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to 1931, China was hardly affected internally by the holocaust that was sweeping the gold-standard world,⁷⁴ just as in 1920-21, Germany had been insulated by her hyperinflation and associated floating exchange rate.⁷⁵

The first major country to cut the link was Britain, when she left the gold standard in 1931. The trough of the depression in Britain and in other countries that accompanied Britain in leaving gold was reached in the third quarter of 1932. In the countries that remained on the gold standard or, like Canada, that went only part way with Britain, the depression dragged on. In China, whose currency appreciated relative to the pound as a result of the sharp depreciation of the pound relative to gold, the depression set in for the first time in 1931.

Of course, the country in the vanguard of such an international movement need not stay there. France, which had accumulated a large stock of gold as a result of returning to the gold standard in 1928 at an exchange rate that undervalued the franc, and therefore had much leeway, at some point passed the United States and not only began to add to its gold stock but also, after late 1931, to drain gold from the United States. The link between the franc and the dollar was cut when the United States suspended gold payments in March 1933, which proved to be the business cycle trough for the United States and countries closely linked to it. In France, which stayed on gold for a further interval, the contraction dragged on still longer. Although there was an upturn from July 1932 to July 1933, the low point of the interwar years was not reached until April 1935.

5. *Development of Monetary Policy*

The course of monetary policy in the difficult and critical years of the contraction was greatly influenced by the struggle for power within the Federal Reserve System, the beginnings of which were described in the preceding chapter. At the time of the stock market crash, the New York Reserve Bank acted in the tradition of its earlier dominance, moving rapidly, decisively, and on its own. The adverse reaction of the Board greatly inhibited further independent measures by New York.

In 1930, New York strongly favored expansionary open market operations, but after the middle of the year was unable to persuade either the other Bank governors—all of whom by this time had become members of the reorganized Open Market Policy Conference, which replaced the earlier Open Market Investment Committee—or the Board in Washington. The same was true in 1931, except that New York was less

⁷⁴Arthur Salter, *China and Silver*, New York, Economic Forum, 1934, pp. 3-6, 15-17.

⁷⁵Frank D. Graham, *Exchange, Prices, and Production in Hyperinflation, Germany, 1920-23*, Princeton University Press, 1931, pp. 287-288.

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vigorous in pressing for expansionary action, though it was now supported by the new governor (Eugene Meyer) of the Federal Reserve Board.

The reaction to Britain's departure from gold did not provoke a flare-up of those conflicts. The measures adopted at that time were favored by almost all affiliated with the System. The agreement reflected the dominant importance then attached to the preservation of the gold standard and the greater significance attached to external than to internal stability, by both the System and the community at large. Not long after, the differences within the System that had been submerged in the fall of 1931 re-emerged, New York generally pressing for expansionary open market operations, supported by the governor and some other members of the Board and by a few Bank governors, and opposed by most of the Bank governors.

The open market operation of 1932 was acceded to largely under Congressional pressure and with the new Glass-Steagall Act ostensibly permitting release of the System's expansionary powers. The operation was terminated in August, shortly after Congress adjourned, because so many Bank governors remained unenthusiastic about the policy and reluctant or unwilling to pursue it. The deadlock persisted through the rest of the contraction.

THE STOCK MARKET CRASH. OCTOBER 1929

At the time of the stock market crash, the Open Market Investment Committee consisted of five Bank governors with the New York governor as chairman. It was operating under its recommendation to the Board, September 4, which had been approved by the Board on October 1, to purchase "not to exceed \$25,000,000 a week" of short-term government securities if needed to supplement purchases of acceptances, "for the purpose of avoiding any increase and, if possible, facilitating some further reduction in the total volume of member bank discounts . . ." Up to the week ending October 23, the Committee had not made any government security purchases because bills had been available. The System's holdings had declined by \$16 million, while its bill holdings had increased by \$115 million.⁷⁶

When the crash came, the New York Bank had no doubt about what steps should be taken and proceeded to take them. It purchased \$160 million of government securities in addition to encouraging New York banks to discount freely. The amount purchased was far in excess of the amount that the Open Market Investment Committee was authorized to purchase, but the New York Bank did not claim to be operating for the Committee. It contended it had the right to purchase government secu-

⁷⁶ Harrison, *Open Market*, Vol. I, minutes, Sept. 24, 1929, and letter, dated Oct. 1, 1929, Young to Harrison.

rities for its own account, as a matter of general credit policy, without the Board's approval.⁷⁷ Harrison informed Governor Young of the Federal Reserve Board that his directors had authorized him to purchase government securities without limitation as to amount, and that on October 29, before the call loan rate was announced, a purchase had been arranged.

Members of the Board regarded the New York Bank's failure to seek the authorization of the Board before taking action as smacking of insubordination, though some regarded the action itself as desirable. As a legal matter, the New York Bank seemed clearly within its rights. Under the 1923 agreement setting up the Open Market Investment Committee, each Reserve Bank retained the right to purchase and hold government securities for its own account. Young and most Board members acknowledged the legal right yet felt that the challenge to the Board's authority was insupportable. After much discussion, the Board finally authorized Young to tell Harrison that, if New York should request approval of a reduction of its rate to 5 per cent, the Board would consent on condition that no further purchases of government securities be made except with approval of the Board.⁷⁸ On November 1, the discount rate at the New York Bank was so reduced. To the New York directors it was clear that the System ought to proceed immediately with further purchases for "unless this is done, after the events of the past weeks, there may be greater danger of a recession in business with consequent depression and unemployment, which we should do all in our power to prevent," as they declared in a resolution they adopted on November 7.⁷⁹ Under the leadership of Harrison, the Open Market Investment Committee, meeting November 12, recommended that "the present limit of \$25,000,000 per week on the purchase of government securities be removed and that the Committee be authorized in lieu thereof to purchase not to exceed \$200,000,000 of government securities for account of such banks as care to participate . . .," having in mind also the fact "that present conditions may possibly develop to the point where, as an emergency measure, in the interest of maintaining banking and business stability, it may be necessary quickly to purchase large amounts of Government securities in order to avoid any undue stringency in credit."⁸⁰

⁷⁷ Of the \$150 million government securities purchased by New York in the week ending Oct. 30, \$25 million was transferred to System account. During the following two weeks, the New York Bank bought an additional \$25 million directly for System account.

⁷⁸ Hamlin, *Diary*, Vol. 16, Oct. 29, 30, 1929, pp. 187-196. Miller did not consider the purchase desirable. He suggested a resolution to the effect that the Board would not have approved the purchase, had it been consulted; that New York was more concerned about the stock market than the general credit situation; that forcing the banks to come to the discount window would have been the proper response.

⁷⁹ For the resolution, see Harrison, *Miscellaneous*, Vol. I

⁸⁰ Open Market, Vol. I, minutes of meeting, Nov. 12, 1929.

The next day, the Board notified the Committee that "the general situation was not sufficiently clarified for the System to formulate and adopt a permanent open market policy at that time," but conceded that if "an emergency should arise with such suddenness and be so acute that it is not practicable to confer with the Governor, the Board will interpose no objection to a purchase operation being undertaken, with the understanding, however, that prompt advice of such purchase be furnished the Board."⁸¹

On November 15, Governor Young of the Federal Reserve Board was in New York, and Harrison had an exchange of views with him: "I told him," Harrison wrote in recording the interview, "that I wanted a very frank and complete conversation with him regarding our present differences in the matter of the purchase of government securities . . . that it had become obvious that the Federal Reserve Board and the directors of the Federal Reserve Bank of New York were reaching a point in their views regarding their respective powers where it might have very serious consequences unless we could come to some sort of a workable understanding or agreement . . . I told him that more and more the Board had taken to itself not supervisory powers but the equivalent of operating functions and the responsibility for the detailed transactions of the various Federal reserve banks. . . ." Harrison then reviewed the Board's veto, earlier in 1929 for a period of four months, of the increase in the discount rate the directors of the New York Bank had repeatedly voted: the Board's decision that year to fix the spread above the minimum buying rate for acceptances within which the Bank might operate, although it had never done so earlier, and, during the fall of the year, its actual determination of the minimum rate, which had always been the Bank's prerogative; and finally, its stand

that we should go to the Federal Reserve Board in advance for a prior approval of any transactions in government securities . . . I told him that the logical consequence of his point of view, which was that the Federal Reserve Board should approve of all these things in advance, was that the Federal Reserve Board would become a central bank operating in Washington . . . [H]is only comment was that the Federal Reserve Board had been given most extraordinarily wide powers, that as long as the Board had those powers, they would feel free to exercise them and Congress could determine whether they objected to having a central bank operating in Washington.⁸²

Neither side was prepared to make any concessions until Governor Young had a meeting with Owen D. Young, deputy chairman of the board of directors of the New York Bank, in the office of Secretary of the Treasury Mellon, the ex-officio chairman of the Reserve Board, on November 22 to discuss the Board's power over transactions in govern-

⁸¹ *Ibid.*, letter, dated Nov. 13, 1929, Young to Harrison.

⁸² Harrison, *Conversations*, Vol. I, Nov. 15, 1929.

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ment securities. Secretary Mellon said he was willing to give the New York directors the widest discretion, but he realized that the Board had rights and duties in the matter. Owen D. Young said he saw no reason—apart from sudden critical emergencies, about which there was no dispute—his directors could not obtain the consent of the Board to all major transactions. Governor Young replied that was just what the Board wanted.⁸³

The next day, November 23, Governor Young and Secretary Mellon met with Harrison, who stated that "we in New York were willing and prepared to operate any policy agreed upon either for our own account or for the System account." Young answered that he was prepared to approve without reservation the Open Market Investment Committee's recommendation of November 12, but first wanted to know

where this would leave the debated question of the New York bank's operating for its own account. I [Harrison] told him that I felt that this involved a matter of procedure and jurisdiction which I would like to leave for determination sometime later on when we were through this critical period and when we could work out some mutually satisfactory procedure when conditions and peoples' emotions were in a quieter and more normal state. I then made this proposition: That if the Federal Reserve Board would approve the Open Market Investment Committee's report without qualification, leaving it to the committee to execute, I would recommend to our directors on next Wednesday [November 27] that the Federal Reserve Bank of New York refrain, until such time as it and the Federal Reserve Board might formulate some mutually satisfactory procedure, from purchasing government securities for its own account as a matter of general credit policy without the Board's approval.

As a result of this understanding, the Board reconsidered, November 25, and voted to approve the Committee's recommendation and the policy outlined in the resolution of the directors of the New York Bank.⁸⁴ Although authorized to purchase \$200 million, the Committee purchased only \$155 million between November 27, 1929, and January 1, 1930.

In response to inquiries from other Banks about the New York purchases during the week of the stock market crash, Harrison wrote a long letter to all governors on November 27, describing the situation in New York at the time, explaining the reasons for the measures the Bank took, and defending them. Some governors supported the action and ex-

⁸³ Hamlin, Diary, Vol. 17, Nov. 12, 13, 22, 1929, pp. 13, 17, 20-22, 31-32.

⁸⁴ The motion to approve was passed 5 to 3, the Secretary of the Treasury and the Comptroller voting with Governor Young, Vice-Governor Platt, and Hamlin. Miller objected on the ground that "money was now cheap and would be made cheaper by the purchase of Government securities" and that it would be bad Federal Reserve policy—"abdication in favor of the Federal Reserve Bank of New York." The two other negative votes were cast by Board members Edward Cunningham, an Iowa farmer, and George James, a Memphis merchant (see section 7, below). Harrison, Miscellaneous, Vol. I, letter, dated Nov. 25, 1929, Young to Harrison; Office, Vol. II, memorandum of Nov. 25, 1929; Hamlin, Diary, Vol. 17, Nov. 24, 25, 1929, pp. 35-36, 38-40.

pressed willingness to participate in the purchases. Others criticized the action on the ground that it merely delayed "natural liquidation" and hence recovery.⁵⁵

The situation which confronted the New York Bank during the first few weeks after the crash was to recur during the succeeding years of the contraction: it had a policy, which the Board or the other Banks would not approve, or would approve only reluctantly after protracted discussion. At the time of the crash, New York went ahead on its own. Though the Bank then yielded to the Board in November 1929, later on it again considered but, as we shall see, did not adopt, the alternative of ignoring the System account and purchasing for its own account, as it had in October 1929.

FROM THE STOCK MARKET CRASH TO BRITAIN'S
DEPARTURE FROM GOLD, 1929-31

From the time of the crash on, the New York Bank favored the reduction of discount rates and purchase of bills and securities in sufficiently large amounts to offset reductions in discounts. The directors of the New York Bank apparently voted to reduce the discount rate from 5 per cent to $4\frac{1}{2}$ per cent for the first time on November 14, 1929, and the Board gave its approval. On January 30, 1930, the directors voted to reduce the rate to 4 per cent; the Board disapproved by a tie vote. On February 7, the reduction was again voted by the directors and on the first vote by the Board again lost on a tie vote. One member then changed his vote to affirmative, not because he approved the rate reduction, but because he disapproved defeat of a motion on a tie vote; so the reduction was approved. The reduction of the rate to $3\frac{1}{2}$ per cent on March 14 was apparently approved by the Board the first time the directors voted it. On April 24, the directors voted to reduce the discount rate to 3 per cent; the reduction was disapproved by the Board. It was voted again on May 1, with the directors this time even considering but deciding against a public statement if the Board should again disapprove. However, the Board approved it. Similar repeated delays were encountered in getting Board approval of reductions in buying rates on bills.⁵⁶

⁵⁵ Harrison, *Miscellaneous*, Vol. I, Nov. 27, 1929; for criticism, see Notes, Vol. I, meeting of executive committee, June 9, 1930.

⁵⁶ For the time before Apr. 17, 1930, the first date of minutes of directors' meetings of the New York Reserve Bank in the Harrison Papers, we have relied mainly on Hamlin's Diary for statements about delays in Board approval of New York's requests for reductions in discount rates. Hamlin simply notes the Board's approval on Nov. 14, 1929, without indicating whether the motion to reduce was before the Board for the first time. He does not refer to the reduction in the rate, effective Mar. 14, 1930. (See Hamlin, *Diary*, Vol. 17, Nov. 14, 1929; Jan. 30, Feb. 6, Apr. 24, May 1, 1930, pp. 23, 87, 97, 139-141, 145-146; also Harrison, *Miscellaneous*, Vol. I, letter, dated Feb. 5, 1930, Harrison to all governors; another letter,

New York had even less success in winning approval of its recommendations for open market purchases. After the purchases in the final months of 1929, which were in accord with the usual seasonal pattern of increase in Federal Reserve credit outstanding, the Open Market Investment Committee was most reluctant to engage in further purchases. Some members were in favor of selling government securities in the usual pattern of the post-Christmas season. The final recommendation of the January meeting of the Committee was that "no open market operations in Government securities [were] necessary at this time either to halt or to expedite the present trend of credit."⁸⁷

In early March, concerned about the worsening of the economic situation and the inability of the New York Bank to maintain its bill portfolio, the directors of the Bank voted to authorize purchase of \$50 million of government securities. The purchases were carried out after approval by the Board and a circular letter to all Bank governors asking whether they wanted to participate. When the Open Market Committee met formally at the end of March, it concluded that "at present there is no occasion for further purchases of Government securities."⁸⁸

That was the final meeting of the Open Market Investment Committee. It was replaced by the Open Market Policy Conference of all twelve Bank governors, with an executive committee consisting initially of the same five governors who had constituted the Committee (New York, Boston, Chicago, Cleveland, Philadelphia). But the executive committee was in a different position from the former Committee. It was entrusted with executing policy decisions of the Conference; it did not, like the earlier Committee, both initiate and execute policy. The Conference itself remained a voluntary organization of equals. Each Bank was free to decide whether it would or would not participate in a purchase or sale recommended by the Conference, though dissenters were required to acquaint the Federal Reserve Board and the chairman of the executive committee with the reasons for not participating. Each Bank also reserved the option to withdraw from the Conference. New York was not at all happy about the change and consented to it reluctantly and only with the explicit proviso that the Conference had no authority over transactions in

dated Mar. 17, 1930. Case to Governor Young; and a letter, dated Apr. 29, 1930, Harrison to Platt; Notes, Vol. I, Apr. 24, May 1, 1930.

At the Open Market Policy Conference meeting on May 21-22, 1930, Governor Harrison reported that "in a number of recent weeks the Federal Reserve Board had failed to approve without delay applications of the Federal Reserve Bank of New York for a lower minimum buying rate on bills, and that for considerable periods the New York bank had therefore been without any downward flexibility in its bill buying rate as was the case at that very time" (Open Market, Vol. I).

⁸⁷ *Ibid.*, minutes of meeting, Jan. 28-29, 1930.

⁸⁸ Miscellaneous, Vol. I, letter, dated Mar. 7, 1930, Case to all governors; Open Market, Vol. I, minutes of meeting, Mar. 24-25, 1930.

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bankers' acceptances.⁸⁹ As in 1929, New York hoped to be able to accomplish through the purchase of bills what it might not be able to persuade the rest of the System to do through transactions in government securities. Unfortunately, New York was not successful with its alternative.

At its first meeting in May 1930, the Open Market Policy Conference made no recommendation but left limited authority in the hands of the executive committee. Early in June, Harrison recommended that the System undertake the purchase of \$25 million a week for a two-week trial period, arguing that "small purchases of Government securities at this time could do no harm . . . and might be desirable" and, as in earlier years, suggesting that security purchases be resorted to only if easing through the acceptance market failed. The recommendation to purchase was much milder than the statements at the meetings of the New York directors, and the amount recommended was much smaller than they thought desirable. Indeed, "there was some reluctance" on the part of the New York directors "to accept this program on the grounds that our difficulties of credit administration have grown largely out of our disposition to postpone action and to administer remedies in homeopathic doses." Apparently, however, Harrison felt that a bold program was certain to be rejected and preferred agreement on a small program to rejection of a large one. A majority of the executive committee and of governors agreed (after being consulted by telephone or telegram), the Board approved, and the purchase was made. A decline in the System's bill holdings during the two weeks largely offset the effect of the purchase of government securities, so, on June 23, Harrison suggested that purchases continue in the amount of about \$25 million a week. This time, the executive committee rejected the recommendation by a vote of 4 to 1.⁹⁰

Faced with a clear rejection of its leadership, the New York Bank considered three alternatives: (1) simply to accede without further action in the hope that its views would eventually prevail; (2) to "withdraw from the . . . Conference and, assuming that the approval of the Federal Reserve Board either can be or need not be secured, purchase Government securities for the account of this bank"; (3) to conduct a campaign of persuasion. The Bank adopted the third alternative, perhaps partly because Harrison had lingering doubts about the validity of New York's

⁸⁹ Commenting the following year on the change, Harrison was recorded by Hamlin as saying that "he had always felt it was a mistake to put all the Governors on the Open Market Policy Conference: that the Governors came instructed by their directors; that under the former System the Executive Committee were never so instructed" (Hamlin, *Diary*, Vol. 19, Aug. 1931, p. 123). See also Harrison, *Open Market*, Vol. I, minutes of meeting, Mar. 24-25, 1930; Notes, Vol. I, May 1, 1930; *Open Market*, Vol. I, letter, dated May 15, 1930, Case to Young.

⁹⁰ Harrison, *Open Market*, Vol. I, minutes of meeting, May 21-22, 1930; *Miscellaneous*, Vol. I, telegram, dated June 3, 1930, Harrison to Young; Notes, Vol. I, June 5, 1930; *Open Market*, Vol. I, June 23, 1930.

position. As the report on the relevant directors' meeting has it, the decision to adopt the third alternative was influenced by the existence of a "real difference of opinion among those deemed capable of forming a judgment, as to the power of cheap and abundant credit, alone, to bring about improvement in business and in commodity prices."⁹¹

In July 1930, Harrison accordingly wrote a long letter to all governors, telling them his directors "felt so earnestly the need of continuing purchases of government securities that they have suggested that I write to you outlining some of the reasons why the Federal Reserve Bank of New York has for so many months favored having the Federal Reserve System do everything possible and within its power to facilitate a recovery of business." There followed a closely reasoned, informed, and well documented analysis of the economic situation and the problem of monetary policy. Harrison stressed the seriousness of the recession, indicated that while there were many other causes of the recession, tight money of the preceding two years had contributed to it, and placed greatest importance on the depressed state of the bond market and the limited availability of funds for long-term financing. "In previous business depressions," he wrote, "recovery has never taken place until there has been a strong bond market." Harrison acknowledged that there was little demand for short-term funds, and that "when the System buys securities, short-time money becomes more plentiful and cheaper." However, "it has been demonstrated in the past that in such circumstances, through a further increase in the reserves of member banks money will be made available for the bond market or shifted to the bond market from the short time market or from other investments less profitable than bonds." He pointed out that Federal Reserve credit had declined and that banks were sensitive to borrowing. "[A]n even small amount of borrowing under present conditions is as effective a restraint as substantially a greater amount was a year ago." He concluded that "while there may be no definite assurance that open market operations in government securities will of themselves promote any immediate recovery, we cannot foresee any appreciable harm that can result from such a policy and believe that the seriousness of the present depression is so great as to justify taking every possible step to facilitate improvement."⁹²

One notable omission from Harrison's letter was reference to the stock of money, as such. Like almost every other document on monetary policy

⁹¹ Harrison, Notes, Vol. I, June 26, 1930. On several occasions, Harrison revealed doubts (Notes, Vol. I, July 17, Sept. 17, 1930). It is clear from internal documents of the Bank that the technical personnel, notably W. R. Burgess and Carl Snyder, were the most consistent supporters of expansionary measures on a large scale. Perhaps because of these doubts, perhaps because of his overriding desire to secure consensus, Harrison continued to present to the rest of the System purchase proposals scaled down well below the level that some of the directors and technical personnel of the Bank regarded as desirable.

⁹² Miscellaneous, Vol. I, letter, dated July 3, 1930. Harrison to all governors.

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within the System until the 1950's, the emphasis was exclusively on credit conditions rather than the stock of money. However, the omission did not affect the policy conclusion; it only altered the line of argument through which it was reached. Consideration of the behavior of the stock of money would have led to precisely the same conclusion: that the System should act so as to prevent a reduction in the amount of high-powered money available and indeed so as to increase it. Moreover, as we saw in section 3, there was a particularly close connection at the time between the bond market and the money stock. Improvement in the bond market would have done much to avert the subsequent bank failures. And though this connection was not explicit in the letter, it was implicit.²³ Harrison's letter and the replies to it provide an extraordinarily illuminating and comprehensive picture of attitudes toward monetary matters within the System. Only two governors—Eugene Black of Atlanta and George Seay of Richmond—clearly and unambiguously agreed with Harrison's analysis and supported his policy recommendations. The rest disagreed, most of them sharply.

James McDougal of Chicago wrote that it seemed to him there was "an abundance of funds in the market, and under these circumstances, as a matter of prudence . . . it should be the policy of the Federal Reserve System to maintain a position of strength, in readiness to meet future demands, as and when they arise, rather than to put reserve funds into the market when not needed." He went on to stress the danger that "speculation might easily arise in some other direction" than in the stock market. McDougal had all along been the most outspoken opponent of the New York policy and was to remain for the rest of the contraction a consistent proponent of selling government securities on almost any occasion. The demands for which the System should husband its resources remained in the future. McDougal's outlook was particularly influential because Chicago was next only to New York in importance as a financial center, and because he had been with the System so long. McDougal had been appointed governor of the Chicago Bank at its founding in 1914, at the same time Strong was appointed governor in New York. He had had disagreements with New York on earlier occasions.²⁴

²³ One important advantage of explicit attention to the stock of money, both on that occasion and later, would have been provision of a clearly defined indicator by which to judge in quantitative terms the needs and effects of policy. The outsider is struck, in reading the reports of discussions within the System, by the vagueness and imprecision of the criteria used. For example, with the "needs of business" undefined, one participant regarded "credit," also undefined, as "redundant," another as "tight." Lack of a common universe of discourse and inability to reduce differences of opinion to quantitative terms were probably important factors enabling differences to persist for so long with no approach to a meeting of minds.

²⁴ Harrison, *Miscellaneous*, Vol. 1, letter, dated July 10, 1930, McDougal to Harrison; Lester V. Chandler, *Benjamin Strong, Central Banker*, Brookings, 1956, pp. 79, 445.

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John U. Calkins of San Francisco was no less explicit than McDougal was. In an earlier letter to Governor Young explaining why San Francisco had not participated in the June open market purchases, he had stated that "with credit cheap and redundant we do not believe that business recovery will be accelerated by making credit cheaper and more redundant." In his reply to Harrison's letter, he repeated the sentiment, expressed the view that "the creation, promotion, or encouragement of a bond market" is not "within the province of the Federal Reserve System," and that "no encouragement of the market for foreign bonds can counter-balance the destructive effect upon our foreign trade of the tariff bill recently approved." He went on to say, "We believe that the volume of credit forcibly fed to the market up to this time has had no considerable good effect, certainly no discernible effect in the last few months. We also believe that every time we inject further credit without appreciable effort, we diminish the probable advantage of feeding more to the market at an opportune moment which may come."⁹⁵

Lynn P. Talley of Dallas wrote that his directors were not "inclined to countenance much interference with economic trends through artificial methods to compose situations that in themselves grow out of events recognized at the time as being fallacious"—a reference to the stock market speculation of 1928-29. Talley's letter, like some others, reveals resentment at New York's failure to carry the day in 1929 and the feeling that existing difficulties were the proper punishment for the System's past misdeeds in not checking the bull market. "If a physician," wrote Talley, "either neglects a patient, or even though he does all he can for the patient within the limits of his professional skill according to his best judgment, and the patient dies, it is conceded to be quite impossible to bring the patient back to life through the use of artificial respiration or injections of adrenalin."⁹⁶

W. B. Geery of Minneapolis wrote that "there is danger of stimulating financing which will lead to still more overproduction while attempting to make it easy to do financing which will increase consumption."⁹⁷

George W. Norris of Philadelphia replied that discussions with an insurance company executive and with a private banker in Philadelphia had confirmed him in his own view "of the fruitlessness and unwisdom of attempting to depress still further the abnormally low interest rates now prevailing." Later in the year, at a meeting of the Open Market Policy Conference in September, Norris, in strong disagreement with what he regarded as the current policy of the System, read a lengthy memorandum summarizing the Philadelphia view. The Philadelphia Bank objected to

⁹⁵ Miscellaneous, Vol. I, letter, dated July 16, 1930, Calkins to Young; letter, dated July 10, 1930, Calkins to Harrison.

⁹⁶ Miscellaneous, Vol. I, letter, dated July 15, 1930, Talley to Harrison.

⁹⁷ *Ibid.*, letter, dated July 7, 1930, Geery to Harrison.

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"the present abnormally low rates for money" as an interference "with the operation of the natural law of supply and demand in the money market . . ." and concluded, "this is a complete and literal reversal of the policy stated in the Board's Tenth Annual Report . . . We have been putting out credit in a period of depression, when it was not wanted and could not be used, and will have to withdraw credit when it is wanted and can be used."⁹⁸

These views, which seem to us confused and misguided, were by no means restricted to the Reserve System. The Federal Advisory Council, whose members were leading bankers throughout the country, consistently adopted recommendations expressing the same point of view, using phrases such as, "the present situation will be best served if the natural flow of credit is unhampered by open-market operations."⁹⁹ However, even in the financial community, the New York Reserve Bank was not alone in its view of the situation. The July 1930 monthly letter of the Royal

⁹⁸ Harrison, *Miscellaneous*, Vol. I, letter, dated July 8, Norris to Harrison: *Open Market*, Vol. I, memorandum read by Norris at Sept. 25, 1930, meeting. The memorandum is such a remarkably clear statement of the real bills doctrine that was so widely accepted at the time and earlier that it is worth quoting at greater length. The policy which had

created artificially low interest rates, and artificially high prices for government securities . . . is an injustice to our member banks. It had resulted in making open market operations usurp the discount function, and tends to foster the regrettable impression that there is some element of impropriety in borrowing by member banks . . . [A]s the result of injecting a large amount of unasked and unneeded Federal Reserve credit into an already glutted money market, we find ourselves with over 600 millions of governments on hand, the bulk of which must ultimately be disposed of . . . We do not undertake to say how much Federal Reserve credit should be in use today, but we do hold to the belief that a substantial part of it should be the result of a demand expressed in borrowing by member banks, and used in cooperation with those banks. Less than one-sixth of it is of this character today.

In addition to the letters quoted, and the two from Black and Seay, a brief letter was sent to Harrison by O. M. Attebery, deputy governor at St. Louis, on behalf of Governor Martin, on vacation, expressing doubts and stating that conditions in the Eighth District provided no justification for further open market purchases (*Miscellaneous*, Vol. I, letter, dated July 9, 1930). Frederic H. Curtiss, chairman of the Boston Bank, sent a lengthy letter dated July 9 (the Boston Bank at the time had no governor, Harding having died in April, and Young, still governor of the Board, not yet having been appointed to fill the Boston Bank vacancy). Curtiss' letter expressed strong opposition to further purchases on the ground that they were likely to feed the stock market rather than the bond market.

Only the Federal Reserve Bank of Cleveland did not reply, but its governor acknowledged the letter by telephone. In a letter to Governor Young, Harrison summarized the views expressed by Governor Fancher of Cleveland on his own behalf and as spokesman for a majority of his directors, "that continued purchases of government securities would not contribute substantially to . . . recovery and that, therefore, they would not . . . favor further purchases" (*Miscellaneous*, Vol. I, letter, dated July 23, 1930, Harrison to Young).

⁹⁹ Quoted from recommendation, dated Nov. 18, 1930 (*Federal Reserve Board, Annual Report for 1930*, p. 228).

Bank of Canada concluded that "immediate and decisive action on the part of the Federal Reserve Banks in putting new funds into the market in large volume is what is necessary to arrest the present serious and protracted price decline and to change the present psychology of business."

One cannot read the correspondence with Harrison just reviewed, the minutes of open market meetings, and similar Reserve System documents without being impressed with the extraordinary differences between New York and most of the other Banks in the level of sophistication and understanding about monetary matters. Years of primary and direct responsibility for the conduct of monetary policy in the central money market of the country and of cooperation with men similarly placed in the other leading money markets of the world had developed in the technical personnel, officers, and directors of the New York Bank a profound awareness of monetary relations and a sensitive recognition of the effects of monetary policy actions. Those qualities were clearly absent at most other Reserve Banks, which had of necessity been concerned primarily with local and regional matters, or at the Federal Reserve Board, which had played only a minor role in the general conduct of policy and had had no important operating functions.

The largely negative response evoked by Harrison's letter induced New York on several occasions during July to consider again engaging in open market purchases on its own but with the approval of the Board, and Harrison sounded out the sentiment of the Board about such action. The results were sufficiently unfavorable to deter any attempt.¹⁰⁰

By September, 1930, some of the Banks were even opposed to seasonal easing. As Harrison told his directors,

Some of the other Federal Reserve Banks, including perhaps a majority of the banks whose governors form the executive committee of the System Open Market Policy Conference, advocate a policy of correction rather than of anticipation. They would allow tightening of the money market and hardening of rates of interest to develop, and then would move to correct the situation through the purchase of Government securities.

A few days later, when Carl Snyder, at a meeting of the officers' council of the New York Bank, suggested that "this deflation should now be aggressively combated by additional purchases of Government securities . . .," Harrison replied that "from a System standpoint it is a practical impossibility to embark on such a program at the present time—to do so would mean an active division of System policy."¹⁰¹

Despite the decline in Federal Reserve credit outstanding, the Board described its policy for the year 1930 as one of "monetary ease . . . expressed through the purchase at intervals of additional United States

¹⁰⁰ Harrison, Notes, Vol. I, July 10, 24, 1930; and Office, Vol. II, June 5, 1930.

¹⁰¹ Notes, Vol. I, Sept. 11, 17, 1930.

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Government securities and in progressive reductions of reserve bank discount and acceptance rates."¹⁰² This is a striking illustration of the ambiguity of the terms "monetary ease" and "tightness" and of the need stressed above (p. 272) to interpret Federal Reserve actions in the light of all the forces affecting the stock of money and credit conditions. It seems paradoxical to describe as "monetary ease" a policy which permitted the stock of money to decline in fourteen months by a percentage exceeded only four times in the preceding fifty-four years and then only during extremely severe business-cycle contractions. And those words seem especially paradoxical when other factors were tending to expand the money stock, so that a potential expansion was converted into an actual contraction entirely by the decline in Federal Reserve credit outstanding.

In the context of the changes then occurring in the economy and in the money markets, the policy followed should be regarded as one of monetary "tightness" not "ease." During a period of severe economic contraction extending over more than a year, the System was content to let its discounts decline by nearly twice its net purchases of government securities, and to let its total credit outstanding decline by almost three times the increase in the gold stock. Through early 1932, the most striking feature of the System's portfolio of government securities and bills bought is the usual seasonal pattern of contraction during the first half of the year and expansion during the second. From August 1929 to October 1930, the whole increase in government securities plus bills bought came in the second half of 1929. The System's holdings of government securities plus bills bought were nearly \$200 million lower at the end of July 1930 than they were at the end of December 1929. Even a mechanical continuation of the System's earlier gold sterilization program, by which it had quite explicitly recognized the need to determine its actions in light of other factors outside its control, would have called for more vigorous expansionary action from August 1929 to October 1930. Such action would have limited the decline in Federal Reserve credit outstanding to \$210 million, the magnitude of the rise in the gold stock, instead of allowing the actual seasonally adjusted decline of \$590 million. As we read the earlier policy statements of the Board, they called for going beyond mechanical gold sterilization in view of contemporary economic conditions. Since the bull market in stocks had collapsed and there were no signs of anything approaching speculation in commodities, any expansion in credit would be likely to be, in the words of the *Tenth Annual Report* (for 1923), "restricted to productive uses."¹⁰³

¹⁰² Federal Reserve Board, *Annual Report for 1920*, p. 1.

¹⁰³ It should be noted, however, that the possibility that easy money conditions might stimulate speculative excesses in the stock market was a recurrent theme in

The stalemate within the System continued, with only minor variations throughout the next year. Harrison was pressed on the one side by his officers and directors—though less consistently by the directors than in the preceding year—to work for greater easing and larger purchases. On the other side, he felt strongly his responsibilities, as chairman of the Open Market Policy Conference, to carry out loyally the policy adopted by the Conference. The one major difference in the situation was the replacement of Roy Young by Eugene Meyer as governor of the Federal Reserve Board. Young became governor of the Boston Bank in September 1930 and, as such, was a member of the executive committee of the Conference, where he joined McDougal in consistently opposing purchases and favoring sales.¹⁰⁴ Meyer was generally favorable toward purchases and, not having gone through Harrison's frustrating experience of 1930, inclined to press strongly for them.

The January 1931 meeting of the Open Market Policy Conference brought out clearly the changes in the situation. From October to mid-December 1930, there had been virtually no change in the System's holdings of government securities. The banking difficulties in New York following the failure of the Bank of United States in the second week of December necessitated purchase of \$45 million of government securities by the New York Reserve Bank for its own account. They were bought from two banks undergoing heavy withdrawals of currency in order to enable them to avoid borrowing. In addition, \$80 million of government securities were purchased for System account, as Harrison explained, "in order to avoid too great tightening of credit due to an unusual amount of 'window dressing'." The purchases were made in accordance with the authorization by the Conference meeting on September 25, 1930, as a compromise between the advocates of "anticipation" and "correction" of purchases up to \$100 million for seasonal ease.¹⁰⁵ At its January 1931

the deliberations of the period, e.g., Harrison, *Miscellaneous*, Vol. I, letter, dated Mar. 17, 1930, J. H. Case (chairman of the New York Bank) to Governor Young; *Notes*, Vol. I, Apr. 24, 1930; *Miscellaneous*, Vol. I, letter, dated Apr. 29, 1930, Harrison to Platt; *ibid.*, letter, dated July 10, 1930, J. B. McDougal to Harrison.

¹⁰⁴ According to Hamlin, Young was eased out of his position on the Board because of the administration's disappointment with his leadership. If so, the result could hardly have been the one intended. As governor of the Boston Bank and a member of the executive committee of the Conference, he may well have been in a position to exercise a stronger influence on open market operations, the key area in which policy had been and continued to be unsatisfactory, than he could have exercised as governor of the Federal Reserve Board (see Hamlin, *Diary*, Vol. 18, Sept. 4, 6, 24; Oct. 3, 10; Nov. 24, 1930, pp. 67, 70, 84, 89, 91-93, 118-119).

¹⁰⁵ See Harrison, *Open Market*, Vol. I, minutes of meeting, Jan. 21, 1931, in which Harrison reviewed changes in the money market since the Sept. 25, 1930, meeting. See also a memorandum, prepared for Harrison by W. R. Burgess, dated Dec. 19, 1930, referring to the absence of change in the System account between Sept. 25, 1930, and the date of the memorandum. The purchases by New York up

meeting, the Open Market Policy Conference recommended that "it would be desirable to dispose of some of the System holdings of government securities as and when opportunity affords itself to do this without disturbance or any tightening of the money position."¹⁹⁶ When the members of the Reserve Board met subsequently with the governors, both Adolph Miller and Eugene Meyer objected. Harrison, in his capacity as chairman of the Conference, defended the recommendation on the ground that it "represented a compromise since some of those present were in favor of considerable sales of securities, while others were only in favor of such moderate sales as might be necessary to take up the slack." Meyer, sensitive to political repercussions, stated that

a reduction of bills and discounts of the System did not involve the launching of any major policy, whereas the sale of governments is commonly interpreted as a major move in Federal reserve policy. The Reserve System has been accused in a number of quarters of pursuing a deflationary policy in the past year, and a sale of government securities at this time is likely to draw fire. In this situation it would appear most desirable to avoid a move which appears to present a major change in policy when there is no necessity for doing it.

Despite Meyer's reservations, the Board approved the Conference's recommendation and, by February 1931, security holdings had fallen by \$130 million, although there was concern about the associated tightening of the bond market.¹⁹⁷

to that date were only \$40 million from one large bank. The purchases for System account after Dec. 20 were made by New York at its own discretion, the executive committee at a meeting on that day in Washington with Governor Meyer and several Board members having agreed "to leave it to the judgment of the Federal Reserve Bank of New York whether some additional amount of government securities should be purchased within the \$100,000,000 authority with the understanding that the New York bank would keep in close communication with the members of the committee" (*ibid.*, minutes of executive committee meeting, Dec. 20, 1930).

¹⁹⁶ The original resolution as passed had the word "undue" (later deleted) before "tightening."

¹⁹⁷ Harrison, Open Market, Vol. II, minutes of meeting, Jan. 21, 1931, and letter, dated Jan. 29, 1931, McClelland for Board to Harrison, approving the recommendation; Notes, Vol. I, Jan. 15, 19, 22, 1931.

A memorandum on the Open Market Policy Conference meeting of Jan. 21, 1931, written by E. A. Goldenweiser, the Federal Reserve System's director of research, stated:

Meyer strongly opposes sales of securities beyond the amount bought in December for seasonal and special purposes The rest of the governors did not change their minds, but were impressed by Meyer's sincerity and force. It appears to have been his first bout with the entrenched hard-money crowd of the Federal reserve system.

The memorandum is part of the Goldenweiser Papers in the Manuscript Division of the Library of Congress (Container 1, folder of Confidential Memoranda.

In April 1931, Harrison, as chairman of the Open Market Policy Conference, presented a report to the Governors Conference. He expressed great concern about the gold inflow and the dangers to the world of continued gold sterilization by the United States.¹²⁷ As to the domestic situation, he noted:

While it is commonly stated that money conditions have been exceedingly easy in recent months, and while indeed money rates have been at very low levels there has not been over a period of months any consistent surplus of Federal reserve funds pressing for use upon the market Furthermore, apart from the relatively easy position of the banks in the larger cities, credit cannot be said to be very cheap or very plentiful generally throughout the country.¹²⁸

Harrison's report was discussed at the Open Market Policy Conference, which approved, at his urging, a three-part program to make gold imports more effective and credit more active: maintenance of the bill portfolio, if possible; reduction of buying rates on bills and, less definitely, of discount rates; and—as a last resort, if bills purchased did not enable earning assets to be maintained—authority for the executive committee to purchase up to \$100 million of government securities. The resolution including the final part of this mild program—the only part within the Conference's exclusive jurisdiction—was adopted with four reluctant supporters, three of the four, members of the executive committee.¹²⁹

No purchases were made under that recommendation until after a June 22 meeting of the executive committee, at which Harrison urged purchases of \$50 million. Meyer, who was present at the meeting, strongly supported Harrison, saying that "the Federal Reserve Board would . . . have some preference for a larger program of purchases" The authorization was granted with only one negative vote—Young of Boston—because Norris of Philadelphia abstained and McDougal of Chicago voted against his convictions out of deference to President Hoover's proposal, announced two days earlier, of a moratorium on inter-governmental debts ("purchases of governments would be received by the public as supporting the President's announcement"). On July 9, the executive

1922-33). Of the seven cardboard letter files (described as containers in the Division's records), only six are open to readers; the seventh may be opened before 1965 only upon written permission from Mrs. Goldenweiser. Only a small fraction of the open collection contains current analyses of Federal Reserve policy in 1919-45, the period of Goldenweiser's service with the Board. The Goldenweiser Papers are meager in coverage compared to the Harrison Papers and provide a far less comprehensive view from within the Federal Reserve System than the Hamilton Diary does. Consequently, we have made only minor use of them.

¹²⁷ See quotation from his report in sect. 4, above.

¹²⁸ Open Market, Vol. II, Apr. 27, 1931.

¹²⁹ Norris of Philadelphia, Young of Boston, and McDougal of Chicago. The fourth was Calkins of San Francisco (*ibid.*, minutes of meeting, Apr. 29, 1931).

committee agreed to a further purchase of \$50 million to complete the \$100 million authorized in April, but buying was stopped on July 16 at only \$30 million because of Harrison's concern over foreign developments and despite the remonstrances of Meyer.¹¹¹

By early August, Harrison and Meyer again pressed for purchases. In discussing the situation with the executive committee of directors of the New York Bank, Meyer presented figures showing that between November 1, 1930, and August 5, 1931, there had been "a total increase of \$421,000,000 in the gold stock of the United States; that currency circulation had increased \$350,000,000 instead of showing a normal seasonal decline of at least \$100,000,000; and that the Bank of France had withdrawn about \$125,000,000 from the market" (presumably the acceptance market). He then pointed out that "while there had been no intentional contraction of the base on which credit could be extended, the sterilization of an amount larger than the gain of gold had been passively permitted." He said that, "if we had been asked last November whether we would favor, or even permit, the sterilization of \$400,000,000 of gold, undoubtedly we would have answered in the negative."¹¹²

When a majority of the executive committee of the Open Market Policy Conference proved to be unwilling to support further purchases, a meeting of the full Conference was called for August 11. Harrison proposed a program, to be put into effect when desirable, authorizing the executive committee to buy up to \$300 million of government securities. Other governors, except Black of Atlanta who joined Harrison in favor of it, were entirely negative in their reaction, and the Conference voted instead an authorization for the executive committee to buy or sell \$120 million.¹¹³

So far as we can discover, that was the first Conference meeting at which there was explicit reference to a problem later to be cited as a major reason for the Reserve System's failure to make any extensive security purchases—the problem of free gold. However, the free gold problem, to be discussed in the next section, played no role in the outcome.

When the Conference met the same day with members of the Board, Harrison was again in the position of having to present and defend a recommendation he did not favor. He explained that the Conference opposed immediate purchases of large amounts of government securities, because banks would not employ excess reserves. The banks' reason:

¹¹¹ Harrison, *Open Market*, Vol. II, minutes of executive meeting, June 22, 1931; *Miscellaneous*, Vol. I, letter, dated July 9, 1931, Harrison to Seay; *Notes*, Vol. I, July 16, 23, 1931.

¹¹² *Notes*, Vol. II, Aug. 10, 1931.

¹¹³ *Open Market*, Vol. II, minutes of executive committee meeting, Aug. 4, 1931; minutes of meeting, Aug. 11, 1931. The \$120 million included the usual \$100 million plus the \$20 million authorized in April but not used.

"most prime investments are selling on a very low yield basis, while secondary bonds consist largely of railroad issues, of which a considerable proportion may in a short time become ineligible for investment by savings banks, insurance companies, and trust funds, due to the provisions of various state laws. In addition the bond market has been uncertain because of pressure on the market, due to forced liquidation of bond portfolios of closed banks." Governor Meyer and other members of the Board expressed disappointment at the action taken by the Conference, "in that it limited possible purchases to an ineffective amount." However, the only consequence of their disappointment was a change in the timing of the Board's session with the Conference. Thereafter, the two bodies discussed policy actions before rather than after the Conference adopted its recommendation. Later, when the Board formally considered the recommendation, it did not approve it outright but delegated to Governor Meyer the authority to approve purchases but not sales.¹¹⁴ In the event, not even the \$120 million authorization was carried out.

BRITAIN'S DEPARTURE FROM GOLD, SEPTEMBER 1931

Britain's departure from gold and the resulting gold outflow from the United States changed the focus of policy-making from the Open Market Policy Conference back to the New York Bank. New York had always had, and continued to have, primary responsibility for international monetary relations. The Bank of England, the Bank of France, and other central banks had always treated the New York Bank as their counterpart and had conducted negotiations and consultations with it. The Board had been kept informed, consulted in the process, and its approval obtained

¹¹⁴ Harrison, *Open Market*, Vol. II, minutes of meetings, Aug. 11, Nov. 30, 1931; and letter, dated Aug. 18, 1931, Meyer to Harrison.

Though Harrison was in agreement with Meyer on the substance of the policy issue, he was disturbed by the Board's response to the Conference recommendation, and complained to Meyer that it was contrary to the rules adopted when the Conference was established. To his own board of directors, Harrison stated:

... the whole situation emphasized the inherent difficulties of existing open market procedure. Direction of system policies by a conference of twelve men who must also consult the Federal Reserve Board means . . . that . . . we run a real risk of having no policy at all. Some of the Federal reserve bank governors . . . attended the Conference with preconceived ideas which would not admit of argument, and others in spite of, or perhaps because of, the fact that their banks would not be able to participate in further purchases of government securities, looked at the whole question from the narrow standpoint of their individual position (*Notes*, Vol. II, Aug. 20, 1931).

Commenting on the results of that meeting of the Conference, Governor Meyer said, according to Hamlin, that "Governor Harrison could present a matter very gracefully, but could not sell it; that if the Board had taken part in the conference, he believed the Governors would have followed the Board and the New York bank" (*Hamlin, Diary*, Vol. 19, Aug. 11, 1931, p. 129). He may have been right on this occasion, but later experience suggests that he was unduly sanguine.

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before final action, but it had never had a major voice in forming policy. The other Reserve Banks had for the most part simply been kept informed. That had been the practice while Strong was alive and had remained the practice. The most recent instance during the contraction had been the negotiations in the summer of 1931 in connection with loans to foreign banks.

New York had little doubt about what action to take. At its October 8 meeting, the board of directors voted to raise the discount rate from $1\frac{1}{2}$ to $2\frac{1}{2}$ per cent. The arguments given at the meeting were, first, the gold outflow itself, and second, "advices from France, where foreign fears concerning the dollar appear to have concentrated, which indicated that an increase in the rate would be interpreted there more favorably than otherwise." Some fear was expressed that the rise in rates might have adverse domestic effects, particularly by interfering with Hoover's efforts to organize a National Credit Corporation, but that fear was belittled. Harrison noted that any unfavorable effect on the bond market could be offset by security purchases, since the executive committee of the Open Market Policy Conference still had authority, under the recommendation of the August 11 meeting, to buy up to \$120 million of government securities.¹¹⁵ The only discordant note was a cablegram from Burgess, who was in Europe on a mission for the Bank, recommending no action that would bring about higher money rates in the United States.¹¹⁶ The cablegram was read at the meeting, then disregarded. The Reserve Board promptly approved the rise in discount rates, several of its members having been strongly in favor of a rise ever since the beginning of the gold drain.¹¹⁷

A week later, Eugene Meyer attended the directors' meeting at the New York Bank. Harrison proposed a further increase in the discount rate to $3\frac{1}{2}$ per cent, giving as the technical reason the continued gold outflow. One director, Charles E. Mitchell, expressed serious doubts about the domestic effects. Meyer replied that "an advance in the rate was called

¹¹⁵ However, three days earlier, at a meeting of the executive committee of the board of directors, Harrison said that "he considered the gold position of the System paramount at this time and on that account would not be inclined to purchase Government securities" (Harrison, Notes, Vol. II, Oct. 5, 1931).

¹¹⁶ Burgess had arrived in Europe on Oct. 9 to attend a regular monthly meeting at Basle of the Bank for International Settlements. It was the first time a Federal Reserve official had formally participated in discussions of European central bankers at the world bank. The New York Bank was not a member, because it had been forbidden by the State Department to subscribe to shares of the BIS when the latter was formed in 1930. However, there were unofficial ties between the two institutions, strengthened by the fact that Gates W. McGarrah, president of the BIS, had formerly been chairman of the New York Bank.

¹¹⁷ Hamlin and Miller, at least, strongly favored an increase in discount rates and considered a possible effect on the bond market as no valid reason for delay (Hamlin, Diary, Vol. 19, Oct. 1, 1931, p. 148).

for by every known rule, and that . . . foreigners would regard it as a lack of courage if the rate were not advanced." He expressed the opinion that "the bond market was already adjusted to a higher level of interest rates, and therefore it would be but little affected."¹¹⁸ A month later, Owen D. Young pressed the desirability of purchasing government securities to offset unfavorable domestic effects. Harrison was exceedingly hesitant to accede.¹¹⁹

The sharp rises in discount rates were widely supported not only within the System but also outside.¹²⁰ The maintenance of the gold standard was accepted as an objective in support of which men of a broad range of views were ready to rally. The drain of gold was a dramatic event for which there were many precedents.¹²¹ Thus both the problem and its solution seemed clear and straightforward. Indeed, one gets the impression that after grappling with unfamiliar, elusive, and subtle problems, the System greeted with almost a sense of relief the emergence of a problem that could be put in black-and-white terms.

Less than two weeks after the second rise in discount rates, the executive committee of the Open Market Policy Conference met. The preliminary memorandum for the meeting outlined the drastic change that had occurred in currency in circulation, pointed out that internal developments had been more important than the gold outflows in their effects on domestic business, and noted that the decline in deposits "constitutes by far the most rapid shrinkage in member bank deposits during the life of the System." Nevertheless, McDougal continued to recommend that the System should reduce its security holdings, although—in addition to the unprecedented pressure on commercial banks at the time—it was the beginning of the season when the System typically expanded its security holdings. The final outcome was a vote against sales but in favor of requesting the Federal Reserve Board to give the committee the same leeway for sales that the Board had given it for purchases under the Conference recommendation of August 11.¹²²

¹¹⁸ Harrison. Notes, Vol. II, Oct. 15, 1931.

¹¹⁹ *Ibid.*, Nov. 25, 1931.

¹²⁰ "We think the really constructive event of the week has been . . . the action of the New York Federal Reserve Bank in raising its rediscount rate . . . This step should have been taken long ago, and, indeed, it was a sad error of judgment to put such a fantastically low rate as that at New York in force. . ." (*Commercial and Financial Chronicle*, Oct. 10, 1931, p. 2305). ". . . [T]he Federal Reserve Bank of New York has been driven into making another advance of a full 1% in its rediscount rate . . . a decidedly wise move. . ." (*ibid.*, Oct. 17, 1931, p. 3460). The *New York Times* reported that the rise was "welcomed by almost all bankers" (Oct. 11, 1931); that the rise was "hailed with enthusiasm in banking circles" (Oct. 16, 1931).

¹²¹ See, however, further discussion in sect. 6, below.

¹²² Harrison. Open Market. Vol. II. memorandum and minutes of executive committee meeting, Oct. 26, 1931. In the course of the meeting, Harrison noted that "the free gold position . . . was not a consideration at this time. . ."

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The preliminary memorandum for a meeting of the full Conference at the end of November noted with satisfaction that the "foreign and domestic drains upon bank reserves were met in the classic way by increases in discount rates combined with a policy of free lending." It recorded that "one result" of the rise in discount rates and the associated rise in other market rates "was certainly to make bankers and others more timid and reluctant in contemplating new uses of funds or new enterprises." It stressed the sharp decline in bond prices and the resulting worsening of the position of the banks. It discussed the year-end seasonal problem, suggesting that purchases "similar to those made last year" should be provided for, and proposed deferring the longer-term policy decisions until after the first of the year. The Conference adopted a resolution giving the executive committee authority to purchase up to \$200 million of governments for seasonal needs.¹²³ Only part of that authority was in fact exercised. Government security holdings were raised by \$75 million to the end of December 1931 and then lowered by \$50 million in January 1932.

During those months, it is not clear that Harrison was as unhappy with the policy followed as he had been before and was to be again. His concern about gold inhibited his desire to expand Federal Reserve credit. New York still had control over the buying rate on bills, subject only to the approval of the Board. As we have seen, New York had repeatedly tried to use bill purchases to enable it to accomplish on its own what it could not accomplish through the System open market account. Yet the bill buying rate, which had been raised from $1\frac{1}{4}$ per cent to $3\frac{1}{8}$ per cent in October along with the discount rate, was reduced only slowly and moderately, to 3 per cent on November 20, and to $2\frac{3}{4}$ per cent on January 12, 1932. Both reductions left the rate above the market rate and therefore did not lead to an increase in bill holdings.

Early in January 1932, partly under pressure from his staff and directors, Harrison resumed his advocacy of a program of further substantial purchases as part of a broader national program which he outlined to the meeting of the Open Market Policy Conference that month. The main features of the program were: passage of an act establishing the Reconstruction Finance Corporation, then under consideration by Congress; organized support of the bond market, predicated on an agreement between the railroads and the unions to cut wage rates; cooperation of Federal Reserve Banks and member banks with the Treasury in its financing program; purchase of bills by the Reserve System when possible; reductions in discount rates; and, as a final step, "buying of Governments, if necessary, facilitated by an alleviation of the free gold position," the

¹²³ Governor McDougal asked assurance at the meeting that no purchases would be made immediately. Governors Norris and Fancher said "they were not disposed to approve of the purchase of government securities solely for the purpose of enabling the New York and Chicago banks to keep out of debt at the end of the year" (*ibid.*, memorandum and minutes of meeting, Nov. 30, 1931).

final phrase being a reference to proposals then under consideration which were finally embodied in the Glass-Steagall Act. The Conference authorized the executive committee to purchase up to \$200 million, "if necessary," over three negative votes.¹²⁴ That authorization was not exercised at all. Between the January 11 and February 24, 1932, meetings of the Conference, government security holdings declined by \$11 million, bill holdings by \$80 million, while discounts rose \$20 million. Federal Reserve credit outstanding fell by \$100 million over the six-week period.

The February meeting of the Open Market Policy Conference was largely a repetition of the January meeting, although the pending passage of the Glass-Steagall Act removed the problem of free gold. At the joint meeting with the Board preceding the formal business session, Meyer, who continued as governor of the Board though he had by then been named chairman of the RFC as well, asserted that "it seemed unnecessary for the banking position to be subjected to severe strain because of the funds withdrawn for hoarding." Miller stated that "he believed there was never a safer time to operate boldly than at present." He indicated that "he would approve purchases on an even larger scale than the amounts being discussed." McDougal continued to argue that "on general principles he preferred to see the banks borrowing to secure funds." The upshot was a mild expansion in the authority of the executive committee. It was authorized to buy up to \$250 million at the approximate rate of \$25 million a week, McDougal and Young voting in the negative. Immediately after the general meeting, the executive committee voted 3 to 2 to start the program.¹²⁵

OPEN MARKET PURCHASE PROGRAM OF 1932

That modest program would very likely never have been expanded into a major one, or perhaps even carried out, if it had not been for direct and indirect pressure from Congress. Harrison told the executive committee of his directors on April 4 that apparently "the only way to forestall some sort of radical financial legislation by Congress, is to go further and faster with our own program." When Harrison reported to a full meeting of his directors on April 7 that the executive committee of the Open Market Policy Conference was deeply divided about the wisdom of accelerating the purchase program, and had voted to continue the existing program, one of the directors asked "if a more vigorous program

¹²⁴ Harrison, *Open Market*, Vol. II, minutes of meeting, Jan. 11, 1932. McDougal of Chicago, Seay of Richmond, and Deputy Governor Day, representing Governor Calkins of San Francisco, were the three who voted in the negative. Neither Governor Young nor any other representative of the Boston Bank attended the meeting. The Kansas City Bank was represented by a director who was not present at the session when the resolution was adopted.

¹²⁵ *Ibid.*, minutes of meeting, Feb. 24, 1932.

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on the part of the Federal Reserve System would not be helpful in defeating the Thomas Lonus bill and other similar legislation. Governor Harrison said that Senator Thomas had indicated to him that he might be satisfied not to press for Congressional action if the System would proceed more vigorously." The Bank directors accordingly voted to have the Bank, subject to the approval of the Board, buy for its own account up to \$50 million of government securities, outside the System account and before the meeting of the Conference, which was set for April 12.¹²⁶

In opening the joint meeting of the Conference and the Reserve Board, preceding the business meeting of the Conference, Governor Meyer "called attention, merely as a matter of information, to the fact that a resolution had been offered in the Senate asking the Federal Reserve Board to state its program Consideration of this resolution had been postponed. He stated that the Reserve System could now undertake to do more toward aiding in the recovery than it had yet done, and that he believed the time had come when the System might be expected to use its powers more fully in an effort to stop the credit decline." Other members of the Board supported Meyer. Ogden L. Mills, since February 13, 1932, Secretary of the Treasury, who had all along been in favor of more extensive action, stated: "For a great central banking system to stand by with a 70% gold reserve without taking active steps in such a situation was almost inconceivable and almost unforgivable. The resources of the System should be put to work on a scale commensurate with the existing emergency."

After the Board left, the Conference voted 10 to 1 to approve a resolution offered by Harrison authorizing the executive committee to purchase up to \$500 million of government securities in addition to the unexpired authority granted at the February 24 meeting. The purchases were to be made as rapidly as practicable and, if possible, to be no less than \$100 million in the current statement week ending next day, April 13.¹²⁷ The

¹²⁶ Notes, Vol. II, Apr. 4, 7, 1932.

¹²⁷ The lone dissenter was Governor Young of the Boston Bank, who had said at the joint session with the Board that he

questioned whether purchases of governments which piled up reserves in the centers would result in the distribution of these funds to other parts of the country. He was skeptical of getting the cooperation of the banks without which success appeared difficult, and was apprehensive that a program of this sort would develop the animosity of many bankers, and was apprehensive also that an extensive program of purchases of government securities would impair the confidence of the public in the Reserve banks. He cited the experience of 1931 as an indication of the futility of government purchases.

Governor McDougal of Chicago asked whether the Reserve System "could retain the confidence of the public after inaugurating a policy of this sort, which was in some measure inflationary, particularly since it involved the use of government securities as collateral for Federal reserve notes" (Harrison, *Open Market*, Vol. II, minutes of meeting, Apr. 12, 1932).

final proviso was inserted after Harrison had informed the Conference he was scheduled to testify the next day before a subcommittee of the House on a bill that in effect would have directed the Reserve System to purchase in the open market until wholesale prices had risen to their 1926 level. He said that "it would probably be necessary for him to make some reference to the program at that time."¹²⁸

After the initial program was voted on April 12, the System bought \$100 million of government securities per week for five weeks. At the May 17 meeting, the Conference again voted another \$500 million open market purchase, McDougal joining Young in dissenting. At the suggestion of Meyer, the weekly rate of purchases after that meeting was reduced. Harrison deplored the reduction: "The temper of Congress is not improving, and the danger of unsound credit proposals is still great. It might, therefore, be unwise to give unnecessary substance to the argument now being used, that the Federal Reserve System intends soon to abandon its open market program." Yet in June, partly no doubt in the hope of conciliating McDougal and Young, he suggested to the executive committee of the Conference that the purchases each week be geared to the maintenance of member bank excess reserves at a figure somewhere between \$250 and \$300 million, the purchases to be as small as possible to preserve the desired level, but with some increase from week to week in the System's holdings, "to avoid the creation of a feeling that the policy of the system had been changed."¹²⁹

By the end of June, as Burgess summarized the results of the program for the New York directors, total purchases of \$1 billion had offset a loss of \$500 million in gold and a reduction of \$400 million in discounts and bills bought, leaving a net increase of \$100 million in Federal Reserve credit outstanding. To Owen D. Young, this meant that "most of our efforts had, in reality, served to check a contraction of credit rather than to stimulate an expansion of credit. We have been clearing the way for action, rather than taking action. . . ." A week later, in discussing the pressure from Chicago and Boston to stop the program, he said,

As it is, we are asked to stop when we are just half way through our program, when we are just at the point where further purchases of Government securities

¹²⁸ The hearings, which threatened to develop into a full-scale investigation of the System, were held by the House Subcommittee on Banking and Currency on H.R. 10517 (a bill to stabilize commodity prices, introduced by Rep. T. Alan Goldsborough). Governor Harrison testified that the Federal Reserve "began to really utilize the" Glass-Steagall Act only two days before he appeared before the committee (*Congressional Record*, House, June 8, 1932, p. 12354, remarks of Mr. Goldsborough). See also *Stabilization of Commodity Prices*, Hearings before the House Subcommittee on Banking and Currency, 72d Cong., 1st sess., part 2, pp. 477-478, 500-501.

¹²⁹ Harrison, *Open Market*, Vol. II. Meyer was referring to the series of bills 1932; Notes, Vol. II, May 26, 1932.

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will bring actual and affirmative pressure to bear upon the member banks . . . To stop just when you have reached the place where you are able to put on the pressure the program was designed to produce, would be a ridiculous thing to do. We shall have no policy left if we do this.¹²⁸

Chicago and Boston took those same facts as evidence in favor of their opposition to the program, as evidence that it had only substituted an undesirable form of credit for a desirable form. McDougal, reported Harrison, "does not see what the purchases have done anyway, and is in favor of stopping." Governor Young felt "that there are going to be a lot more banks closed, that there will be a large increase in borrowing at the Federal reserve banks and that, therefore, we are wasting our resources buying Government securities."¹²⁹

Some officers of the New York Bank, notably Burgess, and some directors favored continuing the program, with the approval of the Board, even if that meant New York would have to proceed without Chicago and Boston. Since the Reserve Board was in favor of continuing the program, it doubtless would have approved. But Harrison was unwilling to follow that course. The gold reserve ratio of the New York Bank was only 50 per cent, of the System 58 per cent, of Chicago 75 per cent. Yet Chicago was reluctant to participate. His own feeling, Harrison said, "is that we should continue with our open market program, and perhaps step it up a bit, but on one condition— that the program be made a real System program and that the Federal Reserve Banks of Boston and Chicago, in particular, give it their affirmative support." When the comment was made that the Board had the legal power to require other Banks to rediscount for New York, if its ratio fell below 50 per cent, Harrison replied "that it would be most undesirable for us to go ahead in defiance of the wishes of the other Federal reserve banks and then to have those banks bale us out under compulsion. System policy and the system Open Market Policy Conference might just as well be thrown out the window under such circumstances."¹³²

At that juncture, Harrison made a final effort to secure the cooperation of Boston and Chicago. He pleaded the case not only with the governors and directors of the two Banks but also with commercial bankers and businessmen in the two cities. Owen D. Young made a trip to Chicago to

¹²⁸ Notes, Vol. II, June 30, July 5, 1932.

¹²⁹ Office, Vol. III, July 5, 1932; Notes, Vol. II, June 30, 1932.

¹³² Notes, Vol. II, June 30, July 5, 1932. Harrison was at first attracted by the proposal that the Reserve Board bring pressure on the other Banks to participate in the purchase program. The Board's authority to compel one Reserve Bank to rediscount paper for another Reserve Bank, it was suggested, would apply also to purchases of government securities, when the reserve position of several Banks was involved (*ibid.*, June 30, 1932). On reconsideration, he decided that the Board had no power to bring such pressure, and that, "furthermore, this bank would be the first to object to such action by the Board, in other circumstances" (*ibid.*, July 5, 1932; see also July 11, 1932).

attempt to persuade the directors of the Chicago Bank. But all to no avail.¹³³

In an attempt to decide the issue, the full Open Market Policy Conference met on July 14. At the joint meeting with the Board, Governor Meyer suggested that "in determining future policy it was important to consider that the public effect of any discontinuance of the policy which had been pursued would be unfortunate, and also that in future policy every effort should be made to secure an effective united system policy." He pointed out that "there existed a trend in Congress toward giving the System more centralization, and that the open market program offered a test of the capacity of the System to function effectively in its present form."¹³⁴ The Conference voted that excess reserves should be maintained

¹³³ Notes, Vol. II, July 7, 14, 1932; Office, Vol. III, letter, dated July 8, 1932, Harrison to Owen D. Young.

¹³⁴ Harrison, Open Market, Vol. II. Meyer was referring to the series of bills introduced by Senator Glass (see footnote 29, above), the most recent on Mar. 17, 1932, predecessors of the Banking Act of 1933. The latest bill was the occasion for a bitter exchange of letters between Glass and Harrison. With the approval of the New York Bank's directors, Harrison wrote to Senator Peter Norbeck, chairman of the Senate Banking and Currency Committee, enclosing a letter he had sent Glass, Feb. 6, about an earlier draft of the bill, which read in part as follows:

Many provisions of this bill are designed further to limit the autonomy of the individual Federal reserve banks and to concentrate more and more power in the Federal Reserve Board [T]he provisions of your bill relating to the open market committee which is given jurisdiction over operations in bills as well as government securities are so cumbersome as to be inimical to the best interest of Federal reserve operation The bill requires approval not only of the Federal Reserve Board but of a committee of 12 representatives of the several Federal reserve banks Under the proposed bill no operations in securities or bankers bills, even the day to day transactions, can be effected, even in cases of emergency, without approval of the committee

To the extent that your bill further shifts power and authority from the Federal reserve banks to the Federal Reserve Board, to that extent, I believe it aims towards centralized operation and control through a politically constituted body in Washington.

On Apr. 9, Glass answered Harrison's letter to Norbeck, writing:

In my considered view it constitutes a challenge to statutory authority and an unyielding antagonism to any restraining influence whatsoever.

. . . you and your board have thus stated in unequivocal terms the misconception of the Federal Reserve banking act which so long has been reflected in the extraordinary policies pursued by the New York bank with respect to both domestic and foreign transactions.

The "extraordinary policies" referred to by Glass, who was an undeviating follower of the real bills doctrine, included the use of open market operations in government securities and the failure to restrict loans to real bills only. In his eyes, the failure was responsible for both the boom and the bust.

Harrison's reply of Apr. 18 concluded the exchange:

The officers and directors of this bank have been just as desirous to do their part in checking the use of bank credit for excessive speculation as you or anyone

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at approximately \$200 million by purchases limited in total to the amount previously authorized by the Conference but not executed—\$207 million. For the guidance of the executive committee, the Conference recommended purchases not to exceed \$15 million a week—except in unusual or unforeseen circumstances—but not less than \$5 million a week for the next four weeks. McDougal, Young, and Seay of Richmond voted against even this resolution.¹³⁵

Freed from Congressional pressure—Congress adjourned on July 16—the Conference lapsed into its earlier pattern.¹³⁶ The program adopted was a minimum face-saving program, and was carried out at nearly the minimum level consistent with the letter of the recommendation. McDougal and Young refused to participate in further purchases. Harrison was unwilling to proceed on his own. As a consequence, in the four weeks after the Conference met, total purchases amounted to \$30 million (\$15 million the first week, then \$5 million a week). From August 10 until the close of the year, the System's holdings remained almost precisely constant.

THE BANKING PANIC OF 1933

The preliminary memorandum for the January 4, 1933, meeting of the Open Market Policy Conference said of the existing situation, "that a good start was made toward recovery, that this movement has been interrupted, and is now hesitant and uncertain." At the meeting, both Governor Meyer and Secretary of the Treasury Mills stressed that any slackening in Federal Reserve open market policy might provide an excuse for the adoption of inflationary measures by Congress. Governor Harrison listed the Congressional situation as one of three reasons for holding the System portfolio of government securities intact; the second was that a reduction "might operate as a check to the bond market thus retarding business recovery and further injuring bond portfolios of banks;" the third

else. From their practical experience in operating a bank in this money center, they feel that in the long run there is only one really effective method of bringing about this result, and that is the traditional method of the vigorous use of discount rate and open market operations The tragedy of the experience of 1928 and 1929 lay, in our opinion, in the failure of the Reserve System promptly and vigorously to use the instruments for credit control which decades of experience have proved to be powerful and effective (Miscellaneous, Vol. II).

¹³⁵ Open Market, Vol. II, minutes of meeting, July 14, 1932.

¹³⁶ To the executive committee of the New York Bank's board of directors Harrison reported on July 11, 1932, a discussion he had had with Meyer in which "Governor Meyer agreed as to desirability of going ahead with the System open market program saying that, if for no other reason, it is politically impossible for us to stop at this particular time. The program was begun at about the time the Goldsborough Bill was introduced in Congress and if it were terminated just as Congress adjourned we would be crucified next winter" (Notes, Vol. II, July 11, 1932).

was that larger excess reserves might lead to the elimination of interest on deposits in principal centers, thus distributing "the pressure for putting money to work more widely." Against those three reasons, Harrison listed three others in favor of some reduction of the portfolio: first, the "System open market policy had not been one to accumulate any definite amount of securities but rather to check deflation through the reduction of bank debt and the creation of substantial excess reserves, which had been accomplished;" second, any further substantial increase in excess reserves might not increase pressure on the banks to lend and invest but would serve only to minimize control when necessary; third, the open market purchases had enabled the Treasury to borrow cheaply and "so in some measure has encouraged the continuance of an unbalanced budget."

The sentiment of most governors was clearly in favor of reducing the portfolio, and the final motion reflected that sentiment. It gave the executive committee authority to reduce the System's holdings of Treasury bills, the reduction in January not to exceed \$125 million and not to bring excess reserves below \$500 million. The committee was authorized to purchase securities if necessary to prevent excess reserves from falling below the existing level, but not if such purchases would do more than make up for declines in holdings. Before any increase in security holdings above the existing level was made, a new meeting of the Conference was to be convened.¹⁹⁷

The policy recommendation was followed, and security holdings reduced by \$90 million in January, despite the concern of Burgess and Treasury officials about the weakness of the bond market, and despite renewed banking difficulties. By February 1, 1933, excess reserves had fallen below \$500 million, and the purchases made were not enough to restore that level. From the last week in January to February 15, the System increased its security holdings by \$45 million, and permitted total Reserve credit to rise by \$70 million. Yet, in those three weeks alone, member bank reserve balances at Federal Reserve Banks declined by \$280 million.

The state to which open market operations—the most potent monetary tool of the System—had fallen was graphically revealed when, as the banking difficulties mounted in February, Harrison ruled out a meeting of the Conference on grounds that it would be "difficult, if not impossible, to hold a meeting of the system Open Market Policy Conference at this time." Instead, New York turned to bills as an alternative. On February 16, New York requested, and the Board approved, a reduction in its minimum buying rates on bills to $\frac{1}{2}$ of 1 per cent. It acquired \$350 million in

¹⁹⁷ Harrison, *Open Market*, Vol. II, preliminary memorandum, dated Dec. 31, 1932, and minutes of meeting, Jan. 4-5, 1933.

bills the following two weeks, though at the end of the second the Bank raised the bill rate twice, to 1 per cent on February 27, and to 1½ per cent on March 1, in consonance with rises in the discount rate. It also acquired \$25 million of government securities in the first of the two weeks and \$2 million in the second, primarily to enable banks to liquidate by selling government securities instead of borrowing on them.¹³³

In the final two months prior to the banking holiday, there was nothing that could be called a System policy. The System was demoralized. Each Bank was operating on its own. All participated in the general atmosphere of panic that was spreading in the financial community and the community at large. The leadership which an independent central banking system was supposed to give the market and the ability to withstand the pressures of politics and of profit alike and to act counter to the market as a whole, these—the justification for establishing a quasi-governmental institution with broad powers—were conspicuous by their absence.

6. *Alternative Policies*

It is clear that the monetary policies followed from 1929 to 1933 were not the inevitable result of external pressure. At all times, alternative policies were available and were being seriously proposed for adoption by leading figures in the System. At all times, the System was technically in a position to adopt the alternative policies.

To give a clearer idea of the consequences of the policies actually followed, we consider explicitly the alternatives available at three critical periods and what their effects might have been. The periods are: (1) the first ten months of 1930; (2) the first eight months of 1931; (3) the four months following Britain's departure from gold in September 1931. This is followed by an evaluation of the chief justification that has been offered by writers on Federal Reserve history for the policy actually pursued in late 1931 and early 1932, namely, that a shortage of "free gold" greatly inhibited use of the policy alternatives available to the System until the passage of the Glass-Steagall Act at the end of February 1932.

The successive banking crises which followed the first period and occurred during the other two were, as we saw in section 2, each more severe than the preceding. Measures that might have been adequate to cope with the earlier ones would have been inadequate for the later ones. On the other hand, as we shall see, the bond purchases actually made in the spring and summer of 1932, which did halt the decline in the stock of money but were inadequate to prevent a subsequent relapse some months after, would have been more than adequate to cope with the earlier crises. As so often in human affairs, a stitch in time saves nine.

¹³³ Notes, Vol. III, Jan. 16; Feb. 2, 6, 16, 27, 1933; Conversations, Vol. II, Jan. 18, 1933. Quotation from Notes, Vol. III, Feb. 16, 1933.