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DISCUSSION FOLLOWING LECTURE BY MR. CHARLES R. GAY,  
THE NEW YORK STOCK EXCHANGE  
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Q - What is the condition of business credit in the United States at the present time and why is it that the bankers are not more active in making loans. Is it due to Government restriction or Government control?

A - I don't think so; there is plenty of money for everybody. The Government is constantly issuing new bonds; they are not being sold to the public but to the banks. The banks have a tremendous excess of reserves which gives considerable alarm. At a talk I made last October I called attention to that fact and at that time the reserve was 2,400 billions. Now it is considerably over 3 billions - an increase of almost another billion dollars. That is a round sum. There is not the demand for the money. If you go back for a period of fifteen or twenty years you will find that the banks at that time bought seasonally huge amounts of commercial paper - that is, promises to pay by the great industrial houses such as Armour, Smith, Cudahy, etc. Some of them used to borrow a hundred million dollars on their own notes. That was automatically wiped out of the banks accounts. As the goods were processed the debts were paid off to the banks and the money was ready to be loaned to the next borrower. These organizations found it easy to finance their own needs by the issuance of stock. Armour, for one, issued a very large amount of Armour A & B common stock; that put them in funds and I doubt very much if that organization goes to the banks for as much as they used to. In the course of time they amass huge reserves and do not need the banks. The bankers' cry is that

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they have too much money and can find no place to put it.

Q - Would you mind discussing briefly the steps that have been taken, and their adequacy, to prevent a speculative orgy such as we had in 1929?

A - Speaking only within the confines of this room, in the heart of the 1929 panic we called a meeting in the clearing room of the exchange because we did not want the public to know we were having a special meeting. We all went downstairs one at a time to avoid the appearance of assembling, and I sat on the edge of a desk and heard a very prominent banker say "We have found in the period from 1925 to 1929 that there is no one man or group of men who would supply all the securities the public will buy; we are now finding in the heart of this panic that there is no one man or group of men who can buy all the American public wishes to sell. Therefore we must take the situation a day at a time and cushion the blows in the hope that as it goes along it will lessen in severity". That was all the help we got from him. The fact is when the American public begins to take its combined resources in the stock market there is no one man or group who can supply the demands and the only thing I am thinking about is the time when the buying psychology changes to a selling psychology. That is the time toward which I am trying to direct thought and attention now. I have never bought or sold securities for my own account on the floor of the exchange; I am purely a commission broker so you can see I look at this from the objective point of view - the point of view of a bystander. I don't think that prices are unduly high at the present time. I believe we are in a continued upturn in business in this country. In every nation

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on earth, with the possible exception of Italy which is at war, and Spain, of which I have practically no knowledge as it is not an industrial nation, this resurgence, this change in the cycle is going on and, in my opinion, we are two years behind the others in the upturn. The United States is not getting more prosperous all by itself - it is world-wide.

Q - I would like to ask a question about the commodities exchange. The Nye bill contains a provision now as reported out by the Senate, giving the President authority in time of war to close the commodities exchange in an effort to control prices. In your opinion what would be the effect on prices if such action was taken?

A - As an economic theory it would seem that it might work temporarily but not indefinitely. I don't believe in this artificial restriction on production. It is like pulling yourself up by your bootstraps; you can't create something by destroying something. The destruction of property in war creates a scarcity and you have to pay for it; so, if we destroy a thing in peace we have to pay for it. As I said, I am just a run-of-mine stock broker; all I know of economics I have inhaled as I went along. I asked a group in New York: "If a crop of wheat at \$1.00 is a fine thing, a crop twice that big at 50 cents is better, isn't it?" They said that it was - but then why destroy it. I am irreconcilable on this question. I can remember Brazil and the great disaster to its finance caused by trying to control the price of coffee. I know what Canada and the United States have done in wheat to the great cost of the tax payer.

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I don't believe in artificial restraints on industry. I remember one day during the war I met a friend of mine who was a sugar broker. He told me he had just sold a shipload of sugar in Philadelphia at 23 and a fraction cents a pound to a big sugar refining company. That price was paid for raw sugar. I immediately called for a list of the people who owned stock in that company and wrote them all a letter advising them to sell. Only one of my customers took my advice and the stock promptly went down. I don't think it has ever gotten back to its figure on that day. The fact was that when sugar went up to that price they began to dig sugar out of the far reaches in China. These things correct themselves.

Q - Would you care to discuss the stabilizing effect of the Securities Exchange Commission?

A - I heartily believe in this securities legislation; I have had nothing but kind and courteous attention from the Commission. They have gone out of their way to cooperate with us. The difficulty is that the hand of Government in any business is a dead hand - the initiative is killed. The only difficulty I see in the SEC act is that it has changed what has been a close professional relationship on the part of broker and client into something in which the activities of both are defined by law and bound in endless red tape. In regard to Regulation T, there have been forty-seven interpretations of the meaning of the regulation since it was promulgated, and frankly, each bewilders us a little more. We are doing the best we can with something very difficult to work with. So far as the

Commission is concerned, I think they are doing a grand job within the limits of their ability but a man who goes into the security business is bound by the limitations of the act under which he must work. That is the reason we are finding it necessary to have more amendments and extensions made. I was here on Friday to see Dr. Landis and we discussed the thing. I have no criticism at all; the objective is fine, and the personnel are 100% fine chaps. The thing I wonder about is that in two or three or five years from now the complexion of the Commission may change. It may be subjected to political pressure; it will be too bad if that occurs. It is certainly not so at the present time but we can't tell what it will do in the future.

Q - Do you think with measures to avoid inflation as much as possible in time of war it would be possible to finance the greater portion of the war through taxation rather than through bond issues as in the World War?

A - As a business man have a feeling that if taxes go much higher I might just as well quit. I have a horror of regimentation in business or of anything that makes us all cut in a common mold. This nation has been built on initiative and the self-reliance of the people who come here. However, in time of war you have got to enlist the population just as you enlist the fighting forces, in my opinion. What the best method will be I don't know but any upstanding self-respecting patriotic citizen would be perfectly willing to do what was conceived to be the best for the good of all.

Q - It has been said that the control of credit is the best

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practical means for preventing a rise of prices in war. It has also been said

that credit is the best means of preventing financial depressions.

Just how would such control be operated?

A - Undoubtedly the control of credit would be vested to the extent deemed wise to use the power of the Federal Reserve System. Credit is a peculiarly sensitive thing. I spoke of the fact that we had two billion dollars excess reserve in the banks and that we have three now. It is a fact that the reserve of banks is good for ten of credit in loaning money - that it can be pyramided to ten; some say fifteen, and some twenty on that original dollar, so when you speak of three billions excess reserve what is really meant is that that is good for thirty billions minimum of credit. That is almost commensurate with the United States debt; the known debt is thirty-five billions now. The thing that worries the economists is how you can control that vast amount of potential buying power - how to control it wisely. It should not be in the power of one man or any group of wise men. I have no doubt that the Federal Reserve Board will do all it can not to allow any undue inflation to occur. I am not talking about the printing of play money - but credit - the vast reservoir of credit. If you will look back to the year 1924 you will remember that we had rising bond prices and low stock prices; 1934 was exactly the same in its various implications - the bond market active and the stock market doing nothing. We thought in 1934 that we were in for a period such as we are now starting. We faced a very heavy loss in my own firm (we are old-fashioned and kept the employees on. I was so convinced that the cycle was coming that I was willing to do that. The cycle of investment goes this way: there comes a time when confidence

is regained and the people want to invest their money. They go into Government bonds, first mortgages, municipals, etc. The money goes into these until the average investor thinks "that is an awful price to pay and the yield is not good. There are still certain people who are forced to go into them - trustees for insurance companies, estates, etc. That continues to go on until now gilt-edged bonds are 130; they are all right but too expensive at a time like this. Then the money seeks the next best thing and goes into the second-best bonds. The next step is generally toward preferred stocks of industrial corporations and they get up to a place where they yield  $3\frac{1}{2}$  or 4%; they begin to appear expensive. Money still seeks a lower level and gets into the companies with dividend earning records - Eastman Kodak; American Can, DuPont, Air Reduction - all good earning stocks. The money gets into the good class of equity stock and then in sheer desperation goes to others and buys in the market as against the expectation of yield. In other words, having lapped up everything worthwhile, there is still plenty of money to go round and people go into the stock market and buy with the thought that prices will go up. Therefore, I can still something for 60 that I bought for 50.

There is one thing that gives me more concern than any other - this tax on capital gain. I was talking to a man the other day who, after the banks reopened, was sure they would close again and he sold a lot of his securities. He told me that he would get the equivalent of 52 for Chrysler after he paid his tax. But what would he do with that money - anything else would be as high? The size of the tax prohibits

him from doing anything with it . In view of this tax and one or two of the provisions of the Exchange Act a man feels prohibited from doing anything. There may be a war or something to change the course of the price structure. Whether there is going to be buying power to take care of it I don't know.

Q - Do you think it is practical for this country to fix prices on a large scale during a long major war - including wages?

A - I should think it might work temporarily, but not over a long war. Perhaps three months - maybe longer - but I doubt if it would last a year.

Q - I understand there is no tax on capital gain issues in Great Britain. On what political philosophy was it necessary to put that in our Government?

A - I don't know; the fact is that such a tax is not assessed anywhere else in the world. I talked a while ago with an English banker who said "We could not have survived the depression if any such tax had been levied here". They have taxed incomes far down the scale; I think they go as low as incomes of 400 pounds (that is about \$2000.) They have taxed income for all it would stand and have conserved the capital of the people of the country; they realize that capital is something that makes money. We have taxed income and capital. I have no quarrel with inheritance taxes if the Government thinks that it should take them but the Government is not using that for capital reductions of its own - it is going down the sewer of daily expense. I could not do that myself. If I spent money at a rate which would leave no capital with which to work the time would come when I would be broke. As a practice of economics it

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would certainly seem that if the Government is going to tax capital it should use that money to retire its own debt. That is as clear as crystal. Suppose a man has amassed a hundred million dollars and the Government takes the major portion of it; that is productive capital - it gives employment and creates industry. It is just like an acre of ground in which you sow crops in rotation - it produces something. If you spend it for daily expenses there will be a time when the income is going to be taxed more and it gets to a place where the people will not stand it any longer. I believe the rich should be soaked but it is the basic theory of ordinary schoolboy economics that if you continue spending the time will come when you are broke.

Q - What effect has our changing from a debtor country to a creditor country had on the viewpoint of the average business man. Has he changed to the same extent? Has he changed his ideas of where he could place his business or where he should place the goods he wants to sell?

A - Our people are national minded but if we make it impossible for other nations to ship goods to us we can't expect to send ours over there; our export and import figures show that clearly. Our great quarrel on the debt payment is due to the fact that if these nations pay they would have to pay in goods. Our people think that as soon as those nations ship goods here it will make our unemployment worse. We have got to cut down these trade barriers of high tariffs that have been set up. The dollar has got to get to a place where a business man will know what he is going to get for what he ships. Is the dollar going to stay at its value today

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or is the business man going to be paid in 50 cent dollars. That is the fear and fear causes hesitation and hesitation stops a man from going ahead with his plans. If we could stabilize our currency relationship with other nations it would be a tremendous help to the whole business structure.

There is one thing I think you should consider when you look forward to the possibility of war. I am told that a very great difficulty is to find skilled men and for this reason: a man in a certain line of business reaches the peak of his efficiency at 37 or 38. The crash hit us in 1929. The skilled men then are now seven years older; they are on the downgrade. During this depression period there has been no business and no new men have come in to learn the business. There is therefore a scarcity of young men and a loss in efficiency. I think you should remember that because in an emergency if you can't get skilled labor to put to work you will be in bad shape.

Colonel McFarland: Mr. Gay, The Assistant Secretary of War asked me to express his regret that he was unable to be here this morning. There is a new war going on in Washington; I have heard it referred to as the Hagood rebellion, and the Congressional leaders are having a skirmish this morning. It was necessary for Mr. Woodring to be on the field of battle; he has been injected into it without any effort on his part. Your address has been most instructive and most interesting, and I thoroughly enjoyed your keen sense of humor.