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Of Credit and Business Conditions

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MONEY MARKET IN DECEMBER

The money market continued tight during most of December and that condition became more acute toward the end of the month. A convergence of peak seasonal credit demands, quarterly corporation tax payments, and the usual heavy demand for currency for the holiday trade created pressure on bank reserves throughout the country and resulted in substantial flows of funds out of New York. A large rise in "float" (credit to bank reserve balances for checks not yet collected from other banks) before Christmas provided only temporary and partial relief, and the contribution of gold and foreign account transactions to reserves, although larger than in most recent months, did not materially offset other pressures. Member banks were able at times during the month to repay part of their borrowings at the Reserve Banks, but the outstanding volume of borrowings frequently was rather high, actually exceeding the aggregate amount of excess reserves for a number of days and generally representing more than one half of the excess balances carried by all member banks.

The repercussions of the unusually severe seasonal strain were reflected in and amplified by the action of several leading New York City banks in raising their commercial loan rates to prime borrowers from 2¾ per cent to 3 per cent on December 19—action which was soon followed by many other banks in various parts of the country. That development was construed in the market as indicative of an upward trend in interest rates, and prices of all maturities of Government securities declined through most of the remainder of the month. Bid yields on the longest outstanding Treasury bills, which began the month at an annual discount of 1.64 per cent, had risen to 1.94 per cent by December 27. The longest-term restricted bonds declined from a bid price of $96^{21}/_{32}$ at the beginning of the month to $95^{28}/_{32}$ on the 27th, reaching a yield of 2.76 per cent, compared with 2.71 per cent at the end of November, and intermediate and shorter maturities of Treasury securities showed considerably greater advances in yield. As the decline in float toward the end of the month caused a contraction of bank reserves in advance of the usual return flow of currency, and member banks were endeavoring to avoid heavy borrowing at the year end, some funds were made available through Federal Reserve open market operations. During most of the month, Federal funds were traded in New York at 1½ to $1^{11}/_{16}$ per cent, or only slightly under the Reserve Bank rediscount rate.

MEMBER BANK RESERVES

Member bank reserves, which had been in extremely tight supply at the end of November, failed to ease significantly through the first two statement weeks of December. As shown in the table, reserves gained through gold and foreign account operations, Treasury transactions, and increases in float were little more than sufficient to offset the heavy expansion of currency in circulation. By December 19, currency in circulation was at an all-time high of 29,263 million dollars, and a further increase of 140 million dollars occurred during the following week, culminating a nine-month outflow that has reached a cumulative total of 2,365 million dollars. As a result of the continuing tightness of bank reserve positions, member banks relied heavily upon borrowing from the Federal Reserve Banks to meet day-to-day and week-to-week adjustments to reserve requirements.

In the statement week ended December 19, the Treasury's December 15 interest payments, along with an expansion of

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Weekly Changes in Factors Tending to Increase or Decrease Member Bank Reserves, December 1951
(In millions of dollars; (+) denotes increase, (—) decrease in excess reserves)

Factor	Statement weeks ended				Four weeks ended Dec. 26
	Dec. 5	Dec. 12	Dec. 19	Dec. 26	
Operating Factors					
Treasury operations*	+ 49	+244	+ 278	− 232	+339
Federal Reserve float	− 74	+148	+1,026	− 781	+319
Currency in circulation	−149	−146	− 226	− 140	−661
Gold and foreign account	+ 28	+ 44	+ 117	− 31	+158
Other deposits, etc	− 12	+ 4	− 101	− 18	−127
Total	−160	+294	+1,095	−1,202	+ 27
Direct Federal Reserve credit					
Government securities	—	—	—	+ 264	+264
Discounts and advances	+476	−249	− 261	+ 348	+314
Total	+476	−249	− 261	+ 612	+578
Total reserves	+316	+ 45	+ 834	− 590	+605
Effect of change in required reserves	+ 15	− 68	− 461	+ 105	−409
Excess reserves	+331	− 23	+ 373	− 485	+196

Note: Because of rounding, figures do not necessarily add to totals.
* Includes changes in Treasury currency and cash.

more than one billion dollars in Federal Reserve float and a relatively large week-to-week gain on foreign account, more than offset large increases in required reserves and currency in circulation, and member banks were enabled temporarily to increase their excess reserves to more than one billion dollars while reducing indebtedness to the Federal Reserve Banks by 261 million dollars. The New York money market, which had been even tighter than the country as a whole early in the month, eased more than the rest of the country in that week, as a result of the concentration of Treasury interest payments in New York City, and the City banks were able to meet a continuing outflow of funds while repaying all of their indebtedness to the Federal Reserve Bank of New York.

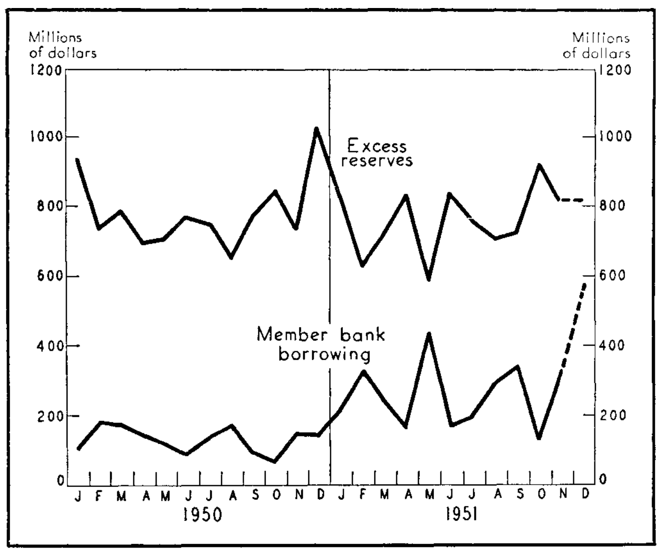
The relative ease of member bank reserves at midmonth was short-lived. In the statement week ended December 26, the record amount of Federal Reserve float was worked down to lower levels and Treasury balances at the Federal Reserve were increased from the proceeds of December tax collections. Flexibility in the use of Treasury "X" balances in qualified depositary banks was indicated when the Treasury announced that only 50 per cent of the tax payments eligible for credit to "X" balances in December could be so credited, the remainder to be paid immediately. Required reserves declined somewhat, and funds were made available by Federal Reserve security purchases, but there was no source of funds adequate to offset all of the losses, and member bank excess reserves were reduced sharply. By the end of December, despite the beginning of the seasonal return flow of currency from circulation during the last few days, member bank reserves were in extremely tight supply as float continued to contract and banks reduced their borrowing from the Federal Reserve to minimal levels to prepare for their December 31 financial statements.

Member Bank Borrowing

The accompanying chart illustrates the reference made above to member bank use of Federal Reserve discount facilities. Member bank borrowing from the System recorded an 18-year high at 959 million dollars in the week ended December 5. In addition to the fact that borrowing by member banks has generally been somewhat greater this year than last, the most striking feature of this chart is the apparent greater sensitivity of bank borrowing to changes in excess reserves in 1951 by comparison with 1950. Whereas in 1950 (and every year since the middle 1930's) aggregate member bank borrowing from the Federal Reserve showed no close relationship to movements in total excess reserves, in 1951 a high degree of inverse correlation is discernible between these two aggregates, member bank borrowings rising when excess reserves decreased and falling when excess reserves rose. In the weeks ended December 5 and 12, and again for a few days near the close of the month, total borrowings were approximately equal to, or in excess of, excess reserves for all member banks.

During many of the years since 1933, excess reserves were so abundant that borrowing to adjust reserves was unnecessary, but since World War II, bank reserves have tended to remain at about normal working levels and periodic adjustment to meet specific situations has been necessary. Fundamentally, the increased use of advances and discounts from the Federal Reserve Banks this past year would seem to be a reflection of the less active role that the Federal Reserve System has played in the Government securities market since March 1951. At that time the last aspect of fixed price supports for Treasury securities was removed and the System was enabled from

Member Bank Excess Reserves and Member Bank Borrowing from the Federal Reserve System
Monthly averages of daily figures, January 1950-December 1951*



* December 1951 is estimated from data through December 25. The figure for excess reserves in November 1951 is preliminary.

that time on to give primary emphasis in its operations to the current credit situation. While individual banks might secure reserves by selling short-term security holdings through the market, banks in the aggregate cannot so gain funds unless the Federal Reserve System is purchasing for the Open Market Account. Thus, the Federal Reserve's moderately restrictive credit policy over recent months has made it increasingly necessary for banks to meet temporary reserve deficiencies by borrowing from the Federal Reserve Banks. In general, reserve funds obtained through member bank borrowing are less likely to be considered by the banks as permanent additions to their reserves than are funds obtained through sales of securities indirectly through the market to the Federal Reserve System, since the borrowed funds represent a contractual debt which must be repaid. The increased willingness of banks to borrow from the Reserve Banks for purposes of making reserve adjustments in 1951, by contrast with the earlier postwar years, may also be partially explained by the corporate surplus profits tax this year which makes it advantageous to many corporations to increase their investment base by borrowing, although there has been no evidence of any tendency for member banks to borrow continuously, or in unnecessarily large amounts to take advantage of this situation.

Government Security Market

Reversing the trend of recent months, nonbank corporations were net sellers of short-term Governments in the first half of December as they adjusted their cash positions to meet the December 15 tax payment, and some of these securities were absorbed by commercial bank buyers. Because of the tight money conditions, however, commercial banks purchased only at rising yields. As a result of the confluence of these forces, short-term yields moved steadily upward, and bids on the bill issue dated December 20 were accepted at an average rate of discount of 1.725 per cent, the highest average issue rate since 1933. Inventories of short-term securities tended to pile up in dealers' hands, and, in the heavy market, dealers widened the spread between their bid and offer quotations, thereby increasing the cost of turn-around operations and perhaps contributing in some measure to the banks' tendency to borrow from the Federal Reserve Banks rather than attempt to obtain funds through sales of Government securities.

After a few days of relative ease during the third statement week, the market became unusually tight for the remainder of the month. The average discount rate on the bill dated December 27 reached 1.865 per cent, dealers' inventories were even further enlarged, and, partly because of year-end bank and corporate adjustments for statement purposes, buying interest in the market was negligible. Increasing uncertainty as to the emerging pattern of rates and year-end adjustments of position caused further marking down of dealers' offering prices so that by December 26, the end of the fourth statement week, three-month Treasury bills were selling to yield in the neighborhood of 1.93 per cent. The System Account took some of the overhanging supply off the market.

Intermediate and longer-term Treasury securities moved irregularly in a thin market through the middle of the month. Bank-eligible issues tended to sell off fractionally on a moderate volume of tax-switching, while restricted issues responded to spotty buying by State funds and other investors and their prices firmed slightly. However, following announcement on December 18 and 19 by most of the large New York City banks that their rates charged prime commercial borrowers would be raised from 2¾ per cent to 3 per cent, prices on intermediate and longer-term securities settled rapidly. The pattern of yield readjustment growing out of the seasonal money market stringency had up to this time been confined largely to the short market, but after the 18th it extended to all market rates. By December 24, both the 2½'s of December 1967-72 (Victory issue) and the bank-eligible 2½'s of September 1967-72, along with most other long and intermediate Treasury issues, had recorded new low quotations, off more than ¾ of a point from their December 17 price levels. This sudden slump was not precipitated by large-scale selling but rather by a tendency for dealers and investors to back away from offerings. In the belief that a pattern of higher interest rates was developing in all parts of the credit structure, the market generally adopted a "wait-and-see" attitude toward the lower prices and higher yields available. For this reason, and because funds for both short and long-term investment were unusually scarce at the year end, both eligible and restricted longer-term bond prices remained at the new low levels until the closing days of December and reflected losses of ⅜ of a point to 1 point over the month through the 28th. Intermediate securities continued to sell off, recording price contractions of ⅜ of a point to 1¼ points for the month to that date.

The 1.1 billion dollars of partially tax-exempt 2¼ per cent bonds of 1951-53, called for redemption December 15, were largely exchanged for the 11½ month, 1⅞ per cent certificates of indebtedness offered by the Treasury. Despite the fact that a taxable short-term security was being offered in exchange for a higher-coupon, partially tax-exempt bond, the market accomplished the exchange smoothly with an over-all cash redemption of less than 5 per cent. The related operations of the Federal Reserve System were nominal in amount and purchases were exactly offset by other sales. Other operations in December included sales contract purchases arranged on several occasions by the Federal Reserve Bank of New York to help dealers carry swollen portfolios of short-term securities over periods of temporary stringency in the market. System Account purchases of short-term securities also provided funds to the market at the peak of money market tightness in the fourth statement week.

Member Bank Credit

Again in December, as in the two preceding months, commercial, industrial, and agricultural loans of weekly reporting member banks in 94 large cities reached new all-time highs. Through December 19, loans in this category had increased by 577 million dollars from their level in the statement week ended November 28, of which 274 million dollars represented credit extended by New York City banks. Allowing for a continued growth in loans to finance defense and defense-supporting activities, however, business loan growth in December appears to be no greater than might have been expected as a result of purely seasonal forces. For the fourth quarter of 1951 through December 19, business loans of reporting member banks increased by 1,364 million dollars, by contrast with 2,076 million dollars for the comparable period in 1950 and 1,221 million dollars average for the postwar years 1946-50.

Three important factors have combined to reduce credit expansion in the fall and winter months of 1951 to more or less normal seasonal proportions, despite the large volume of defense and defense-related credit in the total as contrasted with 1950 and preceding years. One of these is the reduced rate of accumulation of inventories at all levels of the production and marketing process, including the reduced willingness of consumers to add to their holdings of goods after the "scare-buying" waves of 1950 and early 1951. Also important have been the shortages of materials that have restricted production in some industries and the related need for credit. Finally, the tight credit situation that has prevailed over this period, reflected in the highest short-term interest rates since the early 1930's and in the most extensive commercial bank recourse to borrowing from the Federal Reserve System in the same span of years, together with the Voluntary Credit Restraint Program, has acted to reduce credit availability and to make credit more expensive to borrowers.

THE MUTUAL SECURITY PROGRAM

With the launching of the Mutual Security Program, United States foreign aid has entered a new phase. The Mutual Security Act of 1951,[1] the legal basis for the program, differs from previous legislation in that it brings together and coordinates the various types of foreign aid—economic, military, and technical—heretofore administered separately under the European Recovery Program, the Mutual Defense Assistance Program, and the Point Four program.

Since April 1948, the European Recovery Program has been helping Western Europe to re-establish economic stability and restore its productive powers. More recently, after Marshall Plan countries decided to rearm, the Economic Cooperation Administration, through its already functioning machinery, has aided them in expanding their defense production. The ECA, in addition, has undertaken economic-development programs in Southeast Asia, the Philippines, and Formosa. Under the Mutual Defense Assistance Program, which was formally adopted in October 1949, we have been sending military aid, albeit on an initially small scale, to the European members of the North Atlantic Treaty Organization as well as to certain other strategically situated countries. Finally, the Act for International Development of June 1950, codifying the basic ideas of the President's Point Four program, has enabled the United States to make technical know-how available to underdeveloped countries on three continents, either directly or through international organizations.

The individual components of the Mutual Security Program are thus not new. The difference between this program and our foreign-assistance undertakings in fiscal 1951 is one of emphasis and direction rather than of kind. The different types of aid, enacted at various times and motivated by differing needs and circumstances, are now subordinated to one overriding purpose: "to strengthen the mutual security and individual and collective defenses of the free world".

With an appropriation of 7,329 million dollars, allocated as shown in the accompanying table, the program represents our largest *single* foreign-aid venture in any one year since the end of the war. In annual over-all magnitude, however, it ranks second after the approximately 8.1 billion dollars[2] appropriated for all foreign-aid programs during 1950-51.

Although military assistance, in dollar terms, looms largest, constituting approximately 80 per cent of the total sum appropriated, economic aid is nevertheless a vital component of the program. Economic (and technical) assistance is needed to support increased defense efforts and, in the words of Secretary of State Acheson, "to deal with some of the fundamental problems of weakness where weapons alone are no defense". Indeed, in such a nearly world-wide undertaking the kind and amount of assistance needed is likely to vary from country to country. In one case, military equipment may be required; in another, raw materials or machinery to expand domestic military production; in a third, commodities essential to the country's economy. Again, the need may be for technical assistance

[1] Public Law 165, 82nd Congress, 1st Session, approved October 10, 1951.

[2] This included two appropriations for military aid, totaling 5.2 billion dollars, 2.3 billion dollars for the European Recovery Program, and 0.6 billion dollars for miscellaneous economic and technical-aid programs.

Appropriations under the Mutual Security Program for Fiscal Year 1951-52
(In millions of dollars)

Area	Military aid	Economic and technical aid	Total aid
Europe	4,818.9	1,022.0	5,840.9
Spain	—	—	100.0a
Near East and Africa	396.3	160.0b	556.3
Asia and Pacific c	535.3	237.2	772.4
American Republics	38.2	21.2	59.4
Total appropriated	5,788.5	1,440.4	7,328.9d

Note: Because of rounding, figures do not necessarily add to totals.

a Not classified by type of aid.

b Of the total made available, up to 50 million dollars may be contributed to the United Nations program for Palestine refugees. An additional amount, not to exceed 50 million dollars, may be utilized for refugee relief and resettlement projects in Israel.

c Excluding Korea. An unexpended balance of 50 million dollars was authorized to be turned over as United States contribution to the United Nations Korean Reconstruction Agency. An additional 50 million dollars was appropriated to the Army Department for civilian relief in Korea.

d Including 100 million dollars for Spain.

Source: *Mutual Security Appropriation Act, 1952*, Public Law 249, 82nd Congress, 1st Session, approved October 31, 1951.

to improve social and economic conditions, or for training in the use of modern weapons, or for supplies other than military equipment to support a larger contingent of armed forces.

Clearly, in those cases where several forms of aid are needed a delicate balance must be struck, and the right proportion of each judiciously ascertained. Insufficient aid in one form will often merely accentuate the need for another form. Here, Western Europe is the most obvious example. The Mutual Security Program is designed in the main to support the rearmament now under way in that area. Yet, even with separate funds earmarked for military and economic assistance, the dividing line between the two tends to become rather tenuous and both can be looked at as but different aspects of the same phenomenon. Military aid, the furnishing of so-called "end-items" (i.e., finished items of military equipment), alleviates the drain upon a country's economy by freeing resources for other uses. Economic aid, on the other hand, would permit a greater diversion of a country's resources to military production than might otherwise be possible.

Where such a complexity of problems has to be resolved, coordination at the highest possible level is desirable. The Mutual Security Act accordingly authorizes the President to appoint a Director for Mutual Security "in order that the programs of military, economic, and technical assistance . . . may be administered as parts of a unified program . . . and to fix responsibility for the coordination and supervision of these programs in a single person". The Director has the same rank and receives the same salary as the head of an executive department.

The idea of top-level coordination of all foreign-aid programs is not new in itself. It dates back to the creation, in December 1950, of the International Security Affairs Committee (ISAC), headed by a Director, representing the State Department, and consisting in addition of representatives of the Defense Department, the Treasury, the ECA, and the Office of the Special Assistant to the President. The establishment of such a committee had become desirable, if not necessary, since control of the Mutual Defense Assistance Program rested with the State Department, while actual operations were assigned to ECA and the Defense Department. The Director of ISAC was given responsibility, on behalf of the Secretary of State, for matters of policy and programing relating to the North Atlantic Treaty and military and economic assistance for mutual defense. It was further stipulated that he was to provide "continuing leadership in the interdepartmental coordination of policy" and that in performing this function he would be "exercising responsibility for the Government as a whole". In setting up the new program, however, Congress scrapped the International Security Affairs Committee, vesting authority for supervision and coordination in a single individual, outside of any Government department and reporting directly to the President.

On the operational level, responsibility by a different agency for the actual administration of each particular type of aid is retained. Thus, the military-assistance part of the program—involving military planning, provision of military end-items, supervision of end-item use by the recipient countries, and military training—will continue to be administered by the Defense Department. Likewise, the Department of State, through the Technical Cooperation Administration, retains administration of the Point Four program, including the activities of the Institute of Inter-American Affairs.

In the field of economic aid, hitherto the domain of the Economic Cooperation Administration, the new legislation provides for the termination of that agency, establishing in its stead a successor organization, the Mutual Security Agency (MSA), which assumes ECA's functions through June 30, 1952, when the powers given to ECA will formally lapse.[3] MSA will thus be temporarily in charge of all ECA economic-aid programs, both in Europe and Asia.

Beginning with fiscal 1953 the primary responsibility of the new agency will lie in the furnishing of economic aid to "sustain and increase military effort" in countries that are recipients of United States military assistance. In addition, limited economic assistance may be rendered to countries for which the United States has special responsibilities "as a result of . . . joint control arrangements", such as Austria. This means in effect that after June 30, 1952 no economic assistance can be provided for recovery purposes and, save for "joint-control" countries, none can be provided except in support of the countries' defense efforts.

W. Averell Harriman, who is also the Director for Mutual Security, heads MSA. This arrangement is probably not accidental. Economic aid to bolster the Western European econo-

3 Only those powers and responsibilities, granted by the original Economic Cooperation Act, that are considered by the President necessary to carry out the purposes of the new legislation, are permitted to extend beyond that date.

mies during the crucial conversion period is an important factor in our whole aid structure, and the task will be facilitated if the same individual is responsible both for the administration of the aid and for fitting it into the larger framework of the Mutual Security Program. Despite the similarity in names it would be wrong to infer that MSA is responsible for the coordinating and supervisory functions conferred upon the Director. The Mutual Security Agency, an operating body, is entrusted with the planning and administering of economic aid; the larger powers of coordination of all types of aid (including military and technical) given the Mutual Security Director are merely concomitant with those exercised by him as head of MSA, but do not spring from his holding the latter position.[4] Indeed, the change-over from ECA to MSA implies primarily a change in name to indicate the shift in emphasis in the new agency's operations. It does not imply a radical change in organization or personnel, much less an abrupt break in activities. The new agency continues to enjoy the same administrative independence which ECA had; responsibility for its operation has been delegated to Mr. Harriman's deputy, Richard M. Bissell, Jr., who since last September has been Acting Administrator of ECA.

While the appropriations generally set limits up to which funds may be obligated for the areas and the type of aid specified, certain clauses of the Mutual Security Act permit the transfer of a designated portion of the funds, and thus introduce an element of flexibility into the program and make it possible, to a small degree, to deal with sudden emergencies without additional legislation. In view of the changing nature of the defense effort of Western Europe and the close interrelation of economic and military aid, the President is authorized to transfer an amount not exceeding 10 per cent of the total funds appropriated for the area from either type of assistance to the other. Again, military assistance to the Near East—so far scheduled only for Greece, Turkey, and Iran—may, at the discretion of the President, be given to any other country of that region in an amount not exceeding 10 per cent of the appropriated funds. Finally, a provision of considerably wider scope allows for the shift of funds on a world-wide basis, thus making for a fair amount of leeway in the geographical allocation of either military or economic-aid funds. Whenever he determines it "to be necessary for the purpose" of the Act, the President may transfer, within each category, 10 per cent of the appropriated funds from one area to any other.

Another interesting provision of the Mutual Security Act, which once more tends to emphasize the almost global character of the new program, concerns the guaranteeing of private foreign investment. The new program takes over and makes available to a much larger area the investment guaranties initiated by the Economic Cooperation Administration. These guaranties were designed to encourage investments which would foster the broad objectives of the European Recovery Program; the projects themselves had to be approved by the government of the participating country concerned. The guaranties, granted for investments both in tangibles and intangibles, such as patents, covered the convertibility risk as well as losses through expropriation and confiscation; ordinary business risks or losses through exchange-rate fluctuations and through war damage were not covered. These guaranties were limited to investments in Marshall Plan countries and their overseas dependencies. The new legislation provides considerably broadened coverage by including "any area" which is to receive United States aid under the Act. To date, the ECA guaranty powers have been utilized only on a relatively modest scale[5] and ample opportunity would thus seem to exist for applying them to private investment in other parts of the world.

With the Mutual Security Program now midway through its first year, the question of the possible magnitude and scope of the program after fiscal 1952 is still uncertain at this point, although the President's forthcoming budget message should give a preliminary idea of the over-all amount envisaged for 1952-53. At the time the European Recovery Program was under discussion, it will be recalled, the concept of a program extending over a period of four years was being widely propagated and became firmly embedded in the public mind. Indeed, the target date of June 30, 1952, underlay and at the same time dominated all preliminary studies of the program. All estimates and forecasts of expanded production and trade of the participating countries and of the ensuing gradual reduction of the balance-of-payments deficits of these countries with the rest of the world were encompassed within a four-year framework and were oriented toward that key date when United States aid would terminate.

Although it is common knowledge that the new program is to support the building-up of an adequate NATO defense force by 1954, no similar comprehensive schedule has been made public in this case. It is true that the Mutual Security Act fixes June 30, 1954, as the date on which the authority to grant assistance under the Act ceases; an additional year thereafter is allowed for the delivery of goods in the pipeline and the liquidation of all operations in progress. But this is to serve as a mere legislative reference point, permitting subsequent

[4] Mr. Harriman thus occupies two separate, although closely related positions. As Mutual Security Director he is furthermore charged by Congress with administering the legislative ban on aid to nations shipping potential war materials to the Soviet bloc. A fourth function at present assigned to him, independently of the other three, is that of United States representative on the Temporary Council Committee of the North Atlantic Treaty Organization which is to reconcile European and American views on the size and distribution of the rearmament burden.

[5] Although guaranties may be given up to a total of 200 million dollars, only 41.9 million had been issued by the end of last September.

appropriations under an already established program, and does not offer a concrete promise of uninterrupted assistance up to that time.

However, during the lengthy hearings on the Mutual Security Program which took place during the early summer of 1951 before Congressional committees, the idea of a three-year program—through June 1954—sounded like a recurring theme through the testimony of all major witnesses, such as Secretary Acheson, General Marshall, and the then ECA Administrator William C. Foster. During these hearings the cost of the entire program through fiscal 1954 was repeatedly estimated at 25 billion dollars. Yet, no official pronouncement to this effect has come forth so far. On the contrary, Secretary of the Treasury Snyder recently stated that the United States had made no commitments with respect to aid beyond the appropriations for the current fiscal year.

The absence of such commitments has in fact caused apprehension in the countries of Western Europe, since any goal which the combined defense efforts of those countries are to achieve over the next two or three years is predicated upon the availability of such United States resources as they are unable to supply themselves. Of more immediate concern to European countries, however, since it involves the funds actually voted for the current fiscal year, are the relative magnitudes of the military-aid and economic-aid components. By the late fall of 1951 there had appeared many indications that the worsening economic condition of the major rearming countries would necessitate not only full utilization of the current economic-aid appropriations, but also the drawing on such other dollar funds as could be made available, in one form or another, for economic assistance to these countries. At the time of writing, reports are pointing to a possible transfer of the maximum amount permissible—10 per cent of total appropriations for Europe, or approximately 580 million dollars—from the military to the economic sector. In addition, Western Europe is likely to benefit, perhaps up to 1 billion dollars, from the construction of military installations in NATO countries, financed by military-aid funds, and from procurement of goods for the United States armed forces, paid for out of regular United States military appropriations.

The anticipated utilization of these additional amounts, over and above the economic aid originally envisaged, points up once more the extent to which rearmament and economic capabilities are interrelated. Military aid alone cannot benefit an economy that is not sufficiently strong or stable to absorb such aid; in other words, the success of the Mutual Security Program depends just as much on a concerted effort on the part of our allies to achieve economic stability as on assurances that sufficient aid will be forthcoming to permit rearmament goals to be fulfilled.

CONSUMER INSTALMENT CREDIT OUTSTANDING

Among the statistics regularly included in the Business Indicators table are figures on the total amount of consumer instalment credit outstanding. Instalment credits are defined as credits which are extended to individuals for the purchase of consumer goods or services and which are to be repaid in two or more instalments sometime in the future.[1] The amount of consumer instalment credit outstanding usually moves with the business cycle. Unlike some of the other series in the Business Indicators table which have been described in previous articles, the consumer credit totals have not been consistently either a "leading" or "lagging" series. The importance of this kind of credit to the business observer lies in its effect on consumer purchasing power. The use of instalment credit tends to increase in periods of rising business activity, thus expanding consumer purchasing power, and tends to decrease in periods of recession, thus reducing purchasing power. The effect of these swings is usually felt most heavily by the consumers' durable goods industries since the largest part of the credits are extended either directly or indirectly for the purpose of purchasing such goods as automobiles and major household appliances.

Changes in the amount of instalment credit in use are particularly significant today. Consumer instalment credit is highly volatile and may expand or contract rapidly. In an inflationary period, increases in the amount outstanding may have as important an effect on the economy as increases in business or mortgage loans. In the summer of 1950, for example, monthly increases in instalment credit outstanding were more than 400 million dollars. If that rate of increase had continued unchecked, the total increase for the year would have been about 4 billion dollars. The total increase in the commercial, industrial, and agricultural loans of all insured commercial banks during 1950 was 4.8 billion dollars.

The figures for consumer instalment credit shown in the accompanying table are estimates of the amount outstanding at the end of each month. They are prepared by the Board of Governors of the Federal Reserve System on the basis of voluntary reports submitted monthly to the twelve Federal Reserve Banks by a representative group of dealers and lending agencies. The ability of this sampling to provide accurate estimates of the total credit outstanding is checked by comparison with census data, annual reports of Federal and State supervisory authorities, and other sources of bench-mark data as they become available. The estimates are published regularly in the *Federal Reserve Bulletin* and the *Survey of Current Business.*

[1] Strictly speaking most residential mortgage credit should be included in these figures, but historically it has not been. Repair and modernization loans, however, are included in the consumer series.

Back figures, beginning with January 1929, are obtainable from the Board of Governors.

The figures for total instalment credit outstanding, as the table illustrates, are composed of two principal components: (1) sale credit, which is credit extended in the first instance by the dealer who sells the automobile, refrigerator, or other commodity involved; and (2) cash loans, which are loans made directly to individuals by banks, small loan companies, or other financial agencies either for the purchase of some consumer good or for other consumer purposes such as medical expenses, vacations, or the consolidation of debt. The *Federal Reserve Bulletin* breaks down these two components into subtotals for the major types of dealers and lending agencies which compose them; these are also shown in the accompanying table. Consumer credit statistics were originally developed by the National Bureau of Economic Research and the Department of Commerce. They were taken over by the Federal Reserve System early in World War II when the Board of Governors was first asked to regulate the terms of consumer credit, and the components of the series as shown in the table remain in substantially the same form as those originally developed. The

Consumer Instalment Credit Outstanding Classified by Type of Dealer or Agency Where It Originated, October 31, 1951*

(In millions of dollars)

Type of credit	Amount outstanding
Sale credit	*7,324*
Automobile dealers	4,129
Department stores and mail-order houses	1,056
Furniture stores	873
Household appliance stores	603
All other retail stores	663
Direct cash loans	*5,843*
Commercial banks	2,523
Small loan companies	1,191
Industrial banks	299
Industrial loan companies	222
Credit unions	535
Miscellaneous lenders	168
Insured repair and modernization loans	905
Total instalment credit	13,167

* The figures are estimates and are preliminary.

Business Indicators

Item	Unit	1951 November	1951 October	1951 September	1950 November	Percentage change: Latest month from previous month	Percentage change: Latest month from year earlier
UNITED STATES							
Production and trade							
Industrial production*	1935-39 = 100	218p	218	219	215r	#	+ 1
Electric power output*	1935-39 = 100	338	335	330	306	+ 1	+ 11
Ton-miles of railway freight*	1935-39 = 100	—	200p	208	191	— 4	— 4
Manufacturers' sales*††	billions of $	—	22.4p	20.7	20.5	+ 8	+ 8
Manufacturers' inventories*††	billions of $	—	41.3p	41.1	32.2	#	+ 33
Manufacturers' new orders, total††	billions of $	—	23.7p	21.2	21.4	+12	#
Manufacturers' new orders, durable goods††	billions of $	—	11.4p	9.9	10.3	+15	— 6
Retail sales*††	billions of $	12.4p	12.6	12.3	11.8	— 1	+ 5
Residential construction contracts*	1923-25 = 100	—	265p	279	284	— 5	— 10
Nonresidential construction contracts*	1923-25 = 100	—	258p	271	323	— 5	— 15
Prices, wages, and employment							
Basic commodity prices†	Aug. 1939 = 100	327.5	331.1	325.7	343.8	— 1	— 5
Wholesale prices†	1926 = 100	178.3p	178.1	177.6	171.7	#	+ 4
Consumers' prices†	1935-39 = 100	188.6	187.4	186.6	176.4	+ 1	+ 7
Personal income* (annual rate)	billions of $	—	257.5p	253.6	236.4r	+ 2	+ 10
Composite index of wages and salaries*	1939 = 100	—	228p	227	214	#	+ 7
Nonagricultural employment*	thousands	46,370p	46,355	46,435r	45,501r	#	+ 2
Manufacturing employment*	thousands	15,734p	15,723	15,787r	15,635r	#	+ 1
Average hours worked per week, manufacturing†	hours	40.3p	40.4	40.6	41.1r	#	— 2
Unemployment	thousands	1,828	1,616	1,606	2,240	+13	— 18
Banking and finance							
Total investments of all commercial banks	millions of $	—	73,730p	72,590p	73,870	+ 2	— 1
Total loans of all commercial banks	millions of $	—	56,750p	55,960p	51,510	+ 1	+ 14
Total demand deposits adjusted	millions of $	—	94,960p	92,000p	90,300	+ 3	+ 6
Currency outside the Treasury and Federal Reserve Banks*	millions of $	28,526	28,387	28,270	27,298	#	+ 4
Bank debits* (U. S. outside New York City)	billions of $	88.3	88.1	81.2	80.7	#	+ 9
Velocity of demand deposits* (U.S. outside New York City)	1935-39 = 100	99.1	98.6	102.8	97.7	+ 1	+ 1
Consumer instalment credit outstanding†	millions of $	—	13,167p	13,163p	13,306r	#	— 2
United States Government finance (other than borrowing)							
Cash income	millions of $	4,289p	2,857	6,555	3,487	+50	+ 23
Cash outgo	millions of $	5,648p	5,803	4,862	3,415	— 3	+ 65
National defense expenditures**	millions of $	3,430	3,459	2,970	1,607	— 1	+113
SECOND FEDERAL RESERVE DISTRICT							
Electric power output* (New York and New Jersey)	1935-39 = 100	233	232	238	217	#	+ 8
Residential construction contracts*	1923-25 = 100	—	117p	144	170	—19	— 21
Nonresidential construction contracts*	1923-25 = 100	—	162p	182	176r	—11	— 11
Consumers' prices† (New York City)	1935-39 = 100	184.1	183.0	182.5	173.2	+ 1	+ 6
Nonagricultural employment*	thousands	—	7,256.1p	7,278.4	7,187.6r	#	+ 1
Manufacturing employment*	thousands	2,596.4p	2,581.9	2,611.4	2,576.3r	+ 1	+ 1
Bank debits* (New York City)	billions of $	48.2	48.0	43.8	47.0r	#	+ 2
Bank debits* (Second District excluding N. Y. C. and Albany)	billions of $	3.9	3.9	3.5	3.7	— 1	+ 7
Velocity of demand deposits* (New York City)	1935-39 = 100	114.4	114.4	116.6	114.4	#	#

p Preliminary. r Revised. † Seasonal variations believed to be minor; no adjustment made.
* Adjusted for seasonal variation. †† Series revised 1948 to date.
# Change of less than 0.5 per cent. ** Series revised to include Defense Production Act outlays which have become significant in recent months.

Source: A description of these series and their sources is available from the Domestic Research Division, Federal Reserve Bank of New York, on request.

figures shown in the Business Indicators table do not include noninstalment consumer credits (charge accounts, single-payment loans, and service credit) which totaled about 6.2 billion at the end of October, and which are added to instalment credit to give the figure for total consumer credit outstanding.

The single most important reason why consumers borrow is to purchase automobilies. Loans for such purchases accounted for over 5.5 billion of the 13.2 billion dollars of consumer instalment loans outstanding at the end of October (the latest date for which figures are available). Automobile dealers, as might be expected, initiate more credit than any other single group of dealers or lending agencies.[2] Direct loans of commercial banks account for the next largest total. Commercial banks also purchase substantial amounts of consumer paper from dealers, but these loans are not shown in the commercial bank figures in the table since they are counted where they originate. Counting both direct loans and purchased paper, the banks currently hold about 40 per cent of the 13.2 billion dollars of consumer instalment credit outstanding. In addition, of course, they make loans to sales finance companies or to dealers to enable them to carry consumer loans, but such loans, like the purchased paper, are included with the figures for dealers.

The amount of consumer instalment credit in use grew very rapidly after the end of the war, as consumers' durables once again became available in growing volume. The accompanying chart shows the growth of the two principal components of instalment credit (sale credit and cash loans) from the end of 1946 through October 1951. In that period the total amount in use grew from approximately 4 billion dollars to over 13 billion. The prewar peak was a little over 6 billion.

The extremely sharp rise in the use of credit during the middle of 1950, especially after the outbreak of the Korean war, led Congress to direct the Federal Reserve System once again to attempt to control the expansion of instalment credit by imposing higher down payment requirements than were currently being asked by most dealers and by shortening the period within which instalment repayments could be made. Regulation W was, therefore, reissued effective September 18, 1950. As the

[2] Automobile dealers, however, usually hold only a small proportion of the paper they initiate. Most of it is sold almost immediately to a sales finance company or to a bank.

Consumer Instalment Credit

Estimated amounts outstanding at end of month, December 1946-October 1951

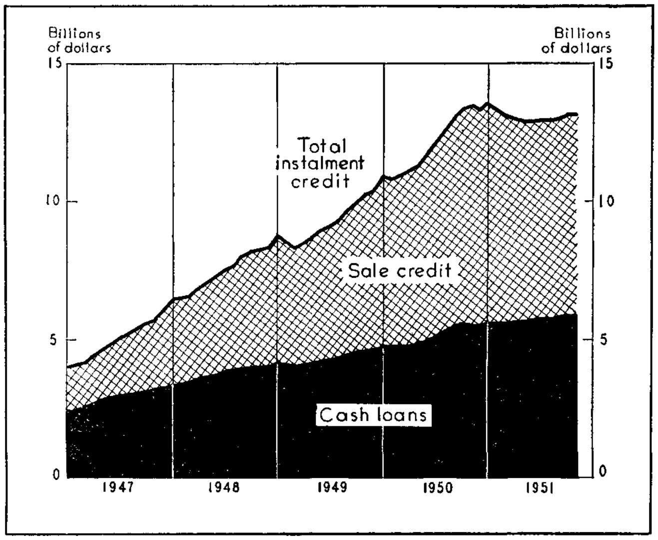


chart shows, following the reimposition of controls, the amount of such credit in use leveled off abruptly. A small seasonal increase took place in December 1950, which, in turn, was followed by a reduction in the early part of 1951 as Christmas purchases were paid for. The total amount outstanding then remained fairly stable from the end of February through July. Effective July 31, in accordance with the provisions of the amended Defense Production Act, the terms of Regulation W were liberalized. The maximum maturity of all regulated credits was extended from 15 to 18 months, with the exception of credits extended for the repair or modernization of homes, for which the maturity was extended from 30 to 36 months, and the amount of down payment required in instalment purchases of major household appliances was reduced from 25 to 15 per cent. As a result of this liberalization, the amount of credit outstanding began to rise, although at a much slower rate than had been evidenced before the Regulation was reinstituted. Seasonal end-of-year demands for credit probably carried the total up somewhat further. The amount outstanding at the end of December, nevertheless, may have been about 200 million dollars less than the 13.5 billion outstanding at the end of 1950.

SUBSCRIPTIONS TO MONTHLY REVIEW

The *Monthly Review of Credit and Business Conditions* is sent free of charge to anyone who is interested in receiving it. If you are not already on the mailing list and wish to receive the *Review* regularly, please write to the Domestic Research Division, Federal Reserve Bank of New York, New York 45, N. Y., and your name will be added to the mailing list.

The Federal Reserve Bank of New York also publishes an *Annual Report,* which appears usually in March or April. Upon written application to the Press and Circulars Division, the *Annual Report* will be sent without charge to those interested.

REVISED INDEXES OF DEPARTMENT STORE SALES AND STOCKS

For many years, the research departments of the twelve Federal Reserve Banks and the Division of Research and Statistics of the Board of Governors of the Federal Reserve System have regularly published indexes of department store sales and stocks relating to their respective Federal Reserve Districts and to the United States as a whole.[1] These indexes, which are generally available on a monthly basis beginning with January 1919, have proved to be very useful not only to the reporting stores whose cooperation has made these series possible, but also to retailers in general, trade associations, marketing research organizations, and to many others concerned with business developments. The usefulness of the indexes is not confined to their primary function as measures of department store sales and stocks; generally, these indexes are also indicative of business conditions in other segments of retail trade. Thus, it is important that the composition of the data underlying the indexes be reviewed periodically and, where necessary, revised in order that the indexes may better serve the purposes for which they were originally constructed. Furthermore, from time to time the base from which the indexes are measured must be brought forward to offer a more meaningful comparison with current developments in department store trade and in the economy as a whole.

In the past, numerous revisions of varying importance have been made in the department store sales and stocks series. When originally published in 1922, these indexes were measured from a 1919 base period. Six years later, 1923-25 was established as the base, and when the 1939 *Census of Business* data became available the base period was shifted again, this time to the average of the five years from 1935 through 1939. Recently, with the comprehensive data of the 1948 *Census of Business* serving as a bench mark, another major revision has taken place—one aspect of which was the establishment of a new base period, the average of the three years from 1947 through 1949.

In addition to the forward shift of the base period, an important revision of the indexes resulted from the adoption of a new definition of a department store for the 1948 *Census of Business*. In preceding years, and for the *Census of Business* covering the year 1939, department stores were defined as:

"General-merchandise stores with annual sales in excess of $100,000, or with ten or more employees. These stores are usually of the full-service type, carrying men's, women's, and children's apparel and shoes, furnishings and accessories, dry goods, homewares, and many other lines. Furniture and hardware are often but not necessarily represented, although homefurnishings, draperies, curtains, and linen are almost invariably carried."[2]

This had been the official definition used by the Federal Reserve System and other governmental agencies in assembling, classifying, and publishing department store trade data. The Federal Reserve System's indexes on the 1935-39 base were thus a measure of department store sales and stocks as described by this definition.

Prior to the collection of data for the 1948 *Census of Business,* however, it was decided that because of changes in retailing practices during the preceding decade and because the increase in the general price level made it relatively easy for stores in other classifications of the general merchandise group to attain annual sales in excess of $100,000, other criteria were needed. As a result, a more restrictive definition was adopted eliminating any consideration of sales volume and at the same time stating more explicitly the principal attributes of the department store as it exists today. The following definition was developed:

"Department stores are retail stores carrying a general line of *apparel,* such as suits, coats, dresses, and furnishings; *homefurnishings,* such as furniture, floor coverings, curtains, draperies, linens, major household appliances and housewares, such as table and kitchen appliances, dishes, and utensils. These and other merchandise lines are normally arranged in separate sections or departments with the accounting on a departmentalized basis. The departments and functions are integrated under a single management. Establishments included in this industry normally employ 25 or more persons."[3]

To comply with this revised definition, adjustments were made in the data of the reporting sample and are reflected in the new indexes on a 1947-49 base. These changes resulted in the dropping of some stores and the addition of others. For the most part, however, only stores doing a small volume of business were involved and, therefore, the resulting net reduction in department stores in the series was considerably less significant in terms of dollar volume than it was in terms of number of stores. In the Second District, the net reduction stemming from the changed definition involved less than 1 per cent of the dollar volume of department store sales reported to this bank for 1939.

A further adjustment in the indexes was needed to offset the downward bias resulting from the use of a constant sample of stores over an extended period of time when there is a net increase in the total number of department stores in existence or when there is a more rapid growth of sales among stores not in the sample. However, because of frequent additions to the

[1] Similar data for many cities throughout the United States are also regularly published by the various Federal Reserve Banks.

[2] *Standard Industrial Classification Manual for Nonmanufacturing Industries,* U. S. Government Printing Office, 1942 edition, p. 62.

[3] *Ibid.,* May 1949 edition, p. 74.

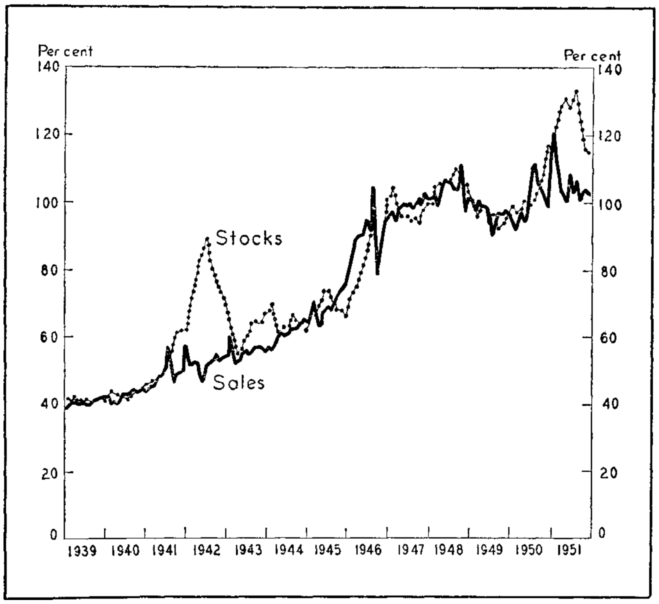
reporting sample, the adjustment required—to equate the percentage change in the annual indexes of department store sales in this District between 1939 and 1948 with comparable census data—was only about 2 per cent of total 1948 sales.

Revision of the indexes of department store stocks involved somewhat different techniques as suitable bench-mark data were not available in the 1948 *Census of Business.* Estimates of end-of-month department store stocks during 1948 were derived by multiplying the stocks-sales ratios of a constant sample of stores reporting both sales and stocks by total sales of all department stores as determined by the 1948 *Census of Business.* The use of this method was based on the assumption that inventories of all department stores move in the same manner as do inventories of the stores reporting both sales and stocks. This assumption was supported by the fact that the relative monthly changes in sales of these two groups of stores showed very little difference during a test period. After estimates of total department store stocks had been computed for the new base period, the adjustment of the new index series to a 1947-49 base was accomplished by the same methods used in the revisions of the department store sales index.[4]

In addition to the major changes in the indexes of department store sales and stocks, the seasonal adjustment factors for both series were reviewed and revised where necessary. Seasonality is an important characteristic of department store trade and, while the seasonal pattern of department store sales is sharply delineated and varies little from year to year, gradual shifts in consumer buying habits are observable over a period of years. As a result, revisions in the factors used to eliminate seasonal influences from the data are necessary. In reviewing the seasonal pattern of department store sales in this District for the past ten years no particularly significant changes in basic buying habits were noticeable, although since 1939 July has gradually increased its share of the year's business, while October has steadily declined in importance. These changes, as well as those which resulted primarily from conditions that developed during World War II, are reflected in the recently revised seasonal adjustment factors.

The end result of the rather extensive review of department store trade data in this District and of the revisions that followed is shown in the accompanying chart.

Indexes of Department Store Sales and Stocks
Second Federal Reserve District, 1939-51*
Monthly indexes adjusted for seasonal variation
1947-49 average=100 per cent



* The December 1951 sales figure is estimated; latest figure shown for stocks is November.

4 A detailed description of the methods used appears in the December 1951 issue of the *Federal Reserve Bulletin.* A reprint of this article and tabulations of monthly indexes of Second District department store sales and stocks, from 1919 to date, may be obtained upon request from the Domestic Research Division, Research Department of this bank.

DEPARTMENT STORE TRADE

Although a late surge in Christmas buying during the week ended December 22 did much to improve the comparative sales performance of Second District department stores during December, the year-to-year declines earlier in the month were too large to be offset entirely by the heavy sales of the last full week before Christmas. As a result, the dollar volume of department store sales in this District during December is estimated to have been about 4 per cent below the record level of December 1950.

While the year-to-year comparison of sales for the Christmas season as a whole (measured from the first Monday after Thanksgiving through Christmas Eve) was somewhat more favorable—2 per cent below the volume of the like period in 1950—this comparison was affected by the fact that there was one more pre-Christmas shopping day in 1951. Reduced to an average daily basis, thus eliminating calendar irregularities, Second District department store sales during the 1951 Christmas shopping season were about 5 per cent below those of 1950, or about the same as in 1949 when retail prices of department store merchandise were approximately 15 per cent below current levels.

Trade observers were generally of the opinion that unseasonably warm weather early in December and frequent rain and snowstorms later in the month had a great deal to do with keeping sales below pre-season expectations. While there is little doubt that weather conditions strongly influence retail activity, other factors of a more fundamental nature appeared to have had significant effects on department store trade during the Christmas season and the month of December as a whole.

The extensive buying of household durables during the summer of 1950 and January and February 1951 sharply re-

Indexes of Department Store Sales and Stocks
Second Federal Reserve District
(1935-39 average=100 per cent)

Item	1951			1950
	Nov.	Oct.	Sept.	Nov.
Sales (average daily), unadjusted	317	262	257	302
Sales (average daily), seasonally adjusted*	246	240	252	234
Stocks, unadjusted	299	294	289	306
Stocks, seasonally adjusted	260	261	274	266

* The seasonal factors used to adjust these indexes do not reflect the revisions included in the factors applied to the indexes on a 1947-49 base. Hence, the month-to-month movements of these indexes do not coincide with those of the seasonally adjusted sales indexes shown in the adjacent table.

Revised Indexes of Department Store Sales and Stocks*
Second Federal Reserve District
(1947-49 average=100 per cent)

	1951			1950
	Nov.	Oct.	Sept.	Nov.
Sales (average daily), unadjusted	131	108	106	124
Sales (average daily), seasonally adjusted	104	103	101	99
Stocks, unadjusted	132	130	129	134
Stocks, seasonally adjusted	115	115	122	117

* Tabulations of these indexes on a 1935-39 base, from January 1919 through November 1951 (revised back to 1940) and correction factors for converting indexes from a 1947-49 base to a 1935-39 base are available upon request from the Research Department, Domestic Research Division of this bank.

duced subsequent consumer demand for these items, and thus the "big ticket" items, which are far more important in terms of dollar volume than in the number of units sold, were not moving well. An indication of the extent to which sales of hard goods lagged behind year-earlier figures is contained in preliminary reports of New York City department stores where, for the four weeks ended December 22, sales of furniture, rugs, radio and television sets, and major appliances were down 4, 11, 25, and 30 per cent, respectively, as against the comparable four weeks last year.

More important perhaps than the relatively poor showing of the durable goods departments was the general increase in prices of "cost-of-living" items, particularly food, during the past year. Steadily rising food prices, which generally have no great effect on the physical amounts of food purchased, have taken a larger share of the family budget and as a result have restricted somewhat the consumer's ability to spend more freely for less essential goods. (According to the Bureau of Labor Statistics indexes of consumer prices in New York City, the retail price of food has increased by almost 10 per cent since November 1950. Similar conditions undoubtedly prevail in other areas of the Second District.)

Combined with increased food costs, similarly higher prices of apparel and homefurnishings have apparently made consumers somewhat more "price conscious" than they were at the same time a year earlier. This may help to explain why many retailers reportedly characterized their Christmas business as consisting of "more shopping than buying" and why the basement departments of New York City department stores generally did much better during the Christmas season, in terms of year-to-year sales comparisons, than did their upstairs, or main store counterparts.

It may be relevant that, while the national income data published by the U. S. Department of Commerce indicate that the increase in personal disposable income (on a nation-wide basis) through the third quarter of 1951 was somewhat larger than the rise in the cost of living during the same period, a comparable increase in real income apparently did not occur in many sections of the Second District, particularly the New York metropolitan area. While it is generally agreed that retail prices in this District have risen at about the same rate as in the rest of the country, it is not likely that the increase in personal disposable income attained the same proportions. The predominance of nondurable goods and service industries, which have not benefited as much from the defense program as have the durable goods industries, tends to exert a stabilizing effect on wages and salaries in this District, holding the rise of personal disposable income in the Second District to a slower rate than that experienced in the United States as a whole.

These factors may explain, at least in part, why department store sales in this District during the Christmas season did not do as well as those in the rest of the country and why local retailers generally received less business than they had expected.

Department and Apparel Store Sales and Stocks, Second Federal Reserve District, Percentage Change from the Preceding Year

Locality	Net sales		Stocks on hand Nov. 30, 1951
	Nov. 1951	Jan. through Nov. 1951	
Department stores, Second District	+ 6	+ 6	− 2
New York City	+ 4	+ 5	− 2
Nassau County	+ 19	+ 15	+ 10
Northern New Jersey	+ 6	+ 6	− 6
Newark	+ 5	+ 6	− 7
Westchester County	+ 18	+ 15	+ 6
Fairfield County	+ 11	+ 6	− 3
Bridgeport	+ 10	+ 7	− 1
Lower Hudson River Valley	+ 8	0	− 6
Poughkeepsie	+ 10	+ 1	− 2
Upper Hudson River Valley	+ 7	+ 8	− 3
Albany	+ 3	+ 8	− 6
Schenectady	+ 10	+ 7	− 2
Central New York State	+ 11	+ 7	+ 1
Mohawk River Valley	+ 8	+ 3	− 7
Utica	+ 9	+ 3	− 7
Syracuse	+ 13	+ 8	+ 7
Northern New York State	+ 9	+ 6	− 3
Southern New York State	+ 15	+ 7	− 1
Binghamton	+ 15	+ 5	− 3
Elmira	+ 18	+ 8	+ 2
Western New York State	+ 6	+ 7	0
Buffalo	+ 6	+ 6	− 3
Niagara Falls	+ 8	+ 7	− 2
Rochester	+ 6	+ 7	+ 1
Apparel stores (chiefly New York City)	+ 4	+ 1	− 1

NATIONAL SUMMARY OF BUSINESS CONDITIONS

(Summarized by the Board of Governors of the Federal Reserve System, December 28, 1951)

General business activity continued to show little change at the end of 1951. Industrial output, construction activity, employment, retail sales, and wholesale prices remained somewhat below the peaks reached earlier in the year and were at about the same levels as at the end of 1950. Consumer incomes and prices were above year-ago levels. Total bank credit outstanding and the privately held money supply were also larger than at the end of 1950.

Industrial Production

The Board's index of industrial production in November held steady at the October level of 218 per cent of the 1935-39 average. Nondurable goods output remained at the reduced October rate, while a small increase in production of durable goods was offset by a decline in mining.

Steel production was at a new record as electric furnace utilization in November reached rated capacity for the first time since early 1949 and despite scrap shortages, steel mill activity increased slightly further in early December. Refinery output of nonferrous metals was practically unchanged from the postwar high of October. Over-all activity in producers' equipment and munitions industries continued to expand somewhat. Auto assembly declined further in November and December; assemblies will be close to 1.1 million units in the fourth quarter, about one-third below the corresponding period last year.

Output of the textile and leather industries was unchanged in November following sharp curtailment in previous months. Paperboard production, however, continued to decline in November, while output at most paper mills apparently remained at very high levels.

Reduced minerals production in November reflected largely a cut in crude petroleum which more than offset further expansion in bituminous coal mining. Iron ore mining decreased somewhat more than seasonally from earlier record levels.

Construction

Value of construction contract awards declined seasonally in November, reflecting decreases in most categories of private awards. The 76,000 housing units started in November brought the 11-month total to 1,023,000 units, 21 per cent less than the record started in the comparable 1950 period. Expenditures for construction put in place, allowing for seasonal influences, were little changed from October, and about as large as in November 1950.

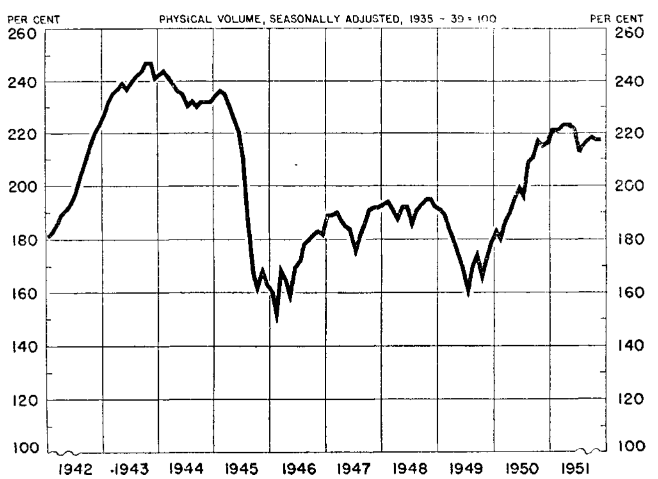
Employment

Seasonally adjusted employment in most nonagricultural lines in November remained at or close to October levels, and total nonagricultural employment continued slightly below the mid-1951 peak. At 40.3 hours, the average work week at factories was little changed from October, while average hourly earnings rose slightly to a new peak of $1.62. Unemployment increased by 200,000 to 1.8 million, reflecting to some extent the seasonal curtailment of outdoor activities.

Agriculture

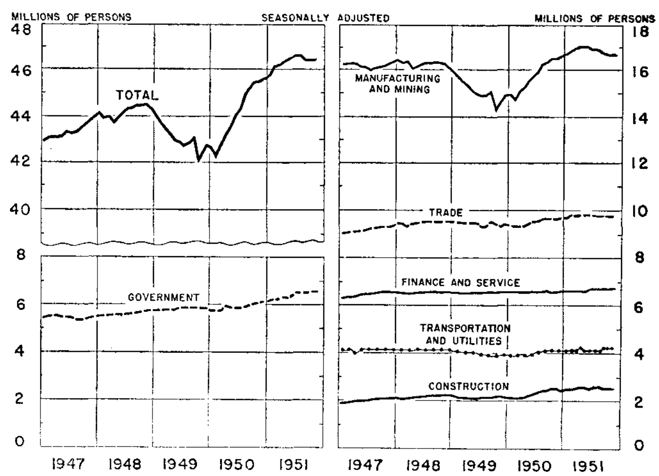
Crop prospects declined further during November, and output for the year is now estimated to be only 2 per cent larger than in 1950. Grain production is indicated to be 6 per cent smaller, while cotton output, though substantially below early estimates, was reported to be 53 per cent greater than last year's small harvest. Meat production has been increasing seasonally and is now at about year-ago levels; egg production in November was 6 per cent above last year.

INDUSTRIAL PRODUCTION



Federal Reserve index. Monthly figures; latest figure shown is for November.

EMPLOYMENT IN NONAGRICULTURAL ESTABLISHMENTS



Bureau of Labor Statistics estimates adjusted for seasonal variation by Federal Reserve. Proprietors and domestic servants are excluded. Mid-month figures; latest shown are for November.

Distribution

Seasonally adjusted department store sales showed little change from the third to the fourth quarter, and the value of holiday sales was about the same as in 1950. Dollar volume of sales for the year is expected to be approximately 3 per cent larger than in 1950. Inventories held by department stores showed a further decline in the fourth quarter, after seasonal adjustment.

Commodity Prices

The average level of wholesale commodity prices continued to show relative stability from mid-November to the fourth week in December. Changes have been largely among agricultural commodities and seasonal in character. Although the December 10 Government cotton crop estimate of 15.3 million bales was 480,000 below the November estimate, in the week following release of the report raw cotton prices declined about 1½ cents per pound, about as much as they had advanced in late November.

The consumers' price index advanced 0.6 per cent from mid-October to mid-November, reflecting chiefly a rise in food prices and increased excise taxes.

Bank Credit

Total bank credit outstanding at banks in leading cities increased further in November and the first half of December. The increase was dominated by a continued rise in bank loans to business, particularly to commodity dealers; food, tobacco, and liquor manufacturers; and metal and metal products manufacturers. The rise in business loans was particularly marked in the first half of December. Deposits and currency of individuals and businesses continued to increase in November and early December, largely because of expansion in bank loans and investments.

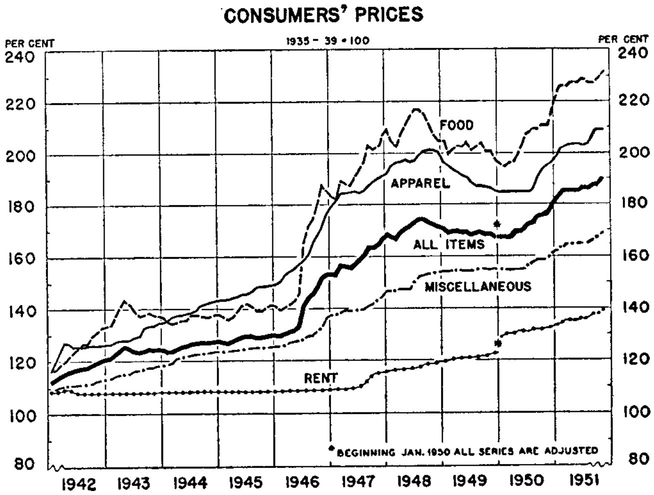
Banks in the larger financial centers increased their interest rates on new loans to prime business borrowers by ¼ per cent, from 2¾ to 3 per cent, in December. This was the second increase in the rate on these loans in two months.

Member bank reserve positions have generally been under some pressure since late November due in part to seasonal factors. Federal Reserve holdings of Government securities were unchanged until late December when short-term securities were purchased to maintain orderly market conditions.

Security Markets

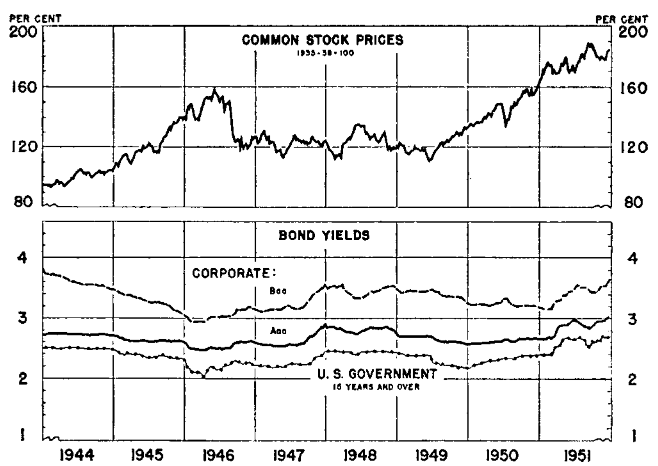
Yields on U. S. Government and high-grade corporate securities were steady during the first half of December and rose thereafter. In late December, yields on most types of bonds were considerably higher than a year ago and money market tightness was reflected in higher rates on all types of short-term paper. On December 3, the Treasury announced the offering of new 1⅞ per cent certificates of indebtedness to holders of the 1.1 billion dollars of 2¼ per cent Treasury bonds of 1951-53 maturing December 15.

CONSUMERS' PRICES



Bureau of Labor Statistics indexes. "All items" includes housefurnishings, fuel, and miscellaneous groups not shown separately. Midmonth figures; latest shown are for November.

SECURITY MARKETS



Stock prices, Standard & Poor's Corporation; corporate bond yields, Moody's Investors Service; U. S. Government bond yields, U. S. Treasury Department. Weekly figures; latest shown are for week ended December 22.

SUPPLEMENT TO

MONTHLY REVIEW

Of Credit and Business Conditions

FEDERAL RESERVE BANK OF NEW YORK

Vol. 34 JANUARY 1952 No. 1

Central Banking

and the

Private Economy

Remarks of ALLAN SPROUL,

President, Federal Reserve Bank of New York

before the

FORTY-FIFTH ANNUAL MEETING OF THE

LIFE INSURANCE ASSOCIATION OF AMERICA

New York, N. Y.

December 12, 1951

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New York, N. Y.

December 12, 1951

NOT many years ago a speaker at a meeting such as this, who chose to speak on some aspects of the operations of the Federal Reserve System, would have had to begin by telling you what the Federal Reserve System is, how it is organized, and how it performs the functions which have been delegated to it by the Congress. I assume that is no longer necessary. The circumstances of the war and post-war years have brought the Federal Reserve System and the life insurance companies in close touch with one another, even if only indirectly. You have been concerned particularly with our open market operations in Government securities, and with the generality of our credit policies. We have been concerned with your purchases and sales of Government securities, and with your widespread activities in the field of term loans, direct purchases of capital issues, and mortgage financing.

It remains true, of course, that our primary and direct concern is with the commercial banks of the country, most of which in terms of assets and about half of which in terms of numbers are our member banks. This is so because the principal function of the Federal Reserve System is to exercise an influence upon the availability and cost of bank credit, so that inflationary pressures may be restrained and deflationary pressures may be moderated. And it is only the commercial banks of deposit which can increase or decrease the supply of bank credit, and of money in the form of bank deposits, based on reserves provided by the Federal Reserve System. This simplified picture has been scrambled somewhat, however, by the fact that we have taken it upon ourselves to maintain and preserve orderly conditions in the market for Government securities, extending this prescription, at times in the past, to the actual pegging of market prices. Right there we became pretty directly involved with the operations of life insurance companies and other institutional investors, who are among the largest holders of and traders in Government securities.

The most critical aspect of this relationship in recent years has grown out of the fact that the market was not always able to come close to clearing the amount of long term Government securities which you wished to sell, at prices and yields which would conform to our ideas of an orderly market, or our ideas of the lowest desirable price for the longest term issues. To make our policies effective meant purchasing, through the dealer machinery, the securities you could not sell in the market. This put reserve funds into the banking system almost as if we had made the purchases direct from the banks, and provided the basis for a possible multiple increase of bank loans and investments. And because inflationary tendencies have been present more often than not, during the post-war years, these support operations usually ran counter to our desire to restrain unnecessary expansion of bank credit.

It is true that we were able, through sales and redemptions of short term or maturing securities, to offset a large part of the addition to bank reserves resulting from our bond support operations, and from gold inflows and a decline in currency circulation as well. Nevertheless, we did provide some net addition to bank reserves during the post-war period.

The Federal Reserve System has been severely criticized for assuming the secondary obligation of preserving order in the market for Government securities. The more severe and doctrinaire critics have challenged us to show any authority from the Congress for the performance of this function. It is my own opinion that the great growth of the Federal debt over the past ten or fifteen years, its dominant position in the whole debt structure of the country, both public and private, and the importance which the instruments of Federal debt have assumed in the money and capital markets, are ample warrant for our concern and our action.

The more moderate critics, including some from your own ranks, have criticized the way in which we have attempted to carry out the task of maintaining orderly conditions in the Government security market, and more particularly the pegging of prices of the longest term securities which we engaged in from time to time. It is not my purpose here to rake over the embers of old controversy, nor to try to justify everything we did, the way we did it, and the timing of our actions. I do want to touch on one or two aspects of this experience, however, which perhaps contain a lesson for the life insurance companies as well as for the Federal Reserve System.

The lesson for the life insurance companies might be that you should not try to eat your cake and have it. During the war years the life insurance companies were among the largest purchasers of long term Government securities. This was not wholly a patriotic demonstration of support of the war effort. The steadily increasing flow of funds into the life insurance companies and the war-time lack of other investment outlets, as well as the safety of the Government's obligations, made most of these purchases a pleasant necessity. At the end of the war the life insurance companies, on the basis of previous standards, had an overbalanced portfolio position in Government securities. And with the appearance of a strong private demand for capital funds in the post-war years, your companies proceeded to redress the balance. They did this by committing new funds to other assets, and by large net sales of Government securities.

Taking all life insurance companies together, this seems to have been an almost continuous process. There were wide variations among you in the amount of Government securities sold and in the method of sale, but many of you gave the impression of feeling that you had the Federal Reserve System over a barrel and could whack it at will. Taking advantage of our market support, Government bonds were treated as short term investments bearing long term rates of interest. They were treated as investments which could be held profitably and disposed of readily, in large amounts, when more attractive outlets for funds developed. They were even made the basis, in effect, for entering into future commitments for large scale financing.

You may say that this is a normal aspect of your investment operations. You may say that this is an evidence of the free enterprise system at work. Or you may say that the blame, if any, was ours for supporting the market, and giving assurances of support even though these assurances were only applicable to "existing conditions" and for the "foreseeable future". That is all right as far as it goes, but I would introduce a note of caution. Many of you have become so big, and the operations of all of you are so charged with a public interest, as to inhibit your recourse to the market practices of investors with smaller aggregates of capital funds and with no public responsibilities. A wise degree of business statesmanship is needed to chart a course between the Scylla of increased public regulation and the Charybdis of falling behind your competitors in the race for business and profits.

It is true that you could not promise to hold forever the Government securities which you purchased during the war or after the war. No one, I believe, expected you to remain frozen into a disproportionate holding of Government securities. Looking at it from my side of the fence, however, you might have been expected not to use long term Government securities as if they were short term investments. You might have been expected not to try to unload long term securities in chunks of five, ten, fifteen, twenty millions, or more, on short notice whenever you wished. Such shifts in holdings, as some of you recognized, require time and marketing. Reliance on such heavy liquidation of long term securities to meet immediate or near term cash needs, meant that the monetary authorities felt forced to intervene to preserve order in the market, or even to peg prices in order to avoid the risks of a possible temporary panic in capital values and a temporary cessation of capital financing. And it also suggests that some of you were probably relying on this action of the monetary authorities to enable you to continue, with safety, drawing long term rates of interest on what were being treated as short term investments. That is trying to eat your cake and have it, too.

Some revision of ideas concerning the proportion of your assets which might be held in Government securities under present-day conditions, a better marketing approach to the liquidation of Government securities when you felt you had to sell, and a little less haste in reaching for the higher returns of corporate obligations, direct placements, and mortgage financing during periods of strain upon our economic resources, might have been becoming to your industry and good for the economy. And I say this recognizing that one of your aims was to reduce the premium cost to your policyholders. As you have so often and so well emphasized, no one has a greater stake in the prevention of inflation than the holder of a life insurance policy. If practices which contribute to a reduction of premiums also contribute to inflation, the policyholder gains at the spigot but loses at the bung.

As for the Federal Reserve System, during the post-war years, it had a harsh and thorough lesson in the difficulties of combining an effective credit policy with the maintenance of Government security prices, and a chastening experience with the problems of "letting go" once you have resorted to pegging a market.

I do not mean by this to agree with those who argued then, and argue now with an "I told you so" inflection, that we should have addressed ourselves solely to reducing the money supply after the war, come what might in the Government security market, or elsewhere in the economy. The financing of the war almost trebled the money supply of the country, and public holdings of liquid assets increased tremendously when incomes were high and civilian goods and services were lacking. These were the inevitable inflationary factors in war financing and in a war-time economy. The inflationary pressures thus generated were held in check but not removed by rationing, price and material controls, and other direct measures. When the war ended, and as direct controls were removed, our job was not and could not be to try to reduce drastically the war-swollen money supply. The most that could be attempted, by way of credit policy, was to prevent increases in bank credit from adding unnecessarily to the money supply, and to avoid creating fears or expectations which would stimulate the increased use—or velocity—of the money which was already in existence.

What this country chiefly had to do in those post-war years was to grow up to the increase in the money supply generated by the war, as quickly and with as little dislocation as possible. I still do not believe that we could have or should have resorted to a drastic policy of deflation. We did try to follow, with disheartening delays in application, a modest policy of restraint on unnecessary credit expansion, while facilitating a rapid strengthening of our productive capacity to meet accumulated domestic demands, and the needs of reconstruction among our friends and allies abroad. But the only final and constructive answer to the lack of balance between the supply of goods and services and the supply of money, inherited from the war, was an increased supply of goods and services growing out of increased production—out of increased efficiency of men and machines. That was the only way we could adjust to the increase in costs which had already taken place in our economy, without the hardships and suffering and the economic losses of widespread depression and unemployment.

If the banks had been placed under severe pressure by a drastic credit policy, they would have had to follow a much more restrictive course in financing business and trade. If prices of Government securities had had a bad fall in the immediate post-war years, the supply of capital for business might have come forward hesitantly and in less than adequate amounts. It is extremely doubtful, in my opinion, that drastic action could have been taken to reduce the money supply in the years following the end of the war, without seriously hampering the necessary expansion of production.

Where we fell short, in the modest program of credit restraint which we did attempt, was not in our arithmetic; it was not in our additions to and subtractions from the reserves available to the banking system, nor in holding down the money supply. Our failure, to the extent that we failed, was a failure to gain sufficient understanding and acceptance for our policies. The influence of a central bank depends a lot on tradition—on the belief that its actions will be wise and timely and effective. The Federal Reserve System has had little enough time to build up such a tradition, and you may question whether it has made the best use of the little time it has had. In any case, our policy of modest credit restraint, following the war, was tardy in application, due to differences with the Treasury, and seemed inconsistent and ineffective to many bankers and businessmen and to the public, because of our involvement with the Government security market. We were not able, except occasionally, to create the atmosphere of credit restraint. We did not do the job we might have done.

In 1950 and 1951, we have had to face a very different situation than that which we faced in the years following the war. By 1950 this nation had achieved a tremendous expansion of its productive facilities and of housing and had, in fact, gone a long way toward "growing up" to the war-generated money supply. So far as the Government security market was concerned, the longer term debt was better fitted into investor portfolios and better held than it had been earlier. Interest rates at short term had already moved upward, so that static rates and fixed prices were no longer the only features of the market landscape to which traders and investors were accustomed. It had become practicable to try to enforce more severe general credit restraints by a coordinated program of credit policy and debt management.

The outbreak of the war in Korea made it imperative to put this program to the test. Strong inflationary forces had regained the ascendency. An insistent large scale demand for bank credit reappeared. Consumers were led to believe that a period of scarcity of goods and increases in prices lay ahead and they acted accordingly. Business plans for improvement and expansion of plant and equipment were revised upward, and inventory accumulation proceeded rapidly. The residential building boom, which had been deliberately encouraged by very liberal financing terms, was accentuated. Deficits in the Federal budget were widely predicted. There was a rapid expansion of the money supply growing out of increased private financing —not out of defense financing—and, equally important, an increase in the willingness of the public to spend. It was certainly high time for the Federal Reserve System to get wholly out of the business of pegging market prices of Government securities, and to step up its program of restraint on the availability of credit.

This was ultimately worked out with the Treasury; an accord was reached last March. A final attempt was made to remove the supply of long term Government securities overhanging the market by means of a conversion offering, and by Federal Reserve and Treasury purchases of securities from those who still wanted cash. The Government security market was then set free except for the maintenance of orderly day-to-day conditions, and the Federal Reserve regained, more completely than for a decade past, the initiative with respect to the availability and cost of reserve funds. And this freedom has been buttressed by a Voluntary Credit Restraint program which enlisted the enthusiastic and effective support of all groups of principal lenders, including your own. On this occasion we have been operating in an atmosphere favorable to credit restraint and with widespread understanding and approval of what we were trying to do.

In reaching this happy if belated resolution of some of our post-war difficulties—getting rid of our split personality—we incurred considerable displeasure in some quarters, however. A study of the Federal Reserve System by a subcommittee of the Congress, which to a certain extent reflects this displeasure, is now under way. When we look at the men making up the subcommittee, however, we can feel reassured that its work will be thorough and objective. If so, we can look forward to its hearings and its findings. It will be good for the country and for the Federal Reserve System to have an intelligent airing of some of the ideas about money and credit, and its management, which are always latent in this country and sometimes come to the surface. If we can lay the ghost of a few of these ideas, even temporarily, we shall be better able to do our jobs. Certainly you have a stake in this study which goes far beyond answering the questions which have been addressed to the executives of some of the life insurance companies. As representatives of institutions holding a tremendous amount of the savings of the people, as large scale investors, and as citizens, you must necessarily be deeply concerned with some of the issues which are raised by this study. I should like to touch on two or three of them briefly.

First, there is the question of the independence of the Federal Reserve System. That word "independence" usually generates more heat than light. Let me make clear, therefore, what I mean by independence, and what I do not mean. I do not mean that an independent Federal Reserve System can have policies and a program which run counter to the national economic policy. That has never been the case, is not now, and never should be. An independent Federal Reserve System is one that is protected both from narrow partisan influence and from selfish private interests. It is a system with special competence in a difficult technical field, acting under a general directive of the Congress within the bounds of national economic policy as determined by the Congress.

This is not a new question although it was brought sharply to the fore by the regrettable public dispute between the Treasury and the Federal Reserve System in late 1950 and early 1951. The question was debated and decided first at the time the Federal Reserve System was established in 1913. Whenever there have been major amendments to the Federal Reserve Act the Congress has reaffirmed its original judgment on this important point. And when the Douglas subcommittee, which preceded the Patman subcommittee, gave its intelligent attention to this problem two years ago, it came out strongly on the side of the angels.

The core of the problem as it has recently presented itself is the necessity for coordinating debt management and credit policy. Debt management and credit policy cannot work separately, but they can work badly or well together. Putting the case from the standpoint of the Federal Reserve System, their coordination requires recognition of the fact that there cannot be a purposeful credit policy unless the Federal Reserve System is able to pursue alternating programs of restraint, "neutrality", and ease as the business and credit situation may require, and to act promptly with each change in the general situation. It requires recognition of the fact that such programs must, as they accomplish an increase or contraction in the volume of credit and a tightening or loosening in the availability of credit, affect interest rates not only for private lenders and borrowers, but for the Government. It does not require that the management of the public debt be made unnecessarily burdensome to the Treasury, or that the cost of servicing the debt, over time, necessarily be increased. It does require that Government borrowing hold its place in the market instead of being floated on a stream of newly created money.

Successful coordination of debt management and credit policy depends on the sensitivity of the money and capital markets, and the possibility of close and continuous contact with all areas of these markets, to make credit policy effective with relatively small changes in credit availability and interest rates. It depends on the great growth that has occurred in the Federal debt, its widespread distribution, and its importance in the portfolios of the increasingly important institutional investor, to make this sensitivity real and this contact with the money and capital markets pervasive. In other words, it uses the facts as they exist to further the purposes of credit policy and to combine it with effective debt management; it does not try to alter the facts.

This does not require or suggest a subordination of the Treasury to the Federal Reserve System. What is needed is to redress the balance in their coordinate spheres. The Treasury is one of the oldest branches of the Federal Government, and the Secretary of the Treasury is one of the highest executive officers of the Government and usually an intimate of the President. It has been natural for succeeding Secretaries to assume, since the relatively recent establishment of the Federal Reserve System, that their responsibility and authority is exclusive in cases where credit policy and debt management overlap. It should be possible, however, to separate the Federal Reserve System from a host of advisers to the Treasury, public and private, so that the Treasury and the System could approach these overlapping problems as equals seeking solutions and, by mutual agreement, finding solutions which best fit the needs of the economy of the country at the time.

Recognizing that there still could be differences of opinion, the situation suggests to some that the Federal Reserve System be brought within the executive branch of the Government, or that the Chairman of the Board of Governors be made a member of the Cabinet, so that as a last resort conflicts might be resolved by the President. This solution runs counter to the whole idea of separation of the central banking system from changing executive administrations, and compounds the mistake of burdening the President with too many responsibilities in fields where a tradition of technical competence is necessary. It would lead either to bottlenecks in reaching decisions, or to decisions actually made by staff members having no direct responsibility to the Congress or to the public. Its practical effect would probably be to place the Federal Reserve System under the domination of the Treasury, or to place both the System and the Treasury under the domination of something like the Council of Economic Advisers.

A more hopeful avenue to follow is the suggestion of the Douglas Committee that Congress give a general mandate to the Treasury and the Federal Reserve System regarding the objectives of debt management and credit policy in the light of present-day conditions. These instructions, as the Douglas Committee said, need not and in fact should not be detailed. They would not challenge the primary responsibility of the Treasury for debt management. They should specify, however, as part of the legislative framework of debt management, that the Treasury have regard for the structure of interest rates appropriate to the economic situation. The implication of such a directive, to me, would be that the Treasury could not, as a matter of right or of superior position, call upon the Federal Reserve System to "make a market for its securities". I recognize that there would continue to be differences of opinion about these matters, and I realize that you cannot legislate cooperation between people, but the Congress, as final judge, might be able to provide a mandate which would charge debt management as well as monetary management with some responsibility for the general objectives of the Employment Act of 1946.

There may be other ways to bring about a better coordination of debt management and credit policy, without sacrificing the independence of the Federal Reserve System or the Treasury. We should be ready to consider them. But they should not sacrifice credit policy on the altar of perpetually easy money. The country cannot afford to keep money cheap at all times and in all circumstances, if the counterpart of that action is inflation, rising prices, and a progressive deterioration in the purchasing power of the dollar—including the purchasing power of the dollars which the Government itself must spend and the purchasing power of dollars invested by the public in Government securities.

Perhaps as a subsidiary of this first question, I should mention the interest displayed by the present Congressional study group in the earnings and expenses of the Federal Reserve Banks, and in whether money has been spent to influence public opinion on controversial questions. The facts as to the earnings and expenses of the Banks are available to everyone, and are included in annual reports to the Congress. The efficiency of operations of the Banks is open to the daily observation of all who have dealings with them. Their operations are under the immediate scrutiny of boards of directors performing a public service but used to the compulsions of operating a private business for profit, and they are subject to check and audit by the Board of Governors of the Federal Reserve System at Washington. There is no lack of control of the financial affairs of the Federal Reserve Banks in the public interest.

Whether expenditures have been made to influence public opinion on controversial questions, depends on what these words mean. If they mean that we have tried to create some public understanding of what we are doing and why we are doing it, even if the questions involved might be termed controversial, I think the System would have to plead guilty. Central bankers in other countries have preferred traditionally to let their actions speak for themselves—some of the actions of a central bank are difficult to explain in terms which can be generally understood and which do not do violence to accuracy. In a country such as ours, however, you are likely to go out of business if you do not explain, from time to time, what you are doing in the public domain. As I see it, we have not only a right, but a duty and an obligation to let the Congress and the public know what our general policies are and why we have adopted them, even if at times we must touch on matters which some consider controversial.

To try to correct some fancied abuses in this area by putting the Federal Reserve System in with the sprawling Government departments and bureaus administered by the civil service and the General Accounting Office would, in my opinion, destroy something fine which has been created in the public interest. And it would be one way to undermine the independence and the regional character of the Federal Reserve System.

The second main question I want to touch on is the desirability and effectiveness of general credit controls in combatting inflation and deflation. Are they still useful or are they outmoded? All that should be claimed for general credit controls, in my opinion, is that combined with other measures working in the same direction, such as fiscal policy, debt management and, in extraordinary circumstances, direct controls, they can contribute to anti-inflationary or anti-deflationary forces. This, I think, they are peculiarly fitted to do in a country with our political, social, and economic leanings and beliefs. There are those who deny this. They admit that a severe policy of credit restraint can be effective, but they say that the resultant declines in production, employment and incomes are no longer socially acceptable. A severe policy of credit restraint is also impossible, they say, in the face of a Federal debt of $250 billion and the needs and requirements of managing such a debt. A mild credit policy, on the other hand, is said to be ineffective at best and may be harmful at worst, at least in its anti-inflationary phase. Then, it is claimed, it may involve increasing the cost of servicing the public debt, disruption of the Government security market, and interference with an expanding economy, in order to get at a handful of private transactions.

I am more hopeful than these critics as to the effectiveness of a modest credit policy and more concerned with the preservation of a control which does not do violence to our private economy. It seems to me that the same circumstances which are responsible for the problems of coordinating debt management and credit policy, contribute to the effectiveness of mild general credit policies, and that we can have an expanding economy without throwing too much of the gasoline of easy credit on the fires of active business. Because of the size of the public debt, and its relative importance in the whole structure of debt, public and private, the Federal Reserve System is now able to carry on its open market operations in a broad homogeneous market, nationally integrated. The effects of its operations are more quickly felt in all parts of the country and in all areas of the private sector of the market than used to be the case. The sensitivity of the market is greater than it used to be; and the leverage of credit policy has multiplied.

It must be frankly admitted that there still are difficult problems to be worked out in providing the proper sphere of effectiveness of general credit policy under present conditions, and in perfecting the mechanics of making the policy work. But I would beware of those who are trying to discredit general credit controls, and who would place main reliance on selective credit controls, or on more direct means of rationing bank credit, in adapting credit policy to our economic needs.

We all recognize that one of the central problems in our country, and in all the western democratic countries, is how far Government guidance and control of economic affairs can go without destroying the effective functioning of a private economy. In this country, with our traditions of individual enterprise, we have preferred to keep such control to a practical minimum, and to have it exercised in largely impersonal ways—by means of controls which affect the general environment, not the individual. One cornerstone of such a philosophy is an independent, competent, central banking system empowered to make general credit policy work to the limit of its usefulness and effectiveness. This is one of the best defenses against Government intrusion in our individual and private affairs.

As a subsidiary of this second question concerning general credit controls, I might pay my respects to the suggestion that credit policy should now be charged with perpetual par support of Government securities. Some bankers and insurance people have succumbed to this idea, I am told, perhaps lured in that direction by earlier actions of the Federal Reserve System and statements of its representatives. I am very sorry if this is so. The idea baffles me. It is an excursion into the land of "hatchy-malatchy", which I hear about once in a while on the radio when I don't turn it off quickly enough in the morning after catching the news. Approach it as you will, perpetual par support doesn't make sense.

Take it from the point of view of credit policy. Unless a workable way can be found to insulate the Government security market from all other markets, a project which I consider to be of dubious desirability and unlikely practicality, perpetual par support of Government securities by the Federal Reserve System would make any pretense of credit policy ridiculous. The essence of general credit control is the control of reserve funds available to the banks, and that inevitably means fluctuating interest rates and fluctuating prices of securities. The Federal Reserve System could not have a general credit policy, if at all times and under all circumstances it had to support Government securities at par.

Or take it from the point of view of debt management. If Government securities had to be supported at par, present forms of debt management would become obsolete. If all Government securities of all maturities can be liquidated at par at any time they become, in effect, demand obligations, and need only bear varying rates of interest if the Government wants to reward various kinds of holders in different ways. I doubt if the life insurance business would want to become a claimant for Government support on that basis.

Or take it from the point of view of the frequently expressed determination of the Congress to prevent unlimited direct borrowing by the Treasury from the central banking system. To fasten on the System the obligation to support Government securities at par, would mean that the Treasury could sell Government securities to the Federal Reserve Banks, in almost any amount, in peace as well as in war, after only a hasty detour through the market. The only check would be the flooding of the market with the reserve funds which we would use to buy the Government securities,* and the resulting willingness of the market to purchase further issues of Government securities at almost any price and yield. That is not the kind of check or restraint the Congress has had in mind.

Or take it from the viewpoint of the public, whose common sense has always resisted the view of a shouting minority that the Government should print the money to pay its expenses. Would the public not perceive that this idea of par support of Government securities is just the same old something for nothing dodge, with interest? I am sure it would.

* That is, the reserve funds which we would supply to the banking system through our purchases.

The third and final question which I would call to your attention is the question of centralization of control of credit policy. So far as the Federal Reserve System is concerned this involves the locus of power and the structure of administration. The framers of the original Federal Reserve Act conceived a system at once national and regional. Despite the vicissitudes of the intervening thirty-seven years, that fundamental idea has retained its vitality. It has done so, I believe, because it is in accord with our political beliefs and the Federal structure of our Government.

This concept has its defects, of course, but they are principally the defects of democracy itself, and of a system which relies on checks and balances to prevent the emergence of dictators. Plausible arguments can be assembled for abolishing the present organization of the Federal Reserve System. Action by boards or committees, such as the Board of Governors or the Federal Open Market Committee, is apt to seem cumbersome, time-consuming, and sometimes productive of group decisions which may not reflect the wisdom of the best men in the group. A distribution of powers between a board at Washington and twelve regional banks may seem to be an unnecessary obstacle to the prompt formation of national credit policies.

We would all admit, I think, that a single administrator or executive, with deputies or assistants, is the best way to manage an operating organization. It is another matter, however, to create a single policymaker in the vital field of national credit policy, no matter how competent the man you might get, once in a while, and no matter what rank you might give him in the Government hierarchy to emphasize the importance of his duties. It would violate our national concept of the way in which Government should exercise its powers in moulding or guiding our economic affairs, at least under any conditions short of total war. And I think it would do violence to the beliefs, and harm to the interests, of all of you.

Similarly, with the regional organization of the Federal Reserve System, and the partial distribution of powers as between the Board of Governors at Washington and the twelve Federal Reserve Banks. In the early years of the System this organization and this division of powers did lead to difficulties in formulating and administering a coordinated national credit policy. An assertion of power by the Federal Reserve Banks, and the emergence of dominant individual leadership at the Banks, reduced the Board of Governors to less than its statutory and necessary position, as the central coordinating body of the System. When major amendments to the Federal Reserve Act were adopted in 1935, in order to bring about a greater degree of central and coordinated control, the Congress was careful, nevertheless, to preserve the regional character of the System.

It recognized that what was needed was not the destruction of the regional system, but to bring the Board of Governors and the Presidents of the Federal Reserve Banks together at a common council table having statutory sanction and responsibilities. That was achieved, so far as open market operations are concerned, by the establishment of the Federal Open Market Committee in its present form. With it was achieved a body within the System which is at once regional and national, and which can act promptly on matters of credit policy with a minimum of internal friction. In this committee the Federal Reserve System has evolved a method of conducting policy deliberations and formulating policy actions that is uniquely in tune with our political and economic institutions. Government is directly represented through the presidential appointees to the Board of Governors. Regional interests which go to make up the national whole, and the lessons of experience "in the field", are represented through the rotating membership of the Federal Reserve Bank Presidents. National policies are established without complete centralization of authority in one man or a group of men at Washington.

This is also a question of men as well as of mechanics. The structure of and the distribution of power in the Federal Reserve System is closely related to the problem of recruiting men who will be equal to the tasks and responsibilities of the System. We need men at the Federal Reserve Banks who are competent both in administration and in the field of credit policy, who have qualities of leadership which will make them a force in their own communities and, collectively, in the nation. That means that the rewards and satisfactions of service must be such as will attract and hold men of talent. That is partly a question of compensation, but even more important is the opportunity for public service, with the power as well as the satisfactions which go with such service. If power and influence are wholly ripped away from the Federal Reserve Banks, if the Banks become branches of a central authority, the men who run the Banks will become branch managers, no matter what they are called. The satisfactions and powers of public service will then be minimized, and the prestige and efficiency of the System within the districts and in the nation will decline. We shall attract job holders when what we want and must have are men—able, competent, imaginative, progressive men. And we must give these men an opportunity to develop their powers in an atmosphere which is stimulating and satisfying, not stifling and frustrating.

In what I have had to say about some of the questions which are now under study by a Congressional committee, I am not arguing that the Federal Reserve System, as it stands, is perfect in its personnel, its powers, its organization, or its functioning. It is not. I am arguing that it embodies certain basic concepts which have proved themselves over the years. I am arguing that these concepts will contribute to the further development of general credit policies which, along with other measures, will be effective in promoting high levels of production and employment in this country and in preserving the integrity of the dollar. I am arguing for effective general credit policies, as contrasted with dictatorial direct controls of individual transactions which would destroy our economic freedom. I am suggesting that an independent regionally organized central banking system can be a bulwark against the destruction of the kind of private economy which will enable this country to discharge its enormous economic responsibilities in a troubled world.