ways, not directly by the reserve system, but by people who interpreted the reports of the reserve system, like the New York Times and Mr. Hoover and others.

Then we find that the demand stopped for more credit, or at least was slowed up.

Now, there are two interpretations possible. You say that the reason that the demand slowed up and prices stopped at that point and production slowed up was because the consumers were not capable of purchasing commodities at that level of prices?

Doctor MILLER. In the amounts in which producers could produce them.

Doctor COMMONS. Now, you have three instruments of the reserve system—selling of securities, the raising of the rate, and the caution to the public—three of the great powers which the system uses, and your tendency is to belittle those three influences and to cast the entire influence upon the failure of the purchasing power on the part of the consumer?

Doctor MILLER. You say——

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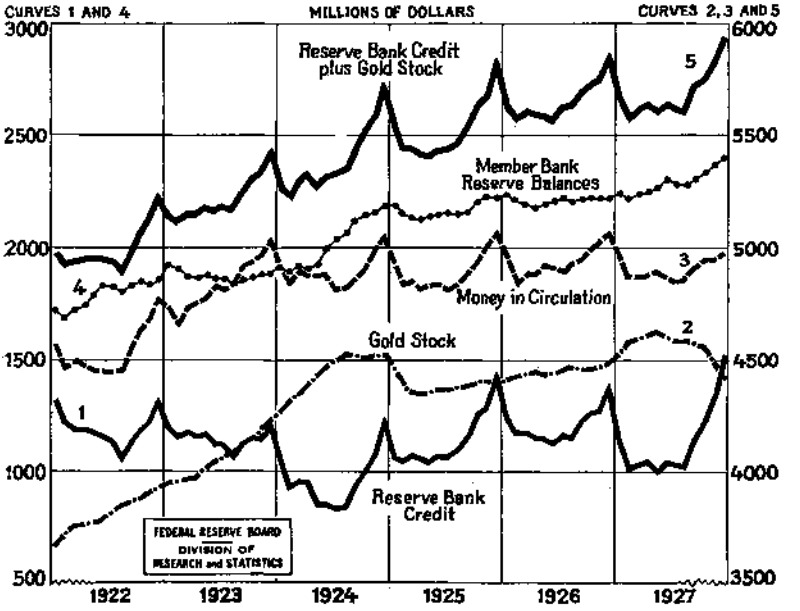
Doctor COMMONS (interposing). There are two elements here, one of which is the diminished power of the consumers owing to agricultural distress, and other things; and then we have three elements of policy, all of which meant contraction—selling of securities, raising of the rate, and caution to the business public not to expand any further—as physically indicated by the slight rise of the rate.

You see the two things that I am trying to contrast there. Which do you place the most emphasis on?

Doctor MILLER. I am not sure that I understand you. Your question is whether the change in the direction of the price curve—say, with early summer of 1923—was due to the pressure that was being exerted to a slight extent by the Federal reserve system through these three agencies you specified?

Doctor COMMONS. Yes.



Doctor MILLER. Principally, or was it due principally to what might be called the noncontrollable factors so far as the Federal reserve is concerned, to wit, the overtaking of consumer demand by production?

I think the latter was more important by far.

Doctor COMMONS. You would give no weight to the other?

Doctor MILLER. Oh, yes; I give weight to them. I would say, Doctor Commons, to make that clear, that what the Federal reserve did at that time perhaps should be described differently, and I would describe it differently from what you did.

If we look at this chart which shows reserve-bank credit, gold-stock money in circulation, and member-bank reserve balances, with a curve at the top showing reserve-bank credit plus gold stock, we

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see in this curve what constitutes the reserve basis of the credit of the member banks. During 1923, even in the earlier months of the year, when you felt that there was contraction going on because of the decline of open-market holdings, the actual total volume of credit in existence in the country and available as a basis of bank lendings was increasing and actually increased quite rapidly in the latter part of the year.

Doctor COMMONS. That would be a seasonal movement, probably.

Doctor MILLER. Now, therefore, that means, Doctor Commons, that in these years particularly, and probably that will be so for a considerable time to come, you have always to consider, in connection with reserve action, what happens to be the temporary movement of gold. You see that in the year 1923 gold imports were steadily and rapidly rising, so that the money, so to speak, taken out of the market by open-market sales was very much more than offset by a net increase in the country's gold stock.

The CHAIRMAN. Let me ask you a question there in that connection. I am interested in your reference, Doctor Commons, to the publicity element that was used at that time. You referred to articles in the New York Times and to a statement by Secretary of Commerce Hoover. Were those statements of such a nature as to affect the purchasing public in connection with the commodities which it was claimed were being overproduced?

Doctor COMMONS. Yes.

The CHAIRMAN. Was the result of those statements such as to slow up the purchasing of surplus commodities?

Doctor COMMONS. Slowing up commitments that business men might make in connection with the quantities they would purchase and the prices they would pay.

The CHAIRMAN. Was that influence probably more patent than was exerted by the open-market operations affecting the buying public at that time?

Doctor COMMONS. Well, the three run together. There was the sale of securities, there was the slight increase in the discount rate, and there were these discussions and warnings, which I find they were all optimistic up to a certain time, and I refer now to page 1693 of the hearings on H. R. 7895. The rate was raised within the latter part of February, on February 23, in New York and Boston. On March 23 the New York Times had an optimistic editorial, said that the money market is not overexpanded. On March 16 President Coolidge warned against too rapid recovery, but predicted it was not likely to happen then. On March 19 Mr. Hoover suggested delay in Government expenditures on new buildings because of great activity of private construction. Mr. Roberts, in a report to the United States Chamber of Commerce on March 23, predicted a further advance in rediscount rates. He is the vice president of the National City Bank. On March 23, Mr. Sisson, of the Guaranty Trust Co., predicted a considerable rise in prices. That is a different note. On March 24 the stock market reported nervousness over rumors that the Federal Reserve Board was about to issue a public warning against inflation. On March 23 the Chase bulletin advised caution. On March 23 the

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Harvard Economic Service predicted continued prosperity. On April 20 Mr. Hoover issued a warning against inflation. On April 27 the American Bankers' Association decided that inflation needed to be watched and advised caution. On May 9 Mr. Hoover again warned against further inflation. On May 19 the National Building Trades Council took action to curb overexpansion in their industry.

The first two of the things that I mentioned, the sale of securities and the raising of the discount rate, required some time to get into the price situation. The prices kept raising up until April and May. May was the highest.

The CHAIRMAN. 1923?

Doctor COMMONS. Yes. The discount rates were raised in the latter part of February, so with the accumulation of those two influences and then the inferences that got into the minds of the public, it required until March 16 before President Coolidge gave the warning. He was the first one to give the warning about too rapid recovery, and up to May 29 this publicity was being given out.

The CHAIRMAN. You mentioned an array of warnings that were issued from various sources. I would like to inquire of Doctor Miller if these warnings were issued as a result of a stated policy of the Federal Reserve Board.

Doctor MILLER. These warnings, of course, were from sources outside of the Federal reserve system.

The CHAIRMAN. Or were they initiated by or reflected from the Federal Reserve Board?

Doctor MILLER. That I do not know.

Mr. STRONG. Did not the board take any action at all?

Doctor MILLER. You mean in the line of publicity?

Mr. STRONG. Yes.

Doctor MILLER. Nothing beyond what was contained in its regular monthly review of conditions.

Mr. STRONG. What was that?

Doctor MILLER. I will give you an example here. Perhaps it would be well worth inserting this whole paragraph in the record.

The CHAIRMAN. Without objection, the whole paragraph will be inserted.

Doctor MILLER. This was in May, 1923, referring to the great increase that had taken place in production. It reads:

PRODUCTION AND CREDIT

The increased use of credit, which is reflected in the larger loans and investments of member banks, but not in the earning assets of Federal reserve banks, has been primarily in response to the increased volume of production. Thus far business expansion has been characterized by a rapid increase in the output of basic commodities. In fact, the growth in the physical volume of production since the middle of 1921 indicates a rate of industrial recovery almost without parallel in American business. Within a year and a half after recovery began the monthly output of 21 basic commodities, as measured by the Federal Reserve Board's index of production, increased over 67 per cent. The volume of goods produced and consumed during the first quarter of 1923 probably exceeds that of any similar period in the history of the country. Fuller employment of equipment and of labor has produced the additional income from which profits and wages were realized. In fact, profits in many

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lines of industry have been dependent upon quantity production, the lower production cost per unit more than offsetting the increased cost of materials. It is partly in consequence of larger output that the prices of manufactured goods have not more fully reflected the increases in prices of raw materials. Larger pay rolls also until quite recently have resulted chiefly from increased employment rather than from advances in wage rates. These increases in production and employment have thus far economically justified the increases in the total volume of bank credit. For credit extension does not result in overexpansion so long as the additional credit yields proportionate results in the larger production and marketing of goods.

Now, those sentences happen to have been written by myself. I do not write these reviews, but at this time particularly I was very much interested in this work and each month, when a preliminary draft was prepared after discussion, I went over it and usually added here and there a sentence, or in some cases a paragraph, and that was largely directed not only to current or prospective Federal reserve policy as I might have conceived it at the time, but also to publicity on the outside, and these particular sentences that I have just referred to took cognizance of, and, I think, to a certain extent, were suggested or provoked by certain commentaries of the kind you have just referred to, Doctor Commons, that indicated anxiety about the situation, and this was a sort of an analytical or scientific way of saying that we did not see occasion for this alarm. At the same time, it suggested by way of statement that we might be reaching a point where the thing would develop into——

Mr. STRONG (interposing). It said, "We are not afraid yet, but we want to be careful."

Doctor MILLER. Excellent.

The CHAIRMAN. Was that issued subsequently or prior to the statements that Doctor Commons has referred to?

Doctor MILLER. I think those statements he read from were in March and April.

Doctor COMMONS. March, April, and up to May 9, somewhat preceding your statement there.

Doctor MILLER. As I look over this, Mr. Chairman, it strikes me it might be worth while in a record of this kind which may have some historical value, it may be worth quoting one or two pages here.

The CHAIRMAN. If you will make reference to them, they will be inserted.

Doctor MILLER. If you will permit, I will just read this. I had forgotten this, and this is bearing out what Congressman Strong said about being careful:

The present lending capacity of the country's banking system, in view of the great growth of the reserves at the reserve banks, is now far in excess of the country's productive capacity. In such a situation, it is the available supplies of labor and equipment and not the potential supply of credit, that in the end must fix the limit which may be attained by aggregate national production. As these limits are approached, credit policy must be increasingly influenced by careful consideration of the continued effectiveness of further additions to the total volume of credit in contributing to increased activity.

If you want to read between the lines there, I think you would have been justified in drawing the conclusion that, as we estimated the situation, it was about reaching the limit of safety according to the tests set up.

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Mr. STRONG. Just a polite, diplomatic way of telling the financial world they want to be careful and look out.

Doctor COMMONS. They read that correctly. It was one of these intimations that the Federal reserve system now contemplates a further raise of the rate.

Doctor MILLER. It might have. My own view was that the business mind of the country was itself in a very cautious state and that these fears that to a certain extent were anticipated were ill grounded. I think there was a spirit of caution abroad in the whole business world in the United States at that time that would have insured against any abuses or any over-expansion that was occasioning solicitude in these comments you quoted and in these extracts which I have read from the bulletin.

Doctor COMMONS. Now, in 1919 there were no comments or cautions uttered by the board or by anybody against that inflation which was going on. I will assume that the inflation started in July, 1919. Prices rose, but employment was not complete until about July, 1919. Now, during all that increase of prices, there was continuous publicity as to the scarcity of goods, the poverty of Europe, and consequently those things would cause prices to rise. Now, that had reached the point where there could be no further production owing to the limited labor of the country.

Was the rise of prices after the middle of 1919 a nonmonetary phenomenon, or was it a monetary phenomenon?

Doctor MILLER. Both.

Doctor COMMONS. Why should prices have risen when people could not buy the increased quantity at the high prices?

Doctor MILLER. Why should they?

Doctor COMMONS. They could buy the increased quantities at the high prices?

Doctor MILLER. There was not the increased quantity to be had.

Doctor COMMONS They could then pay the increased price?

Doctor MILLER. They were buying in a market in which there was no adequate response on the part of the producer; in other words, it was a seller's market. The consumer wanted to consume; he wanted to buy; prices began to rise, and the jobber, the distributor, and the speculator in commodities went out to buy these goods in anticipation of a further rise, and through that helped to bring about the further rise, and the consumer had the purchasing power from one source or another that enabled him to pay these prices and he was in a position where he wanted the goods pretty much irrespective of price.

I want to recall to you the ubiquitous appearance of the silk shirt——

The CHAIRMAN. What year are you now speaking of?

Doctor MILLER. 1919 and 1920. I assume you have in mind the period from the middle of 1919 to July, 1920?

Doctor COMMONS. Yes. What I am getting at, Mr. Miller, in brief, is this: You spoke of the consumers' demand falling off. Now you speak of the consumer having an abundance of money with which to buy goods.

Doctor MILLER. You are now speaking of 1923?

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Doctor COMMONS. In 1923 you see consumer's demand falling off.

Doctor MILLER. No.

Doctor COMMONS. After the summer of 1923.

Doctor MILLER. No; I did not say it fell off. It ceased to grow at the rate it had been growing during the period of the rapid up-swing. On the contrary, there was a well sustained consumer demand which explains why prices and trade were as well sustained as they were during the latter part of the year when production showed a decline, as I recall.

Doctor COMMONS. Now, on the other hand, in 1919, and going on until July, 1920, there was a similar consumer's demand, but it had a great quantity of purchasing power which it did not have in 1923.

Doctor MILLER. Do you think the consumer of 1923 did not have purchasing power?

Doctor COMMONS. Not as he did in 1919.

Doctor MILLER. I would take issue with you there.

Doctor GOLDENWEISER. Here is the chart of factory employment and pay rolls. (See chart on page —.)

Doctor MILLER. There you have a very rapid rise. Pay rolls and employment rose rapidly in 1922, and went on into 1923, and even after it showed some signs of diminution, in the latter part of the year, there still was a good volume of money in the pay envelope. It is pretty well sustained.

Doctor COMMONS. During 1923?

Doctor MILLER. During 1923.

Doctor COMMONS. So that they could take off the commodities at those prices?

Doctor MILLER. Yes.

Doctor COMMONS. Now, compare that with 1919 and 1922. During the beginning we have pay rolls rising rapidly, but do not have employment rising quite as rapidly, the same as in any other period, showing that there was a scarcity of labor which did not go beyond the period of May, 1920, and at the same time the employers of those laborers had much more money to pay and they were competing with each other much more vigorously for the labor, and that sent the pay rolls up, so what happened, I take it, comparing the two periods, was that the elasticity of the Federal reserve policy furnished not merely laborers as consumers but employers as producers, furnished them that much money which they gave to their laborers, thus creating a greater demand on the part of the same quantity of labor for the increased output of the industry.

Doctor MILLER. I do not feel at all sure that I follow you there all the way through. In 1919 you had a large part of the labor population of the country not yet demobilized.

Doctor COMMONS. That was in the first part. I figure that it was all employed by the fall of 1919, that about May, 1919, they pulled in the additional people not usually employed, so you have a very high employment in 1919.

Doctor MILLER. You have in 1919 unmistakably a rise of prices, coupled with speculation in commodities. You do not have that in

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1923. The result was that the producer in his effort to take advantage of the rise in the price scale went into the market and began to bid for labor, so you get this rising pay roll curve. I have no doubt it would also be paralleled by figures showing that wages were increasing at the same time.

Doctor COMMONS. That is quite true, but——

Doctor MILLER. Now, what the laborer received as wages constituted a demand for goods in the market. He came back with his high wages and wanted to buy, and with no commensurate growth in the volume of purchasable commodities, it tended to aggrevate and accentuate the already rapid rate of increase in the scale of prices.

Doctor COMMONS. Now, at the same time you had a very low rate of rediscount.

Doctor MILLER. What was the rate?

Doctor GOLDENWEISER. During most of 1919 the average was close to 4¼ per cent.

Doctor COMMONS. Which is a low rate. When the banks could borrow at 4¼ per cent and lend to these business men and to exporters at probably 6, 7, and 8 per cent, that gave them a greater quantity of money with which to hold inventories and to bid for labor.

Doctor MILLER. They were given that money at a cheaper price.

Doctor COMMONS. So they took much more of it. They marked up the prices, and that required more money, and they increased the quantities up to the limit which they could, which was reached in 1919, the latter part of it, and that took more money, and the fact that the reserve system kept the rate down too long, did not start to raise it until six months too late, enabled them in that period to have much more bank credit with which to inflate wages and to hold onto the commodities, so the difference, I would infer from this, was mainly the difference in the Federal reserve policy.

Doctor MILLER. Well, I would say that you left out what is, perhaps, the most important factor of all, that in 1919 and early 1920 there was a demoralization of mind induced by the steady rapid upward flight of prices, a distinct demoralization of mind since we were going into a period when prices were twofold and more than twofold of the old pre-war scale.

Then came the terrible collapse of 1920, the collapse of commodity prices, the pronounced drop in the activity of industry, trade, the utter depression that overtook agriculture, and that went through the year 1921. That, perhaps, was the most severe experience that this generation of business men has had. The memory of that carried over into 1922 and 1923, and it probably still lingers as a force of some consequence.

Doctor COMMONS. You said this morning that if there had been an increase of rate of 5 per cent it might have accomplished what I had in mind.

Doctor MILLER. I think it would have accomplished it if any rate increase could have, and I think there was enough warrant for expecting that timely rate action, if it could have been taken or if it had been taken in the summer of 1919, would have done a good

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deal to keep the subsequent inflationary developments at any rate within more moderate limits than those that actually occurred.

Doctor COMMONS. But in 1923 you did not need such a high increase of rate as you did in 1919. The public was more cautious, so a slight increase of rate, with corresponding publicity, would accomplish all that a very high increase of rate would—and you would have had to add publicity, of course—in 1919. In other words, this seems to be your general condition, that you adjust your policy to what you see to be virtually the state of the public mind, as to whether it is optimistic or pessimistic, that you have learned now to operate many months in advance of the results that you expect to obtain, and thus by adapting yourself to the changing circumstances you carry out whatever policy you may have; that you did not know in 1919—or, at least, the board as a whole did not know; I have no doubt that you knew—what was going to happen.

Well, now, that leads me to ask you a question about this resolution that you adopted in the latter part of April about open-market investments.

The CHAIRMAN. What year?

Doctor COMMONS. April, 1923, the time of which we were speaking. This is the first recognition which you might call of a legislative character or an administrative rule referring to the open market, showing that the open-market operations were just now being recognized as something of a factor. I am quoting from the May bulletin, 543, of the Federal Reserve Board of 1923:

> That the time, manner, character, and volume of open-market investments purchased by Federal reserve banks be governed with primary regard to the accommodation of commerce and business—

This is new—

> and to the effect of such purchases or sales on the general credit situation.

With reference to time, we have discussed that enough. As to your general attitude regarding time limits it must not be done too late or too early.

Regarding volume I think we understand it must not be too great a volume of purchases, but must be just enough, whatever that may be, under the conditions.

What is meant by the two terms, "manner" and "character" of open-market investments?

Doctor MILLER. Not very much.

Doctor COMMONS. Then we can just use the words "time" and "volume"?

Doctor MILLER. I was just going to add this, that you must remember that this was in 1923, that this was practically at the initiation of something like an attempt to develop an orderly open-market policy. I should say that the terms "manner" and "character" probably in part had reference to the kind of securities bought, bankers' acceptances or Government securities. Since then the actual operations of the so-called open-market investment committee have addressed themselves practically exclusively to short-dated Government securities.

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Doctor COMMONS. Well, coming to "primary regard to the accommodation of commerce," that is in the law. Now, you have added there something that is not in the Federal reserve act, namely, "primary regard to the effect of such purchases or sales on the general credit situation."

What is meant by "general credit situation"?

Doctor MILLER. Well, what does it mean to you?

Doctor COMMONS. I would characterize it somewhat as you characterized this bill, that it is vicious rodomontade; it does not mean anything.

Doctor MILLER. Well, I would take issue with you there and say that if you read the following paragraph from the Federal Reserve Bulletin it throws a good deal of light on it. [Reading:]

Since in open-market operations the initiative can be taken by the reserve banks rather than by member banks, these operations may be used as a gauge of the degree of adjustment between the requirements for reserve bank credit and the volume of it in actual use. The sale of an investment by a reserve bank is a means of testing the demand for credit by placing the initiative for and the cost of such credit directly upon the borrowing banks.

Doctor COMMONS. It has reference, then, to the rate of discount? That is what you mean by that?

Doctor MILLER. I mean by that just what we say in the illustration here regarding the sale of securities, that that is what took place in 1923. You force your member bank either to reduce the volume of its loan operations or to come to the Federal reserve bank to obtain needed credit that it has hitherto had through the open market by the process of readjustment.

Now, at this time more particularly the member banks felt a good deal of hesitation about showing rediscounts. I mean by that to recall that they were still under the influence and memory of 1920 and 1923.

The CHAIRMAN. But, as a matter of fact, during the last sale of securities by the Federal reserve system, the member banks took those same securities which they purchased in the open market and used them as collateral for rediscounts, did they not?

Doctor MILLER. What period are you referring to now?

The CHAIRMAN. The period of April or May of this present year.

Doctor MILLER. Yes. Well, whether they took those same securities or not, they did go to the reserve banks and obtained by way of rediscounts the amount of credit substantially that was taken out of the market by the Federal reserve bank when it sold securities to the market. In other words, when the responsibility was thrown, as in recent months it has been thrown upon member banks, the charts seem to indicate that the member bank took the responsibility of keeping extant in the market an unchanged volume of credit.

The CHAIRMAN. In other words, instead of calling loans to meet the situation, that required more funds, they have gone back into the Federal reserve in the way of rediscounts or borrowings.

Doctor MILLER. Or borrowings. Now, you see, the loans and investments of member banks [indicating on chart of reporting member banks] have gone right up. If we look at this chart, showing reserve

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bank credit, there is a very sharp decline there [indicating] in the security holdings of the reserve banks. The Federal reserve banks are selling out of their portfolio of open-market investments and, as they sell, this line [indicating discounts] shoots up.

The CHAIRMAN. The bills discounted line?

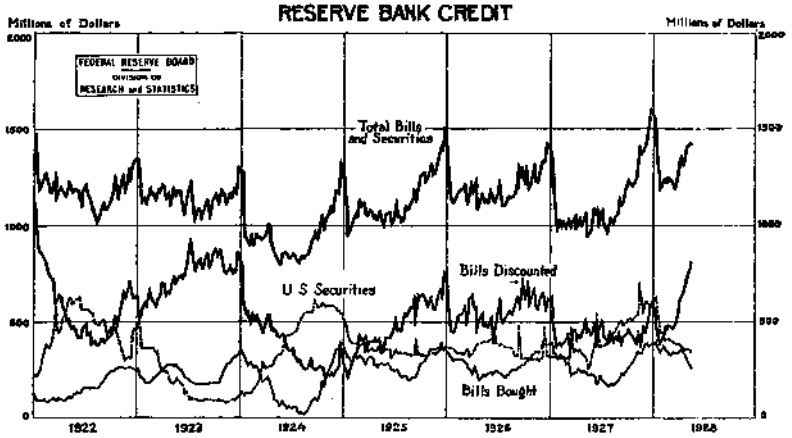
Doctor MILLER. Yes. They were either forced, as you have suggested, to reduce their lendings, or else to borrow from the reserve bank in volume. In fact, the volume has not only been sustained but, as that line of loans and investments of member banks indicates it has been actually increasing at a pretty rapid rate.

Doctor COMMONS. Now, going back to that policy in 1923——

Doctor MILLER. May I interrupt a minute? I suppose these charts will have to be reintroduced again or referred to in the record.

The CHAIRMAN. Without objection, the charts that have been just referred to will be inserted in the record at this point, the volume of reserve bank-credit chart and the reporting member-bank chart, of the Federal Reserve Board.

(The charts referred to are reproduced herewith:)



Doctor COMMONS. Now, operating under that rule, it has turned out since that time, according to your testimony, that the purchases at times have been too large, excessive, and you greatly reduced the open-market purchases on that account. Is that a perversion of the principle laid down here in this——

Doctor MILLER (interposing). No. To the extent it is true, if it is true, it indicates a faulty application of the principle.

Doctor COMMONS. So, so far as that rule is concerned, it does not prevent excessive purchases or sales.

What was the actual reason? In testing out the market, you wanted to use your open-market sales merely to see whether your discount rate would be effective or not?

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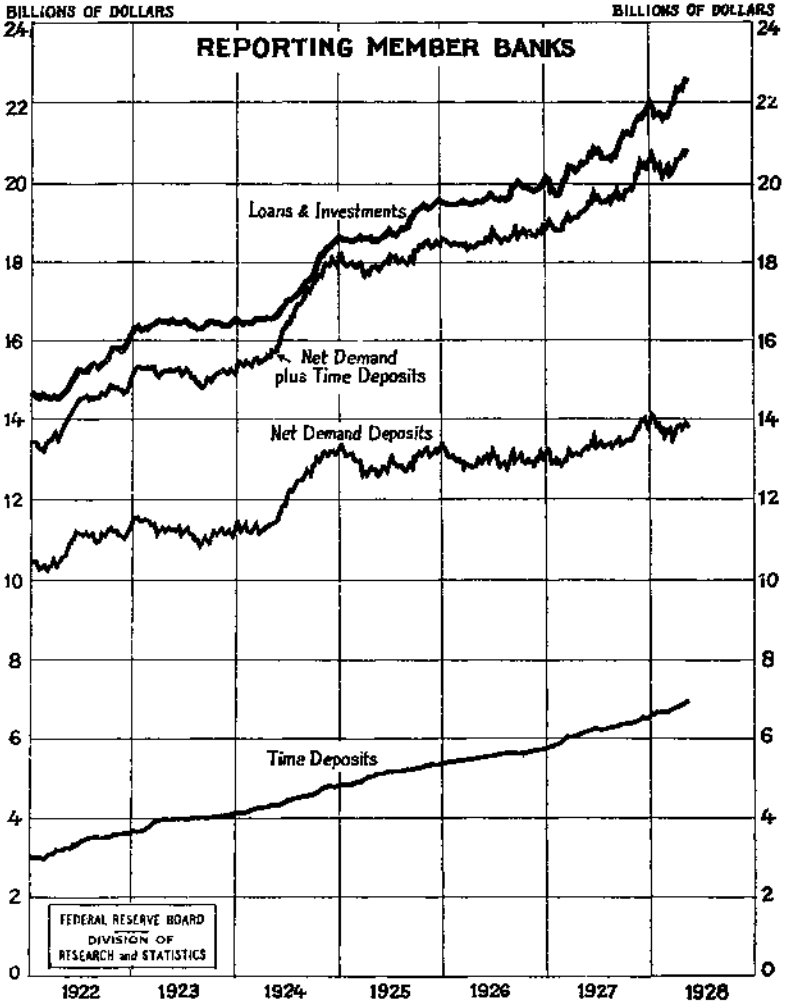
Doctor MILLER. It was to make the discount rate effective by putting the member banks in a position where they would either have to reduce their loan operations or borrow, and therefore put them in the grip of the Federal reserve banks.



Doctor COMMONS. And if it went beyond that, it was excessive? If the sales should go beyond that, they would be excessive, unnecessary, from the standpoint of the general credit situation?

Doctor MILLER. Yes. Well, you come back to the general credit situation, and I was about to add that the general credit situation is a situation that is explained in this bulletin from which you were quoting, the one in which the changes in the volume of credit are related to changes in the volume of credit requirements.

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Doctor COMMONS Production and employment?

Doctor MILLER. Production, trade, employment, and so forth. That is from my point of view the main factor that is involved.

Doctor COMMONS. So this general credit situation means that proportion between credit and production?

Doctor MILLER. Yes.

Doctor COMMONS. Which would not mean inflation or deflation. Now, supposing you had defined the general credit situation there? You have said it meant such a price relationship to production as would not involve——

Doctor MILLER (interposing). No; I would not have. I do not have to answer that hypothetically. I will just answer it by reading to you an extract from the annual report of the Federal Reserve Board for the year 1923, published in 1924. I would call your attention to page 34 and simply read a couple sentences here. [Reading:]

The volume of credit will seldom be at variance with the volume of credit needs as they are reflected in the demands of productive industry, as long as the volume of trade, production, and employment and the volume of consumption are in equilibrium.

Then dropping to the bottom of the page and continuing:

Administratively, therefore, the solution of the economic problem of keeping the volume of credit issuing from the Federal reserve banks from becoming either excessive or deficient, is found in maintaining it in due relationship to the volume of credit needs as these needs are derived from the operating requirements of agriculture, industry, and trade, and the prevention of the uses of Federal reserve credit for purposes not warranted by the terms or spirit of the Federal reserve act.

So that so far as anything in the nature of a working principle or guide for the application of the phrase "the effect of such purchases or sales on the general credit situation" is concerned, I should say that that is approximately the official answer to it, taken from the board's annual report.

Doctor COMMONS. As I understand it, then, this means that if you have a guide or policy that it is to continue issuing credit until agriculture and industry and trade are in a stable condition——

Doctor MILLER. I would rather put it this way—and this is the way it is put—when goods move into consumption about as rapidly as they are turned out of production, you have what is here described as an equilibrium between the volume of consumption and the volume of production and trade.

Doctor COMMONS. You omit all price quotations in that proposition?

Doctor MILLER. All prices are omitted in this.

Doctor COMMONS. And why is that?

Doctor MILLER. My answer to that would be: Because this is a more competent guide and detecter of changes in the volume of credit needs than prices or any other single factor possibly can be; and this self-same report I think sets forth that you have got to have an indication of the direction in which the economic situation is tending quicker than you can get it from a price index.

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Doctor COMMONS. If you accomplish this set-up of equilibrium where they are moving, it means they are moving at that price, does it not? We had stability of prices very decidedly in 1923, and we had also these other conditions of stability of employment, and so on.

Doctor MILLER. No; you did not. You had an improving situation.

Doctor COMMONS. As to employment?

Doctor MILLER. We had not a stabilized situation but a changing situation.

Doctor COMMONS. Changing greater than the population?

Doctor MILLER. I should say so; yes. I should say the volume of employment was——

Doctor COMMONS. Very steady throughout the year?

Doctor MILLER. Not very steady; I should say it was increasing. Were you referring to 1922 or 1923? I would take the years 1922 and 1923 together as marking a period.

Doctor COMMONS. I would say from the time the peak of employment was reached, which was about March through the middle of that year that you had two-thirds of the year perhaps with steady employment. You had also a steady price level—comparatively steady price level—and you had in relation to what it had been in 1920, comparatively steady. So that the price level and the employment level had some sort of relation to the equilibrium.

Doctor MILLER. Well, I would describe that price period, if it is 1922 and 1923, as one that showed considerable movement. We had a steady rise during 1922, which continued until the spring of 1923. We had a short period there, about May, when the price level shows no change; and then it takes a drop, rising in the autumn again. So that, in terms of stability, I should say the period of stability indicated by the price index was a very transitory one, probably, to be described as more or less of an accidental occurrence.

Doctor COMMONS. You will notice this has a bearing on lines 7 and 8 of the bill.

The CHAIRMAN. Page 2?

Doctor COMMONS. Page 2, lines 7 and 8. In the former bill of Congressman Strong he had nothing about stability of industry, commerce, agriculture, or employment; he had only in the former bill the stability of the wholesale price level. In this bill he has, besides stability of price level, stability of commerce, industry, agriculture, and employment. So that he has five purposes here, whereas formerly he tied himself up solely to the price level.

Now, should this be retained in this bill, or would you strike it out—I am trying to get your help as a friend of this bill, you understand. You were very critical of these five different kinds of stability when you started your statement. You said it was quite confusing, but is not that exactly what you are doing when you make that contention? You say stability of price levels does not tell us employment is steady. So that here, according to this bill, you give weight to the price level and you give weight to employment and

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other things; and on the whole you have your mind on several factors, that not one of them will be stabilized, but all of them with reference to some general purpose.

Doctor MILLER. I think we would be just going over old ground if I undertook to answer your question extensively. I do not myself think these phrases contribute anything. If I were Congressman Strong's general physician in this matter, which I am not, I am inclined to think I would rather tie to one definite thing than I would to a variety. I think on the whole that would be better.

Doctor COMMONS. You would take your chances whether the other would be stable or not?

Doctor MILLER. It is taking a chance on words, Doctor Commons. I think the result is going to come, and the less confusion of mind that may arise, I think on the whole, the better the results that you are likely to get will be, if, through a change in the law, a result can be obtained different from what we have now. But I want to say that from my point of view price is always the last term in the equation; it is a result.

Mr. STRONG. But, after all, it is the measure of the value of the dollar?

Doctor MILLER. It is the measure of the value of the dollar. But if you want to trap the dollar, so to speak, and make it behave, you have to keep an eye on its constituent factors of change. I would have no objection to Doctor Commons describing some of these elements I have been talking about as antecedent factors that may subsequently express themselves in price changes. It overstates the matter, but sometimes an overstatement helps to get an idea to the front. But, to my mind, undertaking to regulate the flow of Federal-reserve credit by the price index is a good deal like trying to regulate the weather by the barometer. The barometer does not make the weather; it indicates what is in process. Your price index indicates slowly—very slowly—what is in process. It does not indicate much until after the change has gone so far that there is an actual disturbance.

Mr. STRONG. However, it does not hurt to get the umbrella out when the barometer indicates rain?

Doctor MILLER. No; but you would not want to manipulate the barometer so as to get people to buy umbrellas.

Mr. STRONG. But I would like to set the alarm so that if the barometer indicated rain people could get umbrellas.

Doctor COMMONS. Would not the analogy be something like this: It is more like the thermostat? We want to keep the temperature in the room at 72. There have been devices and there will be many devices. In this case it is commerce, industry, employment, Federal reserve policy, and all things; but we are trying to aim toward that 72-degree level. That would be the analogy if you were going to talk of physical conditions.

I have just one more question I want to ask Doctor Miller. With reference to the future of gold, I reached the conclusion from your statement of what you would do and what you would not do—I got the idea that we will have a continuously falling price level, apart from these cycles we have been talking about toward the pre-war

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level, and that grows out of what has been brought forward in the testimony here. And when we speak of the gold standard there are four meanings to the "gold standard": First, there is the meaning where gold freely circulates—I would say that would be when our gold certificates are freely circulating gold in the community. Now, if the gold freely circulated, as it did in England before the war and is now somewhat freely circulated in the gold certificates in this country, then it would appear that there might be a scarcity of gold. The second meaning of the "gold standard" is that gold shall be corralled in central banks and represented only by note issues, in which case the notes might be in our case two and a half times the volume of gold reserves. So that you might have two and a half times—and that would reduce the demand for gold by about 60 per cent; gold would do 150 per cent more work. That is the second meaning—central banks, with note issue.

The third meaning, which goes along with that, is the gold-exchange standard, and that has been adopted by most countries, either in whole or in part, except England—all European countries; some have no gold, as you know, of course, and others have gold exchange. Lastly, there has been developed here somewhat the idea growing out of these conferences with foreign banks, the idea of internationally managed gold control through agreements on discount rates or otherwise.

Now, these might all be gold standards. Which of those do you have in mind as the one which you think is preferable—the one in your mind which is the goal that we ought to go for?

Doctor MILLER. Well, I am a respecter of facts. I do not think we can control and direct facts according to our own preconceived ideas. I do not expect to see the gold standard in the old-fashioned sense, under which there is a considerable volume of gold actually in circulation, restored.

Doctor COMMONS. That is, we might retire all the gold certificates?

Doctor MILLER. We might retire all of the gold certificates. But I think the uncertain quantity there is not what we may do, but what other countries may do. It looks at times as though there was a little disposition in Europe to think that the gold standard is not well buttressed unless there is a certain amount of gold in circulation, though, as yet, I think Switzerland is the only country where you get much visible evidence of that. I think what I believe you described as Form No. 2, where the gold that has been demobilized from circulation and mobilized as bank reserves in the central bank reservoirs is likely to continue. The indication is that before long in England the currency note and the Bank of England note are to be amalgamated. When that is done the new Bank of England note will be to a great extent a fiduciary note—based partly on credit and partly on gold.

The CHAIRMAN. Similar to our Federal reserve notes?

Doctor MILLER. Similar to our Federal reserve notes in that a part of the collateral back of the notes is of fiduciary character, but different in that no additional notes can be issued except against gold. The gold exchange standard, I think, will not prove well adapted to the monetary ideas and requirements of the large commercial coun-

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tries in Europe; at any rate, I think such appears to be the indication at the moment, and I rather expect to see during the next few years a movement toward the gold standard, or what has recently been called the gold bullion standard under which gold can be obtained in bars for export but not in coin for domestic circulation. Under this standard there is a movement of gold into and out of the country and in and out of the central gold reservoir in accordance with shifts in economic currents and conditions; in other words, a free market for gold. That, to my mind, is perhaps to be expected as the probable form of the orthodox gold standard of the future.

Doctor COMMONS. There is in between there a plan like that of the Bank of Germany, which carries part of its reserves in exchange on New York or London, which is a partial gold-reserve standard.

Doctor MILLER. A partial gold standard, in which you have two banks building a structure of credit on the same reserve of gold?

Doctor COMMONS. Yes.

Doctor MILLER. That is what I had in mind when I said the leading gold-standard countries were likely to adopt a gold standard rather than a gold-exchange standard. They are likely to gather up their reserves into their own vaults.

Doctor COMMONS. But the smaller countries, like Austria and Bolivia, may continue on the gold exchange; you mean that?

Doctor MILLER. Yes.

Doctor COMMONS. You do not mean to rule that out?

Doctor MILLER. I would say the larger countries—England, France, Germany, Italy—and probably Holland would be gold-standard countries.

The CHAIRMAN. I notice in a press report on May 15 the heading—

Reserve banks are putting gold certificates into circulation. * * * The regular circulation statement of the Treasury shows: The reserve banks can narrow the basis of credit, and thus lead to tighter credit conditions, by forcing gold certificates into circulation in the place of Feseral reserve notes * * *.

An important index to Federal reserve policy is thus furnished by the fluctuations in the amount of gold certificates held by the reserve banks. This is made public by the Treasury in its monthly circulation statement. The Treasury reports that gold certificates held in the reserve system on March 31 amounted to $536,541,860, as against $572,019,270 at the end of February. At the beginning of the year, when there is a small specific demand for gold certificates for Christmas-gift purposes, the gold certificates outstanding amounted to $543,284,480.

The reduction of $35,477,410 in gold certificates in the reserve system resulted in an increase of $20,995,060 in the volume of gold certificates in circulation. The difference represents gold certificates withdrawn.

Now, is there a general policy in the Federal reserve operations as regards the paying out of gold certificates?

Doctor MILLER. If there is, I have not heard of it in recent months. There was at one time. Now, let me ask you, Mr. Chairman—I had not seen the extract—as I followed it, it stated there was an actual increase of gold certificates in circulation?

The CHAIRMAN. Yes.

Doctor MILLER. Of about $20,000,000; a decrease of $35,000,000 in the certificates held by the Federal reserve?

The CHAIRMAN. Yes.

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Doctor MILLER. I do not know what the explanation of it is. My first thought was that there was probably a demand from points in some foreign countries for eagles and double eagles, and that those certificates were taken by the reserve bank and redeemed in order to get the coins actually specified for withdrawal. But apparently from this statement there has been an increase of $20,000,000 of gold certificates in circulation. The amount involved is relatively so small that it is well within the limits of accidental fluctuations.

The CHAIRMAN. I have here in my hand the circulation statement of United States money of March 31, 1928, in which I notice the total outstanding gold certificates are $1,561,016,429. I will ask the reporter to put that in the record at this point.

(The statement referred to is as follows:)

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Circulation statement of United States money—March 31, 1928

Kind of money	Total amount	Money held in the Treasury					Money outside of the Treasury				Population of continental United States (estimated)
		Total	Amount held in trust against gold and silver certificates (and Treasury notes of 1890)	Reserve against United States notes (and Treasury notes of 1890)	Held for Federal reserve banks and agents	All other money	Total	Held by Federal reserve banks and agents [6]	In circulation		
									Amount	Per capita	
Gold coin and bullion	[2] $4,304,536,428	$3,408,643,494	$1,561,416,429	$156,039,088	$1,528,132,762	$163,055,215	$895,892,934	$512,777,060	$383,115,874	$3.25	
Gold certificates	[3] (1,561,416,429)						1,561,416,429	536,541,860	1,024,874,569	8.68	
Standard silver dollars	539,602,158	479,395,963	471,257,051			8,138,912	60,206,195	14,017,712	46,188,483	.39	
Silver certificates	[3] (469,948,751)						469,948,751	97,239,724	372,709,027	3.16	
Treasury notes of 1890	[3] (1,308,300)						1,308,300		1,308,300	.01	
Subsidiary silver	300,621,784	2,755,030				2,755,030	297,866,754	23,322,844	274,543,910	2.32	
Minor coin	115,850,498	1,986,433				1,986,433	113,864,065	3,942,108	109,921,957	.93	
United States notes	346,681,016	5,780,167				5,780,167	340,900,849	50,854,495	290,046,354	2.46	
Federal reserve notes	1,949,154,645	886,370				886,370	1,948,268,275	359,877,198	1,588,391,077	13.46	
Federal reserve bank notes	4,335,208	169,210				169,210	4,165,998	27,771	4,138,227	.04	
National bank notes	699,215,219	15,836,392				15,836,392	683,378,827	29,682,590	653,696,237	5.54	
Total Mar. 31, 1928	8,259,996,956	[4] 3,915,453,059	2,032,673,480	156,039,088	1,528,132,762	[5] 198,607,729	6,377,217,377	1,628,283,362	4,748,934,015	40.24	118,009,000
Comparative totals:											
Feb. 29, 1928	8,360,797,917	[4] 4,021,293,269	2,044,013,418	156,039,088	1,630,578,511	190,662,252	6,383,518,066	1,693,087,966	4,690,430,100	39.79	117,890,000
Mar. 31, 1927 [7]	8,694,378,189	[4] 4,197,688,539	2,113,223,032	155,420,721	1,716,404,531	212,640,255	6,609,912,682	1,748,206,715	4,861,705,967	41.70	116,588,000
Oct. 31, 1920 [7]	8,476,904,551	[4] 2,407,741,319	696,854,226	152,979,026	1,206,341,990	351,566,077	6,766,017,458	1,005,063,805	5,760,953,653	53.60	107,491,000
Mar. 31, 1917 [7]	5,395,314,227	[4] 2,944,575,690	2,684,800,085	152,979,026		106,796,579	5,135,538,622	953,321,522	4,182,217,100	40.32	103,716,000
June 30, 1914 [7]	3,796,456,764	[4] 1,845,575,888	1,507,178,879	150,000,000		188,397,009	3,458,059,755		3,458,059,755	34.92	99,027,000
Jan. 1, 1879	1,007,084,483	[4] 212,420,402	21,602,640	100,000,000		90,817,762	816,266,721		816,266,721	16.92	48,231,000

[1] Includes United States paper currency in circulation in foreign countries and the amount held by the Cuban agency of the Federal Reserve Bank of Atlanta.

[2] Does not include gold bullion or foreign coin other than that held by the Treasury, Federal reserve banks, and Federal reserve agents. Gold held by Federal reserve banks under earmark for foreign account is excluded, and gold held abroad for Federal reserve banks is included.

[3] These amounts are not included in the total since the money held in trust against gold and silver certificates and Treasury notes of 1890 is included under gold coin and bullion and standard silver dollars, respectively.

[4] The amount of money held in trust against gold and silver certificates and Treasury notes of 1890 should be deducted from this total before combining it with total money outside of the Treasury to arrive at the stock of money in the United States.

[5] This total includes $16,281,532 of notes in process of redemption, $151,070,555 of gold deposited for redemption of Federal reserve notes, $10,444,922 deposited for redemption of national-bank notes, $2,430 deposited for retirement of additional circulation (act of May 30, 1908), and $6,438,700 deposited as a reserve against postal-savings deposits.

[6] Includes money held by the Cuban agency of the Federal Reserve Bank of Atlanta.

[7] Figures revised to conform to changes effective Dec. 31, 1927.

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NOTE.—Gold certificates are secured dollar for dollar by gold held in the Treasury for their redemption; silver certificates are secured dollar for dollar by standard silver dollars held in the Treasury for their redemption; United States notes are secured by a gold reserve of $156,039,088 held in the Treasury. This reserve fund may also be used for the redemption of Treasury notes of 1890, which are also secured dollar for dollar by standard silver dollars held in the Treasury. Federal reserve notes are obligations of the United States and a first lien on all the assets of the issuing Federal reserve bank. Federal reserve notes are secured by the deposit with Federal reserve agents of a like amount of gold or of gold and such discounted or purchased paper as is eligible under the terms of the Federal reserve act. Federal reserve banks must maintain a gold reserve of at least 40 per cent, including the gold redemption fund which must be deposited with the United States Treasurer, against Federal reserve notes in actual circulation. Lawful money has been deposited with the Treasurer of the United States for retirement of all outstanding Federal reserve bank notes. National bank notes are secured by United States bonds except where lawful money has been deposited with the Treasurer of the United States for their retirement. A 5 per cent fund is also maintained in lawful money with the Treasurer of the United States for the redemption of national-bank notes secured by Government bonds.

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Doctor MILLER. Now, Doctor Commons, to complete the answer to your question: Your fourth item was a gold standard under which there was some cooperative influence exerted by the leading central banks?

Doctor COMMONS. Yes.

Doctor MILLER. I am inclined to think that the future gold standard will increasingly be the second form of gold standard that you outlined, tempered occasionally in its application by what you have described under your item 4. In brief, that at times there will be appreciation of the need of some tempering of the application of the gold standard as defined under item 2 by practices that are outlined in item 4.

Doctor COMMONS. I had in mind also your comment on Lehfeldt. In looking over Lehfeldt I find where you thought that he expected an abundance of gold, that he said there were several conditions under which it would be abundant; for example, France will use checks instead of gold; there will be a gold exchange system developed. Under those circumstances he said there might be an abundance of gold. So that one's mind should be made up with reference to this gold question by the kind of a gold standard intended?

Doctor MILLER. Surely.

Doctor COMMONS. And you were going to investigate that more fully?

Doctor MILLER. I want to ask you a question: Did you introduce your statement by saying that I expected that under the operation of the gold standard prices were going to fall?

Doctor COMMONS. No; I said I gathered from your kind of a gold standard that there would be a fall in prices.

Doctor MILLER. Back to the so-called pre-war level?

Doctor COMMONS. Close to the pre-war level.

Doctor MILLER. I should be very loath to have anyone draw any such conclusion from anything I have said here. I do not pretend to have any opinion that is worth very much as to what the future course of gold and gold prices is going to be. But I rather think that there is pretty good warrant for believing that within the next few years we can regard the world as having again attained something in the nature of a world price level adapted to conditions as they are and as they are likely to be for a term of years.

Doctor COMMONS. That is without any secular fall in the general prices; that is, it would be practically a stable price level on the present basis?

Doctor MILLER. That remains to be seen. I think that a price level around 140 to 150 represents the analogue of a price level of 100 in 1913. Is that on the 1913 base?

Doctor GOLDENWEISER. Yes.

Doctor MILLER. In fact, I think, Doctor Goldenweiser, you have called my attention to the fact if we had had no war and none of the disturbances incident thereto and the same rate of increase of prices had continued during the last 15 years that occurred during the 15 years prior to the war, we would have now about the price level that we actually have.

I would say that about $3,000,000,000 of gold has been mobilized into central reserve banks as a result of the war, and the efficiency of a dollar of gold reserve or ounce of gold in central reserve banks

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has been considerably increased by improved practices and understandings as to the nature of these operations. So that it seems a fair inference that we have now about as much gold, relatively speaking, under the credit structures of the chief gold-using countries as we had before the war, if we make allowance for differences in monetary practice on the part of banks and monetary habits on the part of gold-standard communities.

Doctor COMMONS. In other words, growing economy in the use of gold?

Doctor MILLER. Yes. Just let me add one sentence here, and that is—therefore, there is a pretty good outlook at the moment for the gold standard in the future or, let me better say, the new gold standard is going to function pretty well in the future. It is my disposition to counsel the committee to await actual developments under this new gold standard before determining whether or not it will be necessary to amplify the whole basis and scope of Federal reserve credit practice.

Doctor COMMONS. I take it your opinion in that respect is based upon your idea that owing to the economies of gold the trend of prices will remain about stable?

Doctor MILLER. I would say there, Doctor Commons, that I am not so much concerned with stability of prices, per se, as I am with prices that will induce and maintain a sound, healthy, active state of industry, trade, and prosperity, and well-being.

Doctor COMMONS. That might be accompanied by a fall?

Doctor MILLER. That might be accompanied by a very slow fall of prices in certain circumstances, and it might require a slow and steady rise of prices in other circumstances. In other words, I do not regard the price level as in and of itself the test.

The CHAIRMAN. You speak of the improved use which gold is being put to in reserve banks. Is that due to the management of the gold and the cooperation that is taking place under the central banks of issue?

Doctor MILLER. That is a factor in it. But I think, apart from that, there has been a notable development. I should say that it is probably going to be demonstrated that central banks can operate safely and successfully on lower reserve ratios than were thought requisite before the war. I would say that a factor in giving central banks in countries that may feel that they are still in a more or less uncertain position, courage in acting upon this new principle would be the belief that, if they got into an occasional jam, they might get assistance from other reserve or central banks, just as I think the fact that the reserve system provided a credit of $200,000,000 for the Bank of England—though it was never called upon—was a material factor in deciding Great Britain to go ahead and restore the gold standard in the spring of 1925. How much it actually contributed to the situation beyond giving them a feeling that in the event that they got into difficulties they could have recourse to the Federal reserve banks, of course, we can not tell. It may also have had its influence as an effective warning to speculators in exchange that any attempt to depress sterling by undue speculative sales could be counteracted by the Bank of England availing itself of its credit in this country.

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The CHAIRMAN. In this management that is taking place in the gold in the central banks of issue and the cooperation of the management of the various banks, it does not matter much; then, where the gold is located so long as it is available to that management; in other words, in the successful management of the gold of the world to-day that management has to take into consideration many other elements than gold, for instance, the management of exchange rates, discount rates, and other elements that enter in are all a part of that management, are they not?

Doctor MILLER. Yes.

Doctor COMMONS. I reached this conclusion regarding your opinion that if there should be a steady decline in prices, because of greater efficiency or some other cause not under the control of the Federal reserve system, provided that fall in prices is continued with prosperity in commerce, industry and agriculture, and steady employment, you would not object, or, you would welcome or you would overlook that fall in prices?

Doctor MILLER. Yes, sir. I see no harm that it would do except in certain debtor and creditor relationships, and I do not regard those as so sacrosanct or so important, so essential to the good functioning of the social and economic system that I would glorify them and deify them as the one and conclusive test of good monetary policy.

Mr. STRONG. Do you think, Doctor Miller, that a fall in price level would permit of a prosperous agricultural industry?

Doctor MILLER. It might. It depends entirely on what produces the fall in the price level. If the fall in price level is due to the fact that there is an actual credit and currency stringency; in other words, that a narrow-minded adhesion to traditional practices under the gold standard puts trade and industry into a straight jacket, then I would characterize it as distinctly an injury. But if it is an expression of the increasing abundance of commodities and material services, because of the increased productivity of labor through invention, through better organization, through increased skill and so on, then it strikes me that a representative price index should indicate that fact in a downward trend. I regard it as one of the functions of a good price level that it should be an indicator as to whether goods in relation to gold are getting more abundant because of the greater productivity of industry, or whether they are getting scarce because of impaired productivity. It is a wholesome thing when the price level goes down because of improved industrial productivity and business management; in fact, I should say that the factor of "management" in industry is entitled to have its place in the scheme of price movements just as you would have the factor of "management" in central or reserve banks.

Mr. STRONG. Doctor Sprague in his testimony seemed to take the position that increase or oversupply of agricultural products must bring a reduced price or level of prices.

Doctor MILLER. That an oversupply of agricultural commodities brings a lower price level in general, or simply for the agricultural group?

Mr. STRONG. I think he meant in general. Do you believe that increasing efficiency of American agriculture will be accompanied by a fall in prices?

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Doctor MILLER. I think that depends upon some other factors, such as how rapid the growth of population in this country, what our habits in the matter of food consumption, and so on.

Mr. STRONG. Taking in consideration all of those factors, what is your outlook?

Doctor MILLER. My general expectation would be that agricultural prices in this country are going to rise. I would not undertake, however, to say how much or how soon. We have recently seen a readjustment in the matter of cattle prices. I think there is likely to be a similar movement in prices of other agricultural staples in time.

Mr. STRONG. Do you believe that increased efficiency in industry will be accompanied by falling prices?

Doctor MILLER. I think increased efficiency in industry is bound to bring about falling prices.

Mr. STRONG. And you look for increased prices of agriculture and decreased prices of industrial products?

Doctor MILLER. I think that is likely to be true, except in the case of such manufactured goods as are not susceptible of very much cheapening through improved technology or where the material constitutes a very large part of the expense of producing the commodity. There the situation is akin somewhat to an agricultural commodity or mineral product.

Mr. STRONG. In your opening statement—I want to get back to this gold-standard proposition for a moment—I understood you to say that the gold-exchange standard was passing away and the free-gold standard returning; is that correct?

Doctor MILLER. Yes; I do not know that I used the word——

Mr. STRONG. What do you mean by "free gold standard"?

Doctor MILLER. I mean a gold standard substantially as Doctor Commons has described in Item No. 2, the one under which the central bank keeps its gold reserve in the shape of actual gold, either in its own vaults or ear-marked for its own account in some foreign country, in which it does not make much use of gold credits that it may have established in some other country but banks upon actual gold—gold actually in its own possession or segregated somewhere in the world, ear-marked as its property.

The CHAIRMAN. In other words, if all the gold was segregated in that capacity and they all adopted the same plan that the United States has adopted in the use of Federal reserve notes and the Bank of England is about to adopt, it would mean we have a contraction of two and a half times?

Doctor MILLER. We have it already.

The CHAIRMAN. I know we have it already; but if put in general use the present supply of gold would go two and a half times as far, would it not?

Doctor MILLER. Yes. But there probably would be some contraction due to the fact that in some instances now continental and other foreign banks count as part of their reserves the balances which they have in New York or in London, and that the gold that lies at the base of that is utilized in New York or in London as part of its available gold supply.

Doctor COMMONS. That would also economize the gold, but that, I understand, is the system that you think is to be discontinued?

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Doctor MILLER. I think that that system will be discontinued or considerably abridged in general use by the larger countries of continental Europe.

The CHAIRMAN. Did I understand from you, Doctor, or from this colloquy that gold that the Bank of England deposits in New York is used for the purpose of note issue in the Federal reserve system here and in the Bank of England as well?

Doctor MILLER. No; of course not. Any gold that is the basis of our circulation is actually in our own vaults and shown as gold held against Federal reserve notes. That is a requirement of our law. But some of the continental European banks of issue and some of the South American banks of issue are allowed to count as reserves which they are legally required to maintain against their fiduciary circulation gold balances in certain countries.

The CHAIRMAN. Not ear-marked gold, but balances?

Doctor MILLER. It need not be ear-marked gold. If you want the details on that, I dare say Doctor Goldenweiser can give them.

Doctor GOLDENWEISER. The figures on that?

Doctor MILLER. The countries that permit that practice.

Doctor GOLDENWEISER. A very large proportion of the countries, Mr. Chairman, permit balances in the gold-standard countries to count as part of their reserves. Ten per cent in the Reichsbank, for instance, and no definite percentage in Austria and in Hungary; these countries must keep their reserves either in gold or in gold exchange, and it is left to them how much of their reserves they will carry in gold and how much in demand claims or gold-standard countries. This is true of Chile and many other countries.

Doctor MILLER. It is true of Peru, is it not?

Doctor GOLDENWEISER. Yes.

Mr. STRONG. Just one other question regarding stock speculation. Doctor Sprague suggested in his testimony two methods to prevent stock speculation without reducing commodity prices. One, to follow the Bank of England's practice and limit loans to five to seven days; the other, to refuse accommodations to banks which are over extended on the call-loan market. Do you agree with either or both of the suggestions?

Doctor MILLER. I do not believe the first suggestion would accomplish very much. As I recall it, what Doctor Sprague was criticizing there was the practice of the Federal reserve bank in allowing borrowings for one day to restore the reserves of member banks which were short in their reserve accounts. Suppose they had to borrow for seven days. I do not believe that would deter them from borrowing; I think it would simply tend to increase during that period the amount of money that they would have to make use of, and the only place where they could put it would be in the call-loan market.

The CHAIRMAN. In other words, you think if they were forced to borrow for a seven-day period when only needed for a one-day period, that for the other six days they would loan in the call market; they would keep this money busy while they had it in their control?

Doctor MILLER. Yes.

Mr. STRONG. They might hesitate to borrow. If somebody wanted a loan over night, they would say, "You will have to borrow for seven days and pay interest on it."

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Doctor MILLER. In actual practice I think this is what happens: A bank finds out after the close of business to-day that it is short in its reserves, not necessarily because it has made new loans that have depleted its reserve, but because moneys have been withdrawn by depositors, and it has got to go to the reserve bank and replenish its reserve. Now, so far as it knows, all that it needs to replenish is the deficiency that existed from the operations of the previous day. It borrows for one day. Under this plan it would have to borrow for seven days, and therefore starts business next day with an excess of reserves for which it has got to find employment. It pays the rate of discount on that, and it certainly is not going to carry it as idle reserve, and the most obvious use to make of it is to put it in the call-loan market. It is a thing on which I am expressing a hasty opinion, but I am doubtful that it will accomplish very much, if anything.

Mr. STRONG. There is another question I want to ask you: Doctor Sprague in his testimony expressed a fear that the opposition of the Federal reserve system to the stabilization proposed in this bill would nullify its operations, even if this bill became a law. Do you think that is so?

Doctor MILLER. Please state that again.

Mr. STRONG. Doctor Sprague in his testimony expressed the fear that opposition of the Federal Reserve Board to the stabilization proposed in this bill would nullify its operation, even if the bill were passed by Congress.

Doctor MILLER. No. Are you sure you have quoted Doctor Sprague correctly there?

Mr. STRONG. I do not know. Those are my notes. I just wanted to get your opinion on it.

Doctor MILLER. That carries with it the suggestion that the board would not follow an instruction of Congress in the best of faith.

Mr. STRONG. His idea was they were so opposed to it that they would nullify the operation.

Doctor MILLER. Oh, no.

Mr. STRONG. I did not believe that was a fact.

Doctor MILLER. Oh, no; they could be summarily removed from office. It is their duty to do the best they can. There may possibly be grave misgivings on the part of some people as to what they could do under this bill.

Mr. STRONG. I want to ask you one final question: In your statement you made it plain that you are against the direction by Congress that the powers of the Federal reserve system should be used for stabilization of the purchasing power of money, but that the board and the Federal reserve system should be left free to use their judgment in experimenting with the use of the powers of the Federal reserve system; and I would, therefore, like to have you state to what purpose you wish to experiment in the use of the powers of the Federal reserve system. What is your objective?

Doctor MILLER. My objective, I would say, in what has been brought out in answer to several of Doctor Commons's questions, and, I think, in answer to inquiries by others in earlier days of this hearing, briefly, that I believe you will get on the whole a more competent performance from the Federal reserve system if you let it go ahead and develop a procedure that grows out of its own experience. That

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has been in process and it probably will be in process a good while longer before it can be said to be a finished result, if it ever becomes a finished result. That has been the line of development in recent years, and I think Doctor Commons in some of his references has spoken with a certain amount of satisfaction of the results that have been attained. Now, if those results have not been mere accidents—if they come from an orderly approach to the problem of credit regulation—to my mind, that ought to satisfy Congress that the Federal reserve system is growing in its capability.

I would myself say that until this recent episode, in the midst of which we still are, there was a great deal to justify us in saying that the Federal reserve system was growing up, was not yet of adult age and stature, but growing up and learning how to handle itself better with each additional chapter of experience; and I am not so pessimistic as not to believe that from this recent episode, which has been analyzed here backwards and forwards four or five times, the Federal reserve system will not learn a great deal. After all, there is good intelligence in the system, a lot of ability, and a very high sense of responsibility. I do not think we are likely to repeat the same error twice, if I am justified in characterizing some aspects of this last chapter in the Federal reserve operation as having been in the nature of a mistake or as involving something at least in the nature of an error of judgment.

Mr. STRONG. Doctor, I want to say, as I have said many times in this record, that I have been very much pleased at the degree of stabilization that has resulted from the management of the Federal reserve system during the last three or four years, and I have only sought by this proposed legislation to bring about its continuance. There is no intention on my part to change their accomplishments in the line of bringing about stabilization in the purchasing power of money, price levels, and conditions in this country. To my mind that is the main purpose of having set up a Federal reserve system—to bring about stability in business, in agriculture, the employment of labor, the strengthening of commerce—those are the purposes of the monetary system, to my mind; and I have only intended by this bill to direct a continuance and secure a publicity of what they are doing, to satisfy the public of what they are doing, and to set up in the bill a study to find every possible means of increasing their power to sustain a stable condition.

Doctor MILLER. The public in recent months, especially in recent weeks, has shown a rather lively concern about Federal reserve operations. You, yourself, have asked questions as to what might be done to control the diversion of credit, originally coming from the Federal reserve system, in to speculative loans. The Senate Committee of Banking has had the subject under consideration. As yet there seems to be no consensus of opinion—nobody seems to have made a suggestion that appears to be effective for handling this matter. I would say that until some method, if it is at all practicable, can be devised by which you can satisfy yourself of the destination of credit that comes from the Federal reserve; a program of stabilization such as you have in mind, even if it is attainable under ideal conditions, is not going to be practicable under conditions as they exist.

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When you look at the review of certain of these periods and see that Federal reserve credit has been locked up to a certain extent in security loans it clearly indicates that the Federal reserve system has not devised a technique as yet by which it can control and send credit the way you want it to go—into stabilizing commodity prices.

Mr. STRONG. If the system made a mistake in attempts to give us cheaper money in this country in order to facilitate foreign conditions, which result in increasing the brokers' loans, should not that problem be worked out without trying to maintain the policy of stabilization?

Doctor MILLER. I regard that as one of the most perplexing problems in Federal reserve technique. I think that the remarks made around the table here at certain times have indicated that there is great difference in the attitude here on that matter.

In this country we have been accustomed to a free market for capital, a free market for funds. When we undertake to interfere with that, unless we do it pretty intelligently, with a full analysis of the consequences, both those that we desire and those we would not wish to provoke, we are undertaking to do more than we may appreciate.

Two years ago I expressed my ideas as to what might be done by way of legislative amendment to bring improvement. I still think that the Federal reserve act needs an explicit, definite, point-blank declaration against using Federal reserve funds, directly or indirectly, for any kind of speculative loans.

The CHAIRMAN. Doctor Miller, is it possible to ascertain what is a speculative loan sufficiently so that the board could act?

Doctor MILLER. I think in a case of this kind you would throw upon the Federal reserve system the responsibility of having to satisfy itself as to what are the criteria of speculative loans, at least to the extent necessary to give some effect to a mandate of Congress.

Mr. STRONG. Mr. Miller, if Congress should see fit to write into the law a direction that the policy of the Federal reserve system toward stabilization be continued, what harm could result? I understood you just now that the Federal reserve system has been very successful the past three or four years in that direction. Should Congress direct that the objective of the Federal reserve system should be toward the stability of the purchasing power of money, what harm could result?

Doctor MILLER. You are asking me a pretty big question.

Mr. STRONG. I appreciate it.

Doctor MILLER. Should the majority opinion, or the controlling opinion, in the Federal reserve be one of fear that prices might fall or that the effect of falling prices would be prejudicial to the well-being of the country, I think it would tend to stimulate at certain times a very active open-market policy, a policy of putting money into the market.

Mr. STRONG. But the fear might come without the considerations you have just expressed.

Doctor MILLER. Let me follow through. To my mind, the most difficult thing in the whole operation of the open-market policy is to know when and how much to buy, how much money to put into the

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market and how to get some line upon the effects that the money that is released to the market is going to exercise.

The two principal adventures that we have had in the field of open-market purchases on a pretty extensive scale in recent years I think show that one thing is predictable, that the money in the first instance is very apt to go into the stock market, go into the stock-exchange loan account. It so happens, and probably it is unavoidable, that the money market of the country is also the great stock-exchange market of the country. When, therefore, the Federal reserve system decides to put money into the market, we will say, to alleviate a commodity price situation that is anticipated, the first call, so to speak, on that money is in New York.

This country is undergoing a pretty rapid development. We are optimistic, anyhow; we are more optimistic when things are moving, as we conceive, in the right direction; so I think you have got to reckon with an optimistic attitude on the part of the stock market as a constant factor in banking operations. There is an appetite for credit there that can usually be stimulated by making money a little cheaper; and you are always up against a grave uncertainty as to how much and how rapidly money that is released from the reserve reservoir into the open money market will filter through into the channels of industry in the interior of the country. That is the lesson I myself draw.

The CHAIRMAN. That is always true; that when money release is not absorbed by industry and legitimate business of production that it is bound to go into the market.

Doctor MILLER. It has a tendency to go into the security-loans market.

Mr. STRONG. Let me ask you this further question: Would the passage of the law change your policy as a member of the Federal reserve system?

Doctor MILLER. Would the passage of this law change my attitude?

Mr. STRONG. Your attitude.

Doctor MILLER. My approach?

Mr. STRONG. Would it change it from what it has been in the past?

Doctor MILLER. I would have to study this pretty carefully before I answered.

Mr. STRONG. The purpose of the bill, regardless of the language which may be changed from time to time—the purpose of the bill being that the Federal Reserve Board shall use its powers toward the stabilization of the purchasing power of money—if the bill should become a law, would that change your attitude from what it has been in the past—would it change your policy from what it has been in the past?

Doctor MILLER. As well as I can answer that on the spur of the moment, I would say probably not materially.

Mr. STRONG. Would it change the attitude of any other member of the board?

Doctor MILLER. Of course, I can not speak for them.

Mr. STRONG. They have said they have been trying to bring about stable conditions during the last three or four years; and we all agree we have been very well satisfied with it.

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Doctor MILLER. I would say this, Mr. Strong, if I may say it without carrying the implication that I have in mind my colleagues, or any of my colleagues, that I think one of the main conditions affecting the operating of the Federal reserve banking system is that most Americans are, by temperament, inflationarily inclined. Under such a law as this, were it enacted, there might a disposition, perhaps, to seize the first indication or appearance that things were running off, that prices were down, to put into effect a pretty energetic open-market policy, with consequences that——

Mr. STRONG. That is what you have been doing.

Doctor MILLER. That interpretation can be put upon what has happened in the last eight or nine months. I do not know what the results of that will be.

Mr. STRONG. Of course, at this time your surplus money goes into brokers' loans.

Doctor MILLER. That is where it usually goes.

Mr. STRONG. But the question is whether there should not be something done to check that.

Doctor MILLER. I wish to avail myself of this opportunity to say that when that "something" is done you will find me very much more sympathetically inclined toward your major proposal.

Mr. STRONG. I am glad of that. My thought is this: That if Congress should say to the Federal Reserve Board, "We are directing you to continue the policy you have been pursuing," which is what this bill intends to do, then you will find a way to correct the failure of your experiment if it does not work, and you say that it failed to work last year. If your cheapening of money increased brokers' loans, and you think it is objectionable, you will find a way to prevent it.

Doctor MILLER. The way has not been found.

Mr. STRONG. I know you will keep on experimenting if you are only directed to continue the policy that you have been pursuing. That is the purpose of this bill.

Doctor MILLER. I should say, then, hold off until it is demonstrated that the Federal reserve has found a way.

Mr. STRONG. I say to you frankly, Doctor Miller, that while I do not want to hold up anybody in the wrong, we have built up a business development in this country, and a volume of business that has expanded; we have built up a credit structure greater than we ever had before and developed new industries—automobiles, radio, flying machines—on expanded credits. Now, we are seeking to put the world back upon a gold basis. I am very much afraid in the effort to build this great credit structure, if it perchance should be upon a free-gold standard, it might bring a deflation in this country; and I would like to direct the Federal reserve system to continue the policy they have been pursuing of stabilizing now and not when we have receded to a pre-war price; stabilize at this point as near as may be; go on with their program; that is my thought.

The CHAIRMAN. Is it your thought that this bill should stabilize at the present price levels?

Mr. STRONG. Stabilize now. If you inflate, you will have trouble. If you deflate, you will have trouble. If you are going to stabilize,

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stabilize on present conditions. We have the labor wage scale practically adjusted; everybody has practically adjusted himself and his business to the present conditions. Therefore I say stabilize on present conditions.

I want to direct that the Federal Reserve Board proceed as they have been toward a stabilization now, using the Federal Reserve Board and system to promote stabilization at this time.

The CHAIRMAN. Are you satisfied with the position that agricultural products occupy in the general price level at the present time?

Mr. STRONG. Yes; but I am not trying to stabilize individual prices. That certainly is not the object of this bill. I am trying to stabilize at the present price level. Agriculture will adjust its affairs, I hope. Practically two-thirds of every dollar I made in 30 years was made in agriculture. I hope it will come back to a condition where it will earn a fair return upon its investment, and I believe it will. But it is not agriculture alone that I want to stabilize; it is the Nation's business. If you will stabilize the Nation's business, we will take care of agrculture so it will bring a fair return. It is the level of prices in common that I want to stabilize, the index prices. Agriculture will readjust itself; other things will readjust themselves; but if the common level of prices goes down, of course agriculture will have no chance, because it will be the first industry to be affected.

Doctor MILLER. I wonder if it has ever occurred to you, and I address the question particularly to Doctor Commons, that we have had such a big change in the financial set-up of American business in recent years that many of our large and successful manufacturing corporations operate without very much use, if any, of credit.

Mr. STRONG. I know that.

Doctor MILLER. That is due partly to the experiences of 1920 and 1921.

Mr. STRONG. They had to.

Doctor MILLER. Yes; they had to. Also, it was partly because of the spirit of financial conservatism on the part of the best industrial managers, and partly because, I think, of the peculiar regard in which a business is held as a sort of an entity that is entitled to good treatment by company officers and directors. This led them to build up their cash assets to a position that is unprecedented by comparison with what we find in our earlier business history, and unparalleled by anything which you can find in Europe either now or which you could find there in the days before the war. So these great concerns that are responsible for the bulk of the output in many of the most important lines of industry, instead of being borrowers, are actually lenders of money. On this chart the line marked "Brokers' loans for account of others" represents surplus cash in the hands of these great corporations and firms.

The CHAIRMAN. Without objection this chart of the Federal Reserve Board marked "Brokers' loans" will be inserted in the record at this point.

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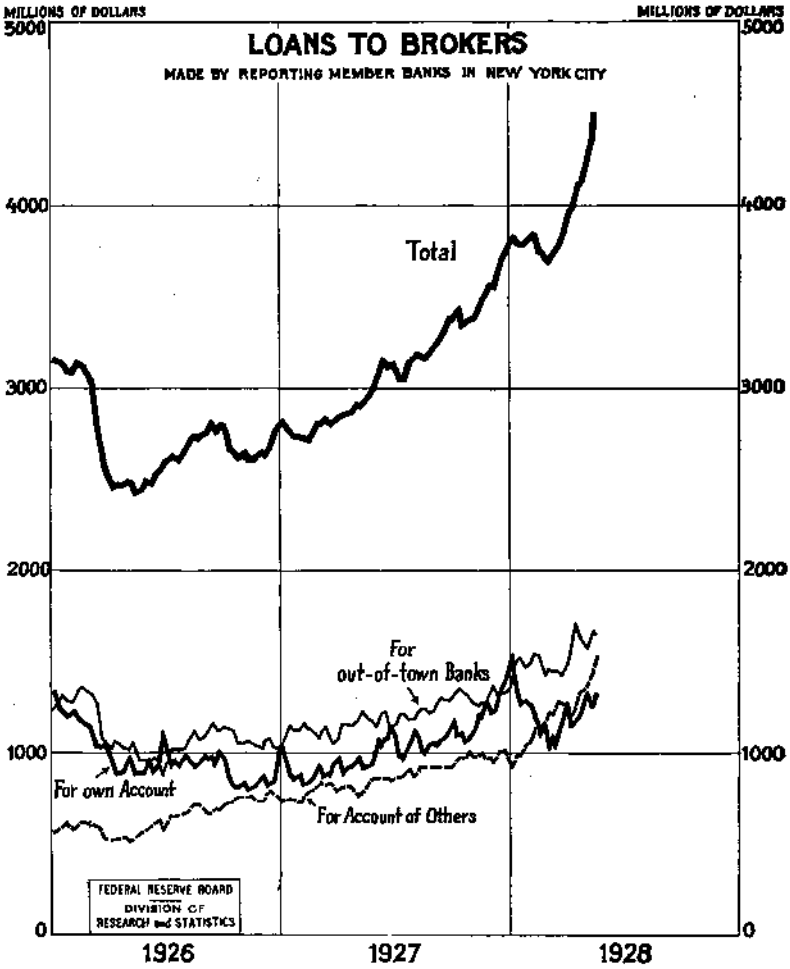

Doctor MILLER. When you go to Europe, to England, you meet a situation which is widely different from this. Their industries can not expand their operations without bank credit, and bank credit there has a relationship to the current volume of trade that it does not have in our country at the present time and can not have. American business has attained a position of great financial independence, and it is a factor rather in the lending situation than in the borrowing situation. That is one of the things that is troubling the Federal Reserve Board to-day, this lending of business money to the market.

The CHAIRMAN. That reduction is one of the things that causes the increase of the investment securities which the Secretary of the Treasury directs attention to that are accumulating in the Federal reserve system.

Doctor MILLER. Yes, sir.

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The CHAIRMAN. And right along with that development has been this new plan of financing and underwriting of existing business organizations which requires a large volume of credit, a part of which has to be obtained in the form of brokers' loans.

Doctor MILLER. Yes; carried for a while.

The CHAIRMAN. In other words, we have developed an entirely new system of finance in this country within the last few years.

Doctor MILLER. That is true.

Mr. STRONG. I do not seek in this bill to try and hedge your board or your system around as to how you shall solve the problems as they come and you must meet them. I am only suggesting the powers that the people have given the Federal Reserve Board shall be used in a policy of stabilization. That is all I am seeking to do. That is what I understand from my discussion with the Federal reserve representatives who have been before this committee the board has been doing for three or four years; and some of them have been very proud of it, and we are all proud of it. I want to direct that it shall be continued; but you will have to work out your own problems as they come before you. However, the aim should be stabilization of the purchasing power of the American dollar.

The CHAIRMAN. It is now nearly 5 o'clock, and I wonder if we should not adjourn. Doctor Miller, have you anything further you wish to present to the committee this evening?

Doctor MILLER. Not at this time.

The CHAIRMAN. Have you, Doctor Commons?

Doctor COMMONS. No.

The CHAIRMAN. We will meet to-morrow at 10.30.

(Thereupon, at 4.55 o'clock p. m., the committee adjourned to 10.30 o'clock a. m. tomorrow, Friday, May 18, 1928.)

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Friday, May 18, 1928.

The committee met at 10.30 o'clock a. m., pursuant to adjournment Hon. Louis T. McFadden (chairman) presiding.

The CHAIRMAN. The committee will come to order. This is a continuance of the hearing on H. R. 11806.

We are very fortunate this morning in having with us Prof. Gustav Cassel, of Sweden, a scholar and an economist of world fame. He has kindly consented to give us a statement this morning on the subject under consideration, and I am going to suggest to the committee that he be permitted to make a connected statement, after which he assures me that he will be very glad to answer questions.

STATEMENT OF PROF. GUSTAV CASSEL

Doctor CASSEL. Mr. Chairman and gentlemen, I think we ought to begin by pointing out that the United States, first of all, has a gold standard. You have a Federal reserve system, and the most prominent function of the whole system is to keep up the gold standard. You ask the Federal reserve system to do that, and you find it quite natural that they should be able to exercise that function.

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And nobody doubts that the Federal reserve system is able to keep up the gold standard in this country. But I think it is necessary that we should ask ourselves for a moment, what does that mean? It means that the purchasing power of the dollar, the unit of your currency, must be kept constantly at par with the purchasing power of the corresponding amount of gold. Therefore, if you expect the Federal reserve system to keep up the gold standard, you actually expect the system to keep the purchasing power of the unit of your currency, as against commodities, at a certain height. And I wish to add that what you expect is a particularly difficult thing, in so far as the value of the quantity of gold contained in your dollar is liable to alterations, and if the value of gold as against commodities alters, the Federal reserve system has to hold the purchasing power of your monetary unit in accordance with these alterations. But you expect them to do that, and nobody doubts that they are able to do that.

There is a lot of experience confirming the fact that a central bank system has that capacity, because long before the War—in some countries almost a century—a gold standard has been kept up, and it has been kept up in no other way than that the central bank in a given country has kept the monetary unit at a purchasing power as against commodities corresponding to the purchasing power of a certain amount of gold.

That is a fact, and that is most important to remember, because it does away with a lot of troubles with reference to the capacity of a central banking system to master the purchasing power of the monetary unit. I think this fact can not be doubted, because it is not only a theoretical fact, but it is a fact established throughout a century in numberless countries.

Now, if gold had a fixed value, the attainment of the purpose would be comparatively easy, because then the Federal reserve system would only have to keep the purchasing power of the dollar in comparison with other commodities at a certain definite figure. But the value of gold is not fixed, and what is still more important in this connection, the value of gold is not independent of the action of the Federal reserve system. If it were, you could say to the Federal Reserve Board, "You have to keep the currency on a par with gold," and that would be a definite fixation of their duties. But if the Federal reserve system itself has an influence on the value of gold, their aim, the ultimate aim of their policy, is not absolutely fixed if you only tell them that they should keep the dollar at par with gold. You must add something telling them how they should use their influence on the value of gold itself.

I think that must be quite clear.

That is not anything artificial. It is not a mere theoretical construction, but it is an obvious necessity that if the Federal reserve system, as every other central banking system, has an influence on the value of gold, you must add to your instruction to your central banking system something telling them how they should use this particular influence that they are in possession of.

Now, if this is clear, I think it should meet with general consent that the central bank can not possibly use this influence in any other way than to prevent unnecessary fluctuations in the value of gold; and I venture to think that the instruction which has to be added

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to the Federal reserve system should not contain anything else than that the system should use its influence on the value of gold to prevent unnecessary fluctuations in that value. I venture to think that this idea could meet with general consent.

You know that the Federal reserve system may increase its demand for gold simply by increasing its gold reserves. They can choose to have gold reserves of, let us say, 80 or even 90 or 100 per cent against their notes and deposits. But they can take another course. They can reduce their demand for gold and allow it to go down to 40 per cent. All that you know. Now, it matters very much what they do. If they have such a very big reserve, and their demand for gold is great, that has an influence upon the world's market for gold and, therefore, upon the value of gold. If they reduce that demand for gold, the market will be better supplied with gold, and the value of gold will fall. It is therefore absolutely undeniable that the Federal reserve system has an influence on the value of gold.

There is another influence, too. If you put gold coin into circulation in this country, the monetary demand for gold will be very much increased. If you prefer to put gold certificates into circulation, the result will be the same. But if you decide not to do that, and to be satisfied with having only the Federal reserve notes and silver coins, you reduce the demand for gold considerably, and this reduction of the demand is bound to have an influence on the value of gold.

But you are not the single country in the world exercising an influence on the value of gold. All other countries have a similar influence. You are only in a singular position, inasmuch as you are the greatest country, and you keep almost half of the world's monetary stock of gold. Therefore your influence is infinitely greater than the influence of any other single country.

When you desire to stabilize the value of gold, you have therefore necessarily to cooperate with other countries, and particularly with their central banks. Some people, I understand, in this country look upon such cooperation with very much of suspicion; but I think there is no ground for such suspicion. There is an interdependence between all countries. You can not avoid it. Your demand for gold has an influence on the value of gold, as I have shown. Other countries also have an influence. If you cooperate to reduce the demand for gold generally in the world, you can attain a certain object. If you do not, you influence the value of gold only in another direction. But you can never avoid influencing the value of gold. That is impossible.

I know that in this country there is a certain tendency, in monetary matters, to be independent, and some people say, "We will have nothing to do with the rest of the world in our monetary questions; we are going to decide them for ourselves; we have only to look upon our own currency, and we have nothing to mingle with the currencies of other countries." Well, you could possibly take that view if you had decided to have a paper standard established in this country. But you are not on a paper basis. You have decided, and I venture to think once for all, that you are going to have a gold standard. But in the same moment you have given up your independence. You have taken gold as your basis, and most countries in the world

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have done that. That means a general interdependence of all countries with respect to their currencies.

That is something that can not be avoided, and I think it is very important that this point should be made quite clear, so that there shall be no doubt about this question. As long as you have a gold standard you are dependent upon all other countries; although naturally the other countries are much more dependent upon you, because, as I said, you are the most prominent country in the whole gold-standard system of the world.

Some people say, "We will have nothing of that sort of cooperation for regulating the world's monetary demand for gold; we will go back to a system where every country tries to get its own gold reserves and does not take any notice of what other countries do in that respect." Think a moment on that proposition. What would that mean? That would mean that there would be a reckless competition for gold among all central banks and among all governments issuing gold coins, and this competition would be bound to raise the value of gold considerably. You would not be independent of other countries in that way, because if the other countries wanted to draw gold to themselves, you had to protect your own gold reserves, and you could not protect them in any other way than by raising your rate of discount. The result would be that you would have to raise your rate of discount exclusively in order to protect yourselves against foreign demand for gold, and there you would have the real dependence on other countries. Perhaps this raising of the rate of discount would not at all be warranted by the internal situation in the United States. The situation here may be such that the low rate of discount is very good, and quite compatible with the stabilization of business conditions in this country and with the stabilization of prices; but there comes the gold demand from abroad, and you are bound to raise your rate of discount. You can see that in this case of reckless competition you would be much more dependent upon other countries than if you accepted the system of friendly cooperation with their central banks.

I have the view that we will have to face in the future an increasing scarcity in the supply of gold. I shall explain a little later the grounds for this view. But I think it is pretty certain that the world's supply of gold is going to be diminished, whereas the need for annual additions to our gold stock is bound to increase, simply because of the general economic development of the world. If you have a certain rate of progress in the world, say an average rate of 3 per cent a year, you must increase the gold stock of the world by something like that. But as the gold stock of the world is always growing, this annual increase must increase itself; and the annual need for gold is, therefore, in a progressing society, bound to rise year after year. Therefore, when gold production can not keep pace with this growing need, you have to face an increasing scarcity in the supply of the metal.

For that reason the cooperation between the different countries must be directed to economizing in the use of gold, and of course that can not be done in any other domain than in the monetary demand for gold. The monetary demand for gold arises from two sources: The desire of different governments to put gold coins into

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circulation and the desire of the central banks to have great gold reserves. Now, these two needs are concentrated in the governments and in the central banks, and it must be comparatively easy to bring these interests together and to come to a certain understanding in the direction of reducing these demands so that the world could economize with the metal.

I first enunciated this program in a memorandum which I presented to the League of Nations at the time when the Brussels Economic Conference was held. There were several Americans taking part in that conference. It was in 1920. Afterwards the program was taken up by the international economic conference in Geneva in 1922, it was discussed, and the conference recommended that the central banks should cooperate to reduce their monetary demand for gold; just for that purpose, as I have now explained. As a member of the conference's expert committee I proposed an amendment that the governments should also cooperate by not putting gold coins into circulation again. That was not accepted, because all resolutions of the conference had to be unanimous, and they could not reach unanimity on that point. Still that proved afterwards to be a most important point.

You know that after the Dawes plan Germany restored a gold standard without putting gold coins into circulation. You know that England did the same in 1925. That step of England's was most important, because it gave an example to the whole world. In the case of Germany you could say that that was a temporary emergency measure. In the case of Great Britain it was very much more important, because you must always remember that the gold standard was from the beginning a British invention, and all people have been accustomed to look up to England as the country setting the example of a gold standard. Now, when great Britain decided not to have gold coins in circulation and not to redeem her notes in coin, but only in gold bars, it was a very important step, and other countries have followed it.

Imagine what would happen if these countries had not acted in this way. Germany had, I assume, before the war a gold circulation of about 4,000,000,000 gold marks. That would be about $1,000,000,000. England had a little less, I suppose, but a very considerable sum. If these countries had added such enormous amounts to the world's monetary demand for gold, it would have influenced the situation here, and the value of the gold would undoubtedly have increased, with the result of a pressure on the level of prices here and in the whole world.

But still that was not the most important fact. The most important fact was that the gold economizing policy succeeded in preventing India from putting gold coins into circulation. As you know, India desired very much to have that. It was a certain kind of national pride, I understand. They thought that India would never be a first-class country if they did not have a gold circulation, and they had the idea that they should exchange the silver circulation, or most of it, for a gold circulation.

The royal commission on Indian currency and finance discussed this problem thoroughly. They asked me to write a memorandum on it, and then I developed these ideas which I have developed here.

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I said, if India is going to do that, that means the end of the whole economizing policy of the world, because the Indian demand will be so overwhelming that it will cause every other gold-standard country to take all sorts of measures to protect its gold reserves. You would have done it in this country, and I suppose most other gold-standard countries would have done it, with the result that we would have to face a very intense scarcity of gold in the whole world, with the natural consequence that the value of gold would have risen and the commodity prices in all gold-standard countries would have been bound to fall. That would have meant a general economic crisis arising, meaning lack of employment and very great difficulties for the whole world. There you see the fact, which is absolutely undisputable, that by cooperating with different countries we succeeded in preventing India from introducing gold coins in their circulation and thereby in economizing very materially in the use of gold. I understand that the American representatives who were called in before the Indian currency committee have a great responsibility for that, and we are bound to thank them very much for what they did there.

I quote that example because that has proved absolutely and indisputably the fact that such cooperation between the different countries may lead up to results which are to the very greatest profit for all countries, without any single country having to make any sacrifice at all. This settlement was not even unfavorable for India. I think it was very good for India, because otherwise the great silver stock of the country would have been infinitely depreciated, with enormous loss for the whole population of India, particularly the poorer classes, possessing mainly silver.

I am anxious to point out that this cooperation is unusually favorable, because it requires no real sacrifice from any country, and it always results in a distinct practical advantage to them all.

We have a similar case now before us. As you know, France is making the last steps for restoring a gold standard, and there is felt a certain uneasiness in several countries lest France should take too much gold for that purpose. The Bank of France possesses a big reserve of gold, and I understand that it would be unnecessary for France to take more gold. But there are some tendencies in this direction; and a certain cooperation between the central banks and a certain understanding between them would perhaps attain the desired purpose, that France should abstain from taking more gold than is absolutely necessary. That would have an influence toward stabilizing the value of gold and preventing an unnecessary lowering of the price level here in this country.

I think we must, from these facts, draw the conclusion that once you have the gold standard in this country you are dependent upon all the other countries. There exists a general mutual interdependence between all gold standard countries, and if you act wisely you can use this interdependence for a good purpose. If you refuse to cooperate, the interdependence will still be there, but it will be used for bad purposes; for a reckless competition for gold with all its pernicious effects.

I have only to add a few words explaining why I believe we are faced with an increasing scarcity of gold. I have already said that we should not only take account of the absolute height of the pro-

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duction for every year, but we should also keep in mind that the annual demand for gold, i. e. the need for fresh produced gold every year, is bound to rise in the same proportion as the general economic development of the world. Now, as you know, most of the gold in the last few decades has come from South Africa, from the Witwatersrand. It is a well-known fact that in the last years very few, if any, new gold mines of great importance have been opened up in South Africa, and the average life of a South African gold mine is only about 20 years. Therefore the experts say that in about 15 years we must expect the gold production in South Africa to have come down very much in comparison with what it is now; perhaps half, or something like that. That means a very great diminution in the world's production of gold.

Now, I want to point out most explicitly that it is not the business of an economist like myself to prophesy in any way about the future discoveries of gold. That is a question which you should not ask me. An economist has only to look upon the present situation, upon what we know of the present gold supplies, and then I think it is clear enough that we shall not be able to get the necessary supply. I estimate that at present the world's gold production is about two-thirds of the normal production which would be necessary in order to keep up the value of gold at a certain fixed height. In about 15 years it is very probable that the production will be less than half of the requirements. That means that the general level of prices is going to fall; not very sharply every year, but if it is going to fall continuously year after year, that means that in 10 years or 20 years you must have a very much lower level of prices than now.

Now, what is the result of that on the general business mind? Well, it has no result on short business, but it has a very material result in all constructing business. If you want to build a house, you can say, "I am not going to do that now; I will wait for 10 years and I can build it much more cheaply then." It is the same if you are going to build a railway or a water-power plant; you can always say that you can build it easier and cheaper in a few years; and if you do not wait, but do it now, at present high prices, you will have to write off considerable capital after a few years. The constructing industries are very important, and the inevitable result is that the great basic industries that porduce materials for capital goods, e. g. the iron and steel industry, are hampered in their development, and this causes a certain unemployment in all industries depending upon these capital-producing industries.

It is possible, of course, that we shall come to a point where there is practically no more gold produced in the world of any importance, and then we will have to face very great difficulties with the gold standard. But that is not the business of the present generation. The present generation is able to keep the value of gold and the general level of prices as it is at present simply by this device of economizing in the monetary demand for gold; and therefore I think that it is very wise to recommend that such an economizing in the monetary use of gold should enter into the general program for the Federal reserve system. This means that we should try as far as possible to stabilize the value of gold and thereby the general level of prices. This is a function of the central banks, because inevitably

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the central banks have an influence on the value of gold. I want to add that this is the only point where the central banks necessarily have an influence on prices. Therefore you should abstain from adding any other duties to the central bank. It is not the function of the central bank to influence the relative prices of different commodities. It is not the function of the central bank to increase wages or stabilize trade or encourage industry or protect the farming interests or to do anything like that. It is not even the business of the central bank to influence the rate of interest on capital. Therefore nothing of that sort should be put into the program of the Federal reserve system.

I think I have now said what I had to say on the general program, and I shall be glad if the gentlemen present will ask me questions. I know quite well that what I have said is not at all complete.

The CHAIRMAN. Are there any questions that members of the committee would like to ask?

Mr. WINGO. Doctor, if the United States continues to have an exportable surplus and also continues to export capital, and thereby increase the demands on the rest of the world by way of capital and interest requirements and settlement of trade balances, that will continue to have a tendency to draw gold to the United States, will it not?

Doctor CASSEL. If the United States wished to increase their export of goods, as they really wish to do, finding new markets all over the world, and if the United States did not like very much to import commodities from other countries, the result would be a surplus in your balance of trade. But in the long run that is impossible if you do not have at the same time a corresponding export of capital. If you have not the corresponding export of capital, the result will be that the foreign countries will have to pay you in gold, and that will be very unsound, both for the other countries and for you, because you can not use this gold for any reasonable purpose. But the question that the gentleman has asked me is a question which belongs to your general trade policy, and I think, for my part, I should keep that out, because that is a very controversial matter. It would lead us to the question of tariff walls or free trade, and I think it is better that we should keep these controversial matters out of this discussion.

Mr. WINGO. I think, Doctor, you misunderstood me. I did not have that in mind at all. I had in mind the effect on the gold supply. I assume that we would also continue to export capital, which, of course, would carry with it interest requirements that would require settlement each year; and my assumption was that if we continued to export both capital and goods, regardless of what our policies might be, and if we continued to have a surplus, however produced, of demand against the rest of the world that called for settlement, that would have a tendency to draw gold here.

Doctor CASSEL. Yes; naturally.

Mr. WINGO. Unless we entered into some kind of agreement to cooperate with the rest of the world so as to check that natural economic flow of gold to the United States.

Doctor CASSEL. Yes; no doubt. But, of course, you can make it easier for foreign countries to pay their debts and the interest on their debts to you if you are more ready to accept their commodities.

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Mr. WINGO. But you are right about that. That is a controversial question, and I did not intend to drag you into it. I was talking about the economic effect upon the gold supply.

Doctor CASSEL. Yes. And it is very likely that the rest of the world, as the conditions are now, will have to pay you in gold. But that depends on many other factors; for instance, the expenses of American tourists throughout the world, which are very heavy and much more important than your gold imports.

Mr. WINGO. What effect would the increase in the price of gold, with the corresponding fall in the commodity price level, have upon an exporting nation? What effect does the increase in the value of gold have upon a nation that has a net surplus for export?

Doctor CASSEL. I do not think that there is any particular effect on exports and imports if the value of gold alters. It is the very alteration in the value of gold, the very increase in the value of gold and the corresponding sinking of the general level of prices that has a depressing influence on trade generally, not only on export trade but on all trade.

Mr. WINGO. That is the point I want to bring out. Do you think that a rise in the price of gold would have a depressing effect upon the economic conditions of a country that is exporting a surplus of commodities?

Doctor CASSEL. Yes; but the effect would be felt in all countries, because if the general level of prices falls, that means that the value of gold increases, and that will be felt in all countries in the same manner.

Mr. WINGO. If you substitute Federal reserve notes for gold certificates in circulation, does that have a tendency to increase or decrease the price of gold?

Doctor CASSEL. That means a reduction of your monetary demand for gold, and that, of course, must increase the supply of gold on the market and the value of gold is bound to fall.

The CHAIRMAN. Doctor, I have here the circulation statement of the United States money as of March 31, 1928. It shows gold coin and bullion, $4,304,536,028. Of that amount, $1,561,416,429 is held in trust against gold and silver certificates in the Treasury. Now, during the past year, or perhaps a little over, we have paid out in the form of gold certificates $1,561,416,429. What effect does that have—the putting into circulation of gold certificates—on our particular monetary situation here?

Doctor CASSEL. I do not think for the moment it has any great importance, because the Federal reserve system has an unnecessarily great gold reserve at present. This surplus reserve is temporary, and the Federal reserve system has always looked upon it as a temporary reserve. Now, if you use a part of this temporary reserve for increasing gold certificates in circulation, it has no particular influence on the world's supply of gold, of course. It is only a means of keeping this temporary reserve.

The CHAIRMAN. Would not that be practically the same situation that would have existed in India if it had put gold into circulation? We have put that amount into circulation——

Doctor CASSEL (interposing). Yes, but you took it from your surplus reserve which you really do not need. India had no such

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reserve of gold, but would be bound to take it from other countries, and that makes a great difference.

Mr. LUCE. Doctor, your argument appears to assume the validity of the quantitative theory of money. There still survives in this country a few economists who do not accept the quantitative theory of money, and among them some gentlemen who are rather high in the Federal reserve system. Will you tell us if there remain any economists in Europe who deny the validity of that theory?

Doctor CASSEL. It is a difficult thing to tell; but I have the view that the quantitative theory of money can be stated in different ways, and if it is stated in the sound way it is undoubtedly true. Now, I do not think that it is absolutely necessary that we should be united on the exact validity of the quantitative theory of money, because I suppose there is nobody who denies that a very abundant quantity of means of payment in a country would always have the effect that the purchasing power of the unit of money would be diminished. If you increase the supply of money, as Germany did a few years ago, nobody doubts that the effect would be the diminution of the purchasing power of the unit of money. There is a certain dependence; I think we can be united in that, without entering upon the subtlety of the quantitative theory; and that is quite enough, because then it is clear that the central banks must put a certain restriction upon the supply of means of payment to uphold the definite value of their currency. It is enough to know that.

Mr. LUCE. Some of the gentlemen who demur at proposed action here insist that the volume of money is the result of trade demands, and not the cause.

Doctor CASSEL. Well, the situation is, of course, complicated; but what determines the trade demand for money in circulation, then? It can never be regulated by any other factor than the conditions upon which the Federal reserve system is willing to put their means of payment at the disposal of the community. Among these conditions, of course, their rate of discount is the most important. It is their currency, and they have the power over it, and if they restrict the supply of it by sharpening their conditions, the business of the country feels it generally. The demand for currency is diminished, and the amount of currency is reduced. The ultimate power always lies with the Federal reserve system, because they are responsible for the conditions upon which to put their own currency into the hands of the public. And I venture to think that this responsibility of the central bank should be emphasized to the utmost. This responsibility was not recognized in Europe during the war and the years immediately following it, and the consequence was this immense inflation, because the central banks were unwilling to accept the responsibility. But since then we have come to the result that the central bank is absolutely responsible for the way in which it supplies the public with its notes and deposit credits.

Mr. CAMPBELL. Doctor, the Federal reserve system being the agent of Congress, which represents the people, should they not take into consideration first of all what is going to be for the best interest of the people?

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Doctor CASSEL. Certainly; there is no doubt of it.

Mr. CAMPBELL. You refer to it as "their currency." They can only issue currency as authorized by Congress. If they take authority unto themselves that is not vested in them, and thereby bring about a fictitious value, either of gold or commodities, then they are not using their authority for the best interests of the general public, are they?

Doctor CASSEL. But what do you consider to be the best interest of the public, the people of this country, with regard to their money?

Mr. CAMPBELL. That which will give the highest purchasing power to their money.

Doctor CASSEL. Do you mean to say it is to the advantage of the public that their money should have as high a purchasing power as posible?

Mr. CAMPBELL. It is to the wage earner.

Doctor CASSEL. No; because any alteration in the purchasing power of money is bound—perhaps not immediately but in the long run—to affect not only retail prices and wholesale prices but also wages in the same manner. You must remember that the monetary unit is only the unit of account in which you reckon all values, and you can not by monetary means alter the relations between different prices. You can not alter the relations between wages and commodities. The only thing you can do is to stabilize the unit itself.

Mr. CAMPBELL. That being true, how can you stabilize it?

Doctor CASSEL. You are bound to stabilize it to a certain degree simply by the fact that you have a gold standard.

Mr. CAMPBELL. Arbitrarily?

Doctor CASSEL. No. You have a gold standard. You have said to your system here, "You must keep up the gold standard." You can not deny that.

Mr. CAMPBELL. Suppose there is an inadequate supply of gold.

Doctor CASSEL. Well, you have to keep up the gold standard anyhow.

Mr. CAMPBELL. That, then, increases the purchasing power of it?

Doctor CASSEL. Yes.

Mr. CAMPBELL. Suppose there is an overproduction of gold.

Doctor CASSEL. In any case I think it is desirable that no alteration in the value of gold should take place, and therefore it is advisable that the Federal reserve system, as well as all central banks, should have a cooperation to prevent unnecessary fluctuations in the value of gold. I think that is pretty clear. That is not sacrificing any interest, because the only true interest of every people is to have an invariable standard of value.

Mr. STEAGALL. Let me ask you a question right there. Mr. Campbell, who just interrogated you, suggested that it was desirable to have the dollar of the laboring man of great purchasing power. If I understand you, you hold the view that the relation would still be maintained, and that an increase in purchasing power would not inure to his benefit. Suppose a man expects to save something, and does not intend to pay out everything he gets; then are not high prices desirable for the laboring man and for the man who has products to sell? Is not that the only way he gets a chance to save anything?

Doctor CASSEL. Well, I will say that——

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Mr. STEAGALL (interposing). Is there not a difference between the man who has labor to sell or farm products to sell and the man who is a money holder? I live in a farming country and it has always seemed that the only time when our people were able to save anything was when prices were high, because they sell more than they buy, and although what they buy goes up, if what they sell goes up their margin is higher and they are able to save something.

Is not that true for producing people?

Doctor CASSEL. Well, I think that an increase of wages and a general leveling up of the standard of the working classes is one of the prominent ends of a civilized society; but I am most strongly of the opinion that this aim can not in any way be furthered by monetary measures except by the scheme which I have recommended here, that the monetary unit should be kept unaltered. A continued rise in the general level of prices would doubtless be a great disadvantage for the wage-earning classes but a fall in prices is not better. It is very easy to say that it is good for the workman if the general level of prices is falling, that he gets more for his money, but I think that that is a very unsound recommendation. A general fall in the level of prices is bound to be followed, as I have shown here, by general economic depression and also unemployment and it results in a very great evil to the working classes.

We can not give the working classes higher wages by falsifying the monetary unit systematically; we can only do it by economic progress and by increasing the capital of the country so that more workmen can be occupied at better conditions and therefore it is necessary that a nation should save as much as possible in order to be able to increase the capital supply of the country; that is to say, to increase its supply of factories, buildings, and workmen's houses, and the supply of water power, electricity, and everything you want in the way of capital equipment.

That is the only way of real progress, and a nation must have real progress if it expects its workmen to get a better standard of living, but we can not serve that purpose in the monetary field better than by keeping the monetary unit inviolate.

Mr. WINGO. Suppose that you had a limitation or restriction in this country on the importation of gold; what effect would that have on the general price level?

Doctor CASSEL. If you put any restriction on the importation of gold in this country, you have virtually abandoned the gold standard; you simply say, we are not going to have the gold standard any longer; we have a paper standard.

Mr. WINGO. Suppose that you had a limitation upon the exportation of capital; what effect would that have upon the general price level?

Doctor CASSEL. That is difficult to say. It would not necessarily have any effect, because if the Federal reserve system regulated its supply according to the new situation, it would be quite possible to keep the general level of prices unaltered; but any attempt to prewent the export of capital would, of course, have bad effects on your general trade situation, and that is another question.

Mr. WINGO. Your theory, then, is that by management and cooperation, you can increase the usable volume of gold?

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Doctor CASSEL. Yes.

Mr. WINGO. In other words, you can by cooperation and economies and management of your gold supply decrease the monetary demand?

Doctor CASSEL. Yes.

Mr. WINGO. And it has the same effect as if you increased the volume of the gold itself?

Doctor CASSEL. Yes; exactly the same effect.

Mr. WINGO. If you have a general economic increase of 3 per cent on the average for the world and 4 per cent for the United States, in order to maintain our present situation, we then would have to add to our gold supply?

Doctor CASSEL. Yes.

Mr. WINGO. Between $200,000,000 and $300,000,000 a year we would need?

Doctor CASSEL. No, no; that is too much.

The CHAIRMAN. Doctor Cassel——

Mr. WINGO. Before he leaves that, you think that would be too much?

Doctor CASSEL. At any rate, for the nearest needs you would not have to add anything to your gold reserves because, as I have explained, and as is generally recognized in this country, the gold supply of the Federal reserve system temporarily shows a considerable unused surplus.

Mr. WINGO. That is true, and the effect would be this: Here we have a gold supply of a billion—we will take that arbitrarily. Then, if our economic increase continues at 4 per cent, which is the estimate you used in one of your articles, and assume that that would require an increase or increase the usable demand at $200,000,000 a year, then in five years' time we would have consumed the surplus and for an additional increase after that we would have to bring the gold in.

Doctor CASSEL. Yes; most probably, if the United States goes on at a faster pace than the other countries you would have in the future to increase your gold reserve more than other countries; but proportionately all countries can restrict their monetary demands for gold, because these demands are, after all, conventional. You have put into your law that you should have 40 per cent gold for your notes and 35 per cent for your deposits. That is all right, but that is conventional, after all, and such figures can be reduced, if necessary. You can keep these figures quite low.

Mr. WINGO. Is it not reasonable to assume that the rest of the world, by necessity, will find due economy in the use of gold? For illustration, do you not think they will more and more restrict the circulation of gold coin in general circulation?

Doctor CASSEL. Yes; they have already done that.

Mr. WINGO. And that they will more and more encourage and develop a greater use of the check in settlement of commercial balances across the counter?

Doctor CASSEL. That is only part of the scheme which I recommend.

Mr. WINGO. Well, now, assuming you are correct, that there is an appreciable threat of a scarcity of gold, that would bring into play that necessity which the ingenuity of civilized man has always found relief for, would it not?

Doctor CASSEL. Absolutely.

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Mr. WINGO. So is not the fear you have more of a theoretical fear than an actual fear?

Doctor CASSEL. No; not at all. What I say is that we must, as a civilized community, try to overcome the difficulties of nature. We have to face a growing scarcity of gold; gold mines in South Africa are beginning to be exhausted. We are not going to make ourselves slaves of the situation; we are going to make ourselves masters of the situation as we have done when we invented steam power, electricity, and everything.

The CHAIRMAN. In that connection, Doctor Lehfeldt, of South Africa, since deceased, was before this committee some time ago, and he made a suggestion that, in view of the possibility of the decreasing gold supply and its effect on the monetary system of the world, the important countries of the world take over the management of the production of gold.

Doctor CASSEL. I know that was his view, but how could they do anything to increase the gold production in that way? His whole idea was formed on the idea of the diamond trust, which is trying to restrict production in order to maintain prices, and he wanted in the same manner to restrict the production of gold in order to increase its value, or at least to prevent a fall in its value. Such a policy is, of course, in the interests of South African mine holders, not in the interest of the world.

Mr. WINGO. One other question. On account of the decreased value of gold since the war, if we undertook to assume what was relatively a normal price level, taking 1913 as 100 per cent, the price level would not have to go back to that 100 per cent in order to get a relatively normal price level, but practically at 160, would it not?

Doctor CASSEL. I consider that the present price level, or the price level you have had as an average for the last three or four years, is the level which is most desirable to keep and to stabilize, because all alterations are undesirable; and I want to add that the Labor Bureau of this country has recently made a new calculation of the general level of prices and they have taken, if I remember rightly, the level of 1926 as 100.

Would not that mean that the Labor Bureau considered this level of 1926 as to be regarded in the future as a normal level?

If the aim is not to stabilize the price level at about its present height, I can not understand why they chose that level as 100. I think they were quite wise in doing so, but then we must draw the conclusion that we regard the new 100 of the Labor Bureau as the normal price level for the future.

Mr. WINGO. The point I had in mind was this, that all terms are relative, and when you are measuring the price level of gold you must take into consideration the fall in the value of gold since the war, and, with that fall, if 100 equalled 1913, then about 160 would be the same relative level for the present.

Doctor CASSEL. Yes; I recognize that, but we have nothing to do with the value of gold before the war. That belongs to ancient history.

Mr. WINGO. The point I am getting at is this, that a great many people think that in order to have a real normal level with the pre-war situation, prices would have to go down to what they were in

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1913, whereas if they did go down to 100 based on 1913 they would, on account of the decrease of value of gold, have about a normal level with that.

Doctor CASSEL. No; I do not think that it is in our interest that the value of gold should go back to what it was before the war, because, as I say, that is a historical fact. We are bound to consider the interests of the present generation, the interests of the great working population of this country and of the whole world, and we are bound to secure for them as stable a monetary unit as possible, and that program involves, of course, that we take the present unit which has been stabilized fairly well for a few years as the normal value for the future. There is no reason at all to make any alterations, all alterations are harmful.

The CHAIRMAN. You said, in connection with the possible decrease in the supply of gold, that along with that there would be a lowering price level.

Doctor CASSEL. Yes.

The CHAIRMAN. Now, in connection with the association or management or cooperation of the central banks, you would bring about a management there?

Doctor CASSEL. Yes.

The CHAIRMAN. Which would obviate that decline in price levels?

Doctor CASSEL. Yes.

The CHAIRMAN. That is one of the purposes to be served by that cooperation, is it not?

Doctor CASSEL. Yes; exactly, but we can not tell before hand exactly how far we shall succeed, and therefore you can not state definitely that we shall for the future have the present level of prices; we can not say anything more than that the central banks together with the Federal reserve system should use their powers to prevent unnecessary alterations of the value of gold. How far we will succeed, the future will show.

The CHAIRMAN. Then, our paying out $1,561,000,000 of gold and putting it into circulation in this country is no impediment in the economies which they are attempting to bring about in gold?

Doctor CASSEL. No; because this must be regarded as a temporary measure, and the gold can be withdrawn from circulation at any moment if should be needed.

The CHAIRMAN. Now, in this cooperation of the banks of issue with our Federal reserve system, in the management that is necessary to be exercised there, they have to take into consideration, among other elements, the question of discount rates, price levels, the rates of international exchange, and trade balances, all coming in for consideration, do they not, in the management that is necessary to be exercised?

Doctor CASSEL. The aim of this cooperation should never be anything else than a systematic reduction or limitation of the monetary demand for gold. It is very dangerous to have the impression that the central banks, working together, command all the things of the world. The only thing they can do is to limit their own demands for gold. To many people that seems to be too little to expect from the central banks, but it is a thing that has a very considerable effect on the material well-being of the world.

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The CHAIRMAN. In connection with the practical situation that confronts us here now, we are in the midst of what has been termed a speculative situation. Yesterday the Federal Reserve Bank of New York raised its rates. Brokers' loans were reported to have increased $150,000,000 in the report that was issued yesterday. Much attention is being directed to the volume of brokers' loans and its effect on the whole monetary situation.

We would be very glad to have your opinion on that present situation, if you care to express it.

Doctor CASSEL. Well, Mr. Chairman, I am very glad that you ask me this question, because it gives me an opportunity to show how the aim of checking this speculation, from the point of view of stabilizing the money of this country, is an outside interest, involving the monetary policy in great difficulties. If you had not that speculative tendency in the New York Stock Exchange, the Federal reserve banks here in this country, I understand, would be able to keep a 3½ or 4 per cent rate of discount. Now, there is this stock speculation, and to meet that the Federal reserve bank in New York feels it is obliged to raise the rate of discount to 4½ per cent. That is, I assume, not at all done for monetary purposes; that is a measure entirely outside of the normal province of the Federal reserve system, which is to regulate the currency of the country; but there seems to be a popular demand that the Federal reserve system should mend all difficulties arising in the country and particularly fulfill the function of keeping the speculators in New York within reasonable limits. I think that is unsound.

It would be a great benefit to the country if some means could be devised by which it would be possible to limit speculation on the New York Stock Exchange without increasing the Federal reserve bank's rates, because such increases may be very unwelcome. They may disturb the whole monetary policy, and it may have an effect on the general level of prices that will result in a depression in production in this country, followed by a decrease of employment, all only for the purpose of combating some speculators in New York.

I think that is absurd, but I must add that the technical means by which we can master the wild stock-exchange speculation must be found by the experts in every country. I suppose there must be some such means as increasing systematically the demands for wider margins in the loans to the stock exchange. I could not give you any more definite advice on that subject; that is a technical subject of the bankers, but I understand that by moral influences it ought to be possible to restrict these speculative tendencies within reasonable limits, at least in the long run.

Perhaps it is impossible, owing to the speculative mind of these people, to entirely prevent speculation on the stock exchange, but I think it ought to be possible in the long run to restrict it within fairly reasonable limits, and I hope that that shall prove possible without applying the means of raising the rate of discount, which is likely to have a very detrimental influence on the whole monetary policy and on the price level of this country; i. e., the general level of commodity prices.

Mr. STEAGALL. You think that the Federal reserve system should serve legitimate business and shape its policy with that end in view?

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Doctor CASSEL. Yes.

Mr. STEAGALL. Rather than to be diverted so as to give first thought to incidental things?

Doctor CASSEL. Yes. It is difficult to answer this question, because I could easily be misunderstood, but I want to emphasize that the Federal reserve system has no other function than to give the country a stable money. The business of checking stock-exchange speculation is disturbing this function, and that makes it undesirable, and I think you must try to find out other means for that purpose so that the Federal reserve system should not find it necessary for such reason to increase its rate of discount, as happened yesterday in New York.

Mr. BEEDY. The testimony of the Federal reserve representatives here, at least the testimony of Doctor Miller, who has been of late testifying here, is that the Federal reserve system ought not to concern itself at all with what is going on in the stock market, and aims not to do so, but you refer to the speculative mind and you will recall the statement of Mr. Ebersole, of the Treasury Department, who concluded his remarks at the dinner which we attended last night by saying that he was convinced that the Federal reserve system did not want stabilization and that the American business man did not want it, and I think that is right. They want these fluctuations in prices, not only in securities but in commodities, in trade generally, because those who are now in control of the situation are making a profit out of that very situation. There is nothing to be gained by them by stabilizing but practically all is to be lost. The gain from stabilization comes in the welfare of the countless thousands who are not in the capitalist class. So the thought that I presume you have in mind is that this stabilization ought to be had in so far as it can be had by the methods which you have there described, for the masses?

Doctor CASSEL. Quite so.

Mr. BEEDY. And it is probably true that if it does not come in a legitimate way, let us say by control through central banking systems, it may come or there may be an attempt to produce it by general upheavals such as have characterized society in the days gone by. The revolutions have been prompted, in other words, by dissatisfaction with existing conditions, the control being in the hands of a few and the many paying the bills.

Doctor CASSEL. Yes; I think that goes very well with what I have said about the purpose of the Federal reserve system, to give the country a reliable and, as far as possible, stable monetary standard. That is the great interest of the great masses of this people and, as I understand, speculators would always have the opportunity to make money anyhow. I do not care for them.

Mr. WINGO. May I ask another question? Monetary causes are not the only difficulties that affect the general level, are they, Doctor?

Doctor CASSEL. Do you mean to ask whether the general level of prices is determined exclusively by monetary causes?

Mr. WINGO. No; I say that monetary causes are not the only causes that affect the general level. There are other things besides monetary causes.

Doctor CASSEL. No; the general level of prices is exclusively a monetary question.

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Mr. WINGO. Your theory is that by monetary control we can control the price level of commodities?

Doctor CASSEL. Yes. You see, you have always done it as long as you have had the gold standard, and all other countries have done it; indeed, they have controlled price levels so completely that the purchasing power of every currency has always been equal to the purchasing power of the corresponding weight of gold.

Mr. WINGO. You think that circumstances have no effect at all upon the play of monetary forces?

Doctor CASSEL. No.

Mr. WINGO. You think that a monetary law, a rule of monetary action, will have the same effect in every condition and circumstance?

Doctor CASSEL. Yes.

Mr. WINGO. It is immutable, unchangeable, and unaffected by monetary climate or economic zone or anything else?

Doctor CASSEL. Yes; as long as the central bank system is being kept intact and has the power of action. If you come to such conditions as in Europe during the war, when the governments asked the central banks to print notes for them and forced them to do so, then, of course, it is different. We must assume the whole time that the central banking system is absolutely independent of any such influences and is only to fulfill the simple function of providing a stable monetary standard for the country.

Mr. WINGO. You think a legislative rule can be devised that would insure the free play of economic forces at all times?

Doctor CASSEL. That is a difficult question, because it is too wide.

Mr. WINGO. It is pretty wide.

Doctor CASSEL. It is wide, but whatever may happen to be the economic policy, the central banking system and the Federal reserve system is absolutely able to adjust its means of payment to keep up the purchasing power of the dollar.

Mr. WINGO. Do you think that in the Federal reserve system lies the power to absolutely control price levels in this country?

Doctor CASSEL. Yes. If you do not believe it, then you must make a resolution here to abolish the gold standard. How can they keep the gold standard if they do not keep the purchasing power of the dollar exactly like the purchasing power of the weight of gold comprised within the dollar?

Mr. WINGO. I often have expressed my idea about it this way, that there are certain economic forces and laws that in their operation are far superior to either the wisdom or stupidity of legislative bodies.

Doctor CASSEL. No; there is no economic force which would prevent a country from keeping to their gold standard as long as the central banking system is intact and can follow its own policy, because they are supreme masters of the situation, simply by the fact that they have to regulate the supply or means of payment.

Mr. WINGO. Suppose that the Federal reserve bank faces a situation where it had exhausted its securities that it could put in the market. I am assuming it is trying to tighten money. Suppose they face the situation where they do not have any securities to sell and that the member banks are not coming to them to rediscount; how could they, by either the open-market operation or by raising

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the rediscount rate, control the action of the member banks in the loans they make or the business they foster or the business they refuse to accommodate or foster?

Doctor CASSEL. That remark has been made many times, and you have never seen a situation where the central bank has really lost influence on the market. If the central bank raises its rate of discount, the effect must come. The market is never so independent of the central bank.

Mr. WINGO. They have been selling their securities now for months, and they have run down until their till is almost empty. They have been increasing Federal reserve rates, and what effect has it had? They are doing it ostensibly to try to check the increase of brokers' loans, and yet brokers' loans were higher yesterday than ever before.

Doctor CASSEL. I have already said that it is not the function of the Federal reserve system to check stock-exchange speculation; and I am not sure that a raising of the discount rate will always serve that end. But the central banks have always the power of regulating the purchasing power of their currency as against commodities.

Mr. BEEDY. You are familiar with the Goldsborough bill that was introduced in this Congress providing for the appointment of a commission to revaluate the gold dollar?

The CHAIRMAN. That is the Fisher plan.

Doctor CASSEL. Oh, yes; I am quite familiar with that.

Mr. BEEDY. What do you think of that?

Doctor CASSEL. I think it is quite unnecessary.

Mr. BEEDY. Do you think it is practicable?

Doctor CASSEL. No; I think it is unnecessary on the ground that if we confine ourselves to stabilizing the value of gold by such means as I have described, we have done everything we ought to do.

Mr. BEEDY. I call your attention to page 2 of the pending bill, subsection (h). From your testimony, I deduce the conclusion that you would strike out all the phraseology, practically, of that paragraph and confine it to a direction to the Federal reserve system to maintain a stable gold standard and in so far as possible to promote a stable purchasing power of the dollar? You would leave everything else out?

Doctor CASSEL. Yes; quite so. But I would not formulate the instruction in that way. I would rather say that the first purpose of the Federal reserve system is to keep up the gold standard, that is to say, to keep the dollar at a purchasing power parity with gold. That is unquestionable, because there is practically no other opinion in this country.

Mr. BEEDY. You think that when we go beyond that——

Doctor CASSEL. Then you should say that the Federal reserve system should use the influence it may have upon the value of gold, in cooperation with other central banks, to prevent unnecessary fluctuations in that value.

Mr. BEEDY. And stop there?

Doctor CASSEL. And stop there.

The CHAIRMAN. I would like to ask you one question before we recess. I would like to ask you what effect on exchange rates the gold cover of the moneys of the different countries have, if any?

Doctor CASSEL. They have no effect because the exchanges are always regulated by the purchasing power of the different currencies.

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The rate of exchange between England and the United States, for example, exclusively in the long run, depends on the relative purchasing power of the pound and the dollar in terms of commodities.

The CHAIRMAN. If there are no further questions, I suggest that the committee adjourn.

(Whereupon, at 12.05 o'clock p. m., the committee adjourned.:)

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Wednesday, May 23, 1928.

The committee met at 10.30 o'clock a. m., Hon. Louis T. McFadden (chairman) presiding.

The CHAIRMAN. This is a resumption of the hearings on H. R. 11806.

I have here a letter which I desire to put in the record from a member of the Federal Reserve Board, Mr. Cunningham, in answer to the invitation extended to him to appear before the committee. It reads as follows:

FEDERAL RESERVE BOARD,
Washington, May 22, 1928.

MY DEAR MR. CHAIRMAN: For the past several weeks I have been confined to my home on account of illness and am now preparing to spend a few weeks away from Washington for the purpose of hastening convalescence. I am advising you of this in order that you may understand why you have not heard from me, at least with an acknwoledgment, in response to the invitation which your committee has extended to members of the Federal Reserve Board to express themselves individually on the bill pending before your committee, introduced by Congressman Strong of Kansas, known as the "Stabilization bill."

I am advised that the committee has heard from Governor Young and Doctor Miller and that Mr. Hamlin expects to be present at the meeting of your committee to be held to-morrow morning. Just at the moment I do not know that I have any views on the pending legislation which I would care to express formally to your committee, nor that I would care at this time to make any statement for the record of my own position with relation to recent policies of the Federal Reserve Board concerning which, I understand, there has been some discussion before the committee. As a matter of fact, should I feel otherwise, I doubt whether the condition of my health just now would permit me to expend the effort necessary to make either a written or oral statement for the information of your committee.

On the other hand, as I understand your committee is inviting expressions of the individual members of the Federal Reserve Board, I do not want absence from the record of any statement of my own views to be construed as my acquiescing in or being opposed to all that has been or may be said concerning the pending legislation, and particularly as to the policies of the Federal Reserve Board since I have been a member of that body. If the hearings on the measure which your committee is conducting are not closed with this session of Congress, and should your committee desire my presence, I will hold myself in readiness to respond to a request, when hearings are resumed, to come before your committee and answer any questions which the committee might care to ask of me concerning the policies of the Federal Reserve Board in so far as I have had knowledge of them since my membership on the board.

With kind personal regards, I am,

Sincerely yours,

E. H. CUNNINGHAM.

Hon. LOUIS T. MCFADDEN,
Chairman Banking and Currency Committee,
House of Representatives, Washington, D. C.

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I also have a letter here from one of the deputy governors of the Federal Reserve Bank of New York, dated May 19:

FEDERAL RESERVE BANK OF NEW YORK,
May 19, 1928.

MY DEAR MR. CONGRESSMAN: As you may have heard, Governor Strong sailed for Europe last week. He has not been at all well since the first of the year, and while he appeared before your committee during March it was only shortly after that that he suffered a very severe attack of shingles, which has sorely racked his nerves and made it quite necessary for him to take good care of himself.

It was on this account that before he sailed he asked me to write you to explain how sorry he was that he was not able again to appear before your committee relative to the discussions of Congressman Strong's bill. I wrote to Congressman Strong to explain the reason of Governor Strong's absence, but the governor wanted me to let you know personally why it was that he could not be there. I hope, therefore, that you will please understand how disappointed he was.

With warm personal regards, I am,
Sincerely yours,

GEORGE L. HARRISON.

Hon. LOUIS T. MCFADDEN,
House of Representatives, Washington, D. C.

Referring to the colloquy that occurred the other day between Mr. Miller, of the Federal Reserve Board, and members of the committee on connection with an editorial appearing in the Journal of Commerce, I desire to place in the record at this point a statement appearing in the same paper under date of May 22 headed "Strong Visit Said to Involve Credits for Stabilization. France, Rumania, and Yugoslavia Are Called Beneficiaries."

(The article referred to is as follows:)

STRONG VISIT SAID TO INVOLVE CREDITS FOR STABILIZATION—FRANCE, RUMANIA, AND YUGOSLAVIA ARE CALLED BENEFICIARIES—GOLD EXPORT FROM UNITED STATES SECOND BIG QUESTION—MONETARY UNION PLANS NOW WILL HAVE CLEAR SAILING IS VIEW

WASHINGTON, May 21.—It is stated in well-informed circles here that the chief topic that is being taken up by Gov. Benjamin Strong, of the Federal Reserve Bank of New York, on his present visit to Paris in the arrangement of stabilization credits for France, Rumania, and Yugoslavia. It is expected that an announcement of this step will be made during the next few weeks.

A second vital question which Mr. Strong will take up, it is stated in these same quarters, is the amount of gold which France is to draw from this country. A total of $180,000,000, largely earmarked last year for French account, has already been exported to France, but the French are in a position, through the large foreign-exchange holdings of the Bank of France, to take out more gold. It is believed that large additional purchases for French account were made since May 1.

FRENCH GOLD POSITION

The large gold imports of France have put her in a position, not only to carry out her own stabilization, but able to assist in that of the Balkan countries. Her gold supply is large enough to withstand any withdrawals that may be occasioned through the establishment of the gold exchange standard in those countries.

Furthermore, it is stated in these quarters that the way is now clear for the establishment of a new monetary union to include France, Rumania, and Yugoslavia. The plan is stated to comprise first the stabilization of the franc at the present level. Following this step, the Rumanian leu will be stabilized legally at the present quotation of 0.62. After several months, a conversion of the leu into another currency unit will be brought about, at a rate which will make the new unit equivalent to the French franc. Following this step, Yugoslavia will take a similar course.

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ENGLISH APPROVE

Information is stated to have reached here that the monetary union plan has been approved by the Bank of England. The stabilization of Rumania on Paris is a natural step in view of the fact that the Bank of France has arranged an $80,000,000 loan to Rumania. On the other hand, the Yugoslav financing is being handed in London.

However, the Bank of England is said here to have little interest in taking a direct hand in Yugoslav stabilization on London, as it would constitute another possbile source of demand on the gold stock there, and besides trade relations between Great Britain and Yugoslavia are not very great. Another obstacle to a Yugoslav accord with France on monetary problems was removed when the Serb-Croat-Slovens ambassador in Paris signed a compromise agreement on the pre-war debts of Serbia to French bondholders.

The CHAIRMAN. I desire also to refer to an editorial appearing May 21, 1928, in the same paper, headed "'Constructive' Program." I think that it would be well, in view of the fact that Governor Hamlin is here this morning, if he has not already noted that editorial, that it be read; so I will read it and ask that it be inserted in the record.

This editorial is as follows:

"CONSTRUCTIVE" PROGRAM

Recent discussions before the House Banking and Currency Committee, as well as elsewhere, have more definitely than hitherto presented to the country, and especially to the financial community, the question of relations between our banking system and those of other countries. The problem is undoubtedly one of first-class importance and has been ever since the close of the war, if not longer. Yet, like other great issues, it has been allowed to drift and to fall into a dangerous, not to say hazardous, position. When critics have anything to say about it they are, as usual, blamed for finding fault with what is, and the complaint is made that they are not constructive.

The Journal of Commerce has had a good deal to say on this question, because it believes that the issue is fundamentally significant. A sound settlement of it is quite important, no matter what that settlement may be. Danger comes much more truly from leaving it unsettled, letting it drift, allowing ambiguous conditions to grow up, and "playing politics" than from acting in either one of two ways which are directly opposed to one another. The evolution of a constructive program is consequently a perfectly easy one. This newspaper has no hesitation therefore in offering two, as follows:

The first program is based on adherence to existing law, and includes these steps—

(1) Insist that the Federal Reserve Board shall exercise its legal function of supervising and representing the reserve system and accordingly require that it either represent the system at all conferences of foreign banks in which American interests need to participate, or, if it chooses, that it send such a representative associated with advisors drawn from among the executive officers of the several reserve banks, preferably with some degree of rotation among them.

(2) Whenever an action has been taken which fundamentally affects our relationship to the banking systems of other countries in such conferences, let the matter be formally reported to the Federal Reserve Board and such reports be placed on file, being eventually acted upon by the board in a recorded ballot.

(3) At stated intervals, or whenever conditions fully warrant, let the board issue to the public a statement of the resolutions or actions it has taken in this connection, just as the Federal advisory council finally brought itself to do with respect to domestic questions. Such publication might be made in the annual report or oftener.

(4) Let the board make plain to the public from time to time the general theory of discount rate management upon which it is acting so that the public need have no difficulty at all in interpreting steps that are taken, such as the raising or lowering of the discount rate, etc. If, from time to time, the board feels that a complete change of policy or the adoption of a new theory is necessary, let it frankly so state in its monthly publication or eleswhere, indicating exactly what changes in its underlying methods of action have occurred.

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(5) Since the rate function is actually performed by the several banks and the action which they take is merely ratified and confirmed (or rejected) by the board, the results of international conferences should, of course, be reported at once to the several reserve banks (simultaneously) either by the board itself or by such advisors as may be associated with it in the conferences. Action under the terms of such reports or designed to carry out their purport will then be taken by the several reserve banks when, as and if they see fit, but if taken will conform to a general program for which the system as a whole will be responsible.

The second and alternative program contemplates either continued nonobservance or defiance to existing law or else alteration of existing law (preferably the latter), but in either case should be definitely formulated and made known, thus:

(1) Let the Federal Reserve Board announce to the banking system and to the country that it has designated a single reserve bank or the governor of that bank to represent it in negotiations with all foreign institutions. Let it further make known the fact that it will expect this bank to do whatever is necessary to acquaint other reserve banks with the outcome of decisions reached in such conferences in order to bring about an approximately uniform sort of policy.

(2) Let the board accordingly definitely disclaim any knowledge of or responsibility for what the system is doing under this leadership, and let it disclaim in an official way any responsibility for anything except, of course, the ratification or disapproval of formal actions which may be submitted to it by the several reserve banks as the result of their agreements with foreign countries and among themselves.

(3) In order to bring about the necessary harmony of action, let it declare its intention to act, as it did last summer, in compelling any recalcitrant reserve bank to carry out its orders designed to render effective the wishes of such bank as may be intrusted with the foreign negotiations.

(4) Let the board officially state that it expects to keep no records of anything whatever relating to foreign policy and has no official knowledge of anything under that head.

The adoption of either one of these programs would enormously simplify the whole banking situation, put the responsibility for current action exactly where it belongs, and, perhaps most important of all, inform foreign countries of the precise source of authority in the Federal reserve system. Such adoption would be a most valuable reform of existing methods.

Mr. STRONG. Mr. Chairman, I think it is up to me, as the author of the bill now under consideration, to express my appreciation of the fact that the Journal of Commerce at last comes in and indorses one of the provisions of the bill, that of publicity, because that is what that editorial certainly does.

The CHAIRMAN. I desire also to place in the record an editorial appearing in the same paper under date of May 23, 1928, headed "Purpose of Bank Negotiations."

(The editorial referred to is as follows:)

PURPOSE OF BANK NEGOTIATIONS

According to a Washington dispatch, the negotiations abroad between central banking representatives, including one member of the Federal reserve system, are intended to deal with stabilization credits for certain European countries and also to determine the amount of gold to be surrendered by this market for the benefit of the Bank of France. It is not stated how this information came to Washington, a member of the Federal Reserve Board having testified on the witness stand a few days ago that the board had no information on the subject, either "official or actual." It is in line with the understanding that has prevailed, however, in this market, these being the leading topics which have been agitating a number of financial minds, from an international standpoint, for some time past.

What our legislators, and perhaps our banking authorities in some cases at least, should bear in mind, however, is that these are matters which very deeply and profoundly affect the domestic credit situation in the United States. Certain members of the reserve board are alleged to have adopted the attitude

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formerly embodied in the classic phrase, "What do we care for abroad?" Just at this juncture what we think about foreign matters and policies implies, however, a very definite point of view with respect to our own affairs. If we part with more gold, or if we increase our credits very much, we shall necessarily have to adjust our domestic banking policy accordingly. Perhaps we ought to do just that—it may be that the "stabilization" of foreign monetary systems is of so important a significance as to make credit questions in this country quite secondary. The point is not whether this may or may not be true, but is simply that whatever we do with regard to foreign countries in these particulars we are really doing with regard to ourselves.

The conferences which are to take place abroad between the heads of central European banks are therefore, as this newspaper stated a few days ago, a continuation of those that have been carried on in the past, and particularly of the one which occurred last summer, at which time the discount policy for this country was arranged for the coming half year.

The CHAIRMAN. Governor Hamlin, the committee will be very glad to hear from you now.

STATEMENT OF CHARLES S. HAMLIN, MEMBER OF THE FEDERAL RESERVE BOARD

Mr. HAMLIN. Gentlemen, I come here in response to the request of the committee, and I assume the committee desires to have me express my opinion on this present bill; to state whether in its present form I approve it, and to give my reasons for approval or disapproval.

The CHAIRMAN. You are quite correct. We shall be very glad to have you proceed in that way.

Mr. HAMLIN. I shall be very brief. I know how busy the committee is.

First, I want to say that in its present form I do not approve of the bill; but I have formulated some suggestions, in the desire to be helpful, and in those suggestions I think will be found removed many of my objections, perhaps all of my objections to the bill.

The first point I want to raise is as to section 28–C, the repealing act. There is a repealing act now in section 26 of the Federal reserve act which I think is in much better form than this; and, of course, if this bill becomes law, it becomes part of the Federal reserve act, and the old section 26, I assume, will apply. So I think there is no need of that section at all. But, personally I would prefer to have this section modified so as to state that this amendment is merely declaratory of the present law as Congress understands it. That is, I understand it has been stated over and over again that there is no intention to change the present law or to add to or subtract from the duties and responsibilities of the Federal Reserve Board, and I think it would clarify the matter very much if instead of putting in this repealing clause we merely state that this act is declaratory of the law as Congress understands it to-day.

Then, turning to page 2, paragraph (g), we are defining the Federal reserve system. Of course, for the purposes of this act, that definition is correct; but as this will become part of the Federal reserve law, I merely suggest that you add the Federal advisory council. You are merely describing the whole system. It is not material, but I think that will be unobjectionable.

Then, coming to paragraph (h) of the present bill, defining the duties of the board, I have redrafted that paragraph, changing it, I think, very slightly. If I may, I will read it. It is very short.

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I would substitute the following; and, of course, I am speaking now simply personally. I have no authority to represent the board. I am merely giving my personal views, which I understand the committee wants.

The draft I would suggest is this:

The Federal reserve system shall use all the powers and authority now or hereafter possessed by it to maintain a stable gold standard, and shall furnish credit facilities adequate to maintain the credit stability of agriculture, industry, and employment, and the purchasing power of the dollar.

The rest is exactly the same. At the end I say: "To this end the Federal reserve system is authorized," etc.

Mr. STRONG. I may say, Mr. Hamlin, that I am in thorough accord with your suggestion, for that was the original bill as I drafted it. The lines you have omitted at the end of the section were suggested to me by various prominent members of the Federal reserve system, and are not my own language.

Mr. HAMLIN. I want to say there that I have used the words "The Federal reserve system shall use all the powers and authority now or hereafter possessed by it to maintain a stable gold standard," as they are contained in the bill. At first I wanted to omit the word "stable" and simply say, "a gold standard"; but it at once occurred to me that that is the business of the United States Government and not of the Federal Reserve Board; so I think the word "stable" is necessary, expecially as explained by the last clause giving the system authority to enter into negotiations with central banks.

Mr. KING. Referring to the last sentence in the paragraph, "Relations and transactions with foreign banks shall not be inconsistent with the purposes expressed in this amendment," do you look upon that as an extra grant of authority?

Mr. HAMLIN. I do not. I think we have now, through the open-market operations, under section 14, the power to buy and sell gold and the power to buy and sell bills.

Mr. KING. Is there anything that the Federal Reserve Board desires to do in foreign countries, in connection with stabilizing the gold standard, upon which there is any question in their minds as to whether they have full authority; and if so, would that authority be supplied by this general proposition here, so that they would be entitled to conclude that they had all the authority required?

Mr. HAMLIN. I have no doubt, personally, that we have that authority; but I should like very much to have this clause remain as it is to remove any possible doubt.

Mr. KING. You think you ought to have that authority?

Mr. HAMLIN. Yes; I believe that is wise.

Mr. STRONG. I might add this to my previous statement: In discussing this bill with various members of the Federal reserve system they pointed out to me that now that we were the creditor Nation, dealing with other nations, in order to maintain the exportation of our surplus crops by the use of a stable money that would have a somewhat fair rate of exchange in other countries, it was necessary to have these agreements to assist in permitting other countries to reach stable conditions. So this language was suggested. It was my thought, however, that their relations and transactions with the banks should not be inconsistent with the purposes of stabilizing the purchasing power of our own money.

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Mr. HAMLIN. I merely put it in the other form. It amounts to the same thing.

I will pass now to paragraph (i), the publicity clause. And let me add in parentheses that, speaking personally, whatever law Congress passes I shall do my best to carry it out faithfully, in substance and in spirit. It is hardly necessary to say that.

As to the publicity policy, I have some doubts. It will be very difficult to state all the reasons for action. As you gentlemen know, the Federal reserve banks, for example, establish a rate of discount. That is approved or disapproved by the Federal Reserve Board. The primary judgment is the judgment of the directors. I think that in order adequately to give the reasons for action the board would have to have a poll of every director of the reserve bank who votes to establish a rate. Then, coming to the reserve board, the board has affirmatively to approve or deny and prevent that rate being established. There may be a very close vote in the board. In my judgment it would be necessary to poll every member of the board, because some members might say that they voted to establish the rate for reasons other than those given by the directors of the banks. They might say they did not believe in the reasons given by the directors of the banks, but for other compelling reasons they voted to establish the rate.

I think it would be intensely difficult at times to give out any statement to the public that would not be misunderstood and that would not lead to very great confusion. For example—I hesitate to bring this up—take the case where the board on September 6 put in a rate of 3½ per cent at Chicago on its own initiative. Now, there were so many issues there that it would require almost a book to state the exact facts to the public, and I think they could hardly be stated in such a way that they would not be misunderstood and would not have to be reexplained.

So I have some doubts about that. If Congress decides, however, that that is the proper thing to do, I shall most cheerfully accept it and carry it out.

For example, in the Chicago rate case there were several questions involved. The meeting was held on Tuesday. On Friday we knew that the rate would be reduced by the directors. Some of the members felt that the rate should be put in on Tuesday and that we should not wait until Friday. Others felt that we ought to wait until Friday and then settle the question. Some felt that the rate ought to be reduced, but that the members would hesitate to override the mature judgment of the board of directors, who were on the spot, who knew all of the conditions and did not want that rate reduced. You might state four or five distinct issues. To present to the public a clear conception of that would be very difficult and almost impossible. I think the board now, as a rule, publishes as far as it can, or as far as it deems wise or necessary, everything in connection with discount rates in its annual report and from time to time in the Federal Reserve Bulletin.

It would take some space to take up the question of the reduction of the rate last summer from 4 to 3½ per cent. There were several questions there discussed. That, however, is not as difficult a question as the other that I cited. But I feel that a decision on a rate question involves not only the present and the past but it neces-

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sarily involves a looking into the future; and if the board, for example, felt that there should be a future policy of easy conditions or more rigid conditions, that would be an announcement that I should suppose those in a speculative frame of mind might take advantage of and defeat its very purpose.

I merely throw this out as my opinion. I am perfectly willing to accept the judgment of the committee on that very important question.

Mr. STRONG. I want to say this for the record, Mr. Hamlin: I think you have known that I have had a rather extensive correspondence, running into hundreds of letters, with financiers and bankers on this bill. Many of them insisted that there should be a publicity of a change of policy, change of rates, open-market operations, and any other decided change of policy in the Federal reserve system, and so I placed in the first draft of this bill a publicity clause. Then, in conference with members of the Federal reserve system and the Federal Reserve Board, the language now carried in the bill was suggested, it being pointed out to me that, first, just as you said, various members of the board would have different opinions. I then made the suggestion that no decided change of policy in our system should be made unless there was a reason for it that could be stated, and that was accepted by the very prominent member of the board that I talked with, but he made the suggestion that it ought not to be immediate; that immediate publicity of a certain action would defeat the purpose of your action. So this language was adopted, that the Federal reserve governor should announce the policy at such time and place thereafter as he might deem proper in order that the public might be advised and the working of the board might not be interfered with; and the word "reasons" was used so that he might not feel compelled to state everybody's reasons, but give the reasons that the board acted upon in changing its policy.

Mr. HAMLIN. I think if that were enacted into law the board would insist on giving all the reasons; in other words, complete publicity, which would mean a polling of every member of the board; and, as you can easily see, oftentimes we would have two or three decisions a week that might be construed to affect policy. We would have to poll the board. It might happen almost every day. I am afraid the public would become very weary of that information. But on that matter I am entirely content to accept the judgment of the committee.

Mr. STRONG. I am glad to have your views, because when we get into executive session on this bill they will be useful.

(Thereupon the committee proceeded to the transaction of business in executive session, after which it adjourned to meet to-morrow, Thursday, May 24, 1928, at 10.30 o'clock a. m.)

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Thursday, May 24, 1928.

The committee met at 10.30 o'clock a. m., pursuant to adjournment, Hon. Louis T. McFadden (chairman) presiding.

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The CHAIRMAN. The committee will come to order. This is a resumption of the hearings on H. R. 11806 with Mr. Hamlin, of the Federal Reserve Board. Do you remember where you left off yesterday, Mr. Hamlin?

Mr. HAMLIN. Yes, sir. I had nearly finished.

The CHAIRMAN. We will be glad to have you proceed.

STATEMENT OF CHARLES S. HAMLIN—Continued

Mr. HAMLIN. I would like to ask the permission of the committee to substitute a new form for my substitute for paragraph (h). I have merely phrased it in a little better language.

Mr. STRONG. What change did you make?

Mr. HAMLIN. I put in the word "commensurate." I think yesterday I used some other word. That is in the record. I thought the word "commensurate" expressed the idea better.

Mr. STRONG. It now reads, "Shall furnish credit facilities commensurate with the requirements," and so forth?

Mr. HAMLIN. Yes. I think that is the only change, except, possibly, in punctuation.

The CHAIRMAN. Without objection, this substitute of Mr. Hamlin's will be placed in the record.

(The matter referred to is as follows:)

SUBSTITUTE FOR PARAGRAPH (H) OF STABILIZATION BILL

The Federal reserve system shall use all the powers and authority now or hereafter possessed by it to maintain a stable gold standard and shall furnish credit facilities commensurate with the requirements of credit stability of agriculture, industry, employment, and of the purchasing power of the dollar, so far as such purposes can be accomplished by monetary and credit policy. To this end the Federal reserve system is authorized to enter into relations with foreign central banks not inconsistent with the purposes of this amendment.

Mr. HAMLIN. I want to make one addition to my testimony of yesterday. It is immaterial. It is in connection with the Chicago rate case. I merely want to say that one member at least of the board opposed any reduction. I did not quite complete my statement.

I want to say also that I approve thoroughly the investigations which this bill calls for. I should like very much to have them made, and to profit by them when made.

There is one further suggestion I wish to make. In the fifth clause of section 28-A you direct us to make inquiries as to the various index numbers; but under the bill, if they is any mandatory force in the bill, we have to begin at once. The question is, What indexes have you in mind? I assume that you mean the wholesale price indexes.

Mr. STRONG. Yes.

Mr. HAMLIN. But I wanted to point out that there is great difference. For example, in the period from 1925 to 1927 the Bureau of Labor wholesale indexes show a price decline of about 12 per cent; but if you take the curve of the cost of living, the decline was barely 2 per cent. If you take a composite index like Mr. Snyder's, there was hardly any decline at all. Now, I understand that you have confidence in the board and trust them to make a proper selection.

Mr. STRONG. I certainly have, Mr. Hamlin. My purpose is to direct that all of the powers of the board be used to stabilize the purchasing power of the monetary unit, the dollar, which I believe

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is the purpose of any financial system set up by any government. I think that is the fundamental purpose. Now, when it comes to the measurement they shall use for stabilization, I realize that they can not have a clear-cut straight line of stabilization; that it must be variable. My idea was that by their experience and their judgment they shall so use their powers as not to permit violent inflations or deflations above or below the measure of stability. That is my purpose.

Now as to the index numbers: A year ago I used the words "stabilization of the price level of commodities in general." Of course, personally I think what should be used is the general commodity price level of all commodities; but when I was drafting the bill I was urged to adopt different index numbers as the measurement which the board should use in using its powers for stabilization. But the question of index numbers is a disputed proposition. There are several index numbers. Personally I prefer the index number of the Bureau of Labor, because it has 404 commodities in general, which I believe is best for the country. But I was urged to suggest an index number, and after hearing various advocates of the different index numbers, realizing that it was a disputed proposition, I thought it best to only direct the Federal Reserve Board to use its powers for stabilization of the purchasing power of money, and leave to their investigation and study and judgment what was the best index number to use. I think that is about the only thing that we should do.

Mr. HAMLIN. I assume that the base that we take—assuming now, for example, that we take the wholesale index numbers—would be the base in effect at the time of the passage of the act.

Mr. STRONG. Yes.

Mr. HAMLIN. That would be your idea. I wanted to be sure of that.

The CHAIRMAN. Go right ahead, Mr. Hamlin, with your statement.

Mr. HAMLIN. Then I want to say, finally, that with the changes that I have suggested in this bill, and assuming a new bill such as I have suggested, I put myself this question as a test: Suppose that gold, over a certain period, is perfectly stable; there is neither appreciation nor depreciation; but suppose there has been a decline in the wholesale index numbers caused by some very great improvements in productive processes, inventions, savings in costs, and so forth, which bring down the wholesale level of prices, and that those same inventions and improved processes have taken place in Europe as well as in the United States. Under the bill as I have suggested changing it, would it be my duty to regard that reduction as an evil and to stabilize prices at a higher level, knowing that at that higher level, with no change in Europe, with no stabilization in Europe, it would mean serious injury to our export trade and would mean such a flood of imports that we would have to have a mountainous tariff to shut them out?

That was the question that I put to myself as a test; and I reached the conclusion that under the bill, with the suggestions I have made, I would not be obliged to try to keep that price level up; in other words, that a lower base of wholesale prices brought about by improvements in productive processes would be perfectly consistent with a stable condition of agriculture, industry, and commerce. And,

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having reached that conclusion, I am now prepared to say that, with the suggestions I have made, my objections to the bill are practically removed.

That is all I care to say, Mr. Chairman.

Mr. STRONG. There are one or two questions that I would like to ask you. Do you think increased efficiency in industry will necessarily bring about a corresponding lower price level?

Mr. HAMLIN. I think it might. It might produce a lower price level and a higher wage level.

Mr. STRONG. Do you think that increased efficiency in agriculture will naturally produce a fall in the general price level?

Mr. HAMLIN. It might.

Mr. STRONG. Do you think there ought to be a reduction of our general price level to meet European conditions?

Mr. HAMLIN. No. I think the reduction in the general price level should be brought about by improved processes, as I have stated, as frequently happens, due to savings, elimination of waste, and so forth.

Mr. STRONG. But we should not endeavor to reduce our price level in order to help conditions in Europe?

Mr. HAMLIN. No; I should not care to use that as a reason. On the other hand, I should not care to keep up an artificially high-price level, which would mean that our exports would practically be driven out of the field and our imports tremendously accelerated.

Mr. STRONG. Of course, our exports represent approximatey 8 per cent of the commerce of the Nation. Ninety-two per cent, approximately, is commerce inside the Nation.

Mr. HAMLIN. Yes.

Mr. STRONG. I was wondering whether you felt that in order to meet the conditions that might arise in maintaining the 8 per cent of foreign commerce, the price level that would affect the 92 per cent of our domestic commerce should be lower. Let me put it a little more clearly. Do you think that we ought to have a recession of the price level in this country toward a pre-war level?

Mr. HAMLIN. No. That had never occurred to me, if you mean it in the sense of deflating prices.

Mr. STRONG. Yes.

Mr. HAMLIN. Not at all. But I do not believe that the recession of prices brought about by improvements in productivity and manufacturing processes, elimination of waste, and gain to the consumers, is a disadvantage that in any way affects stable conditions of commerce or agriculture.

Mr. STRONG. Some authorities believe that the beneficial conditions brought about by that increased efficiency will alleviate any attempt to reduce the price level. But, leaving that out of the question, I wanted to get your idea as to whether or not we should have a lower price level; because there has been some suggestion that this action directing the Federal reserve system to maintain the price level was untimely, and some suggestions have been made to me that we ought not to put that kind of a mandate into the law until the price level has receded—which, to my mind, would be a very bad thing to do, because I want to stabilize now, and not when the country has been deflated and the price of money and gold appreciated.

Mr. HAMLIN. You would say, if not now, when?

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Mr. STRONG. Yes.

One other question, Mr. Hamlin: Do you think the condition in the stock market, whether an inflated one or a deflated one, should have such concern with the Federal reserve system as to prompt any change of policy by them to meet conditions in the stock market?

Mr. HAMLIN. I feel that the Federal Reserve Board or the Federal reserve system primarily has nothing to do with operations in the stock market, and I have always hesitated to think of increasing a rate—for example, on agriculture and commerce—because some people are speculating in Wall Street. But, on the other hand, I think a condition can arise where that speculation so threatens business, threatens to curtail, perhaps, business credits that may be demanded, that the board would have a right to act. I should always be reluctant to act. The only direct power you give to us over any speculative transaction is to put up the rates on agriculture, commerce, and industry. That is like telling a father that he must cut the ears off his child because a drunken man is carousing in the street.

Mr. STRONG. Exactly.

Mr. HAMLIN. I hate it; but I do admit that a condition may arise where it is the only thing to do, and it has got to be done; and in the long run it will be better for agriculture, commerce, and business to do it.

Mr. STRONG. Do you not think that the power of regulation of the extension of credits, through advice and publicity, that the Federal Reserve Board can use against conditions in the stock market would be preferable to raising the rate on the business of the country?

Mr. HAMLIN. Almost anything would be preferable, if you ask my personal opinion. But I recognize that an extreme may come where the discount rate is the only possible remedy.

The CHAIRMAN. I would like to ask you a few questions, Mr. Hamlin, in view of some statements that have been made before the committee by other witnesses. In connection with the suggestion that you have made of redrafting section (h) of this bill, you direct attention more particularly toward the stabilization of gold, the international commodity. Now, in that connection, at least, one witness has suggested that in order to bring about the return of the world to a gold basis, in which we are cooperating as far as we are able to do so here, unless that gold is managed properly by the several banks of issue, including the Federal reserve, we will have a receding price level.

Mr. HAMLIN. That is, a scarcity of gold?

The CHAIRMAN. A scarcity of gold; yes.

Mr. HAMLIN. I think there may be that danger; it may be avoided, however, by proper management of gold reserves.

The CHAIRMAN. You concur in that view?

Mr. HAMLIN. Yes, as I have just stated; and I believe that for that reason it is very essential that everything that the Federal reserve system can do to help stabilize foreign currencies is of advantage to the people of the United States.

The CHAIRMAN. Then you are in accord with the apparent cooperation of the Federal reserve system with these other important banks of issue?

Mr. HAMLIN. Absolutely. I think it is indispensable for the good of the whole people of the United States.

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The CHAIRMAN. There was mention made here the other day, I think when Doctor Miller was on the stand, of a conference of statisticians recently held in Paris; men representing the various banks of issue, at which conference Mr. Goldenweiser, of the Federal Reserve Board, was present. It was left rather in the air as to what this conference was, and in that connection, also, these various conferences that are taking place abroad, either participated in with the authority of the Federal Reserve Board or without that authority. I wonder if you would not tell the committee this morning, just briefly, what this conference was that Mr. Goldenweiser attended.

Mr. HAMLIN. There was a conference at which the various central banks of issue of Europe and the Federal reserve system got together to consider the whole subject of reporting statistically as to banking conditions; making reports as to production and distribution, etc. In other words, the foreign central banks have watched very carefully what the Federal Reserve Board has done, beginning, as Doctor Miller testified, about 1923. Having found that the reserves were no longer a positive indicator of credit policy, the board began, as has been told you, to secure very comprehensive production and distribution data, and Europe has followed that with very great interest. They have not advanced over there as we have under our system, and they wanted to go into the whole question with a view to learning exactly what our operations were, in the hope that they might extend the same principles over there. That was the sole purpose of the conference.

The CHAIRMAN. I suppose that would enable them more intelligently to cooperate in the various conferences that necessarily will have to take place between the banks of issue in the future.

Mr. HAMLIN. Yes; you have expressed it better than I could. That is absolutely so. That was the sole purpose; and Doctor Burgess and Mr. Goldenweiser went over and attended that conference.

Mr. KING. What authority did they have to do that?

Mr. HAMLIN. The general authority that I think is given to the Federal Reserve Board in connection with matters of that kind—general investigation.

Mr. KING. You think that without this bill the Federal Reserve Board would have authority to do that?

Mr. HAMLIN. Oh, yes. We carefully looked into that before we did it.

I want to say that I consider Mr. Goldenweiser and Mr. Burgess probably easily among the best equipped men in the United States for that purpose. They each have published valuable books on the Federal reserve system. Mr. Goldenweiser is the director of our research bureau. Mr. Burgess is assistant Federal reserve agent of the Federal Reserve Bank of New York. I really felt proud that we could send such men over there to explain the modus operandi of our system.

Mr. KING. Do these European banks desire, and is it their ultimate object, to get legislation in this country which will cut down the Federal reserve money?

Mr. HAMLIN. I have never heard of any such desire. This had solely to do with the reporting of the movements of trade and similar banking statistics.

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Mr. KING. You never have heard anywhere any suggestion of that kind?

Mr. HAMLIN. No; I have not.

The CHAIRMAN. These conferences that Governor Strong, of the Federal Reserve Bank of New York, was participating in abroad were of an informal nature?

Mr. HAMLIN. You mean at the present?

The CHAIRMAN. The present and on one or two other occasions.

Mr. HAMLIN. Speaking of the present, all I know of it is that the governor, as you know, has been very ill, and he has gone over primarily, I understand, as a matter of health.

The CHAIRMAN. Yes.

Mr. HAMLIN. Of course, he knows well the various officers of these central banks. He may meet them while he is over there. I certainly know of no authority that has been granted by the board or asked of the board for any conference over there.

The CHAIRMAN. There is one other thing that I want to mention to you. There has been much discussion of the open-market transactions and the effect of these open-market operations, and whether or not the recent expansion of loans, and particularly brokers' loans, was the outcome of the open-market operations of the Federal reserve system.

Mr. HAMLIN. The best answer I can make to that, as to their effect on the general expansion of loans in the country, is to introduce a table that I have here, in which I think the whole period from October 31, 1923, to April 30, 1928, is covered.

The CHAIRMAN. Is that in form so that we can put it in the record?

Mr. HAMLIN. I would like to introduce that. It will not be necessary for me to go into detail. It speaks for itself. I should merely like to make a couple of generalizations.

The CHAIRMAN. Without objection, then, that statement will be inserted in the record at this point.

(The statement referred to is as follows:)

Total bills and securities, by classes, members' reserve deposits, monetary gold stock, and amount of money in circulation October 31, 1923, to April 30, 1928

[In millions of dollars]

	Oct. 31, 1923	Oct. 31, 1924	Oct. 31, 1925	Oct. 31, 1926	Oct. 31, 1927	Apr. 30, 1928
Bills discounted	884	264	616	690	412	834
Bills bought in open market	205	200	347	323	342	357
United States Government securities	92	584	327	301	522	296
Total bills and securities	1,181	1,052	1,296	1,316	1,276	1,488
Member bank reserve account	1,895	2,138	2,214	2,223	2,324	2,442
Monetary gold stock	4,167	4,509	4,407	4,473	4,541	4,266
Money in circulation	4,925	4,942	4,969	5,021	4,946	4,750
Bills discounted		−620	+352	+74	−278	+422
Bills bought in open market		−5	+147	−24	+19	+15
United States Government securities		+492	−257	−26	+221	−226
Total bills and securities		−129	+244	+20	−40	+212
Member bank reserve account		+243	+76	+9	+101	+118
Monetary gold stock		+342	−102	+66	+68	−275
Money in circulation		+17	+27	+52	−75	−196

NOTE.—Minus (−) equals decrease; plus (+) equals increase.

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Mr. HAMLIN. I will say that these figures have been carefully gone over, and that they are correct. The conclusions you may draw from them are, of course, your own; and mine are as I state them.

This covers a period of five years. Briefly, you are asking now whether the open-market operations contributed to the expansion or inflation. In only two of the five years did the Government securities and acceptances held by the Federal reserve banks increase in amount. During the first year—1923 to 1924—as you have already heard in the testimony, the holdings of Government securities increased $492,000,000. That amount was poured into the circulation; into the credit pool. Of course, ordinarily that is an enormous amount of money. You would think it would have a very vital effect. But when you realize that in that year the banks paid off, not the $492,000,000, but $620,000,000 of discounts, you see that washed right out; and they had $100,000,000 to spare. In addition to that, in that first year there were net gold imports of $342,000,000, and the total Federal reserve credit did not increase at all—on the contrary, it decreased, although the Government securities increased about $500,000,000. The Federal reserve credit total decreased, because of the large amount of discounts that were wiped out.

Now, taking the same analysis, in three of the years the total Federal reserve credit increased; but in those three years this table shows that the Government securities and acceptances held by the Federal reserve banks decreased. So I say that the only conclusion I can draw from that table is that the open-market operations, taken over this long period, had no permanent appreciable effect in the way of expansion.

The CHAIRMAN. In that connection, do you figure that the open-market operations are essential to the management of the Federal reserve?

Mr. HAMLIN. I do.

The CHAIRMAN. You think that in the carrying out of the Federal reserve policy the open-market transactions are necessary and helpful?

Mr. HAMLIN. I think that the open-market operations are the very heart of the Federal reserve policy, as was well said by Doctor Miller on May 9 in his testimony before the committee. I am frank to admit that they have not worked out exactly as we hoped and expected they would, because of the fact that where we have, for example, Government securities and sell them, we take that money out of the market; the banks come right in and rediscount, and it offsets, and vice versa. I think if we were to abolish the open-market operations it would leave our system practically an emergency system. If that were done, we would have to sit back until the banks came to us. With the open-market operations we can go to the banks. We can throw our securities in the market and take out the money, and then they have to come in and rediscount; and that gives us a better hold on the situation than any discount rate could.

The CHAIRMAN. Doctor Miller referred the other day to the limitation on these powers of the board in open-market operations. Should the board be specifically limited as to open-market operations so as to require the affirmative vote of five members of the board?

Mr. HAMLIN. I believe not. With discount rates we have the right to approve or disapprove them by a majority vote of the board, and

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I see no reason for any other rule in regard to the open-market powers. I may say that the question has also arisen whether the power of the board should be extended in controlling open-market operations of the banks. I see no reason for that at all. I think we have power enough at the present time. Every open-market operation at the present time is conducted either under the general discretion of the open-market committee, which we have granted to it, or under the specific authority which we have granted. There is, sure, to be a question of law as to how far our power extends over some of these open-market operations. That is to say, we are given the power to regulate the purchase and sale of Government securities, whereas in other open-market matters—acceptances, for example—we are given the power to limit and restrict as well as regulate. But as a matter of fact I think it has worked well in operation, and I think that the open-market principle has been always accepted by the board and approved by the board, until perhaps very recently. Of course, there are many times when we may differ among ourselves as to a specific transaction; for example, the offsetting of gold exports or the replacing of securities that are about to mature. Naturally we might differ on that. But the general principle, I think, has been favored by the board. I believe it is a wise one, and I think that we have power enough now.

The CHAIRMAN. In that connection I think you are speaking now of the open market as one of the powers of the Federal Reserve Board.

Mr. HAMLIN. Yes, sir.

The CHAIRMAN. I was thinking, in connection with the power that is vested in the board as regards discount rates, whether that power rests in the board or whether it rests with the banks. I rather infer, if you consider these two powers together and of equal value, that your position might indicate that it was well to leave the fixing or approval of the change in the rate of discount to the banks rather than to the Federal Reserve Board.

Mr. HAMLIN. No.

The CHAIRMAN. You would not go that far?

Mr. HAMLIN. No. Under the law to-day, of course, the Federal reserve bank, establishes the rate. That is, they weigh all the conditions, they determine what the rate should be, and they establish, as we call it, the rate. That rate, of course, does not take effect until it has been approved by the Federal Reserve Board, and it may be disapproved. I thought possibly you had reference to the power of the board on its own initiation to put in a rate. I was not sure what your question led up to.

The CHAIRMAN. I was thinking at the moment of the happenings last year when the question arose over the fixing of the rate in Chicago.

Mr. HAMLIN. Yes; that is what I assumed.

The CHAIRMAN. As to whether the board had the right or whether the bank had the right. Of course, I know that there is involved in that the interpretation of the law, and there has been much controversy back and forth as to whether or not the power was solely in the banks or subject to review by the board.

Mr. HAMLIN. No such express power is granted in the act to the board; but the Attorney General in 1919 stated that the board had

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the power on its own initiative to put in a rate over the heads of the directors of the bank, and that is what was done in the Chicago case.

The CHAIRMAN. The board, then, is relying on the opinion of the Attorney General as regards the law in that respect?

Mr. HAMLIN. Absolutely. But, of course, in that particular case there was great difference of opinion. For example, some of the members admitted that the board had the power, because the Attorney General had told us we had the power; but, having the power, they believed it was a power that should not be exercised at that time. That was one of the questions before us. Of course, the board, having been advised by the Attorney General that it had the power, is bound so to regard the law. Under the statute they are bound by an opinion of the Attorney General. So we were bound to take up that case on the assumption that we had the power. The only question was whether we should exercise it.

Mr. STEAGALL. Mr. Hamlin, if I understand you correctly, the board is now operating with the accepted view that they have the power, not alone to review or to regulate but to initiate the rates in the different districts?

Mr. HAMLIN. Yes, sir; we are bound to take that view, the Attorney General having so advised us.

Mr. STEAGALL. The different banks, under the law, accommodate one another whenever it is desirable and practicable to do so, do they not?

Mr. HAMLIN. You mean inter-Federal reserve bank rediscounts, as they call them?

Mr. STEAGALL. Yes; in the matter of loans.

Mr. HAMLIN. Yes; the board has the power to do that.

Mr. STEAGALL. In other words, one bank borrows from another bank?

Mr. HAMLIN. One Federal reserve bank borrows from another; yes. The board has the power to direct them to do it, also.

Mr. STEAGALL. Yes. They not merely review that action or regulate it, but they have the power to direct that that be done?

Mr. HAMLIN. By an affirmative vote of five members.

Mr. STEAGALL. Well, I do not see why they should not have it. I did not have in mind that provision of the law for the moment. Here is the question I wanted to ask: In view of all those things, why should not the Federal reserve rate be the same in all the banks at all times?

Mr. HAMLIN. That raises a very broad question. It was so designated in the Aldrich Act, as you know. It was provided there that there should be a uniform rate. I think the framers of that act abandoned that idea. They felt that it would not operate.

Mr. STEAGALL. The Aldrich plan differed, though, from the present law, if I understand it, in that the present law has the 12 districts, whereas the other contemplated a central bank.

Mr. HAMLIN. One central bank, with branches. Here we have 12 practically independent banks subject to the general control of the Federal Reserve Board.

Mr. STEAGALL. Each operating in a particular section of the country.

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Mr. HAMLIN. I do not believe, for example, that the Federal Reserve Board would have any authority to decree that there should be one uniform discount rate between the reserve banks under the Federal reserve act. As a matter of fact, the rates for a long time have been uniform in practice, but that is accidental. That is not under any uniform direction.

Mr. STEAGALL. You mean, I suppose, that it was not intended by the law that they should by specific rule require a uniform rate. But operating under the accepted view that they have the power to initiate and direct and regulate the rate in each district, they would have the power, as a practical proposition, to fix the same rate in each district?

Mr. HAMLIN. Yes. That is to say, they could take the local conditions in each district and fix a rate, and that might happen to be the same rate in every other district. That is true.

Mr. STEAGALL. They could do it for whatever reason they saw fit. There is nothing in the law that requires them to act for any particular reason or to give any particular reason. They are given plenary power, or at least they are operating under the accepted view that they have their power, as indicated by the opinion of the Attorney General. So, while it might not be one order, they could, as a practical proposition, make the same rate in each district?

Mr. HAMLIN. Yes; they could initiate the rate in each district as a separate matter, and the result might be a uniform rate.

Mr. STEAGALL. Now, this has often occurred to me. I am not prepared to say what is the best thing to do about it, and I have wondered what would be the views of the Federal Reserve Board and others for whose judgment I have great respect as to the suggestion of a uniform rate. You know we have that in the land banks, and it has many desirable features in it. The biggest thing that the poorer sections of the country have gotten out of the farm-loan system is the fact that they have gone into business with farmers in the more-favored sections, where capital is more plentiful and interest rates lower; and I have often wondered if the Federal reserve system might not, like the farm-loan system, have a uniform interest rate throughout the country. In view of the fact that it is one system, that each bank could borrow from any other bank, and that the board has the power to control the rate in each district, I have often wondered if it would not be desirable, practical, and wise to have the same uniform rate throughout the 12 districts. I would like to have your views about that as a policy.

Mr. HAMLIN. I would rather answer that, Yankee-like, by asking you a question. Would you agree that the law as to usury should be the same in every State of the Union?

Mr. STEAGALL. No; probably it should not. And I am not one of those who believe that everything should be standardized. But the interest rate in each State is the same, and, as you say, in practical operation the rate in the various Federal reserve banks is practically the same already.

Mr. HAMLIN. To a great extent.

Mr. STEAGALL. And in view of the fact that it is one system and under one control, with the rate fixed by one body of men, with each bank permitted to borrow from any other bank, I have often won-

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dered if it might not be practical and wise to establish one rediscount rate for all 12 banks.

Mr. HAMLIN. Personally I do not believe it would be wise.

Mr. STEAGALL. Does it not almost work itself out that way naturally?

Mr. HAMLIN. Yes; at the present time.

Mr. STEAGALL. It has occurred to me that probably it would be a good thing to do it by rule.

Mr. HAMLIN. There has been a tendency actually toward uniformity. When we began, the rates differed, and gradually they got together. Of course the war conditions had something to do with that. They were uniform, as a matter of fact, when we put in the lower Chicago rate, and the other banks went down, and the uniformity continued. But to my mind, in the theory of the law, it would not be wise or proper to put in, if we had the power, one uniform rate, although a uniformity might be reached as the result of the conditions in the various districts of the United States.

Mr. STEAGALL. Well, of course, if conditions should be the same in each district, the presumption arises that the rate would be fixed the same in each district; but inasmuch as they are so nearly the same, and in view of the fact that each bank has access to the resources of every other bank, as a practical proposition, I have wondered if it might not be well for the board to fix a uniform rate for all of them. But I am not attempting to set up my judgment on that or to reach a conclusion about it.

The CHAIRMAN. There is just one other question that you have not answered, and that was, Should the power be limited as to open-market operations, so as to require a unanimous vote of five members?

Mr. HAMLIN. I do not believe that would be advisable. I think, having the power by majority vote to disapprove or approve discount rates, we should have the same power, assuming that such power exists, of approving or disapproving in connection with open-market operations.

The CHAIRMAN. Do you think that the law should be changed so as to give you more power over open-market operations than you have now?

Mr. HAMLIN. No; I do not see any necessity for any change in the law. The Federal Reserve Board is not an operating board. I think we have ample power now. As I said before, there may be some question as to the legality of our complete power over open-market operations, but, in fact, there is no question that we are exercising the power. Every act of the open-market committee is incidentally reported to us. The question of giving them authority in emergencies is passed on by us and determined, and occasionally that question comes up where they come and get specific authority. So, as a matter of fact, I see no necessity at all for any change in the law.

The CHAIRMAN. Do you think there is a leak of Federal reserve credit into the stock market, for instance?

Mr. HAMLIN. I do not think it is possible, looking at the expansion that is taking place, to deny that indirectly what we call Federal reserve credit has leaked into the market, but I do not see any practicable way of stopping that. For instance, commercial paper is discounted by a bank. The man that gave that paper may have

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wanted to pay off a mortgage, and the mortgagee can take that money and put it into Wall Street or any place he wishes.

I do not think it would be practicable for the Federal reserve system to follow the use of those funds; in fact, I think it would be almost impossible.

Now, the system has done a great deal in that direction. We have used what we call direct pressure. Where a bank is a continuous borrower and has a large line of call loans, we talk to that bank and explain the situation to them in a very effective way, so that to-day there are practically no banks which are continuous borrowers that are operating to any great extent in these speculative loans.

Let us consider the extremes of the situation. Supposing a bank should come to the Federal reserve bank and want $1,000,000 and offer choice, eligible, paper, and if they were asked what use they wanted to make of it they might say, "Well, we see an opportunity to make some money by lending this on call."

Of course, such a proposition would not be entertained for a moment.

To take the other extreme, a bank president not a continuous borrower, comes to the Federal reserve bank and he says, "I am temporarily short in my reserves and I want to discount this paper to make good that shortage."

You ask him, "What causes the shortage? Was it the loans to brokers, or speculative loans?"

He will say, "I can not tell you. The shortage was caused by all the transactions my bank has been going through in the last day or the last week, and as the result there is a small deficit in the reserve."

Under those circumstances it would seem impossible to refuse to permit that bank to rediscount.

I think the question really goes far deeper. It is a question of reserves. All the expansion that takes place in this country by member banks resulting in deposits is based on the member bank reserves in the Federal reserve system. They can not expand their loans unless they furnish money to keep their reserves up.

To state an extreme case, I think you can say this, that if you wanted absolutely to stop that you could only do it by giving, for example, the Federal Reserve Board or the Federal reserve banks power to go to any bank and, if they found that the proportion of its loans for speculative purposes has reached such a percentage of its total deposits, that it is threatening business conditions, they should have the right to increase the reserve requirement of that individual bank.

I do not now advocate that but I say that that would be a real remedy, because the increased reserves would soon control the situation, and I am speaking now not of this present situation, but of normal times, in avoiding expansion rather than doing away with expansion already existing. To do it, however, the Federal reserve system would practically have to put a receiver in many large banks in the United States to see how they were carrying on their business.

If you gave that power to the board it would be intensely difficult to execute it.

I merely state these illustrations as the two extremes. We have taken the middle course. Where a bank has been a continuous bor-

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rower, we have told them the situation and I think we have cleaned it up very effectively, and I believe that in ordinary times the existing laws are adequate.

I think, however, that there should be a change in the laws as to reserves, and on that subject the governor, I think, may have something to say to this committee later.

The CHAIRMAN. One other question, now, before you leave. Some statements have been made here about these various conferences that have been held by the heads of some of the Federal reserve banks here with the central banks of issue abroad, more in the form of conversations or informal conference, and it was stated here that the board has no record of these meetings and they were not authorized.

Have you anything to say on that subject?

Mr. HAMLIN. Well, I presume you have in mind, for example, the conference or the coming over here last year of the European representatives——

The CHAIRMAN. Yes; it was stated here before this committee by Doctor Miller that as a result of the conference in New York participated in by the governors of the Bank of England and the Bank of France and the Reichbank, an informal conference took place here in Washington, after which the discount rate was lowered, and it was stated that there were no minutes or no authority except that the raise in discount rate was the result of those conferences.

Mr. HAMLIN. I think I can speak accurately from memory. Those gentlemen came over here to confer with the Federal Reserve Bank of New York. My recollection is that the board was duly advised that they were coming over. They did come over, and shortly after arriving they all came down to Washington and the governor of the board gave them a lunch and we were with them perhaps an hour or two and then they proceeded back to New York.

Their visit to Washington was purely, as I understand it, a visit of courtesy. I talked with most of them. We had nothing to say about discount rates, merely general conversation, conditions in Europe, and conditions in the United States, and I assume that that was their sole purpose—to pay their respects to the President and the Secretary of the Treasury and the board.

Then, if my memory is correct, they had a conference, a general talk, with the directors of the Federal reserve bank in New York, and my impression is that the members of the open-market committee were also there—I am not sure about that, but that is my distinct impression. Governor Crissinger went on and attended that conference. Later the governor reported to the board just what the conference was. As I remember, it was purely a discussion of the international question, leading up to no agreement as to rates and no agreement whatsoever, as I remember it.

Then, later—I think in July, 1927—the open-market committee, with Governor Strong, came before the board and they gave us a formal report of conditions in this country and conditions abroad and they made certain recommendations. I think one recommendation was that the discount rate at New York could be and should be reduced, and they discussed the international situation and, as well, the local situation.

Their recommendation, as I remember it, was more largely based on international considerations and the necessity of stabilizing the

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purchasing power of Europe as a means of helping the exports of our great agricultural products, but there was some discussion of local conditions also.

Then the board went over the matter in great detail and finally reached a conclusion—they made no decision as to rates—that it would be advisable to lower the discount rate at New York and at the other Federal reserve banks, and I think that in reaching that conclusion some of the board rested primarily on the international situation, that if our rate was not lowered the European rates must be increased and that would cause trouble in business; it would lower the purchasing power and would have a direct effect on the export trade; and, as you know, the rates were finally reduced.

It is interesting to know that, following that rate reduction, the great agricultural exports at once began to rise in price. I do not mean to say that it was because of that; I merely cite that as a fact. It did happen; it caused a great boom or it was followed by a great boom to agricultural exports.

Now, in reaching the conclusion that the board did—and it was no decision; it fixed no rates, but merely expressed a feeling—the members differed considerably in the reasons they gave, and that is one of the questions I spoke of yesterday, on the difficulty of publicity. Some of the members seemed to think—and I do not want to quote them; I merely state a general impression—that the rate should be lowered primarily on the international situation and the fact that it would greatly benefit our agricultural exports. Other members admitted that and perhaps relied somewhat on that, but referred to base their feeling on the effect of the rate on local conditions.

I know that in my own case I stated that I agreed fully with what the open-market committee said about the international situation and the advantage to our great agricultural export trade in giving the lower rate, but I said that I also based my feeling not primarily but certainly to as great an extent as on the international situation, on the local situation in this country, and I went into that in some detail.

I said that I saw a faint parallel between the years prior to 1893 and to-day. In those early years, you know, there was a tremendous improvement in productive processes by inventions and development of railroads and steamships, and there was a steady fall of prices. Many claimed that that was due to the appreciation of gold; others that it was the improvements in production and distribution, lower railroad rates, and marvelous inventions which reduced costs.

I said that I saw the same thing happening to-day. That, of course, was a year ago, when these prices were steadily going down, as a result, I believed, of the marvelous improvements in manufacturing, elimination of waste, and other things. While prices were going down, yet wages of labor were either stable or going up.

Now, I said that in 1893 then came a crisis, but that I expected nothing of that kind to-day, because conditions are different, but I pointed out that at that time prices were low, that they were down to the very lowest point, and I said that there was some industrial recession of business; that while I believed that that recession would disappear, no one could tell but that it might not become more acute; and I put to myself the question whether the 4 per cent rate

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might not possibly be somewhat restricting business at that time in recession but struggling to come up. So I said to myself, as a purely local matter, that if there is to be any further recession I hope that our rate would be the very lowest rate consistent with prudence and safety, and I wanted to try that 3½ per cent rate.

So, you see, there were many differences of opinion, but in answer to the other part of your question I will say that there is a minute of the board covering that whole meeting, which was read carefully after it had been prepared and formally approved by the board and it is in the board's records to-day.

The CHAIRMAN. We thank you very much.

Mr. GOLDSBOROUGH. May I ask you one question? Professor Cassel was here the other day and he emphasized several times his opinion that the central banks could absolutely control the price level; that nothing else was necessary than the powers which the central banks now have, referring in this country to the Federal reserve banks. Do you agree with him?

Mr. HAMLIN. I did not hear the professor. I am very sorry; I should hesitate very much to place my opinion against that of such a learned economist, but I am not an economist; I am a poor layman and I am not impressed with that statement. I say that will all modesty.

Mr. GOLDSBOROUGH. You said a few moments ago, as I understood you, that the machinery you now had was sufficient to control conditions under ordinary times.

Mr. HAMLIN. I was referring to the general reserve provisions of the law.

Mr. GOLDSBOROUGH. Now, do not the necessities for some machinery especially arise under extraordinary conditions in the way of something to stop the period of speculation?

Mr. HAMLIN. Yes; if the extraordinary conditions are not merely caused by some other force or other power. I think it is ordinarily said that this speculation has been caused by easy money. In a psychological sense that undoubtedly is true, but I think there is another factor. The wonderful increase in savings has helped bring about that condition, a condition where business has not required much credit and where the savings of the community seemed to be pouring into Wall Street. This is not so much a banking condition; it is a state of mind and it has got to run its course and it will.

There is always a danger, of course, in giving extreme power in these extreme cases, but, as I have pointed out, the real power would have to be given in the way of a power to increase reserves, and that would undoubtedly stop future increases in speculation. I do not mean for the means of deflating loans at all; that is a danger in itself, but it would stop future unwise expansion if you gave that power.

As I say, I do not ask for that power; I doubt if Congress would ever give it, and it would be a power almost impossible to be exercised by any board of eight human beings.

Mr. GOLDSBOROUGH. One other question: Doctor Miller, when here the other day, testified that in his judgment the board should not have members ex officio; that the great prestige of the Secretary of the Treasury in any case where the members were somewhat on a

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mental equipose was such that it resulted—and I do not want to misquote him, because he was careful in what he said, but we have the record of it—in the last analysis in the Secretary of the Treasury controlling too largely the action of the board.

What do you think about that?

Mr. HAMLIN. My opinion would not be the same. I feel that the presence of the Secretary of the Treasury, to me at least, is very helpful. He represents the Government, which is a great depositor of the system. Furthermore, the Federal reserve banks in exercising fiscal agency function all under the absolute jurisdiction of the Secretary of the Treasury. It seems to me to be essential that an officer having such important relations with the board should be on the Federal Reserve Board.

I have found the very greatest help in having the Secretary a member. In fact, I have always favored a change in the law so that the Secretary, who can not be at every meeting, as you understand, would be able to designate an Undersecretary or one of the Assistant Secretaries to sit with the board, and I would not object to giving them the right to vote on the board. I think it rounds out the whole financial system, with representation of the Treasury on the board.

Mr. STEAGALL. That was one of the main reasons assigned for the view that it might not be wise to have the Secretary of the Treasury as an ex officio member of the board, because in the nature of things it would be found that he could not devote to the Federal reserve problems the same time and study that members of the board could whole sole duty was involved in the administration of that law.

Mr. HAMLIN. I should say, speaking of the present Secretary, that I know of no Secretary who has been able to devote so much time to the board as has Secretary Mellon. Of course, we do not expect him to attend every meeting. Many meetings cover matters of detail, but on any important question he comes in and goes over everything in the greatest detail.

As I say, I would go further and permit him to send a representative to sit with the board. That is my personal view. I have not thought that over. On every other question I tried to prepare myself.

The CHAIRMAN. Thank you very much.

Mr. STEAGALL. Let me ask just another question: I have often wondered if it might not be desirable to increase the membership of the Federal Reserve Board and provide for a member from each Federal reserve district. You know the Bible says that in a multiplicity of counsel there is wisdom. You would certainly get a better expression of the viewpoint of the interests in each district, and I have wondered if it would not be possible to do that?

Mr. HAMLIN. Do you put that question to me?

Mr. STEAGALL. Yes; I am asking for an expression of your views.

Mr. HAMLIN. I think that would tend to turn the board into a legislative body. A member necessarily would be influenced by conditions in his own district. On the board to-day, no one represents any district; every man represents the whole country.

I believe that that would be injurious to the system. It would turn the board more or less into a legislative body, and I think it would be inimical to the best interests of the system.

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Mr. STEAGALL. The thought has occurred to me, not that there should be any particuuar interest or any sectional view represented on the board, but that by having an enlargement of the board and a member from each district you would have a larger sum total of information covering the whole country to present and to consider.

Mr. HAMLIN. Well, I think it would be for the best interests of that board to have a small number of men to try to see the whole country from the whole country's point of view, and that the work that we do would be done better and more expeditiously, with the present board rather than with a board such as you suggest.

That is merely my opinion in answer to your question.

Mr. STEVENSON. I move that we discontinue this hearing. We have a quorum here now, and I suggest that we want to dispose of one piece of legislation which, if it is to be passed, is of great importance.

(Whereupon the committee proceeded to the consideration of other business.)

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Monday, May 28, 1928.

The committee met at 10.30 o'clock a. m., Hon. James G. Strong presiding.

Mr. STRONG. This is a resumption of the hearings on H. R. 11806, and we have present this morning Mr. W. C. Hushing, legislative representative of the American Federation of Labor, whom we would like to hear on this bill.

STATEMENT OF W. C. HUSHING, LEGISLATIVE REPRESENTATIVE OF THE AMERICAN FEDERATION OF LABOR, WASHINGTON, D. C.

Mr. HUSHING. Mr. Chairman, the American Federation of Labor would favor very much a bill which would stabilize the purchasing power of the dollar. We note in this bill under consideration the proposition for investigation, which appeals to us very much. Now, whether this bill will accomplish the purpose in mind or not we do not know; but it seems to us that it is a start along the right lines, and we would very much favor some practical way, as I said before, of stabilizing the purchasing power of money.

Mr. STRONG. Mr. Hushing, none of us know whether we can ever have an absolutely stable purchasing power of money; and, in fact, it probably never will be done in this world. But the purpose of the bill is to direct that all the powers that the Federal Reserve Board now has or which may hereafter be given to it shall be used with that end in view. If the purchasing power of money rises, they are to use their powers to check it and turn it back toward a stable policy; if it goes below the present stable purchasing power of money, they are to use their powers to raise it. So, while it may fluctuate above and below an exact stable line, they will try to keep it in small fluctuations, working toward a policy of stabilization of the purchasing power of money, so that there may be no violent inflations or violent deflations.

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That is the main purpose of the bill. The study is going to help them get additional information to do that.

Section (h) of the bill reads as follows:

The Federal reserve system shall use all the powers and authority now or hereafter possessed by it to maintain a stable gold standard; to promote the stability of commerce, industry, agriculture, and employment; and a more stable purchasing power of the dollar, so far as such purposes may be accomplished by monetary and credit policy.

Now, you understand that we might have a war or some great calamity, and they could not do it; but the purpose of the bill is that they shall use all the powers they may have or which may hereafter be given to them to that end. In case they should decide, after investigation, that they needed additional authority, they would come to Congress and Congress might give it to them; but they are to use all the powers they now have or which may be given to them in the future toward the policy of a stable purchasing power of the American dollar. That is the purpose of the bill.

Mr. HUSHING. Well, sir, I am not an economist, but that would seem to me the practical way to go about the matter.

Mr. STRONG. That would have the indorsement of your organization?

Mr. HUSHING. I should think so; yes, sir.

Mr. STRONG. That is all. Thank you very much, Mr. Hushing.

(Thereupon the committee adjourned subject to the call of the chairman.)

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Tuesday, May 29, 1928.

The committee met at 11.15 o'clock a. m., Hon. James G. Strong, presiding.

STATEMENT OF ROY A. YOUNG, GOVERNOR FEDERAL RESERVE BOARD

Mr. STRONG. This is a continuation of the hearing on the bill H. R. 11806. Mr. Young, the governor of the Federal Reserve Board, is present this morning, and we will be glad to hear anything that he has to say. I would like also to ask him some questions when he has concluded his statement.

Mr. YOUNG. Mr. Chairman, I want to make a little statement to you in reference to my own experience about these matters. For the greater part of my life I have been a country banker, and when I was at Minneapolis I dealt almost entirely with country problems. The subject of economics is one about which I have very limited knowledge.

The original Strong stabilization bill first came to my attention in 1926. It came to my attention at that time from a letter I received from you, and I replied to it. I would like to introduce that letter into the record here. I do not know that it is necessary to read it, because you are familiar with it, and there are no other members of the committee here.

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Mr. STRONG. I have not seen it for a long time, and if you have a copy of it, I would like to read it again.

Mr. YOUNG. Since I have been in Washington I have had but little opportunity to reflect upon the contents of that letter. At times I have been inclined to think that in that letter I minimized a little too much the powers of the Federal Reserve Board, or, rather, the Federal reserve system, but recently I have been rather inclined to think that that letter was a pretty accurate statement, as I see the situation.

(The letter referred to is as follows:)

JUNE 11, 1928.

Congressman JAMES G. STRONG,
House of Representatives, Washington, D. C.

DEAR CONGRESSMAN STRONG: Before replying to your letter of May 21, I have taken some time to study your suggested amendments. I have approached your suggestions with an open mind, but frankly, Mr. Congressman, I do not feel that your amendments would be of any benefit, and might be an opportunity for harm. My conclusions necessitate explanation.

Bankers deal primarily in credit. Credit is that commodity that plays such an important part in our everyday life, and its use is not confined to banks entirely. Everyone uses it to a certain extent. Some one has estimated that the borrowers in the United States owe the lenders well in excess of $200,000,000,000. Banks handle but a fraction of this immense volume of credit—approximately $49,000,000,000—member banks but $31,000,000,000 of the $49,000,000,000. Of the $31,000,000,000, but $2,200,000,000 is on deposit with the Federal reserve banks as legal reserve.

Inasmuch as banks function in this credit structure as borrowers from their depositors and lenders to their borrowers, it is interesting to observe how the $49,000,000,000 of deposit liability has come about. Bank deposits are created through two sources—(1) the deposit of gold, (2) the granting of loans which directly or indirectly are redeposited. The total gold holdings of the United States aggregate approximately $4,500,000,000. Therefore, a large percentage of the deposit liability of the banks has been created because of the granting of loans. In other words, the banks, on the inverted pyramid principle, can extend a large volume of credit without using the reserves of the Federal reserve system. That credit can be extended discriminately or indiscriminately, because there are no legal restrictions, either under the notional law or State laws, as to how a bank may lend its money, except the amount it may lend on real-estate security or the amount it may lend to any one person, firm, or corporation. This general statement applies to practically all banks with the exception of a few mutual savings banks and trust companies.

The Federal reserve system has three methods of exerting influence upon credit: (1) Open-market operations, (2) rediscount rate, (3) lending policies.

The system, by selling or buying in the open market, can adjust unusual credit conditions that are brought about because of international, national, or seasonal conditions, but when you stop to consider the relation between $200,000,000,000, the amount of credit used, and $500,000,000, the probable extent of the system's open-market operations, you can understand why the effect upon credit can be only a temporary stabilizing one. Sometimes these large figures confuse us, and by resorting to cancellation we grasp their significance more readily. In the above figures, if we eliminate eight of the ciphers, we have lenders with $2,000 to lend to borrowers, and the system with $5 attempting to control how the $2,000 be lent. It is obvious that it can not be done. Psychologically the system's open-market operations may have a more far-reaching effect, but from a purely mathematical standpoint the effect is limited.

It is likewise obvious that when member banks are not borrowing from the system a rediscount rate or lending policies can have but little effect upon credit other than psychologically. I have had sufficient experience during the last 11 years to know that you can not always depend upon the psychology of the American people. One of the outstanding examples occurred between the years 1914 and 1919. During that period, and without any great assistance from the Federal reserve banks, the banks doubled their deposits, and at the same time doubled their loans. The increase in loans contributed largely to the increase in

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deposits. War conditions existed, labor was scarce, prices were high, and speculation developed. Such conditions could not very well have been avoided. Dealing with credit which is based upon inflated values is hazardous, and naturally mistakes were made, even by our most conservative people. As deposits are created largely through loans, in inverse manner loans must be reduced largely by reduction of deposits. At times banks can not reduce loans rapidly enough to offset reduction in deposits, and reserves run short or become exhausted. They must then seek assistance, either directly or indirectly, through the reserve system. In 1919 banking found itself in this position and had to come to the system for relief. At that time the system was in a position to exert a far-reaching effect upon credit. That influence could have had a good effect or a disastrous effect.

When the banks came for assistance with sound, liquid, eligible paper based upon productive enterprise the system, knowing that many of the other loans in their portfolios were of an entirely different character, had one of two courses to pursue; one was to deny credit to all those who had used credit indiscriminately and extensively, and the other was to forget the harm that had been done, grant credit, and arrive at an understanding with the borrowing banks as to how credit would be used in the future. Fortunately, the system followed the latter course, with the result that its advances to member banks increased very rapidly and to large amounts between 1919 and 1921.

These facts convince me that the system can not control credit at all times, under all conditions. It can not altogether prevent harmful inflation, although it can stop it from going beyond a certain point, and certainly can minimize the disastrous effects of deflation. If my conclusions are correct as to credit, I do not believe that the system could control or stabilize prices. I am therefore opposed to the suggested changes in the Federal reserve act that you recommend. I further believe that if the changes are made the great majority of the American people will be led to believe that the system has the power to control credit, curb inflation, and also to fix prices. I am also of the opinion that it would be extremely dangerous to create this impression in the minds of the American public. I have a specific example in the form of a letter on my desk at the moment. A gentleman has written, complaining about investment banking, and urging the system to curtail it, stating that it has the power to do it, because the reserve act reads: "To establish a more effective supervision of banking in the United States."

The language is there, but the authority is lacking.

In replying to your communication I have expressed myself freely, and it is my sincere wish that you read my letter in the spirit in which it is written.

With very kind personal regards, I am,

Yours respectfully,

R. A. YOUNG, *Governor.*

Mr. YOUNG. Now, it is rather hard for me to discuss intelligently a subject to the study of which men like Doctor Commons and others have given their entire life. In any event, I am only expressing the views that I have at the moment on the present bill. I can not help but feel that the present bill is the result of the ideas of certain economists, strengthened to quite an extent by expressions that have been made by various Federal reserve authorities. It originally started as a price-fixing measure, as I see it. The present bill, to my mind, represents a compromise of the views of various people and it still has some price-fixing earmarks. As I see the bill, it covers three points—one is stabilization, one is publicity, and one is study.

Now, stability is a big question and a big problem. It is one that I am not capable of talking about definitely at this time. As for publicity, I have been trying it in my own way along the line of the suggestions made in your bill, but up to date that experiment has not been particularly successful. However, it is too early in the experiment to condemn that feature of your bill, and I would like to have a little more time on that before I make a definite statement on that phase of the measure. The third part of the bill directs or commands

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the Federal reserve system through the Federal reserve banks to make certain studies, and those studies are very far-reaching. Many of them, no doubt, will be beneficial to the system. Some of those studies we are already making. If all of those suggestions are followed, I can not help but arrive at the conclusion that it will be extremely expensive, but the fact that it is expensive should not deter the system from going on with the studies if they are productive of good results.

Taking the three points of the bill, the first part of the bill commands us to do something in reference to stability, and it is the third part that requires us to study and determine whether we have the power to do these things and whether it would be desirable to do them. That, it seems to me, Mr. Congressman, is a little inconsistent. It seems as if we should do the studying first and take the action afterwards.

I have tried to figure this out in my own mind from the operating standpoint. At the present time we have 12 banks that are autonomous in their operation, and we have one board in Washington that is a supervisory rather than an administrative body. Let us assume that this plan could be successful from the operating standpoint. In that case I am convinced in my own mind that we would have to abandon the regional system of banking and establish a central banking system in this country in order to make it successful. I question very much whether the American public would ever consent to any such set-up as that.

The present situation is an extremely interesting one. There is a slight advance of commodity prices, and it may be that those commodity prices will go higher. If they do go higher and this bill were in effect it would command the Federal reserve system to take certain action at that time, which, in my opinion, would not be desirable, regardless of commodity prices. When you analyze those commodity prices you find that the increase in the index price comes almost entirely from agricultural products—cotton, wheat, cattle, hides, and some of the other grains—which have also increased in price. Now, if I understand this bill correctly, if those agricultural commodities should continue to increase in price to a certain point under this index, regardless of whether you used the Fisher index, the Department of Labor index, or any other index—and you would have to use one of them—it would command the Federal reserve system to take action to stop that increase. I may be entirely mistaken about this, but it seems to me that the agricultural and livestock interests during the last nine years, in so far as their products are concerned, have not been getting as fair a price as other industries. In other words, it looks to me as if they have about nine years of good prices coming to them, and I would not want to be a party to the taking of any action at this time that would curb any agricultural prices that may be advancing.

Mr. STRONG. Do you think that is the purpose of the bill?

Mr. YOUNG. As I say, if I understand it correctly, Mr. Congressman, that would be the effect.

Now, that is simply a statement made from my own limited experience. I have made it in good faith, and I have the utmost respect

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for the views of the gentlemen who have appeared before you on this bill. I believe fully in their sincerity, but that is my honest opinion.

Mr. STRONG. Is that all you you have to say?

Mr. YOUNG. Yes.

Mr. STRONG. Now, Mr. Young, what was the language in the first bill that led you to believe that it was a price-fixing measure?

Mr. YOUNG. I have not a copy of that bill. It was a price-fixing measure, in so far as commodities are concerned, just as the present bill——

Mr. STRONG (interposing). It was not the idea to fix prices, but the idea was to stabilize the purchasing power of money.

Mr. YOUNG. The original bill?

Mr. STRONG. Yes. There is no difference between trying to establish the stability of the purchasing power of money and establishing stability in what the money will buy of commodities in general. They are synonymous.

The first bill was a direction to the Federal Reserve Board, or system, to use all of its powers to promote stability in the price level of commodities in general. The price level is the measurement of the value of money or of our dollar. Now, realizing that people who did not study the purpose of the bill, and who simply wanted to oppose any legislation, would put out propaganda about it to the effect that it was a price-fixing measure, I, this year, drew this bill (H. R. 11806), in which the Federal Reserve Board is directed to use its powers to stabilize the purchasing power of money or of the dollar, which, to anyone who studies the proposition, is absolutely the same thing. Of course, the purchasing power of money is measured by what it will buy, and we must take as the measurement of what it will buy, the average prices of commodities. Now, that was and is my purpose.

As has been previously stated in this committee, I am not seeking to direct the Federal Reserve Board that when any individual price changes, the board shall act to use its powers to correct the same. That is not the purpose of the bill. That would be a ridiculous proposition. I certainly do not desire that you or any other member of the board would change its policies for any such purpose, but what you should do, if this bill becomes a law, would be to observe the index number of average prices of all commodities, and if they tended to a point where inflation was threatened, then you would act with the powers that you now have under the law. If, on the other hand, the general trend was downward to a point where disaster of deflation threatened the Nation, then you would act to relieve that situation, my purpose being that it would be your aim to use all of your powers for the stabilization of the purchasing power of the dollar as measured by the prices of commodities in general.

In this connection I would like to ask you if you do not believe that it is the first duty of any financial system set up in any country to stabilize the purchasing power of its financial unit.

Mr. YOUNG. No; I hardly think so.

Mr. STRONG. Do you think that the financial system is set up only for the benefit of the bankers of the country—in order to give them credit or to help them in their business?

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Mr. YOUNG. I think if you use your powers as a central bank or banking system to maintain the value of your money, that is about all you could require of a central bank.

Mr. STRONG. But your aim would be to maintain its stability, or the stability of its purchasing value, would it not?

Mr. YOUNG. Our money is always at a certain value in respect to gold.

Mr. STRONG. But you would want to maintain its purchasing power, would you not?

Mr. YOUNG. How could you do that?

Mr. STRONG. You would want to try to do that, would you not?

Mr. YOUNG. If you can not do something, I do not know that you would want to try it.

Mr. STRONG. Do you not think that the first duty of any financial system is to attempt to stabilize the purchasing power of its unit of value?

Mr. YOUNG. It never has been.

Mr. STRONG. Should it not be?

Mr. YOUNG. No, sir; I am not going to say that.

Mr. STRONG. Have you, meaning the Federal reserve system, not been doing that very thing?

Mr. YOUNG. No.

Mr. STRONG. Doctor Miller advised us that last summer, when you wanted to bring about stability in the financial condition of other countries, you reduced the rediscount rate.

Mr. YOUNG. That is not entirely my understanding.

Mr. STRONG. If you do that for other countries, would you not do it for America?

Mr. YOUNG. I do not think that was done for other countries. That was purely an American policy.

Mr. STRONG. You were doing it for America, then?

Mr. YOUNG. Yes.

Mr. STRONG. That is all this bill would have you do. Under this bill you would keep on doing that for America.

Mr. YOUNG. That had nothing to do with prices. It simply made it easier for some people across the water to buy our exported products. It anticipated a situation that might have developed into a danger.

Mr. STRONG. Your purpose was to affect the European condition by leveling the discount rate and the exchange between our money and their money, was it not?

Mr. YOUNG. I think that was purely an American policy. It was a very unusual situation, which has been covered repeatedly in these conferences. The choice was between taking action at that time or making it necessary for foreign countries to raise the discount rate, resulting in a lack of free movement of credit, which would have interfered to a certain extent with our export commerce.

Mr. STRONG. It was for the purpose of stabilizing the conditions in those countries.

Mr. YOUNG. I do not know why you continually use the word stabilize."

Mr. STRONG. You can use any word you please, if you can find another word that meets the situation as well.

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Mr. YOUNG. A part of the program last year was to bring about restoration, if you want to use that word——

Mr. STRONG (interposing). Restoration of what?

Mr. YOUNG. The restoration of sound money conditions in some countries.

Mr. STRONG. Would you say the purpose of policy is objectionable because of the use of the language in the bill, because of the use of the word "stabilization"? What difference does it make? It does not make any difference what word you use. It is evident from your own testimony that you wanted to stabilize financial conditions in Europe for the better protection of our foreign trade. I would like to assure you that I am far from being a price-fixing advocate, meaning special or individual commodities, and that has not entered my mind in connection with this bill. I would like to fix as nearly as possible the purchasing power of the unit of value that our Government has set up and the people employ in their interchanges with each other, in the exchange of their products, their goods, and their labor. To my mind, the policy and purpose of any financial system that is set up under our Constitution would be "to coin money" and to establish and try to maintain as nearly as possible the stability of its purchasing power.

The purpose of the bill was not to force you—meaning, of course, the Federal Reserve Board—if wheat went up or steel went down, or any other individual commodity, varied even greatly in price, to change your policy, but if the whole average of prices general commodities tended upward, and you believed that there was going to be an inflation of commodity prices in general in the country, then you would use your powers to check it. On the other hand, if you found that business was retarded and there was a slump of general commodity prices—that the average of commodity prices in general was tending downward month after month—then you would use your power to restore stable conditions, so as to keep the purchasing power of money, or the unit of value, which is or should be the basis of our financial policy, at as nearly a stable purchasing value as possible. I can not conceive that there would be any reason for a change of policies under any other conditions, but all of the efforts of the Federal reserve system would be used simply in the interest of the maintenance of stability, meaning the purchasing power of our dollar as measured by what it will buy of commodities in general throughout the country.

Mr. YOUNG. Mr. Congressman, I am the one who is being investigated——

Mr. STRONG (interposing). No; I do not want you to get that idea at all.

Mr. YOUNG. As I explained when I first sat down, I know very little about the theory of this, but I think I do know a little about the mechanics of it. Perhaps I may be under an erroneous impression as to what this bill intends to do. If I understand it correctly, it commands the Federal reserve system to shape all of its policies toward a price index. Am I correct or wrong about that?

Mr. STRONG. I will read you this provision of the bill:

> That the Federal reserve system shall use all the powers and authority now or hereafter possessed by it to maintain a stable gold standard; to promote the stability of commerce, industry, agriculture, and employment; and a more stable

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purchasing power of the dollar, so far as such purposes may be accomplished by monetary and credit policy.

That is just a direction that you use all of the powers you now have for the stabilization of the purchasing power of our money, as maintained in comparison with gold.

Mr. YOUNG. All right; what should have been our policy during the last six months? The commodity price index has not moved much in either direction. Should we have sat still and not done anything?

Mr. STRONG. Governor, I have not the intimate knowledge of the Federal reserve system that you have, and it seems out of place for me to suggest what you should have done. I have the greatest confidence in you and the Federal Reserve Board, and I think that during the last three or four years the Federal reserve system has been using its policies and powers, as has often been stated by members of your board, very successfully toward the stabilization of the purchasing power of money. Now, whether you should have done anything under recent circumstances, I do not know. It has been intimated that the rise in the discount rate was because of the inflated condition of the bond market. Frankly, I do not think that gambling and speculation on the bond market should be anything of very great concern to the Federal Reserve Board, unless they think it is coming to be a menace to the country. I believe that they have powers through their publicity and advisory functions to check that. If not, they should come to Congress for further legislation that would enable them to control the situation. I do not think that gambling in stocks and bonds is any cause for alarm as to the purchasing value of the dollar of the country. I do not think that the price of wheat going up or down or any other single commodity going up or down would call for action by the Federal Reserve Board, and I do not think that the index price number of commodities in general has changed very radically. Therefore, I would not have done anything unless by reason of unemployment, or owing to conditions that you would have an opportunity to determine through forecasting or from your charts of production——

Mr. YOUNG (interposing). What I am trying to bring out is this, that, in so far as the price level is concerned, for the last six months, at least, and, perhaps, further back than that, there has been a very slight fluctuation, of not over 10 points, perhaps, in all of those commodities.

That alone would not have prompted the Federal reserve system to take any action at all. I am willing to go along with you that you are not trying to have a price-fixing measure in so far as any particular commodity is concerned. But if I understand your bill correctly, you are attempting to have a price-fixing measure within certain limits—10 points or 20 points, or what not—in so far as all commodities are concerned.

Mr. STRONG. The purpose of my measure is to stabilize the purchasing power of money, measured by what it will buy in general of the things the people of this Nation have to buy. In other words, we have set up a monetary unit called the dollar. As that monetary unit changes in its purchasing power, so that it will purchase a considerable percentage more or less of commodities in general, accord-

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ing to the average of prices, then I think you ought to use the power that has been given you to correct that situation. But if there is a slight change, because one commodity goes up or perhaps several, I do not think you need do very much merely to have a straight line on your chart of wholesale prices.

My purpose in this bill is to avoid violent inflations and violent deflations of the kind which brought a crisis and disaster to the Nation and caused hundreds and hundreds of banks to go out of business in the past, caused so many farmers to lose their farms, caused business houses to fail. That was caused through a policy of deflation, and we all know that the deflation followed as the result of inflation. So if you can maintain fairly stable the purchasing power of money, we will not have any great money crisis in this country.

I am not directing that you shall do it absolutely; but I say that these powers that have been given you should be used with that policy in mind; and I think you have been doing it, as has been stated in the hearings on this bill; for the last three or four years you have been very successful. Some members of your system have said with a great deal of pride that you have been using your power to do just what this bill provides. Under that interpretation this bill only means to assure for the future a continuation of the policy that you have used for the last three or four years except with regard to the stock market.

If I have made myself plain as to the policy of the bill, I would like to have your comment on it.

Mr. YOUNG. I would be glad to comment on it. You refer to the statements made by some of my associates and my colleagues, and I have no criticism of those gentlemen for making those statements, because I really believe I would have made the same statements myself at that time had I been before this committee; and I think I can make this statement and get all of my colleagues and associates to agree with me that many of the people within the Federal reserve system overestimated the powers of the Federal reserve system, and we have had a clear demonstration of that for the last six months.

Mr. STRONG. Has not that been mostly with regard to the stock market?

Mr. YOUNG. Not necessarily.

Mr. STRONG. How much have commodity prices changed in the last six months?

Mr. YOUNG. The funny part of it is that the price of credit has gone up; the volume of credit has increased and commodity prices have gone up.

Mr. STRONG. How much?

Mr. YOUNG. Slightly.

Mr. STRONG. What per cent?

Mr. YOUNG. About 1 per cent.

Mr. STRONG. Is not that a very satisfactory condition?

Mr. YOUNG. If the theory is correct, it should have gone the other way.

Mr. STRONG. Why?

Mr. YOUNG. With the increased cost of money and the tightening of the credit situation, it is assumed that that would bring down

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commodity prices. That is what you have reference to when you refer to 1920.

Mr. STRONG. Of course, you have not pursued that policy very long.

Mr. YOUNG. Since last November—November 10.

Mr. STRONG. Did you change the discount rates last November?

Mr. YOUNG. We did not change any discount rates in November. The rate changes were not made until February, or the latter part of January.

Mr. STRONG. That is what I thought.

Mr. YOUNG. Starting November 10, we failed to offset the earmarkings and exports of gold, which, of course, took a corresponding amount of funds away from the market. Between November 10 and January 1 we took $155,000,000 away from the market. Since January 1 there has been in the neighborhood of $500,000,000 taken away from the market, either by exports of gold, earmarked gold, or securities we have sold to the market. That makes a total of $650,000,000, which is partly offset by return of currency of approximately $200,000,000, leaving a net amount taken away from the market of $450,000,000.

Mr. STRONG. We have an immense surplus of gold here. It has been estimated by very eminent members of your system that we could part with $1,000,000,000 of gold without very greatly affecting the gold reserve or the price level in this country.

Mr. YOUNG. I think that this country could lose a billion dollars' worth of gold. That is my own view.

Mr. STRONG. Could lose a billion dollars of gold?

Mr. YOUNG. Yes; but not from here on. I should say from here on it would be about $600,000,000. What the result of that would be—psychological or otherwise—I can not tell; nobody can tell.

Mr. STRONG. But you do think, Governor, if we had inflation in this country, that if you tightened up money, both as to cost and to volume, that would tend to check it? As a business man and a banker, you think that is true?

Mr. YOUNG. If you go high enough I think it would.

Mr. STRONG. On the other hand, if we had stagnation of business and the index of average commodity prices was going down, and there was furnished an adequate supply of cheap money, that would tend to correct the situation?

I wish, Governor Young, to assure you most positively that I also would not be a party to any action that would curb any agricultural prices from advancing to a point where they would bring a fair return to their producers. I am personally interested in agriculture as well as the Representative of an agricultural district, but the purpose of this bill has nothing whatever to do with attempting to regulate the prices of any single or individual commodities or group of commodities, its sole purpose being to direct that the Federal Reserve Board and system shall use the powers which Congress has given to them "for the stabilization of the purchasing power of money, so far as such purposes may be accomplished by monetary and credit policies," and inasmuch as you seem to have had an erroneous opinion regarding H. R. 7895, may I state that H. R. 11806, while different in form and wording, has for its objective the same purpose, for since the purchasing power of money can only be meas-

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ured by what money will buy, in justice to all people who use money, such measurement must be of all those commodities that people buy, hence an average of general commodity prices must be used, namely, an index number to denote the price level, so that we find that the stabilization of the price level and the purchasing power of money are synonomous. Individual prices like those of agriculture or other industries must rise and fall by reason of supply and demand and marketing facilities, but when the average price of all commodities takes a decided upward or downward trend, it is evidence that the purchasing power of money has lessened or increased; hence, if we are going to avoid the disaster from deflation that has always followed inflation and do away with the business cycle that causes business depression, we must find a way to stabilize the purchasing power of money, which was authorized by the Constitution when it directed Congress "to coin money and regulate the value thereof."

When the Federal reserve system was enacted it gave to the Federal Reserve Board and the Federal reserve banks the right to increase or reduce the volume of money in circulation, which it does by its purchase or sale of Government securities and other methods, and gave also the right of regulating the cost of money by increasing or decreasing the rediscount rate, and made it possible through advice and influence of the Federal Reserve Board and Federal reserve banks to control largely the contraction and expansion of credit, and I am insisting that these powers can be used and ought to be used for the stabilization of the purchasing power of our dollar that our Government has set up as a unit of value to measure all things that its citizens buy and sell; and from the hearings that have been held before this committee on both H. R. 7895 and H. R. 11806 it is evident that the very large majority of the financiers and economists, who, unprejudiced and without personal interest have made a study of our financial system, agree can and should be done.

The provisions added to H. R. 11806 providing for publicity of change in policies and the reasons therefor by the Federal Reserve Board and the direction for a systematic study of all questions that would enable the Federal reserve system to further promote and make as stable as possible the puruchasing power of our dollar are the result of information and study which these hearings have produced.

The publicity clause is, speaking frankly, to try and win and hold the confidence of the people in the Federal reserve system so that they may be assured that the policies it follows in the use of the powers Congress has given it are in the interest of the maintenance of a stable financial system, of which I believe a dollar of stable purchasing power should be the objective. People do not understand the Federal reserve system, and when its policies are changed the motives for changing them are misinterpreted. There are a number of price forecasters trying to sell their information to the public, and the public does not know whether or not there is some one on the inside from which this information is derived, so there is considerable distrust of the Federal reserve system. The recent hearings before the committees of the Senate and discussions in the public press are evidence of this fact.

It seems to me the only publicity that should be given out to the public is that by the Federal Reserve Board, when they think it is

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safe for the public to have it, but I do think the public is going to insist on knowing why a change of policy in the use of the powers held by the Federal reserve system is or has been made, and I am confident such publicity is necessary for the preservation of the Federal reserve system, which, I believe, has given to our Nation the best financial system on earth.

Before coming to Congress I was both interested in and attorney for the management of some power and electric light companies, and I found that the best asset that such corporations had was the confidence of the public which resulted in its good will toward the companies, and I always advised public-service corporations that employed me as their counsel that the best asset they had was not in their physical properties or their earning capacity but the good will of the people they served. That when they had that they could build safely.

Mr. YOUNG. That is true; I agree with you on that.

Mr. STRONG. And I advised that the way to win such good will is to take the public into their confidence. If they wanted to change rates, to tell the people the truth as to why they were to be or had been changed, I therefore think the Federal reserve system ought to be run on that same policy; that the people should know the cause or reason for a change of policy in the use of the powers which they have given to those who manage the Federal reserve system. Otherwise there will always be those who attempt to mislead the people regarding the Federal Reserve Board and the motives that prompt its change of policy in the use of its powers, as if the advice of the price forecasters does not prove to be correct they will blame the Federal Reserve Board.

Mr. YOUNG. I think the fact is we do not attempt to predict. Our monthly bulletin carries a world of information as to our policies and everything else.

Mr. STRONG. I understand that. I do not say you should predict.

Mr. YOUNG. I say I think that is what the complaint is in the country now, that we do not attempt to predict. We can not overcome that.

Mr. STRONG. But I believe the public will have full confidence in the policies of the Federal reserve system if they are correctly advised of what policies are being carried out and the reason therefor. It was with this thought in mind I placed the publicity clause, paragraph (1), in the present bill.

It was at first suggested that there should be immediate publicity of the reason for change of policies by the Federal reserve system, but my attention was called to the fact that publicity might some times interfere with the results sought to be obtained, and suggestion was made to me by officers of Federal reserve system, that such publicity should be made "at such time, place, and in such detail, as may be deemed by the governor of the Federal Reserve Board to be most effective in furthering such purposes and at least once each year in the annual report of the Federal Reserve Board to Congress," which suggestion I adopted and is the language carried in the bill. I do not care just what kind of publicity you have but I do think there should be publicity.

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In regard to the clauses of the bill providing for study and research for the purpose of determining all possible information that would assist in the stabilization of the purchasing power of our dollar and of the best index number to be used as a measure of such purchasing power, I wish to state that during the hearings held on H. R. 7895 it seemed to be generally understood that the Federal Reserve Board did not approve of the index number prepared and used by the Department of Labor, and felt that they should have one of their own, which resulted in my being urged to state in this bill that an index number of commodity prices should be used. Governor Strong had pointed out that there was no perfect index number, which, of course, is true, since there is nothing perfect. Doctor Fisher publishes an index number, as do commercial agencies and the Department of Labor and your board, no two of which are alike, so when I wrote the bill I thought that a study of what index number would produce the best measure for determining the purchasing power of our money, would be advantageous, and that after such study your board would be in a position to decide the best index number to use.

During the present hearings we have been informed that the Federal Reserve Board is now using the index number of the Department of Labor, which is an "all-commodity" index and in accord with my own views, since I do not believe that stocks and bonds and real estate, which are so generally speculative, should be included in an index number, but I believe a further study of the matter would be advantageous.

The main purpose, however, for directing the study and investigation provided for in the bill is to secure all possible information and knowledge that would further promote the stabilization of the purchasing power of money. Nearly everyone who has been before our committee has approved of such investigation, and I do not know what money the Government could spend to better advantage than to learn how best to stabilize the purchasing power of its unit of value, which is my purpose in urging the passage of the proposed legislation. The bill has no other purpose.

Mr. YOUNG. Do you want to hear Mr. Platt now? I have nothing more to say.

Mr. PLATT. Do you want to hear from me?

Mr. STRONG. If you wish.

Mr. PLATT. I do not think I can add anything to what has been said.

Mr. STRONG. If you do not want to add anything, that is all right. We have talked so much without using the stenographer that I do not know whether we have this record to suit you or not.

Mr. YOUNG. Yes, sir.

Mr. STRONG. When you get the record you can make such changes as you wish, and I will do likewise.

At this point I want to introduce into the record a statement by Doctor Commons. He has a statement prepared, but is unable to come before the committee as he intended. So his statement will be introduced at this point.

(The matter referred to is as follows:)

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STATEMENT BY PROF. JOHN R. COMMONS

The testimony of witnesses has resolved the questions relating to this bill into one of administration. All are substantially agreed on what may be termed the underlying economic principles. But the doubtful questions turn on the ability of the administrative authorities to know when to apply these principles, when to act, or to refuse to act, or to postpone action, or to hasten action. This is one of the main objections advanced against the bill and explains the desire of Federal reserve authorities to get back to the pre-war condition of an "automatic" gold standard where each country has possession of what it consideres to be an adequate gold reserve, and where the only exercise of judgment required of central banks is that of protecting that reserve by raising discount rates when gold is leaving, or is about to leave, the country and lowering the rate when gold is coming into the country. This "automatic" gold standard requires the discontinuance of the existing gold exchange standards, that is, of all legislation whereby the legal reserves of central banks may consist, partly or wholly, of bills of exchange stated in terms of pound sterling or of dollars, on balances owed to them by foreign banks in countries, like England and the United States which maintain adequate reserves of gold. By abandoning these gold exchange reserves—hardly thinkable in view of the impending world scarcity of gold—so that each country will acquire and protect its own exclusive gold reserve, it would follow that very little administrative ability would be needed, since attention would be given solely to the rather simple matter of regulating the export and import of gold by raising or lowering the discount rates.

This free gold movement, even before the war, was not, however, truly automatic in countries having central banks, but was partly automatic and mainly controlled, because it required positive action in raising and lowering the rate of discount by central banks in order to prevent too great a loss of gold to foreign countries or too great an acquisition of gold from those countries. Even this amount of control, which now seems automatic, and especially the necessity for timeliness, or quick action in control, was not discovered by the Bank of England which, prior to the great war, practiced it most successfully, until after the crisis of 1847. In the next crisis, of 1857, the Bank of England put into practice the knowledge gained through painful experience, and consciously and quickly stopped the otherwise automatic outflow of gold by raising the discount rates.

The raising and lowering of the discount rate was not the only means of control under the pre-war so-called automatic gold standard. When an outflow of gold was taking place, central banks would frequently sell foreign bills of exchange upon the market in order to affect exchange rates, or would redeem their note and deposit liabilities in light-weight gold coins, and, in some instances, would refuse to pay out gold excepting upon receipt of a premium. To encourage imports of gold central banks then and now granted interest-free advances to the amount imported. The pre-war gold standard required management by central banks.

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The Bank of England did not and could not pay attention to the direct or indirect effect of changes in the discount rate upon the general level of prices of commodities, although it was known, since the bullion report of 1810, that a raise of the rate tended to reduce business activity and thereby reduce the prices of commodities, and a lowering of the rate stimulated business and helped to raise prices. These industrial and price effects were, indeed, the instruments through which the discount rate became effective over the export and import of gold, yet they had to be subordinated to the purpose of protecting the gold reserve.

Since the World War, however, in order not only to protect her gold reserves, but also to acquire enough gold to restore the gold standard, the Bank of England has been compelled both to retire paper currency and, for the past several years, to maintain generally a higher discount rate than the rates in gold standard countries, which, with other circumstances, has resulted in a long-continued depression of business, unemployment, and reduction of prices. This depression was not, however, necessary during the year 1919–20, when the United States was lending to Europe nearly $4,000,000,000 at low rates of interest. Here was the period when the Federal reserve system learned its first lesson respecting the psychological effect of low discount rates in increasing the demand for credit by foreign and American business men, and the resulting rise of prices.

This lesson shows that the administrators of the Federal reserve system learn only by experience and not by theory, just as the Bank of England learned after 1847, and just as every banker, every business man, and, indeed, everybody learns only by experience. Through the greater part of 1919 the discount rate at New York Reserve Bank was kept at what was then a low rate of 4½ per cent, on loans secured by Government collateral, which constituted nearly 90 per cent of the immense borrowings of member banks from the reserve banks. (See Chart No. III, Commons: Federal Reserve Bank Holdings of Bills Discounted, p. 77.) Prices began rapidly to rise in March, 1919, and continued to rise notwithstanding large net exports of gold ($407,216,000 from May, 1919, to March, 1920), which were more than offset by increases in Federal reserve credit. Labor became fully employed and, indeed, exceedingly scarce by July, 1919, but the maximum of production in manufactures was not reached until February, 1920 (Woodlief Thomas, of Federal Reserve Board, Journal of American Statistical Association, September, 1927), after labor had been drawn from agriculture and other sources by the high industrial wages. Any further rise in prices and wages could not call forth more production nor more labor. Hence, with the low rate of discount, it was found that prices and wages, and to a lesser extent, factory production and employment, kept on increasing until May, 1920.

What stopped further inflation in 1920 was the realization that the gold reserve of the system was rapidly approaching the legal minimum of 35 and 40 per cent. This realization forced the system rapidly to raise the rates of discount in 1920, finally reaching, in June, 6 per cent on Government collateral and 7 per cent on commercial paper (Chart No. IV, p. 78, Commons: Bond Yields in Relation to Commercial Rates, Rediscount Rates, and Stock Yields), with the resulting collapse of production, employment and prices, not only

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in America but in all countries which did not continue to inflate their paper currency. The raise in discount rates, in America, was not based on a policy of preventing the rise in prices, but on the pre-war policy of preventing a further deflation of gold reserve, after permitting, as a matter of course, a surplus gold reserve to be used for expansion of bank credit.

Furthermore, the illusion was generally accepted in 1919 and 1920 that the rise of prices was not due to monetary policy but was due to a world scarcity of goods, caused by the war, over which the reserve system had no control. Yet it is now admitted that this world scarcity of goods was largely mythical, especially in the United States, and, in any case, could not have raised prices had it not been for the supporting abundance of credit furnished at low rates by the Federal reserve system. Demand is only effective if backed up by purchasing power, and this was provided by a sky-rocketing increase in money and credit.

The discount policy of the system had not been directed, in 1919, toward preventing a rise in prices, but was directed toward maintaining the price of Government securities which had been issued at low rates of interest. These Government issues were made at 4¼ per cent (Chart No. II, Commons, p. 77, Money Rates at New York), at a time when the bond yield on the best private bonds was 5 to 5¼ per cent, so that, in order to support the par value of Government securities, the discount rate at the reserve banks, when secured by Government collateral, had to be kept at 4¼ per cent. Had the discount policy been directed toward preventing a rise of prices in 1919 beyond the point where production, trade and employment were at their maximum, the rate of discount, as learned by later experience, would have been raised as early, perhaps, as March, 1919, when business was hesitating, instead of waiting until the end of 1919 and the early part of 1920, when business demand for credit was expanding, not for production, but solely in expectation of higher prices. And public warnings would have been given out, not that there was a world scarcity of goods, requiring increased production, over which the reserve system had no control, but that there was a menace of excessive inflation of prices and wages beyond the needs of productive credit, which the reserve system could and would prevent, if necessary, by raising the discount rates.

How high the rate of discount needs to be raised in order to prevent further increases in prices is a matter of which much may be learned through experience. Experience has taught the reserve system that if they wait too long, until a frenzy of commodity speculation is running headlong, it requires an excessive rise of the discount rate, like the 7 per cent rate on commercial paper in June, 1920, to check the further optimism of business and rise of prices. But if they begin early, when business activity is hesitating, then a very slight increase will prevent a further rise of prices. Doctor Miller, of the Federal Reserve Board, estimated, on the basis of experience, that a raise of only three-fourths of 1 per cent—that is, from 4¼ to 5 per cent—if taken as early as the middle of 1919, would have prevented any considerable rise of prices thereafter. If this estimate is accurate, then a very slight increase in the discount rate as early as April, 1919, when member banks were in debt to the reserve banks and business was beginning to recover, but was still hesitating, would have accom-

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plished, for the time being, all that is intended in the bill, H. R. 11806, under the name of stabilization of the purchasing power of the dollar. Even if Doctor Miller's estimate is not correct, the Federal reserve system could, by its usual practice of experiment, have raised the rate of discount early in 1919 more than 5 per cent even to the 7 per cent level of 1920, in which case, however, the result might have been a general recession of business and fall of prices in 1919, instead of the extraordinary rise encouraged by the 4¼ per cent rate of discount.

The experience of 1919–20, therefore, substantiates the power of Federal reserve policy over the general-commodity price level, within the limits of the then existing circumstances and timeliness of action—a power that might have been used for the stabilization of the purchasing power of the dollar if such stabilization had been a primary purpose of the system. But it was not a primary purpose, partly because publicity encouraged the illusion that the rise of prices was a nonmonetary effect of a world scarcity of goods, over which monetary and credit policy could have no effect; partly because the maintenance of par value of Government securities, issued at less than market rates of interest, was deemed the important consideration; partly because the system started with an excess gold reserve in 1919 and did not need to take action to protect it until it had fallen to near its legal minimum early in 1920.

All of these features of monetary and credit policy in 1919–20 may be reduced to the single item of the purpose or goal toward which the system was directing the use of its powers. The purpose was not that of stabilizing the purchasing power of the dollar, but was a different purpose—first, of maintaining the value of Government securities, and, second, of protecting the gold reserve.

But the lesson of experience was only half learned. The enormous fall of prices in 1920–21 was now ascribed to the illusion of world overproduction of goods, just as the rise of prices in 1919–20 has been ascribed to a world scarcity of goods, over neither of which could monetary or credit policy have any control. Yet during 11 months (June, 1920, to May, 1921) of this precipitate fall in production, trade, employment, and prices the system retained its panicky high rate of 7 per cent, whose tendency, experience shows, was to drive down production, business, and prices further than strictly nonmonetary causes of overproduction ordinarily would have done. While rates of discount at central banks in gold-standard countries have, on occasion, been raised to higher levels, yet never have they remained at a level as high as this for so long a time. Not until after protests had been made by Federal reserve banks, initiated by the Bank of Boston, against maintaining the high rate of 7 per cent, did the Federal Reserve Board permit the reduction to less than 7 per cent, and then the successive reductions were rapid.

Here, again, the mistake of waiting too long showed its effects. When prices started to tumble in May, 1920, the needed effect of a high discount rate was already accomplished, and instead of ascribing the fall solely to overproduction, over which monetary and credit policy could have no control, the system should have taken action to reduce the rate gradually after June, 1919, thus beginning probably 10 months earlier than the rates were actually reduced. The gold reserve ratio had begun to increase after April, 1920, from the low

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point of 42.4 per cent, and there was little menace in that direction, so that a timely but gradual reduction of the rate would have changed the pressure of credit policy from that of driving down prices to that of mitigating and slowing up the general fall of prices. While the excessively high rate of 7 per cent in June, 1920, was probably justified as a means of protecting the gold reserve when once it had been reduced to its legal limit by the excessively low rates of discount of 1919, yet the continuance of that high rate during 11 months of rapid depression of business can be explained only by the illusion that monetary policy had no effect on prices or by the determination to penalize producers for their previous overproduction and inflation of prices, although these had been stimulated by the low discount policy of the system itself in 1919.

At any rate, there was no guiding principle of stabilizing the purchasing power of the dollar, either by preventing the general rise of prices by higher rates of discount early in 1919 or of cushioning the fall of prices by low rates soon after the fall had begun in June, 1920. Extreme liquidation was, indeed, temporarily delayed by renewing frozen loans, but this was done at such high rates of interest that it could do little more than postpone the bankruptcies inevitable on account of the excessive fall of prices.

After the depression of 1921 a new problem came to the front, not present in 1919, namely, that of the open market purchases of the Federal Reserve banks. In the latter part of 1921, the Federal reserve banks, when the demand for commercial credit was at its minimum, began separately to use their excessive gold reserves for the purchase of Government securities, and purchased, up to May, 1922, about $410,000,000 of such securities. This turned out to be equivalent to the importation of that much gold, and, to gether with the large imports of gold itself accumulated during the latter part of 1920 to the end of 1922 ($1,083,000,000) and recovery of business owing to scarcity of goods, helped to reduce the rates of discount to 4 per cent in New York (Chart No. II, Commons, p. 77, Money Rates at New York) and to encourage borrowings by the business public. The combined effect began to show itself on general prices in January, 1922, which rose 12 per cent within six months.

This new problem of open-market purchases by the 12 reserve banks competing with each other was taken in hand in May, 1922, by joint action of the governors of the reserve banks, who then, for the first time, instituted a centralized control of open-market operations. They sold securities to the amount of $511,000,000 from May, 1922, to October, 1923, proceeding at a particularly rapid rate from March to October, 1923. This compelled member banks to rediscount in large amounts, to raise commercial rates and, together with increases in the rates of rediscount following these increases in commercial rates, to aid in restraining the rise of prices. The volume of production, trade and employment, however, continued toward their peak until March and April, 1923, followed by a decline in prices, production, trade, and employment, which reached bottom in June and July, 1924.

There arose, in 1922 and 1923, within the system itself, two conflicting theories, not as to the economic effects of the open-market operations and rediscount rates, but as to their timeliness and amount.

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One side was alarmed at the rapid rise of prices in 1922, more rapid at first than even in 1919, and therefore having the symptoms of inflation similar to those of 1919 and 1920. This side demanded extreme, drastic, and immediate measures, and was able to carry through the extensive sales of securities just mentioned, but not to carry out drastic increases in discount rates. The other side, which prevailed in part, and which wrote its conclusions regarding open-market operations and discount rates in the monthly bulletin of May, 1923, and in the annual report for 1923, maintained a policy of waiting, because, on the basis of statistical investigations newly made by the new division of analysis and research, the conditions of easy credit had not as yet produced speculation or excessive inventories, nor exceeded the needs of increasing production, trade, and employment.

The two conflicting theories worked out happily in combination, for the year 1923 turned out to be a year of full employment without any further increases in the price index after April. Open-market sales as a counteractive to the gold imports and increasing rise of prices, brought about a gradually more stringent credit supply, and then the slight but delayed increases in rates of rediscount diminished the demand for credit. Along with these the public warnings against excessive business commitments for the future, addressed to a public which had learned caution, augmented the restraining influence of open-market sales and raise of rediscount rates. These combined operations in time, degree, and amount, adjusted to the nonmonetary circumstances of the time, checked the increase in prices. A certain rise of prices was necessary to correct the extreme depression in production, trade, and employment in 1921. But when these had reached their full expansion in 1923, any further depreciation of purchasing power, or rise of prices, would have been inflation.

On the other hand, since there had not been an extreme inflation of prices, as in 1919–20, beyond the point needed to bring full production and employment, then the succeeding deflation of prices in 1920 and 1921 would not have had even such semblance of justification as it had. It would have been absurd, under the name of stabilization, to have prevented a considerable rise of prices when production and employment were at their minimum in 1921, or to have prevented a fall in prices when speculation had overreached full production and employment and threatened the gold reserve in 1920. For stabilization of prices does not mean stabilization of unemployment nor stabilization of overinflation, but such average stabilization over a period of years, taking into account minor ups and downs above or below the average, as may happen during moderate increases and recessions of business and employment.

The events of 1922 and 1923 were afterwards represented by witnesses from the Federal reserve system, both in the hearings on H. R. 7895 and H. R. 11806, to be due solely, or for the most part, to nonmonetary causes and not to any power of the system over the movement of prices. This may be designated the official view of the system, designed to belittle the public impression of the power of the system over general price changes. But suppose the system had made mistakes in 1922 and 1923 in its credit policy, as it did in 1919 and 1920. Suppose that, instead of selling United States securities

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to the amount of $511,000,000 from May, 1922, to October, 1923, it had purchased securities to the amount of, say, $500,000,000; and instead of raising its rates of discount in February, 1923, it had lowered its rates earlier below the preceding level of 4 per cent. And, instead of the publicity advising caution, suppose there had been a continuance of the publicity advising greater production and expansion. It is wholly unlikely that the rising price movement would have been checked in the early part of 1923, as it actually was checked. The inflation would probably have continued, much as it was expected to continue by those who were alarmed at the rapid rise of prices in 1922. Faced by the choice of these alternative policies and probably different results on prices, it becomes evident that it required considerable dogmatism and evasion to contend that Federal reserve credit policy had little or no effect on the happy outcome of 1923. A better explanation, and more creditable to the system, would be the one that it had learned by the experience of 1919–20 and later, not to use its powers of open-market operations, rediscount rates, and publicity to stimulate an already rapid expansion of business and rise of prices beyond the needs of full production and full employment, but had learned somewhat how to begin early enough, and in the right degree and amount, to use its powers to check that over-expansion and rise of prices beyond the limits of production and safety.

These considerations apply to the fall in the index number of wholesale prices from 159 in March, 1923, to 145 in June, 1924, a 9 per cent decline, accompanied by the above-mentioned decline in production, employment, and trade. This fall proceeded in part from nonmonetary considerations, especially the fall in agricultural prices. But it does not follow that the extreme fall was due solely to nonmonetary causes. The rate of discount was maintained at 4½ per cent throughout 1923 into 1924 from May to October, at the different reserve banks. This was a relatively high rate at this time, when the increased savings of the country had brought a rise in bond prices so that the bond yield had fallen to slightly under 5 per cent (Chart IV, Commons, p. —, Bond Yields, etc.) In 1919, the discount rate of 4¼ per cent had been a low rate compared with the bond yield of 5.01 to 5.35 per cent, but in 1923 the discount rate of 4½ was a much higher rate compared with the lower bond yield which ranged from 4.77 to 4.94 per cent. (Chart IV.) Whether a discount rate is low or high is not to be measured absolutely in itself but relatively to other rates of interest, especially to the bond yield which represents mainly the rate on savings. Accumulated savings were scarce in 1919, so that bond yields were high, but became more abundant in 1923, with a marked fall in bond yields.

Hence the relatively high discount rate of 4½ per cent in 1923, compared with the lowered bond yield, at a time when member banks, owing to sales of securities, were in debt to the reserve banks, added its force to nonmonetary causes; and the combination of circumstances reduced prices to the low index of 145 in May, 1924. Here again the lack of timely action in reducing rates and purchasing securities instead of selling them immediately after prices began to fall in April, 1923, showed itself in that, after the decline in business

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and prices had proceeded in 1924 a panicky purchase of securities was carried on from February to July, 1924, the total increase in holdings of securities amounting to $492,000,000 in 12 months from November, 1923, to October, 1924. This was augmented by a panicky and rapid reduction in discount rates from 4½ to 3 per cent (New York), the lowest rate in the history of the system since the war. Governor Strong, in his testimony on H. R. 7895 of the first session of the Sixty-ninth Congress (p. 334), ascribed the motives which induced these panicky and excessive operations of the Federal reserve system to the recession in business, the serious bank failures in the West, the relatively high rates of interest and reserve discounts, the perilous condition of the cattle industry approaching national disaster, and the strong feeling throughout the West in favor of radical proposals for legislative and other Government relief. Thus the monetary and nonmonetary circumstances, including public opinion, were such that, when now stimulated by excessive purchases of securities, continued net imports of gold and drastic reductions of discount rates, the price level of commodities shortly responded and rose 11 per cent from June, 1924, to March, 1925, the greatest rise being in agricultural products, which rose 20 per cent from June, 1924, to March, 1925 (Federal Reserve Bulletin May, 1927, p. 313), with the result that factory production, trade, and employment in 1925 increased to almost the full development attained in 1923. (Federal Reserve Board charts on production and employment, pp. 293 and 294.)

These events of 1923 and 1924 showed again the failure to employ timely action, under the illusion that only nonmonetary forces caused the rise and fall of the price level, over which monetary and credit policy could have no control. Had stabilization of the purchasing power of money been a guiding principle of the system, then much greater attention would have been given to timely action in the use of its economic instruments. The relatively high rate of 4½ per cent would have been reduced in the early part of 1923 when the danger of inflation had been stopped, instead of waiting a year—until May to October, 1924—when only the panicky and drastic reductions could accomplish results; and open market sales, instead of continuing during 1923, would have been changed to open market purchases soon after the price level had started to decline in April, 1923, instead of waiting until November, 1923, followed by excessive purchases needed to get results desired. In either case, nonmonetary causes would have been highly important, and the monetary and credit policy of the system could only operate either to exaggerate or to minimize the nonmonetary forces. But, at the beginning of either monetary or nonmonetary changes when business is hesitating, a very slight use of its powers has much more stabilizing effect than a drastic and panicky use of its powers at a later period when business has been plunging toward inflation or deflation.

This principle of timeliness was elaborately discussed in the tenth annual report of the Federal Reserve Board for the year 1923, but it has not adequately been observed by the system, because it has had in view changing purposes other than stabilization of purchasing power. Timeliness is the essence of stabilization, and timeliness, for this purpose, apparently can not be brought home to the system until the people, through their representatives, have directed stabili-

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zation as a primary purpose of the system. Furthermore, the method of learning by experience and experiment has no signficance except with reference to the goal or purpose toward which the experiments and the lessons of experience are directed. Leaving out of account the future expected rise or fall of prices leaves out of account the need of early monetary and credit action in order to stimulate or restrain the nonmonetary forces, both of which afterwards show themselves in the rise or fall of the price level.

Since the middle of 1925 three new events have arisen, upon which the purposes and experiments of the system have not yet had time to yield the conclusions of experience. These are the restoration of gold standards in other countries, the rise of stock and bond prices, and the fall and subsequent rise of commodity prices. United States securities were sold to the amount of $284,000,000 from October, 1924, to January, 1927. This more than offset the net imports of gold during the period from July, 1925, to September, 1927, of $260,000,000. The rates of discount were raised (New York) from the low points of 3 and 3½ per cent in 1924 to 4 per cent in the beginning of 1926, and were maintained at that rate (excepting four months) until the middle of 1927. Other reserve banks maintained 4 per cent until August and September, 1927. Wholesale commodity prices fell, from the beginning of 1925 to the middle of 1927, about 11 per cent in the United States, about 17 per cent in England, and about an average of 12 per cent in 14 leading countries having a gold basis. (L. D. Edie, Proceedings, American Economic Association, March, 1928, p. 55.)

The fall in the price of industrial or nonagricultural products in America was about 18 per cent from 1923 to March 1927. This was explained by the Reserve Board as partly due to the increased efficiency of American industry, the increased output per person employed during that period being calculated at 10 per cent (Federal Reserve Bulletin, May 1927). Afterwards, witnesses from the Federal Reserve Board expressed the opinion that there should be a fall in prices corresponding to the increase of efficiency in industry and agriculture. This may be taken as one of the goals or purposes toward which the policy of the system is directed over a period of years, namely a gradual reduction of the general price level corresponding to the reductions in costs of production through increased efficiency. Since this is a view widely held by salaried, wage-earning, and creditor classes, made effective by bankers' control of the Federal reserve system, its validity as a goal or purpose of the system should be examined.

Its theoretical, or rather, idealistic basis, appears to be that money incomes of consumers will remain relatively constant and that they therefore, as consumers, can share in the increased efficiency of industry chiefly by reduction in prices, especially retail prices, whereas they lose, as consumers, if prices rise.

I realize that the best exact standard for stabilization is a matter of controversy, though any proposed standard is better than none. But I submit that this goal of general price reduction is mistaken as against the purpose of maintaining a stable purchasing power of money over commodities with its minor variations as above described.

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If it is a goal of the system to adapt its policy toward a gradual decline in prices proportionate to the increase in efficiency, it is the same as saying that the purpose is both to increase the value of the gold standard measured by a general fall in prices, and to increase the commodity purchasing power of the dollar, measured by the same fall. The wording of the bill may be improved, but the object evidently is to incorporate the gold standard in the Federal reserve act, where it now exists only by implication; to stabilize its value or purchasing power, thereby stabilizing the purchasing power of the dollar redeemable in gold; and thus to prevent a Federal reserve policy directed toward a general fall in prices whether alleged to proceed from a nonmonetary cause, such as improved efficiency, or otherwise.

One justification of such a direction by the Congress to the Federal reserve system is that of the supreme public interest in having the producing classes, who are the sellers of products, retain the gains derived from their own energy and initiative in increasing their efficiency. If general prices fall proportionately to increased efficiency, then, in general, manufacturers, farmers, and wage earners fail to get the gains of their own increasing efficiency, since they have no efficiency margin to be shared as higher profits and higher wages. This general fall of prices discourages the expansion of industry and agriculture, and especially discourages the starting up of new industries to absorb the employees laid off by those industries that are increasing their efficiency. So that, with a general fall in prices, the illusion is created that improvements in technology are a cause of unemployment, whereas a more important cause is the depression in industry and agriculture which prevents reemployment of those displaced by improvements in technology. In a period of rising prices improvements in efficiency do not seriously cause unemployment but they do in periods of falling prices. But since rising prices, beyond the needs of full production and employment, bring an unearned surplus to producers or sellers at the expense of consumers and buyers, it is by means of the reasonable stabilization of the dollar's purchasing power that producers get the income earned by their own efficiency, and consumers are protected against unearned income going to producers.

Besides this, the greatest number of consumers, including manufacturers, farmers, and wage earners, can not become consumers until they are first producers. While statistics of employment and unemployment, reflecting as they do, changes in prices, production, and profits, are inadequate, yet various estimates agree in indicating a decline in employment when prices in general are falling, and an increase in employment when prices in general are rising, if they do not rise beyond the point of full employment. An illusion respecting the real earnings of labor, that is, its purchasing power is created by the imperfect statistics of employment. The computed statistics of real earnings of labor are based on the average rates of earnings of those actually on the factory pay rolls, and these show great stability from 1890 to 1914, and then a rapid rise from 1915 to the present time. This rise was not greatly affected by the rise of prices and the accompanying increased prosperity and scarcity of labor from 1915 to 1920, and it continued even during the

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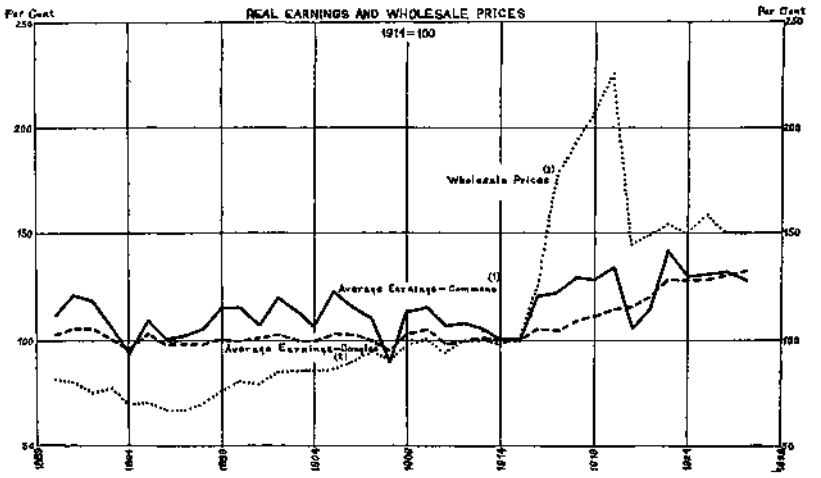
extreme depression of 1920 and 1921, when millions of laborers were unemployed. (Chart, Commons: Real Earnings and Wholesale Prices.)

Evidently, the unemployed laborers are not taken into account in these computations, but if the computations of average earnings were made, not merely for those on the pay rolls, but for all laborers dependent on industry for wages, both employed and unemployed, then the average real earnings of the labor population as a whole would fluctuate widely according to the state of employment and unemployment, and corresponding closely to the changes in the wholesale price index. A tentative estimate of this kind is made in the chart above referred to, Curve (1).



(1) Commons' estimated relative average annual real earnings of total factory wage-earning population.

$$\frac{\text{Total pay rolls}}{\text{Est. total number available for employment}} = \text{Ave. money wage of wage earners.}$$

$$\frac{\text{Relative ave. money wage of wage earners}}{\text{Relative cost of living}} = \text{Rel. ave. real earnings of factory wage-earning population.}$$

(2) Douglas's relative average annual real earnings of employed workers in manufacturing.

$$\frac{\text{Total pay rolls}}{\text{Average number employed}} = \text{Ave. money wage of employed workers.}$$

$$\frac{\text{Relative ave. money wage of employed workers}}{\text{Relative cost of living}} = \text{Rel. ave. real earnings of employed workers.}$$

(3) Bureau of Labor Statistics, 1913=100.

Source: Proceedings of American Economic Association, March, 1926. Estimates for 1925, 1926, and 1927 by an analogous method.

This shows that average real earnings, or purchasing power of all laborers, both on and off pay rolls, follows closely the ups and downs of the average price level. Especially during the years 1915 to 1920 when labor was in great demand, the average real earnings of both employed and unemployed labor rose about 34 per cent, whereas the pay-roll average shows a rise of only 14 per cent. On the other hand, during the fall of prices and its accompanying depression of industry and the unemployment of 1921, the average real earnings of all laborers fell about 22 per cent, although the earnings of pay-roll employees continued to rise at the rate of 2 or 3 per cent per year. Similar contrasts appear for subsequent years.

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Since employment and unemployment reflect in general the movements of production, as well as prices and profits of manufacturers, and these together constitute the purchasing power of producers as a class when looked upon as consumers, it follows that much more important in the public interest is the purpose or goal of stability of the purchasing power of money, than the purpose of a gradual decline in prices or increased purchasing power of money, corresponding to increased efficiency of producers. This reasoning applies to the increased efficiency of agriculture.

The claim that increasing efficiency calls for a declining price level also confuses changes in particular prices with a change in the average price level—a special case of the confusion maintained by several opponents of this bill. All industries and agriculture do not increase their efficiencies at the same time, and consequently the fall of prices, owing to increased efficiency, in a single industry or group of industries, signifies a corresponding increase in the purchasing power of other industries, whose efficiency has not increased, over the increasing product at lower prices of the single industry or group whose efficiency has increased. If automobiles are cheapened, owing to technical improvements, the producers of other industries, whose products have not been cheapened in a similar way, can buy more automobiles. The relative changes in purchasing power between industries themselves is a change in particular prices, and this not only can go on, but is expected to go on, while the average of all prices, which measures the purchasing power of the dollar, remains stable.

This shifting of employment and production from one industry to another, owing either to changes in supply and demand of particular industries, or to changes from decaying or inefficient industries to new or expanding industries, is not a matter for monetary or credit policy—in fact, changes in the distribution of credit must follow, and not control, changes in the distribution of industry. Expanding industries require more credit which they can be trusted automatically to draw away from decaying industries. It is only the total volume of credit, relative to the total volume of products, trade, and employment that can and should be regulated by a monetary and credit policy as one of its instruments in stabilizing the general price level or average purchasing power of money. Otherwise a "rationing of credit" is substituted for the automatic apportioning of credit according to changes in business and technology.

These considerations indicate that there is an ambiguity in the present bill, H. R. 11806, in that it calls not only for stability of the gold standard and stability of purchasing power, but also for "stability of commerce, industry, agriculture, and employment." These latter should be eliminated, as suggested by Professor Cassel in his testimony, as not pertinent to the purposes of monetary and credit stability. Such stability of commerce, industry, agriculture, and employment, including such stabilization of their particular prices as may be obtained, belongs to the various industries themselves, and has been proceeding by collective and State action, as in the case of railroads; or by the stabilizing of commodity prices through various forms of collective action, beginning with steel, glass, cement, and extending to other manufacturing industries; while the stabilizing of agriculture is making progress through cooperative marketing sup-

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ported by legislation. The stability of employment will be obtained in so far as stability in these various fields is accomplished.

But the most important stability, upon which all others depend, is the stable purchasing power of money, because all of them must use money in accomplishing their own stability, and no stability of particular prices can be adequately accomplished if the purchasing power of money rises or falls unduly. This is the proper field for monetary and credit policy.

The restoration of the gold standard in foreign countries is definitely provided for in this bill, although the reserve system has used its powers for that purpose by implication. In 1925 the reserve banks took such action by extending to England a provisional revolving credit, if needed, to the extent of $200,000,000, and by keeping rates in the discount market low. Again, in the middle of 1927, the restoration and the maintenance of the gold standard in Europe imposed upon the reserve system the necessity of taking drastic action. The system then reversed its open-market operations by purchasing about $290,000,000 United States securities between April, 1927, and December, 1928, and by reducing the rate of discount to 3½ per cent. Evidence shows that these operations were probably taken upon the representations of European central banks, the substance of which was that any great loss of gold to this country would require those countries to raise their rates of discount and thereby make more serious the existing depression of industry and decline in prices in those countries. This would reduce their effective demand for American exports, chiefly agricultural products. In acting favorably toward these European representations, the Federal reserve system, by buying securities and reducing the rates of discount, was acting in conformity with the clause in section (h) of this bill which directs that "Relations and transactions with foreign banks shall not be inconsistent with the purposes expressed in this amendment." For, if the depression and fall of prices in Europe reduces the prices of American exports, they thereby, to that extent, further depress the already declining general price level in America. It is well known, and is shown in the chart on export, import, and average prices (Chart, Commons: Wholesale Prices, p. 278), that export and import prices, consisting largely of raw materials, have wider fluctuations than do manufactured goods and domestic prices. In times of prosperity and rising prices the prices of exports and imports rise sooner and more extremely than does the all-commodity index of prices (including exports and imports), and in times of depression and falling prices they fall sooner and more extremely.

This relation showed itself in the period from the peak in the beginning of 1925 to the low point in April, 1927. (Chart, Commons: Wholesale Prices, p. 278.) While the general level of prices fell 10 per cent, export prices declined 27 per cent. Hence, the reserve system, by reducing its own rates of discount and thus helping European countries to preserve the gold standard without raising their rates of discount, was acting consistently with the purposes of this bill relative to "relations and transactions with foreign banks." Almost immediately gold began moving to Europe from our surplus stock, replenishing their deficient stock, the total net exports from September, 1927, to April, 1928, being $352,000,000. Of course, favorable nonmonetary causes were also operating, but the liberal

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policy of the system toward Europe, combined with the nonmonetary causes, was accompanied by a rise in American export prices in the latter half of 1927, thus lifting somewhat the general price level (chart previously referred to) which previously had been declining.

The testimony and also public information revealed a strong difference of opinion among the Federal reserve banks and within the board itself respecting these operations in 1927, resulting in a change in the membership of the board in opposition to the easy money policy. On this opposing side was the opinion that easy money would not affect commodity prices while business was in a state of depression and falling prices but would augment the existing overspeculation and extraordinary rise of stock exchange prices. With this in view the open market policy was reversed, and sales of securities were begun in January, 1928, amounting to $222,000,000 during three months, and rates of discount were raised from 3½ to 4 and 4½ per cent just at the time when business was recovering and commodity prices rising. The purpose apparent now was to check stock speculation rather than assist the recovery of business and the stabilization of the purchasing power of money in terms of commodity prices. No method had as yet been discovered or applied by which stock speculation could be restrained without, at the same time, restricting the recovery of business and restoring the full employment of labor by rising commodity prices. Several such methods were suggested, such as a requirement that time deposits be invested in securities; or higher rates of discount be imposed on notes secured by Government collateral than on commercial paper, thus reversing the practice during the war and until 1921; or no discount less than seven days, following the practice of the Bank of England; or by refusing to lend to a member bank which is extending its stock exchange loans at such a period; or by the extension of branch banking. All of these proposals are objected to on the ground that they are either impracticable, or unpopular, or would require additional legislation, or require too much interference with member banks.

Whatever may be the fate of these proposals or of experimentation upon them, there are evidently several circumstances connected with the rise of stock prices over which the reserve system can not obtain control. One is the immense increase in savings, going on at a more rapid rate than ever before, which goes into securities and other investments, and which can not readily be distinguished from increased supply of money because they are themselves money savings. These have become especialy large in the case of corporate savings, which render corporations relatively independent of the banks. There is a vast difference between a large accumulation of savings seeking investment and a plethora of funds in the New York market, although the difference may not be capable of statistical measurement.

Another uncontrollable factor is the large investment by banks throughout the country in the call-loan market, which is the most secure and liquid of all markets, instead of investments and loans in their local markets, where they might get higher rates of interest but less secure or liquid. Another is the mad speculation throughout the country regardless of real earning power of the companies whose securities are purchased for a rise, a kind of speculation that usually accompanies the peak of stock prices. These circumstances have

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made ineffectual the effort of the reserve system to restrict stock speculation.

Moreover, although the Federal reserve system, when established, was purposely planned to encourage legitimate commercial business and discourage stock speculation, it is a serious question whether its discount policy should not let stock prices alone. To attempt to control so volatile a matter cripples the power to control the purchasing power of the dollar. And while stock gambling is reprehensible, it would be a serious error to ascribe every rise in stocks to speculation. A large part certainly represents improved prospective earnings. The very prosperity accomplished, other than in agriculture, during the past few years of relative stabilization has had as one of its notable effects a cumulation of prosperity bound to be reflected promptly in higher prices of the securities in business. The increased savings of the general public from the same causes, have similar effects, and the trend of modern investment from bonds toward stocks has a like effect.

Along with the uncontrollable factors is the illusion created by current statistical bureaus which show the rise of only a small part of all the securities dealt in on the stock exchange. These are 20 to 197 selected industrial stocks of especially large and profitable companies, while all of the listed companies are about 1,100. The weighted average of the prices of these 1,100 listed stocks, as shown by the stock-exchange reports, has risen only 22 per cent from January, 1925, to January, 1928 (25 per cent for April 1, not shown in chart). But these selected stocks have risen, according to different statisticians, 70, 87, and 76 per cent to March, 1928. (Chart, Commons: Stock Prices, p. 438.) Other computations, not shown on the chart, show a rise to a similar extent. If, in addition to listed stocks, the stocks of all corporations throughout the country were included, many of which have suffered serious declines, it would perhaps become apparent that stock prices, as a whole, have not materially advanced beyond what lower rates of interest would justify, compared with the advance in the average of commodity prices; and that the rise of selected profitable stocks above the average rise of stock prices indicates rather a shifting of increased savings and speculation from unprofitable to profitable companies, from companies which do not show an increase of assets to those which do show an increase, resulting from great changes in the distribution of wealth and savings among the American people, all of them mainly nonmonetary factors not directly controllable by the monetary and credit policy of the reserve system.

From these considerations it appears, and is confirmed by the testimony of Gustav Cassel, that the control of inflation or deflation of stock prices should not be one of the purposes of monetary and credit policy, but the purpose should be the control of the rise and fall of the average of commodity prices, which is stabilization of the purchasing power of money in trade, commerce, industry, and agriculture. Changes in prices of stocks and bonds, like changes in real-estate values, are changes in the expectations of net earnings accompanied by changes in the supply of savings and changes in the speculative temper of the community. If Federal reserve credit "leaks" into the stock market, this is to be expected, since the stock market is

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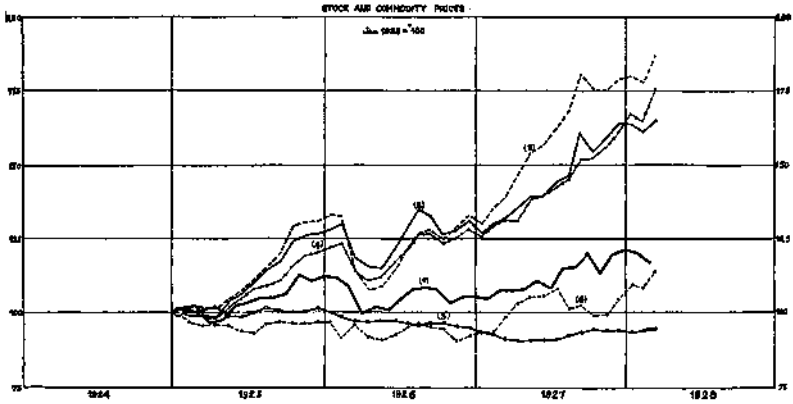
the money market, and because prices of stocks reflect the expectations of future net earnings, and therefore ordinarily precede changes in commodity prices. If, however, there is an excessive "leakeage" into the stock market, it might be remedied, if sufficiently important, by some of the above-mentioned remedies or others less objectionable,



CURVES

(1) Average prices of listed shares of the New York Stock Exchange. Approximately 1,100 issues.
(2) Dow-Jones 20 industrial-stock prices—average of high and low prices for each month. Nearly 2 per cent of total listed issues.
(3) Annalist (New York Times), 25 industrial-stock prices—average of high and low prices for each month. About 2.3 per cent of all listed issues.
(4) Standard Statistics Co.'s index of 197 industrial-stock prices—monthly average of weekly index numbers. About 18 per cent of all listed issues.
(5) Bureau of Labor Statistics revised index of wholesale commodity prices. (Extended to March, 1928, by the per cent of change in the Annalist index number); 550 listed commodity prices.
(6) Annalist sensitive commodity prices index number. Three commodities—hides, zinc, and scrap iron. Less than 0.3 per cent of the total listed commodities.

COMMENTS

	Per cent
Increases and decreases:	
Over the entire period—increases—	
Average listed shares	17
Dow-Jones	70
Annalist	87
Standard Statistics Co	76
During the period from:	
(1) January, 1925, to February, 1926—increases—	
Average listed shares	12
Dow-Jones	30
Annalist	33
Standard Statistics Co	23
(2) February, 1926, to April, 1926—decreases—	
Average listed shares	11
Dow-Jones	11
Annalist	18
Standard Statistics Co	10
(3) April, 1926, to September, 1926—increases—	
Average listed shares	9
Dow-Jones	15
Annalist	19
Standard Statistics Co	14
(4) September, 1926, to October, 1926—decreases—	
Average listed shapes to November, 1926	5
Dow-Jones to October, 1926	5
Annalist to October, 1926	2
Standard Statistics Co. to October, 1926	3
(5) October, 1926, to January, 1928—increases—	
Average listed shares from November, 1926	18
Dow-Jones	30
Annalist	44
Standard Statistics Co	35
(6) January, 1928, to March, 1928—	
Average listed shares, increase Jan. 1–Apr. 1	3
Dow-Jones, increase	4
Annalist, increase	4
Standard Statistics Co., increase	5

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which would discriminate against loans for speculation and in favor of loans for commercial purposes. But while this "leakage" is relatively important from the point of view of the earning assets of the reserve banks, it is relatively unimportant from the point of view of the country's volume of credit, since even the excessive amount of brokers' loans are even yet scarcely 8 or 10 per cent of the overwhelmingly great volume of commercial and productive loans of all the banks in the country. These conclusions are evidently tentative, so far as statistical measurements are concerned; yet they are called for on account of testimony showing the diverse and changeable purposes in the administration of the reserve system which now obstruct a consistent use of their powers toward the stabilization of the commodity purchasing power of money.

Equally important with the prevention of so-called cycles of prices and industrial activity hitherto discussed, is the expected long trend of the purchasing power of money. In general the evidence of experts on the present and future supply of gold (Lehfeldt, Cassel, Kemmerer, referred to or incorporated in the testimony as exhibits), points to a world scarcity of gold and unless certain economies are effected, such as retirement of gold from actual circulation and using it in central banks as the basis of notes and member bank credit reserves; the extension of cooperative arrangements between central banks, which, it is deemed by Doctor Miller, will permit a reduction in gold reserve ratios held by central banks; the increased use of checks, etc. All of these and other possible economies of gold are provided for in this bill under the two directions of maintaining a "stable gold standard" and "relations and transactions with foreign banks shall not be inconsistent with the purposes of this amendment."

This long-time trend of scarcity or abundance of the world's supply of gold can not, however, be left to the future, or to the present experiments of the reserve system unguided by a policy of price stabilization, as proposed by witnesses, but is a matter of immediate attention, because the proposed economies will not come automatically of themselves. Present policies are already proceeding which will determine whether the above-mentioned or other economies of gold shall be inaugurated and directed towards stabilization of the value of the world's gold standard at present levels, or toward an increase in the value of gold and a falling trend of prices. Since the matter, however, is one of detailed investigation and of prediction over a period of years, it can not be cared for by legislation except in the general terms of a stable gold standard and stable purchasing power of the dollar, as a purpose directed in this bill to be followed by the Federal Reserve system. I will therefore conclude by submitting as an exhibit the summary of a monograph on the future of gold, made by Prof. Lionel D. Edie, of the University of Chicago, based on extensive investigations and the previous studies of others. This exhibit should be preceded by a more recent investigation by Professor Edie, to be published in the Journal of Political Economy, but furnished to me in outline by him in advance of publication. He makes these general inferences:

1. The usual estimates of our "excess" gold stock are about double the true figure.

2. If no further exports or imports of gold were to take place, we should, in the United States, grow up to our gold stock within about four years, instead of 10 to 15, the usual estimate.

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3. The usual claims about greatly reduced reserves under the Federal reserve act are absurd exaggerations, because the new method of note issue wastes about as much gold as the deposit reserve ratios economize.

4. The notion that 35 to 40 per cent is the minimum of potential reserve of Federal reserve banks is illusory because of the manner of putting gold in the Treasury and backing notes by commercial paper. The de facto minimum potential reserve ratio is nearer 60 to 70 per cent, roughly 65 per cent.

5. Although nine-tenths of our business is transacted by deposits and checking accounts, fully two-thirds of our gold stock is used up as backing for note issue, which transacts only one-tenth of our business. Note issue is absolutely defective when secular elasticity is concerned.

6. Using Cassel's method in modified form, I estimate that the 3 per cent rate of Cassel needs to be split between the United States and the outside world. The normal gold rate of increase in United States stocks turns out to be 4.3 per cent per annum, that of the outside world 2.4 per cent. This means that, by 1930, the United States alone requires about $180,000,000 increment in gold stock annually, an amount equal to the entire new gold produced annually and available as money. If this is even roughly correct, then all the vague hopes about gold economy from pooled reserves and gold exchange standard are futile. The United States alone will require all the new money gold turned out annually by the mines. This would have to be imported. I will not elaborate this further, but will merely emphasize that the official, optimistic view of gold economies seems to be completely rejected by the quantitative investigation of all phases of the problem.

The exhibit of the summary of Professor Edie's earlier study is as follows:

EXHIBIT

The Value of Gold Money, Present and Future

By Lionel D. Edie, Indiana University Studies No. 78, pp. 126 to 136, March, 1928

RESTATEMENT OF THE PROBLEM

The many separate factors in demand and supply of gold, which have been discussed, bear directly upon one central problem. This problem was stated at the outset in the following words: What changes in supply and demand of gold have taken place since 1913 and how may such changes be expected to affect the secular trend of the price level during the next few decades? The details of the foregoing analysis are closely related to this basic problem. But, as details, their bearing upon the primary issue may be lost sight of unless the lines of connection are summarized in brief form.

SUMMARY OF GOLD SUPPLY AND DEMAND FACTORS

In order to preserve stability of the secular trend of prices before 1913, it was required that the world stock of gold money increase at the rate of 2.7 per cent per annum. During the second and third quarters of the nineteenth century, the rate was about 3.1 per cent. During the war period, 1913–1925, the rate was about 2 per cent. Under postwar conditions, the normal future rate of increase in world stock may be estimated at approximately 2.7 per cent per annum. This rate represents the gold requirement necessary to prevent serious fluctuations in the long time trend of prices.

Actual gold money supply may differ radically from this normal requirement. Any such divergence would tend to create a corresponding fluctuation in the price level. The forces governing the actual supply may be summarized as follows:

1. Supply is not likely to be increased by lowering the cost of production, because exhaustion of better grade ores and application of the law of diminishing returns tend to offset increased efficiency and improved processes.

2. Supply is not likely to be increased by new gold discoveries, since geological surveys have already made known most of the resources of the world.

3. Supply is not likely to be increased by exploiting known supplies of low-grade ores, since cost of production rapidly becomes prohibitive.

4. Supply is not likely to be increased by transmutation of gold from baser metals, since even if the scientific possibility of transmutation is demonstrated, the cost of the process is so great as to make commercial production out of the question.

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The above alternatives exhaust the possibilities of increasing the world production of gold. Since none of these alternatives contains a serious hope of enlarged production, the conclusion is reached that production can not be expected to expand materially beyond the present rate of about $400,000,000 annually. In the course of the next 10 years, it is probable that production will have so seriously exhausted high-grade ores that a falling off from the 400,000,000 mark will be in evidence.

The factors of demand for gold money have been examined in order to discover whether there are any new economies in the use of gold which might reduce the world requirement for an annual increase in stock of gold money. The following summary of demand factors indicates the extent to which the secular trend of demand has been modified by new habits in the use of gold:

1. World demand for gold in the industrial arts will tend to equal or exceed the pre-war consumption, and should be expected by about 1930 to equal at least $120,000,000 annually.

2. Demand for gold by the Orient for hoarding purposes will tend to be fully as great as before the war, and should be expected to exceed $100,000,000 annually.

3. Demand for gold has been economized greatly by centralization of the metal in reserves. This economy warrants the assumption that the price level of 1913 would normally have been about 35 per cent higher than it actually was, if all gold had been centralized in reserves at that time. In other words, the normal pre-war price level was 135, on a base of the actual 1913 level as 100. Furthermore, the economy of centralized reserves warrants the assumption that the future normal annual increase in world stock of gold money will be about 2.7 per cent, but that rate will be applied to a principal sum one-third less than that which would be required if gold were to be returned to circulation in the pre-war proportions.

4. Demand for gold has been economized slightly by establishment of lower reserve ratios back of notes and deposits; but in the aggregate this does not account for more than about 10 points in the price index, or the difference between the hypothetical normal index of 135 and the actual index in gold standard countries of about 145. The year 1913 is taken as a base of 100 in calculation of these indexes.

5. Demand for gold has been economized by modification of the gold standard and introduction of the gold exchange standard. Such economy is chiefly due to the withdrawal of gold from circulation. This factor has been fully allowed for in point No. 3 above. Such economy is further due to the pooling of reserves, but this arrangement is limited. Nationalism makes quite unlikely a permanent willingness on the part of any first-rate power to keep its gold reserves in the vaults of a foreign country.

6. Demand for gold is not likely to be seriously altered by adoption of the gold standard by new countries. It will not be abruptly increased from this cause, because China and a few other countries are the only ones which have not already been on come form of gold standard. On the other hand, demand will not be abruptly decreased from this cause for the reason that a great many countries now on the gold exchange standard are trying to grow up to the full gold standard. The world saturation point in gold demand is far from reached; and if all countries eventually require as much gold per capita as England, the United States, and other advanced industrial countries, the potential demand for more gold per capita will vitalize demand for many decades to come.

7. Demand for gold due to secular trend of trade and population promises to follow during the next two or three decades substantially the same curve as before the war. The setback to production caused by the World War was confined chiefly to Europe; and Europe shows every evidence, after a decade of hesitation, of going forward again at the old pace of growth.

The above alternatives exhaust the possibilities of fundamental changes in the demand for gold. As a result of allowing for rather definite probabilities on each point, we have a sound basis for concluding that in 1913 the price index under conditions of centralized gold reserves would have been 35 per cent above the index which actually prevailed under conditions where large amounts of gold were in circulation. Likewise, we have a sound basis for concluding that the normal postwar requirement for the world stock of gold money is an annual increase of 2.7 per cent. We may now proceed to apply these conclusions to the gold situation of the postwar period. Actual gold stock and production may be compared with the estimated normal requirement. In this way, it will be possible to ascertain whether a shortage of gold is in sight, and whether the value of gold is likely to appreciate or depreciate.

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ESTIMATED NORMAL SUPPLY COMPARED WITH ACTUAL

The following table compares the estimated normal stock of gold money with the actual. The estimated normal is computed by carrying forward to 1925 the actual stock of 1913 at the rate of an annual increment of 2 per cent and thereafter projecting it at the rate of an annual increment of 2.7 per cent. The estimates of actual stock are derived from three separate sources, and are believed to afford a reasonably accurate measurement of supply.

In the accompanying table three separate estimates are presented of the actual world stock of gold money. A word of explanation is necessary in order to appraise the relative accuracy of these estimates. The first column contains an estimate by the Director of the United States Mint. It is based upon reports obtained from all improtant gold-using countries. Although the reports are carefully compiled, nevertheless a study of the records of past years leads one to infer that the reporting countries do not always observe uniform methods of filling out reports. In addition to nonuniformity, there is a degree of incompleteness in the records; some countries are not represented at all. Consequently it is probable that the estimate for 1925 is slightly below the true figure.

The second column contains estimates published by the Federal Reserve Board based upon reports of the central banks of leading countries. These estimates are incomplete. The countries which are omitted are small, but in the aggregate they would add perceptibly to the total. Moreover, the figures purport to cover only gold in reserves. Of course, very little gold is now in circulation anywhere in the world in the form of coin, but the amount would make a slight addition to the estimates offered by the Federal Reserve Board. Consequently we may safely assume that the 1925 estimate is somewhat below the actual figure.

The estimate by Joseph Kitchin contained in column III is arrived at by carrying forward the actual figures of earlier years by adding thereto the current world output of gold for succeeding years less the gold consumed in the industrial arts and absorbed by the Orient. These estimates involve certain arbitrary assumptions and probably result in a slight overestimate of the actual stock for the year 1925. It is the belief of the present writer that an estimate of about $9,800,000,000 would approximate the true figure. This amount is almost identical with the estimated normal stock required by the 2 per cent rate of interest, namely, $9,801,000,000.

World's stock of monetary gold

[000,000 omitted]

Year	I United States Director of the Mint	II Federal Reserve Board (estimates of central bank reserves)	III Joseph Kitchin [1]	IV Normal stock (2 per cent from 1913 to 1925, 2.7 per cent from 1925 to 1935)	V Normal annual increase required
1913	7,728	5,421	7,728	7,728	158
1914	7,111	5,921	8,059	7,882.5	154.5
1915	8,258	6,862	8,448	8,040	157.5
1916	(2)	7,191	8,779	8,201	161
1917	(2)	7,642	9,013	8,365	164
1918	8,339	7,225	9,329	8,532	167
1919	7,873	6,978	9,392	8,703	171
1920	8,246	7,671	9,621	8,877	174
1921	8,680	8,425	9,884	9,055	178
1922	8,925	8,771	9,986	9,236	181
1923	9,408	9,000	10,166	9,420	184
1924	9,699.9	9,381	10,220	9,609	189
1925	9,800	9,343	10,399.9	9,801	192
1930	[3]10,700	----------	[4]11,217	11,197	231
1935	[3]11,400	----------	[4]11,801	12,793	235

[1] See Report of Royal Commission on Indian Currency and Finance, 1926, Volume III, p. 534.
[2] Data not available.
[3] Preliminary estimates by the writer. These are believed to be maximum figures rather than minimum.
[4] Preliminary estimates by Kitchin.

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As indicated by the accompanying table and by chart No. 14, the estimates have been projected at 5-year intervals to 1935. Some time between 1930 and 1935 a deficiency of actual stock below normal would be expected to exert an influence upon the value of gold. This deficiency would each year become progressively greater. The reason for a growing discrepancy would be that the 2.7 per cent rate is each year being applied to a larger base number. For instance, 2.7 per cent of $12,000,000,000 is considerably more than 2.7 per cent of $10,000,000,000. The amount of production can scarcely be expected to increase at such a progressive rate. Owing to exhaustion of deposits and the application of the law of diminishing returns future production is more likely to decline than to increase. Chart No. 15 shows the trend of actual production since 1900 and illustrates the data upon which present conclusions are based.

As this discrepancy becomes of material proportions, it will tend to cause a secular decline of the price level in all gold-standard countries. We may with good reason assume that no serious long-time deflation of the price level in gold-standard countries is likely to take place until about 1935. But after that time it is likely that there will set in a gradual lowering of the price level over a long period of years.

CORRECTION OF SOME WIDELY ACCEPTED ASSUMPTIONS

Probably the most widely accepted assumptions relative to the value of gold are as follows: (1) That a gradual return to the pre-war price level of 100 is in prospect, (2) that the annual requirement of new gold money is about 2.7 per cent, (3) that a shortage of gold below normal requirements set in about 1920, (4) that postwar changes in the gold standard may have taken place, such as to cause some extraordinary economies in gold usage and so to upset all existing calculations.

The present analysis warrants important corrections in all of these assumptions. The common expectation of return to a pre-war level does not take into account the fact that, had the 1913 stock of gold money been in reserves, the price level of that year would normally have been 35 per cent higher than it actually was under then existing conditions. The same total gold supply now as in 1913 would normally support a price index of 135, because of the withdrawal of gold from circulation. Hence, so far as gold supply is concerned, a post-war index of 135 is equivalent to a pre-war index of 100.

The second assumption—namely, that the annual requirement of new gold money is about 2.7 per cent annually—seriously overrates the true requirement under war and postwar conditions. Largely because of the new practice of impounding new gold in reserves, the normal annual increase of gold money is applied to a base only two-thirds as great as that which would have been required under pre-war habits of circulation. This lowered rate means that the future price level can be sustained by a much smaller annual output of new gold than has hitherto been assumed necessary. Moreover, during the period 1913 to 1925 the normal annual requirement should be set at 2 instead of 2.7.

The third assumption—namely, that a shortage of gold below normal requirements set in about 1920—is fallacious. The notion originated with investigators who carried forward the estimates of normal requirements by applying a 2.7 or 3 per cent annual rate of increase during a period which was quite abnormal. The rate which should be used during the war era is 2 per cent. When the correct per cent is applied the estimated gold shortage is postponed about 15 years, and when it does take place will be much less acute than has commonly been supposed.

The fourth assumption relative to changes in the gold standard has been practically a confession of failure to analyze the changes in question. An air of mystery has surrounded the matter. A notion that financial practices have been violently upset and that they have not yet settled down in permanent or normal form has prevailed. A feeling that any attempt to analyze the situation must inevitably be futile has been allowed to paralyze research. In the absence of knowledge, most authorities have assumed that gold usage will return to the pre-war form, but have warned that such an assumption is dangerous.

The present inquiry has been aimed at the unknown factors in this situation. The changes in the gold standard which might bring about an economy of gold prove, upon analysis, to be twofold: The withdrawal of gold from circulation, and the pooling of reserves. The former is fully taken into account by our revision of the conceptions of the normal pre-war price level and of

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the normal annual increase of gold money. The latter is found to be primarily a temporary arrangement and does not hold out any real hope of permanent large economy in use of gold.

THE OUTLOOK FOR GOLD

The gold standard has been under trial for more than a century.

The World War destroyed it in most countries temporarily. But after the war, all countries determined to return to some form of gold standard as rapidly as possible. The vitality and tenacity of the gold standard has been demonstrated in a remarkable way.

Nevertheless, more than ever before the nations of the world are aware of the imperfections of gold as the unit of value. They are aware that reasonable stability in the standard of value is of the utmost importance, but that the gold standard as such provides no assurance of the stability desired. The present quantitative analysis of gold points to a renewal of serious fluctuations in the secular trend of prices in the future as in the past.

The literature of monetary economics already abounds with schemes and plans to control the value of money. It is quite possible that this discussion will gradually bring public opinion to a point where it will support the principle of a managed gold standard. Then, by manipulation of the discount rates of central banks, or by international regulation of the amount of metal produced in the gold fields, or by applying the principle of the compensated dollar, or by some other device, the value of money may be stabilized. Such an eventuality is possible, but it is quite doubtful during the next two or three decades. The prospect which confronts the financial world for the proximate future is a gold standard subject to the fluctuations of demand and supply of gold and to the disturbances of severe secular variations in the purchasing power of money.

Mr. STRONG. I will state that I also will introduce a statement which I have prepared in closing the hearings.

(The matter referred to is as follows:)

STATEMENT OF JAMES G. STRONG, AUTHOR H. R. 7895 AND H. R. 11806, WHICH HAVE BEEN UNDER CONSIDERATION BY THIS COMMITTEE

As I have stated, and as is readily understood by those who have given any study to the proposition, H. R. 7895, introduced by me at the last session of Congress, and H. R. 11806, introduced at this session and now under consideration by the committee, have the same purpose as an objective, namely, that the Federal Reserve Board and system shall use the powers that have been given them by Congress for the stabilization of the purchasing power of our dollar.

Both bills have been attacked by financiers, bankers, and financial writers, some for selfish reasons, others because, having become versed in existing conditions, hesitate or refuse to consider and study the real purpose of the proposed legislation, which was also true when the Federal reserve system was proposed and sought to be enacted by Congress; but I am being forced to the conclusion that the main opposition is because of the fact that certain bankers and financiers, together with those they control, desire the Federal reserve system to continue to use its powers to "accommodate business and commerce" and not "for the stabilization of the purchasing power of our monetary unit," which I hold, with Doctor Cassel, Dr. J. R. Commons, and others who have come before this committee, to be the first duty of a financial system set up by any government authority.

When the Federal reserve act creating the Federal reserve system was framed as the administration bill, it contained the direction that the powers so given should be to "accommodate business and com-

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merce" and to aim "to promote stability in the price level," but the House struck out the clause for stabilization, and the Senate did not restore it.

But little information has ever been given as to why this was done, but it was evidently the work of those who did not wish the Federal reserve system used for the stabilization of the purchasing power of money. But to those who have read and followed these hearings it must be evident that the direction to "accommodate business and commerce" is practically no direction whatever and may be interpreted to mean almost anything or nothing. Certainly it was not the intention of Congress that the powers given the Federal reserve system should only be used for the accommodation of those who are engaged in business and commerce.

Realizing this, those who are recognized as the most able of the officers of the Federal reserve system have used their influence to have the powers of the Federal reserve system used for the purpose of stabilization of the purchasing power of our money. This was admitted during the hearings on H. R. 7895, but has sought to be obscured and even denied by some of the members of the Federal Reserve Board that have appeared before this committee at this session; yet the introduction of various charts in these hearings showing the "General price level," "Demand deposits," "Federal reserve credit," "Stock of gold in the United States," "Money in circulation," "Loans and investments," "Price level of various commodities," "Exports and imports," "Foreign exchange rates," "Price movements during a term of years," "Wages," "Cost of living," and "Wholesale prices," etc., which were prepared by economists and statisticians employed by the Federal Reserve Board and Federal reserve banks furnish the best evidence that they were seeking information of price levels and conditions as a basis for determining any change in the policy of the use of the powers of the Federal reserve system that they believed necessary to maintain stable conditions, which, of course, can be secured in no other way than in the stabilization of the purchasing power of money.

Some of the witnesses have used much language in an effort to present reasons to this committee why it should not make a favorable report to the House upon this bill, but such arguments as they did not themselves contradict have been fully controverted and explained by the splendid statement of Dr. J. R. Commons, whose years of study of the subject of stabilization and his knowledge of the Federal reserve system qualify him as one of the best-informed economists on these subjects, and I wish to express my sincere appreciation of the splendid assistance he has rendered during these hearings.

My purpose in presenting various drafts of H. R. 11806 before its introduction at this session of Congress to various officers of the Federal reserve system was because of my earnest desire to have their cooperation in its preparation. My nine years' experience upon this committee has caused me to realize that the Federal reserve system has given us the best financial system of any of the nations of the earth, and I have come to hold in high regard the ability of many of the officers of the Federal reserve system and I had hoped to have their assistance in forming the phraseology to be used in the bill, to

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the end that the directions for the use of the Federal reserve system for stabilizing the purchasing power of money might in no way interfere with the proper operation of the Federal reserve system and I did receive many such helpful suggestions and after the bill was introduced, several suggestions were made, which I have called to the notice of the committee, but in the final conferences it became evident that the decision had been made "to oppose the bill," and it was in an effort to learn what merit, if any, was behind this opposition that I sent the questionnaire to each of the members of the Federal Reserve Board and asked that they be requested to appear before this committee and give their position on the bill and their reasons therefor. That so few of the members of the Federal Reserve Board appeared has been a disappointment to me, and I hope that when the hearings are continued at the next session of Congress they will be willing to come before us and give their views regarding the legislation.

I have stated the reasons for placing paragraph (i) in H. R. 11806, providing for publicity of the decision of the Federal Reserve Board in changing its policies regarding the use of its powers and the reasons therefor, and I want to make it plain that the paragraphs of the bill under section 28A, authorizing and directing the Federal Reserve Board and the Federal reserve banks to continue investigations and studies of the questions named, were suggested to me by those whose long experience with and study of the Federal reserve system have convinced them that such a study of all questions involved in the stabilization of the purchasing power of money by the officers of the Federal reserve system is greatly needed and would result not only in their willingness to so use such powers as have been given them by Congress for such stabilization but also advise them of the best methods to secure such results.

As to the "measure" to be used in determining the purchasing power of our dollar, I believe that the index number of the average of prices of commodities as determined and published each month by the Department of Labor should be adopted.

I do not believe there is any objection to the powers of the Federal reserve system being used to aid the stabilization of financial conditions in other nations, because our extensive trade relations with them make the same most desirable, but the stabilization of the purchasing power of our own money should not be sacrificed by such action.

I, however, do not believe that the powers of the Federal reserve system relating to rediscount rates and open-market operations should be used for the stabilization of the stock market, as the evidence of some of the members of the Federal Reserve Board during this hearing clearly indicates they have attempted to do. It is evident that the inflation in the stock market was and is the result of speculation in stocks and bonds, causing their inflation far above their value if measured by their earning power, and that the sale of Government securities to reduce the volume of money and the raising of the discount rates in an effort to check such speculation has resulted in preventing the expansion of business, so needed in the early spring after the Nation has passed through the depressing effects of the winter months.

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If through the system of brokers' loans so great an amount of the Nation's savings has been drawn into the stock market as to be a menace to the public welfare, the Federal Reserve Board might properly use their power of "advice and publicity," and if necessary recommend to Congress legislation to correct such evil, but certainly gambling in stocks and bonds ought not to divert the Federal reserve system from its responsibility to the Nation at large.

I sincerely regret that these hearings are not to be completed at this session of Congress, but members of the committee have requested the appearance of persons who will not be available before Congress adjourns, and before the consideration of the bill in executive session I want to have all possible information pertaining to the proposed legislation presented. However, at the beginning of the next session I will ask that these hearings be continued to completion when the bill will be taken up for study and amendment by the committee, after which I will move that it be reported favorably to the House.

(Thereupon, at 12.45 o'clock p. m., the committee adjourned.)

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