

and of the supplementary means of credit policy that has been completely justified by its results.

"The federal reserve system has been criticized for its reduction of the rate of discount to 3½ per cent in August, 1927. It has been said that the system thereby gave the first stimulus to the great period of stock exchange speculation. The business of the federal reserve system is, however, to supply the country with means of payment to such an extent that the general level of commodity prices is kept as stable as possible.

Rediscount Rates

"Now in the summer, 1927, the price index had come down to 94 and it was the obvious duty of the federal reserve system to take measures to bring back the price level in the neighborhood of the normal figure of 100. With more reason the system may be criticized for not having reduced the discount rate in March when the downward movement of the price index was already manifest enough. However, the effect of the reduction of the discount rate was a rise of the general level of prices.

"During 1928 the rise proved so strong that it was necessary to raise the bank rate repeatedly. In July, 1928, the New York Federal Reserve Bank raised its rate to 5 percent, and this rate was sufficient from October onward to keep the commodity price index between 96 and 98. Thus on the whole the credit policy of the federal reserve system has proved to be correct.

"No doubt it may be said that the aim of the system has not been to stabilize the general level of commodity prices but rather to fight the stock exchange speculation. Banking policy, however, should be judged according to its results rather than by aims that may have been expressed by its leaders. As a matter of fact, the federal reserve system has proved, for the first time in economic history, that a central bank has the supply of means of payment so completely under its control that it is perfectly able to prevent a rising tide of industrial prosperity from causing any inflation of the currency. By this very remarkable accomplishment the federal reserve system has not only done a great service to present American economy but also set an example which will prove to be of the highest value for all countries and for all future times.

*Banking Policy
Judged by Results*

"In comparison with this great achievement it is of secondary importance that the attitude of the federal reserve system with regard to stock exchange speculation has been a mistake. It is fundamentally a mistake of a central bank to try to regulate stock exchange business. A central bank has no other function and should never for a moment contemplate taking over any other function than that of keeping the purchasing power of its currency in regard to commodities at the highest possible stability.

*Attitude Toward
Stock Market*

"Any attempt to do anything more must either result in failure or lead the policy of the central bank in a false direction. In the present case the attempt to regulate the stock exchange has failed in the most manifest manner. * * *"

The Committee in effect proposes that federal reserve authorities in cooperation with member banks should attempt to discriminate among the uses to which credit is put. This should not be a function of the reserve system, the task of which is to see that there is a proper volume of sound credit and not to direct the uses to which it is to be put.

Speculation

When credit is made available by the reserve system and the banks in amounts greater than are proportionate to the needs of industry and commerce, the excess is very likely to find employment in the securities market, in the various forms of operation for which the securities market exists and for the performance of which it has very efficient mechanism. There are students and economists that maintain the federal

*Origin of
Speculation*

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