AMENDMENT TO ABOLISH OFFICE OF COMPTROLLER OF THE CURRENCY, ETC.: HEARING BEFORE THE COMMITTEE ON BANKING AND CURRENCY OF THE HOUSE OF REPRESENTATIVES. WEDNESDAY, JUNE 1, 1921. STATEMENT OF HON. W.P.G. HARDING, GOVERNOR FEDERAL RESERVE BOARD

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Amendment to Abolish Office of Comptroller of the Currency, Etc.: Hearing Before the Committee on Banking and Currency of the House of Representatives. Wednesday, June 1, 1921. Statement of Hon. W.P.G. Harding, Governor Federal Reserve Board by Various

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VARIOUS

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Trieste

COMMITTEE ON BANKING AND CURRENCY.

HOUSE OF REPRESENTATIVES.

SIXTY-SEVENTH CONGRESS.

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AMENDMENT TO ABOLISH OFFICE OF COMPTROLLER OF THE CURRENCY, ETC.

COMMITTEE ON BANKING AND CURRENCY,
HOUSE OF REPRESENTATIVES,
Washington, D. C., Wednesday, June 1, 1921.

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

The CHAIRMAN: Gentlemen of the committee, when we recessed two weeks ago we were in the midst of a discussion of the resolution offered by Mr. Strong of Kansas, and it was suggested by members of the committee at that time they would like to hear Gov. Harding in connection with certain phases of this bill. I therefore asked Gov. Harding to come up, and he is here this morning, and would be glad to answer any questions members of the committee have to ask. He is not appearing for or against the measure, but will be glad to answer any questions which members wish to propound to him.

Mr. WINGO. What is the Strong resolution?

The CHAIRMAN. I should have said the amendment offered by Mr. Strong that—

The Federal Reserve Board shall have no power or authority to restrict the amount or class of eligible paper a Federal reserve bank may rediscount so long as it complies with the law that applies to member banks, except by an order adopted by two-thirds of the members of the Federal Reserve Board, a copy of which shall be mailed to all banks affected thereby. Said resolution shall not take effect until 30 days after its receipt by the Federal reserve banks.

Inasmuch, however, as there has been more or less discussion about the powers of the Federal Reserve Board, this discussion, with Gov. Harding here, is not to be confined to this particular amendment, but will take in several others, I understand. I would suggest, Gov. Harding, that you proceed in your own way, and the members of the committee will interrupt you as we go along.

Gov. HARDING. Mr. Chairman, may I ask just what is the object of this proposed amendment?

The CHAIRMAN. We are considering H. R. 4906, and Mr. Strong has offered the amendment which I have just read.

Gov. HARDING. Your idea is, then, that the Federal Reserve Board shall not restrict the amount or class of rediscounts of a Federal reserve bank except by an order adopted in conformity to your amendment?

Mr. STRONG. Yes, sir.

STATEMENT OF HON. WILLIAM P. G. HARDING, GOVERNOR UNITED STATES FEDERAL RESERVE BOARD.

Gov. HARDING. The discount features of the Federal reserve act are found, in part, in section 13, where eligible paper is defined and where power is given the Federal Reserve Board to make regulations as to eligible paper, subject to the terms and provisions of the act. Other reference to discount powers is found in section 4, relating to the authority of the Federal reserve banks themselves.

There is no limitation imposed upon the amount that a member bank may borrow from the Federal reserve bank. The directors are given certain discretionary powers, just as directors of all national banks have, and they are charged with the duty and responsibility of administering the affairs of the Federal reserve bank fairly and impartially and in extending discounts, loans, accommodations, and advancements to pay due regard to the requirements of other member banks. I do not see, offhand, just what effect an amendment of this sort would have unless it should repeal section 4, because as section 4 now stands the matter of loans, if eligible, is entirely in the hands of the directors of the Federal reserve banks. The Federal Reserve Board has no power, or certainly never has attempted to exercise the power, to say to the Federal reserve bank "you must not rediscount eligible paper," or that "you shall discount paper which is technically eligible and which, in the opinion of your officers and directors, is not solvent or desirable paper."

The Federal reserve act seems to contemplate not a central banking system but a regional banking system under centralized supervision. In other words, there is a localization of credits. The Federal Reserve Board here in Washington has no power, or never has conceived that it had any power, to bring any pressure to bear on the banks as to what particular applications for rediscounts they should approve or decline. They have a board of directors, six elected by the member banks and three appointed by the Federal Reserve Board, and the whole responsibility for discounting paper offered by member banks is vested in the board of directors of the Federal reserve bank. The Federal Reserve Board merely defines eligibility according to the terms of the act.

Mr. GOLDSBOROUGH. You attempt to regulate that by a progressive interest rediscount rate?

Gov. HARDING. I will say that the progressive interest rate was an emergency proposition. We were confronted with a real financial emergency a little over a year ago, but that emergency has passed; we have no such emergency now. I have a chart with me this morning, Mr. Chairman, which I would like to show to this committee, briefly, to illustrate this matter graphically.

The CHAIRMAN. I was going to suggest, as a preliminary to your talk, if you will go into that matter it will be helpful.

Gov. HARDING. I will say, in regard to the progressive interest rate, there were only four districts that every adopted it, and in two of those districts they have abolished it.

Mr. GOLDSBOROUGH. My question was not in criticism of it at all.

Gov. HARDING. In the Atlanta district the progressive rate was tried for a while but was abrogated on November 1, 1920. In a certain Alabama town there was a case, which has been given much publicity, where a bank paid a very high rate for a small amount for a short time. The Federal reserve bank of Atlanta has recently received authority from the Federal Reserve Board to refund to all member banks any interest they paid during the operation of the progressive interest rate in excess of a maximum of 12 per cent.

Mr. STEAGALL. In excess of how much?

Gov. HARDING. In excess of a maximum of 12 per cent. This brings the average rate charged down to about 6½ per cent.

Mr. GOLDSBOROUGH. That does not help the public.

Gov. HARDING. That action has been taken at Atlanta. The progressive rate of the St. Louis district has been modified, so that hereafter banks will pay 7 per cent in excess of the normal line and 6 per cent on the normal line. It will probably be abrogated altogether in the near future. In the Kansas City district—I spent three days out there on my recent trip—you have a very vigorous community; you have some virile, upstanding men, who know what they want, and there is more or less scrapping out there when interests conflict.

The Federal Reserve Board has insisted that the Kansas City bank must not put any general restrictions on credit; that it must not say that any paper, whether it is automobile paper or oil paper, if it is technically eligible, shall be discriminated against as a class. All such paper can be offered by a member bank for rediscount. If the Federal reserve bank directors do not regard an offering as good or desirable they can turn it down, under section 4, but they must not discriminate wholesale against any class of eligible paper. At a dinner which I attended while I was out there, at which the governor of the Federal reserve bank was present, he stated that in future the bank would adopt this policy. Furthermore, there is a limit put on the progressive rate in the Kansas City district. The normal rate is 6 per cent and 8 per cent the maximum. The main trouble out there is the State contract rates. In Kansas, Nebraska, and Oklahoma they have a contract rate of 10 per cent; in Wyoming they have a contract rate of 12 per cent; and I think Colorado has either a 10 or 12 per cent contract rate. Sometime ago their rate of progression was limited to 12 per cent and more recently to 8 per cent. We discussed the matter while I was out there; and, in view of the improved credit conditions, they decided that at the next meeting of the directors to put a limit on their rate of progression to 8 per cent.

There is a peculiar situation in that district. One-third of the member banks, almost exactly in number and almost exactly one-third in banking resources, have discounted for their customers very liberally and have borrowed, in consequence, from the Federal reserve bank amounts considerably in excess of their basic line. Another third have borrowed very moderately from the Federal reserve bank, and their total borrowings are about $30,000,000 less than their basic line. And still another third have not borrowed at all; they are carrying strong reserves and they do not seem to have responded, as fully as they might have done, to the requirements of the district and have not borrowed at all. One of the things that has bothered the directors of the Kansas City Bank has been the clause in section 4, requiring them, in extending accommodations, to pay due regard to the wants and requirements of other member banks, and this has bothered them, because they have one-third of the banks which have borrowed anywhere from two to three or four times their basic line; another third, which have not borrowed up to their basic line, and still another third which have not borrowed at all, but which may call for accommodations at any time.

Mr. WINGO. I gather from your suggestion that the way they interpret the law, they are holding back awaiting a possible claim and demand from banks which have not yet borrowed; in other words, they have interpreted the statute to say that they shall not discriminate and shall be prepared to meet the wants of member banks, when, as a matter of fact, they may not make any demand?

Gov. HARDING. That was the situation last year. As a matter of fact, the situation has changed. The policies of the Federal reserve system have not changed, but conditions have changed and the methods of applying policies must necessarily change.

Mr. WINGO. You do not catch my point. You suggest that they were embarrassed by the fact that other banks were not borrowing, and they felt they could not grant all the demands of one set of banks because there was another set that were not coming in and making any claim at all?

Gov. HARDING. That was last year when the Federal reserve bank of Kansas City had borrowed from other reserve banks about $50,-000,000, and at the same time had one-third of its member banks which had not called upon it for anything.

Mr. WINGO. If that is true, on what theory do they deny rediscounts to banks that want them?

Gov. HARDING. They did not deny them rediscounts. It was the progressive rate which held them in check; that was the reason for the progressive rate.

Mr. WINGO. If these banks were not coming up to the Federal reserve bank of Kansas City—if that is true—then the bank was not required to consider their possible wants in the future.

Gov. HARDING. What I have said is true; but suppose you gentlemen down at this end of the table had gone to the Federal reserve bank and borrowed to your limit, and then some two or three times over, and the gentlemen up at the other end of the table had not borrowed anything and then made loans upon the assumption that they could be rediscounted. Would it be much satisfaction to them, when they came to the Federal reserve bank, to be turned down and for the bank to say, "Why, we have already loaned you gentlemen down at this end of the table all our available funds and therefore can not accommodate you"?

Mr. STEAGALL. Have let other folks have it.

Gov. HARDING. Have let other folks have it. In other words, they felt they had at all times to keep in mind the possible claims and demands which might be made upon them.

Mr. WINGO. But they were not required to hold back a certain maximum amount for banks that were making no claims?

Gov. HARDING. All that water has now gone over the dam, anyway.

Mr. WINGO. But it is going to rise again next fall.

Gov. HARDING. No—I beg your pardon—and I will show you why it is not going to rise again next fall.

Mr. WINGO. I will be mighty glad to have that assurance; at least, I shall not personally, but the banks out in my section will be glad to have that assurance.

Gov. HARDING. Here is some Federal reserve history from the 1st of January, 1919, to last Wednesday night [indicating chart]. These squares represent three months; here is 1919, here is 1920, and here is where we have gone to in 1921. The Federal reserve note circulation is in green; the discounts, earnings, and assets of the Federal reserve banks, everything we have that is earning any money, is shown in black. The cash reserve is shown in red. The wholesale price index, exports and imports, and excess is shown in solid black.

Shortly after the armistice the Federal reserve banks had about $2,250,000,000 of loans and investments; that is, rediscounts for member banks, Government securities held, bills of exchange, and bank acceptances purchased in the open market. We had $2,600,000,000 Federal reserve note circulation outstanding and $2,100,000,000 cash reserve.

In the early part of January, 1919, the loans and note issues went down. This was during a normal period of liquidation. The crops had moved, the retailers had done a big Christmas business, and, as they collected a lot of cash, they took it to the banks and paid off their notes, and so on to the Federal reserve banks; so that the note circulation was reduced in January and rediscounts were reduced. But this did not last long. In 1919 rediscounts and note issues were soon up again. And the same thing occurred in 1920.

You will recollect that on the 26th of June, 1919, the embargo on gold shipments was taken off and we established a free gold market in this country, and thereby lost perhaps $300,000,000 of gold, and then we gained about $170,000,000 gold from Germany for foodstuffs, and then we lost some more, until we got down to a total cash reserve of $2,000,000,000 in February, 1920.

On the 15th of September, 1919, in relation to reserves and invested assets and loans, we stood just about as we were on the 1st of January. The Federal reserve note circulation was also about the same as it was on the 1st of January.

During the year 1919 the impression prevailed that there was a world-wide shortage of goods. The people of the Old World and in America had deprived themselves during the war of most luxuries and of many of the necessities of life. They had subscribed heavily for bonds and were saving and paying for them. Our Government issued obligations amounting to over $25,000,000,000 within a period of 18 months. The normal investment power of this country was estimated to be about $6,000,000,000 a year, and it had become necessary, therefore, to expand credit. People were encouraged to buy bonds, to make notes at the banks in order to carry them, the member banks discounting the notes with the Federal reserve bank, and this, together with the burden which abnormal values placed upon our credit structure, caused great expansion of credit.

Wages advanced. Prices advanced, and with raw materials advancing and wages advancing the cost of production was greatly increased. But there was such an urgent world-wide demand for goods that even in Europe, war torn and debt ridden, a very active demand for American supplies of all kind sprang up. Our large exportations to Europe during the first half of the year 1919 were financed very largely out of the unused balance of the $10,000,000,000 fund which Congress authorized our Government to lend to those nations which were associated with us in the war. There remained over $2,500,000,000 still unexpended and available when the armistice was signed, and our large exportations to Europe during most of the year 1919 were paid for largely out of funds advanced by our own Treasury.

About the middle of September, 1919, various influences were at work which, all combined, gave a tremendous impetus to production and to commerce and business generally. This impetus at first was justified, but the situation was soon affected by speculation, and dangerous tendencies developed.

In the fall of 1919 there was manifest a great wave of speculation. It was not confined to any particular section, but it swept over the country everywhere and over all countries. People who had commodities of all kinds to sell were in no hurry to place them on the market. They saw week by week prices rise and rise again, and they saw that as they took this as a guaranty of the stability of prices, prices rose and costs of production advanced also. Merchants thought it advisable to lay in large stocks of goods in anticipation of future requirements, and many of them were in no hurry to dispose of their goods at a reasonable profit, because it seemed that the longer they held their stocks the more valuable they would become. But there were dangers in the situation, and not a few were alive to those dangers. Many, however, failed to sense them.

There were signs all over the world that a reaction was coming. After frequent warning, to which little heed was given, the Federal reserve system took action. The discount rates of the Federal reserve banks which had been advanced first to 4¼ per cent and 4¾ per cent were, during the latter part of January, advanced to 6 per cent. The final advance to 7 per cent did not come until about the 1st of June, 1920. These rates were less, however, than current market rates, and the banks having the 7 per cent rate have recently reduced it, some to 6 per cent and others to 6½ per cent.

On the 19th of September, 1919, the earning assets of the Federal reserve banks amounted to about $2,350,000,000. By January 23, 1920, during a period of four months, they had increased by nearly $1,000,000,000. What would have been the result if those who had charge of the administration of the Federal reserve banks had sat supinely by and permitted this rate of expansion to continue? If no restraining measures had been taken, if no warning signals had been given, it is probable that this rapid and reckless pace might have continued for perhaps two or three months longer, when a collapse would have been inevitable. It was highly desirable that nothing should be done of a sensational nature but that the unavoidable reaction should be controlled and made as gradual and orderly as possible. The effect of advanced discount rates of the Federal reserve banks was merely to slow down the rate of expansion. There was no curtailment of credit on the part of the Federal reserve banks, nor was there any contraction of the currency. As a matter of fact the loans and invested assets of the Federal reserve banks increased from the middle of January, 1920, until the 5th of November, 1920, a steady and gradual increase all the way along by about $400,000,000.