George L. Harrison
Governor, November 1928 to December 1940

Harrison was the Bank's chief executive during a period of national economic hardship and financial instability: the early years of his term coincided with the stock market collapse of 1929, the Great Depression, and the bank failures that culminated in the banking crisis of 1933. In this speech, Harrison advocates reforms to strengthen the U.S. banking system and calls for the removal of remaining barriers to international trade. He argues that domestic financial stability in the major trading nations, along with a reestablished system of fixed exchange rates and orderly international payments, is crucial to stabilizing the world economy.

Some Essentials of Monetary Stability by George L. Harrison

The subject of this session of the Academy — Economic Recovery and Monetary Stabilization — has exhausted most of the day. It might easily exhaust most of the night. Being scheduled as the last speaker, I shall make sure that it does not.

The morning session was devoted to the domestic aspects of these problems; the afternoon session to the international aspects. I wish that it were possible for me to tie together these two parts of this subject and to present to the Academy a complete solution. Lacking both the wisdom and the authority to present a final program, I want merely to discuss some of the basic essentials of monetary stability, as I see them, in their relation to recovery and economic stability.

I think we will agree that monetary stability is not an end in itself. What we desire is to promote and maintain a prosperous level of trade and employment. Our objective is economic stability, and monetary stability is important only as a means to that objective. We all know that money itself is not wealth — we cannot eat it, we cannot wear it, it will not keep us warm (even though at times it may burn our pockets!). But we know, too, that we live in a money economy, and that a stable mechanism of monetary exchange and a stable measure of value are essential to our economic life.

Address delivered before the Semiannual Dinner Meeting of the Academy of Political Science, New York City, April 2, 1936.

The importance of international trade

I am one of those who believe that the world has now reached the stage where international trade — the movement of goods from points of surplus to points of shortage — is an important factor in maintaining economic stability and in producing a higher standard of living not only for the world in general but for this country too. It may be true that a nation can live within

itself if it must do so, but the price of complete nationalism must be a lower, not a higher, standard of living. In prehistoric time the family unit was the economic unit; the caveman had to content himself with his own ability to hunt for his living; he provided as best he could for himself; his standard of living depended entirely on his own powers to provide for himself. As time went on, as the economic unit grew from the single family to groups of families, or later on, as peoples became organized into geographical or political units, they too, owing to an inadequate mechanism for trade, had to live largely within themselves and to be satisfied with what they could grow or make for themselves.

After centuries of struggle, with the development of transportation and communication to the point where goods and people and opinions can be moved about rapidly and cheaply, the world has learned to expect and to demand much broader opportunities and a much higher standard of living than was possible when those facilities were lacking. Improved methods of communication and transportation have not only made the opportunities for distribution greater, but the press, the telephone, and the radio have stirred the imagination and enlivened the desires of peoples everywhere for the products of other communities and other nations. People are no longer content to accept only that which their own nation affords them any more than people within a nation are satisfied with the produce of their own particular locality. It is true that there has been much discussion and even advocacy of the ideal of a closed economy. I cannot but feel, however, that we are still far from taking seriously such a definition of our ultimate goal—that it is a passing phase, an expression of the world's discouragement with the tangled state of affairs resulting from the war and depression.

The difficulty of maintaining international monetary stability

It was as a natural development of the growth of international trade, and of the recognition of the importance of international monetary stability as a means to that end, that the international gold standard was developed. Our problem today is not that international trade is any less essential to the maintenance of a full economic life, but rather that we have been compelled to recognize by the events since 1914 that international monetary stability has become far more difficult to maintain than it was during the last century. The war disrupted and dislocated previously existing economic and monetary arrangements. We have been struggling with the consequences ever since. Probably no monetary system that human ingenuity could devise could have withstood economic changes of such magnitude and rapidity as the world has witnessed since 1914. Just when and how we are to succeed in restoring some definite workable arrangement is hard to tell.

Primarily, the specific responsibility for international monetary stability rests with governments. The difficulties cannot be dealt with by economists working under laboratory conditions, nor by central bankers alone. Rather, the solution of these difficulties depends on a whole background of world conditions and on the development of a public understanding of the problem which will make it possible for governments to act, and in turn discourage governments from doing those things which will threaten the success of action once it is taken. The solution requires a meeting of many minds.

Anyone who has followed the course of international negotiations since the war and up to this very moment must realize how difficult it is to reach agreements even under the most favorable circumstances. We all remember the amount of worry and work, the amount of international discussion, and the amount of patience and goodwill that went into the effort to reestablish international monetary stability in the 10 years after the close of the war. In the light of that experience, we have no reason to hope for a quick and easy solution of our present problems.

The complete cure is not to be found in a single international conference, nor in some flash of governmental wisdom, but in persistent and painstaking efforts over a period of time. Our efforts in the 1920s temporarily achieved their objectives but failed of a permanent solution. The question today is whether we can do a better job with these puzzling problems than we did in the 1920s. We start with a handicap of failure behind us which in certain ways makes our task more difficult. On the other hand, we should have learned something from our experiences.

No meeting of minds on international stability can be expected or desired without a favorable combination of circumstances that will give a reasonable assurance that any formal agreement which might be reached will have a fair prospect of being sustained. At the moment, with a large part of the world harassed by grave political uncertainties, and many important governments, whose budgets are already badly out of balance, spending more and more borrowed money for necessary relief and for what I hope are unnecessary military establishments, it is hard just now to foresee any very early combination of circumstances that will permit of definite world currency stabilization by international agreement. We can only hope that there may soon develop a quieter and more cooperative atmosphere.

Already there is a favorable side to the picture. The progress of world recovery since the middle of 1932 is

now creating underlying economic conditions which make international monetary stability more feasible. During the depression the fall of world prices, the general contraction of production, and the decline of national incomes greatly accentuated the many elements of unbalance resulting from the Great War. Each nation felt forced to resort to policies designed to protect its internal economy. The result has been a tangled network of defensive measures such as the depreciation of currencies, the arbitrary control of foreign exchanges, and the restrictions of trade through embargoes, quotas, clearing agreements, licenses, and tariffs.

All these defensive measures, while different in form, were essentially of the same origin, purpose, and effect. Whether they were necessary or unnecessary, the general result was a progressive strangulation of international trade, which in turn reacted seriously, in many cases, upon domestic trade and employment. At the lowest point, the total value of world trade was only one-third that of 1929, and the physical volume of trade had fallen by 25 percent, the largest decline in history.

On broad economic grounds one might now expect a reversal of this process. For just as nations during the depression cut themselves off from external deflationary influences, they ought in recovery to seek, by a removal of barriers, to share in the beneficial effects of a general trade revival. In other words, nature is now on the side of the doctors.

It is a mistake, however, to suppose that the problem will eventually solve itself, even when political conditions become quieter. There is much that can and should be done to pave the way for effective international stability when governments determine, in the light of both the political and the economic situation, that the time is ripe to act.

The value of international monetary standards

One of the first things we may well do is to think through and try to dissipate the philosophy of defeatism which has been growing up with respect to the possibility of operating an international monetary standard, even in modernized form. We must, I think, fairly recognize that there is now a considerable school of thought which is frankly skeptical about the desirability of a return to the gold standard or to any international standard. Their doubt arises in part from the general drift towards national economic autonomy. It is more largely derived, however, from theoretical considerations as to the relation between domestic and international stability, and these considerations have led many to believe that there is a fatal antagonism between the two.

I think that this belief has grown out of the prewar theory of the gold standard and our experiences of the past 20 years. The prewar theory of an "automatic" gold standard carried the implication, in its abstract logic at least, that economic disturbance, wherever originating or whatever its nature, could be dissipated and corrected by the flow of gold. There was a sound core of truth in this view, but it also contained the dangerous suggestion that all a country had to do was to adopt the international standard and fold its hands in the confident expectation that that beneficent system would protect it from all economic ills.

That there were shortcomings in the gold standard, as we have known it in the past, no one now questions. But it was not the gold standard per se that failed us after the war. World recovery was never soundly reestablished. The reparations question, despite all that was done to effect a settlement, refused to be settled. War debts remained a source of disturbance. The economic position of a number of the countries of Central Europe was never really adjusted. The rates of stabilization of some countries, such as England for instance, were such as to require a greater economic readjustment in those countries than could easily be achieved with existing inflexibilities in those countries. America's new position in the world's economy favored a flow of gold to this country which weakened the position of a number of other countries and formed a basis for excessive speculation here. These and other economic causes for instability were back of the later financial disasters. They were responsible in a large measure for the tremendous volume of short-term funds washing about the money markets of the world in defiance of all the ordinary rules except the rule of fear.

It was against this background that the events of the years from 1931 to 1933 succeeded in generating an overpowering psychology of fear which became in itself a disturbing element apart from its original causes. Fear, following the failure of the Credit-Anstalt in Vienna early in 1931, precipitated a crisis in Germany. Fear then crossed the Channel to England and forced the suspension of gold payments there. Fear of disaster here began to draw gold from the United States in vast quantities. As the focus of fear turned upon this country, it found to feed upon a banking situation built up very rapidly during the past three decades, when weak unit banks were allowed to spring up like mushrooms all over the country. We know the results. When such fear takes hold of the imagination of the people, nothing will stop it until the structure itself collapses.

No one who went through the banking crisis of February and March 1933 will ever forget the irresistible rush of panic through the country. On February 14 the Governor of Michigan declared a state bank holiday and then in rapid succession one state after another in

different parts of the country took similar action until on Saturday, March 4, practically every state in the Union had closed its banks. In the period of about three weeks from February 9 to March 3, the people of America, in fear, had withdrawn approximately $1,700,000,000 in money from their banks, an amount which equaled about 35 percent of the total money in circulation in the country, even in the boom days of 1929.

We shall never forget the first three days of March in the Federal Reserve Bank of New York. On Wednesday, March 1, in that bank alone, we paid out $51,000,000 of currency to our member banks; on March 2 it was $80,000,000; on March 3 it was $176,000,000. On that last day, March 3, we also lost $87,000,000 through transfers of funds to other districts, and $78,000,000 through gold exports and earmarking. In addition, the public crowded into our bank corridors to withdraw gold. In those three days, they carried off in bags, in suitcases, and in their pockets over $100,000,000 in gold coin and certificates. The movement was cumulative. Each day was worse than the preceding one. This was a fear which would wreck any sort of banking system. It was this situation which President Roosevelt must have had in mind when he said in his radio address to the nation at the end of the bank holiday in March: "All we have to fear is fear itself."

I do not suggest that the collapse of the gold standard in the early years of this decade was entirely due to international maladjustments or to the psychology of fear which spread through the world. We must also recognize the effects of an increased rigidity of the internal economic mechanism of many countries which had been developing over a long period of time. The impact of external forces, operating through gold flows, upon the internal economy of these countries had become much more painful than was formerly the case. It is not too much to say that this increasing inflexibility has become the central economic problem of our generation, the root difficulty, whether one is considering the feasibility of international monetary stabilization or the problem of how to achieve and maintain economic stability at home. Given a rigid internal price structure, rigid costs of management and labor, there is danger that the international gold standard may have exactly the opposite effects from those which the gold standard theory contemplated. Instead of correcting economic disturbance, instead of encouraging stable prices, the gold standard may then become the channel of communication through which disturbances are transmitted around the world, bearing the germs of disease rather than the serums of prevention and cure.

I think this becomes clear if we bear in mind the fundamental distinction between rigid and state prices. A rigid price structure is a static thing in a dynamic world. It resists adjustment, and so intensifies maladjustment. Stable prices, on the other hand, are dynamic. The ship and the airplane offer no blind resistance to the winds and currents but move steadily through them by a process of constant adjustment. They move, they have a destination, and they carry passengers and freight.

Now, the increasing rigidity which we have witnessed has been cited by some as proof that an international monetary standard is no longer workable. That seems to me the shallow and short-sighted conclusion. It ignores the great dangers and hazards of fluctuating exchanges as well as the competition in defensive measures to which they lead. Financial armaments, like military armaments, are expensive and unsatisfactory. Moreover, there is implied in this whole view the fallacious notion that nothing more is involved than a mere act of choice; that we are entirely free to choose between domestic monetary stability and international monetary stability. It would be nearer the truth, in my judgment, to say that neither is possible without the other. Unless each country is literally to build a wall around itself, our economic problem will always be one of interplay between internal and external forces, and no amount of choosing between fixed or flexible exchanges will get around that fact.

Maintaining monetary stability at home

We are apt to think of the world as an abstraction, as something apart from the countries that make it up. If we get beyond this, we are apt to think of it as consisting of some 60 countries, all mutually and more or less equally interacting upon each other. It is perhaps nearer to reality to think of the world as consisting of a few pivotal countries and their economic spheres. What happens to the world depends primarily upon what happens to these pivotal countries. From this point of view is it not reasonable to conclude that the money question is mainly one of the impact of internal monetary conditions in these few countries upon the remainder of the world? If these countries could preserve monetary stability at home, coupled perhaps with some safeguards against excesses of international capital movements, then fixed exchanges and gold flow would provide a means of imparting to the rest of the world the stabilizing influences developed and maintained in the pivotal countries.

This approach focuses attention on the problem of internal control in the leading commercial countries. On it would depend the achievement of both internal and external monetary stability. There is, after all, nothing very novel in this view. Stated in homely terms, it simply means that we who make up this group can do

much to keep the world in order if we can keep our own houses in order.

We in this country have already made some progress in this direction. The dollar has been stabilized in terms of gold since February 1, 1934. We have maintained the stability in relation to other gold currencies by the free purchase or sale of gold at fixed prices. Furthermore, responsible officials of our government have indicated, in effect, that we are ready to consider international currency stabilization when other countries are ready to do so.

We have enacted legislation designed to avoid a recurrence of some conditions which contributed to our own and to world difficulties. That is particularly true with reference to the speculative apparatus which in the late 1920s drew funds to this market from all over the world — funds which we did not want and funds which the rest of the world sorely needed.

In certain particulars we have amended and, I believe, strengthened our central banking mechanism by giving the Federal Reserve System additional powers of credit control, such as the powers to fix margin requirements and to change reserve requirements. The exercise of these powers will call for wise judgment and courage. It must be admitted, however, that even though the powers of the Reserve System for dealing with credit problems have been increased, they are not complete in themselves, partly because other governmental agencies also have vastly increased powers. The System, therefore, cannot of itself assume final or full responsibility, at least not until some of the emergency laws dealing with monetary and credit matters have expired or have been modified or repealed. These emergency laws not only divide responsibility. Conceived in depression, they risk being real sources of danger in recovery.

So, also, our commercial banking system, which collapsed under the strain of 1931, 1932, and 1933, has been safeguarded in various respects. After the banking holiday of 1933, only those banks believed to be sound were permitted to reopen, so that many weak banks were eliminated from the banking structure. Furthermore, a large number of banks have since joined the Federal Reserve System and are now under some form of national supervision through the Federal Reserve System or the Federal Deposit Insurance Corporation. The capital structure of undercapitalized banks has been restored through private subscriptions and through the Reconstruction Finance Corporation.

Resolving problems in the domestic banking system

In spite of these steps, however, there are still some fundamental shortcomings in our banking system which, to my mind, must some day be corrected if we

Allan Sproul, the third chief executive of the New York Federal Reserve Bank, once referred to central bankers as "members of the silent service." George Harrison was the least disposed of all the New York presidents to make public statements—in fact, "Some Essentials of Monetary Stability" appears to be the only full-length address Harrison delivered during his term of office. Reprinted below is a letter from Harrison explaining his reluctance to give speeches.

Mr. Walter B. French
Chairman, Speakers' Committee
Annual Convention
New Jersey Bankers Association
c/o The Trust Company of New Jersey
35 Journal Square
Jersey City, N.J.

Dear Mr. French:

Please let me thank you for your letter of March 19 through which you were good enough to ask me to speak at the annual convention of the New Jersey Bankers Association, to be held at Atlantic City in May.

I hope I may be perfectly frank with you. For years now, in fact ever since I have held my present position, I have made it a rule, with one unavoidable exception, not to make any speeches. Many times I have been tempted to do so but I have always declined, not so much because of the burden of preparation as because I sincerely feel that I can maintain currently a much greater independence of judgment if I am not committed by some previous public statement. Whether I am right or wrong about this is not so important now as the fact that I am afraid I would be greatly embarrassed if I were now to make an exception to the rule which I feel has kept me out of a good deal of trouble in the past. Some day I may have to change, but I will be most grateful to you if you will understand my position and excuse me now.

I attended a part of the convention at Atlantic City last year. You were all so cordial and hospitable that I hope to join you again this year. I shall have to be in New York on May 12 for my regular directors meeting, but if I can satisfactorily arrange my plans, I shall certainly be there the last two days of your convention. I shall look forward to seeing you at that time.

Faithfully yours,
George L. Harrison,
President

want to avoid future weakness.

Our commercial banking system grew up much like Topsy. At the beginning of the depression it consisted of about 24,000 separate unit banks, all organized and operating under 49 different sets of laws — the Federal law and the laws of the 48 states. Some of these banks were members of the Federal Reserve System but two-thirds of them were not. The Federal Reserve System was superimposed upon this heterogeneous group of banking institutions without any substantial change in the basic system itself. No central banking system can be made a substitute for a sound commercial banking system. So, while many steps have already been taken, we shall not be able to boast of a wholly adequate banking structure until such time as it may be possible to develop a more unified commercial banking system with greater concentration of both authority and responsibility.

This implies a greater uniformity of banking laws between the different states, on the one hand, and between the states and the federal government, on the other. It implies greater consistency and effectiveness of banking supervision, responsibility for which is now divided among too many agencies. It implies the necessity of improving the general character of banking management through the development of some more liberal system of branch banking within appropriate areas. It implies some satisfactory disposition of the knotty problem of separating the commercial banking function from the savings banking function. The combination of these two functions in the same institution has been one of the apparent causes of our banking troubles of the past. Lastly, it implies the ultimate necessity of bringing all the commercial banks of the country into the Federal Reserve System.

The precise answer to these questions is difficult to determine either as to time or method. It will require thoroughgoing and thoughtful study, and perhaps a gradual solution; but we should not rest content until the problem has been recognized and its solution undertaken. I do not mean to imply that our banking system today endangers the economic stability of the country or the funds of its depositors. But I do mean that it will never function to the full limit of its usefulness and safety until these questions are considered and disposed of in some satisfactory fashion.

In this brief summary of some of the things which we have done in this country and still need to do in setting our house in order, I have referred altogether to the financial aspects. To avoid misunderstandings, let me add this general qualification that the financial soundness of a country is not something independent from the soundness of its whole economy. It is not possible to have sound finance unless there is also a sound industrial policy, a sound labor policy, a sound basis for the distribution of the national income, and a sound governmental fiscal policy. To a considerable extent the financial well-being of a country is but the reflection of its whole economic life. So I have been discussing not the whole of the problem but rather that part of it which comes more within the direct sphere of the responsibilities of a bank of issue. One of the results of our complex existence is that responsibilities can never be wholly segregated and fixed. No question of great importance in terms of human welfare can be narrowed down and dealt with in a single sphere. Each question is dependent somewhat on the other.

It is obvious, therefore, that domestic problems will not solve themselves any more than will international problems. We should not be content to sit back and wait complacently for the solution. Each nation, while working for a removal of the international barriers to stability, might profitably direct its course towards domestic stability.

As I say, we in this country have made some progress, but we have more to do. The same thing is true of others. Many nations have unbalanced economies, drastic trade and exchange restrictions, problems of relief and unemployment, or budgetary difficulties, quite apart from political uncertainties. The solution of some of these problems and the removal of at least some of the existing obstacles to international trade might well be undertaken promptly in order to facilitate world monetary stabilization. If these things are not done, if governments persist in stifling international trade for uneconomic reasons, and if nations or whole groups of people over too long a period are denied the right of a decent standard of living because of manmade barriers to the exchange of their goods and services, then, in the light of past history, they will seek that right, sometimes ruthlesly and by force, just as men have done from the beginning. If, on the other hand, nations now persistently and vigorously apply themselves to a solution of these quesions, then when the time does come for international monetary action, whether it be between large groups of nations or simply between the nations whose currencies are the principal media of international trade, we can look upon whatever action is wisely taken with a fair degree of confidence that it will survive and contribute to the prosperity and happiness of peoples everywhere and, not least, to our own people.