THE FEDERAL RESERVE ACT

ADDRESS OF

HON. CHARLES SUMNER HAMLIN

GOVERNOR OF FEDERAL RESERVE BOARD

DELIVERED AT

32ND ANNUAL BANQUET

OF

THE CHICAGO REAL ESTATE BOARD

FEBRUARY 13, 1915

FEDERAL RESERVE BANK
OF CHICAGO

"THE FEDERAL RESERVE ACT"

Mr. President, and Gentlemen of The Chicago Real Estate Board. I cannot tell you what a pleasure it is to me to be able to be here with you tonight and to partake in these festivities. I have had the pleasure of being present at a good many dinners in my now somewhat advanced life, but I never yet have attended anything that would serve as a proper curtain raiser to the splendid entertainment in which I have participated and enjoyed this evening. (Applause.)

I think the last time I had the honor of speaking in this great city was just about twenty-one years ago. I thought then it was one of the greatest cities in the world, and coming back after that space of time, now I know it is one of the greatest cities in the world, and I am delighted with the honor you have given me by inviting me to come here. (Applause.)

Federal Banks

I am sure you all join with me in the pleasure I feel in that you have one of the great Federal banks of the Federal Reserve System (applause) and I want to say that the Federal Reserve Board has unbounded confidence in the ability and the integrity of Governor McDougal and Chairman Bosworth (applause), and the other officers and employes of that great bank. We know their ability. We know their good judgment; and we know that they will faithfully represent the Federal Reserve Bank of this great district, as well as its member banks, and back of it all, as well, the people of Chicago and the other great cities and towns of this Federal Reserve District.

I only wish that I could have had the pleasure in coming here from Washington of bringing with me your fellow townsman and my associate, Frederic A. Delano. (Applause.) Unfortunately he was not able to come with me and it is to my regret and I know to your regret, but I want to express my appreciation of his great ability and of the splendid way in which he is serving the people of this great city and the people of the United States in his work as a member of the Federal Reserve Board. (Applause.)

Federal Reserve Act

The Federal Reserve Act is, as you know, in operation, and I am going to state to you very briefly tonight something about the act and the principles underlying it. I first want to say to you, as I have said many times, that the principles underlying that act are not new principles. They are not any new discovery. They are old principles, recognized on the Continent of Europe for fifty of sixty years, but it is only now that we have taken them to ourselves and have adopted them as part of our own.

We had twenty years ago the so-called Baltimore plan of currency reform, which doubtless you remember. We had many other plans. We had the Indianapolis monetary convention of 1896. We had the so-called Fowler plan, a very good plan of monetary reform. We had the Aldrich-Vreeland Act of 1908 with which you are familiar, and then we had the further so-called Aldrich Bill with which also you are all familiar. All of these bills developed the same principles. Finally we have the Federal Reserve Act, so-called, which took the same principles, arranging them in a different manner, and it is under that system now that the United States financial government, so to speak, is in full effect and operation.

The legislation resulting in that act was not partisan legislation. It was party legislation under the leadership of President Wilson, who is entitled to more credit than any one man for its final enactment, and I say this with due regard for the splendid services of Mr. Glass in the House, Senator Owen in the Senate, the Secretary of the Treasury and many others. It also received the sanction of a party caucus, but it was in no sense partisan. The opposition party had much to do in the way of amendments. Many Republicans as well as Democrats voted for that bill. One distinguished Republican Senator from my State, Senator John W. Weeks, voted for the bill. He said he considered it eighty per cent good. My friends, if you can say that a bill is eighty per cent good, there will be little harm to come when that legislation is enacted into law and has the signature of the President.

The Aldrich Bill, as you all remember, provided for one huge bank centered in Washington, with branches spread all over the country. The people of the United States without regard to political differences, were distrustful of that bill. They were afraid too great power was concentrated in the banks. Some were afraid there was too great centralization, and it soon became evident that the bill could not become law.

Then the Federal Reserve Act was taken up and that you now know is law. To those who feared the great centralization of the so-called Aldrich Bill with the central bank at Washington, I think it would be well to tell how large the areas of some of these Federal Reserve Districts are under the Federal Reserve System. In the first place, the population of the Chicago Federal Reserve District is twelve million. That exceeds the total population of Sweden and the Netherlands, or of Belgium and Switzerland. Its area is not so large as some other districts, for example, the Texas District is twice as large as Germany. The San Francisco District is larger than France, Great Britain, Italy and Germany combined. So I think you will see we have some pretty large banks and great areas of population under the Federal Reserve System.

Now, we can better appreciate the Federal Reserve System if we think just for a moment of the old system from which we are just emerging. Under that system we had seventy-five hundred, approximately, independent banks, and seventy-five hundred independent reserves. Now, my friends, the ordinary thought of the word "reserve" is that it is something for use, that the bank is to draw on its reserves freely in times of stress. But the peculiarity under the laws of the old system was that these reserves were reserves in name only, and if any bank was imprudent enough or foolish enough to dip into these reserves to below the legal limit, if it obeyed the law of the United States, it would practically have to cease business until they were restored, and it was only the forbearance of the Comptroller of the Currency that saved that bank from being put into the hands of a receiver in case the depleted reserves were not restored.

Federal Reserve System.

Now, the Federal Reserve System has a system of reserves entirely different from that. Under the old system the national bank discounted notes and when a note was discounted it became dead, only to be resurrected at maturity, and when discounted it was laid away in the vault of the bank and hermetically sealed with almost funereal solemnity, and the banks of this country were merely mausoleums containing dead commercial notes, and if any venturesome bank president with ghoulish propensities took one of those notes out of the vault for rediscount that bank would be pointed at with distrust.

Then we had the national bank notes. These bank notes had some strange characteristics. They had a tendency to expand when they ought to have contracted and they had a tendency to contract when they ought to have expanded, and sometimes when there was need of expansion their expansion would only begin long after the necessity of expansion had ceased. We had these national bank notes linked to government bonds. Think of that. The national currency, supposedly responsive to the needs of expanding business of the country, linked to government bonds, which represent the wars and the necessities of the past; and it actually came to pass that the extension of the trade and commerce of this twentieth century was linked with the evidence of destruction of trade and commerce of the nineteenth century.

Now, there may have been reasons for that strange alliance in the past, but there is no reason for it today.

Then, there was the call loan. It was supposed to be liquid, and it was liquid; whenever you did not need its liquidity it was as liquid as flowing water, but when you did want it then its liquidity was like solid ice. And in this last year when we needed its liquidity the stock exchanges quietly closed up and there was nothing left liquid in that sort of a situation.

In other words, the best financial experts in the world agreed that the United States had probably the worst financial system in the world. Now, my friends, I think we will agree that the United States is entitled to have the best financial system in the world, and I believe today, under the Federal Reserve System, that she at last has got it. (Applause.)

You remember the alarming events that took place last summer just prior to the opening of the Federal Reserve Banks. You remember the steady exportation of gold, the high rates for foreign exchange; our export trade annihilated; the adverse balance of trade against us; the piling up of bank reserves and the hoarding of gold that took place—and, my friends, we saw much of that hoarding of gold, but I think far worse than any hoarding of gold of an individual is the hoarding of gold of a frightened bank, and long before the individuals in this country begin to hoard gold, from my experience, you will find that the banks are doing it, and it is the fear of the banks that has come to affect the people.

In this crisis, as in the crisis of 1907, we saw many banks through the United States, instead of freely drawing on their money and taking care of their customers, solemnly retreat into their citadels and pull up their portcullis and pile reserves on reserves, neglecting their customers, and it came about that many banks throughout the country who needed to keep only 15 per cent in reserve could be found carrying 60 or 70 per cent. Now, is it a wonder, when that condition exists, that the people of the United States become frightened and they try to do a little hoarding of their own? But that crisis was successfully met, and how it was met under the Federal Reserve System, my friends, will be an epoch in the financial history of the world.

United States Financial Reserves.

We exported last year, in the calendar year, two hundred and twenty-two millions of gold, and when you deduct the gold which was imported it left a net export of one hundred and sixty-five millions of gold; and although this great country was able to send out the net sum of one hundred sixty-five millions of gold, yet the stock of gold in this country was reduced only eighty-nine millions, a little over 4½ per cent decrease.

A greater tribute could not be paid to the strength of the United States in its financial resources and productiveness in its gold holdings than what we saw happen in the last calendar year.

Now there were different relief measures that had to be taken to remedy the situation which presented itself last summer. The Secretary of the Treasury, you will remember, had prior to June 30, deposited some thirty-seven millions of dollars for moving crops in different parts of the country. Some people said: "You will never get that money back." Gentlemen every single dollar was paid back to the treasury at the appointed time together with over $267,000 in interest. In addition the Secretary promptly issued the so-called Vreeland notes. There were about three hundred and eighty millions of dollars of these notes shipped to various banks. Some people said that they would never be redeemed. I want to say that out of the three hundred and eighty millions there are now left only fifty millions unpaid throughout the United States, and as I speak now I have no doubt it is nearer forty than fifty. (Applause.) The Federal Reserve Act made that possible because it amended the Aldrich-Vreeland act by reducing the righ rate of taxation imposed and increasing the amount which the banks could issue. The redemption of these notes was also facilitated by the Federal Reserve notes.

These measures gave relief, but there was much left to place our finances on an absolutely sound basis. The people from all over the United States said: "We owe obligations to pay gold abroad. We want to appeal to the banks to raise a gold fund for the purpose of settling the debts we have." The Federal Reserve Board appealed to the banks of the United States and those banks instantly responded. They not only gave us over one hundred millions, but, if we had called upon those banks for two hundred and fifty millions I believe they would have shipped it to us as fast as the express or parcels post could have carried it to us at Chicago or New York. We found we owed abroad some five hundred millions of dollars due between August and January, and the manner in which the fund was subscribed quickly demonstrated the desire and ability of our people to pay their foreign gold obligations in gold.

Then there was the cotton fund for which we raised one hundred and thirty-five million dollars to enable the farmers of the United States to make long time loans. Of that amount we had, in fact, only one loan of about $27,000. But that cotton fund was not a failure. It did its work. It inspired the people of this country with perfect confidence that they would be taken care of in times of stress, and it did its work just as well and just as successfully as did the gold fund and the other relief measures we had to take.

The establishment of the Federal Reserve system has been a potent cause in our financial recovery, and I would like to point out what it has accomplished. The Federal Reserve

Act has among other things lowered the reserve requirements of banks, thus releasing an enormous amount of cash, which will serve as a basis for loans in the future when needed. It has mobilized a considerable part of the reserves of the various national banks, so a bank need not keep a dollar in its vaults over the legal reserve. It has provided for the re-discount of commercial paper, which previously, as I have said, had to be held in the vaults of the bank until maturity, but can now be used as a basis for rediscounts at Federal Reserve Banks. Any bank president who wants for any purpose the cash can simply go to the Reserve Bank and the notes are turned at once into money, and what was a dead investment has now become one of the most liquid investments in the world, as the banks and the people of this country will soon find out when they need money.

Elastic Currency

We have also provided an elastic currency, secured by a gold reserve of 40 per cent, and commercial paper up to the value of 100 per cent. My friends, by elasticity we mean currency that can be spread out and expanded or, as well, contracted. We now have the true elasticity and you will find that these Federal Reserve notes will expand and contract in accordance with the law of trade.

We have provided for acceptances by national banks in the import and export trade; that is a very great power and it is going to help us to finance our own import and export trade, in fact, we are actually doing it today. The Federal Reserve banks are also given the power to rediscount these acceptances, and it will mean the saving of enormous sums of money to the people of the United States.

We have provided for the establishment of foreign correspondents and agencies of Federal Reserve banks abroad. We have also provided that banks can establish branches in foreign countries. I want to say that under the Federal Reserve act we are never again going to see a financial panic like the panic of 1907. (Applause.) The business man may have the opportunity to speculate and pay the penalty under the new law as under the old, but never again will the strength and stability of the financial system of the United States be threatened. Do you realize the power the Federal Reserve Board has? Banks can draw on their own reserve account deposited in the Federal Reserve banks if permitted to do so by the Federal Reserve Board, and the Federal Reserve Board can suspend any reserve requirements under the Federal Reserve Act, if necessary.

My friends, if a financial panic ever again stalks in this country and looks at the Federal Reserve banks with their power, that panic will fold its tent like the Arab and will silently steal away. (Applause.) The only use for financial panics in the future will be the relegation to the museum of financial curiosities and antiquities.

Reserve Deposits

Another point. The reserve deposits of the member banks are nearly three hundred millions today, and they will be much more, and every dollar of that large sum is impressed with a trust forever for the benefit of agriculture, commerce and industry in the United States, and is forever removed from the stock market or the call loan. Think of what that means. That enormous sum placed as a trust for the benefit of business, commerce and agriculture of the United States. Every dollar deposited in those banks by the United States government will also be impressed with the same trust, although the United States can check against it to pay the debts of the United States, but every dollar not so checked against will have the same trust and be used for the benefit of the people, the manufacturers and the farmers of this great country.

Now, that great transfer of capital and reserve deposits was accomplished marvelously. Many feared that these transfers would cause trouble. They said the banks would call upon their reserve agents, thus necessitating a general calling of loans, and a financial catastrophe would ensue. My friends, there was not a ripple on the financial surface. The Board sent a letter to every member bank in the United States. It said it will be for the good of the country to pay that capital and reserve deposits out of your own vaults. It said: "We wish you to make those payments in gold or gold certificates." And I want to testify to the patriotism of the banks of this country, for they almost invariably complied with that request, and I want further to say that about 90 per cent of the reserves of the Federal Reserve Banks are held in gold or gold certificates. I think that was a great financial achievement, and for that, as I say, we have to thank the patriotism of the banks of the United States.

Up to now the Federal Reserve banks have been appealed to but little for rediscounts or for the issue of Federal Reserve notes, but that, as you all know, is because of the lowered reserve requirements of the Federal Reserve Act, which has released so much cash, so that the member banks do not need to go to the Federal Reserve banks except in some parts of the south and southwest, but in a few months you will see how far the Federal banks can help the other banks and the people of the United States.

Now, some people are afraid the Federal Reserve banks won't pay expenses. Some of them are not paying, because they are hardly in use. When the Federal Reserve banks get into business there will not be any difficulty in paying both expenses and dividends. If they did not, however, it would not be any discredit to the system. They stand there as an insurance to the country.

There is a difference between making money and issuing money. The banks of the United States make money for the stockholders, but the Federal Reserve banks were organized not to make money, but, among other things, issue money. The Federal Reserve banks are not intended to be huge money-making institutions. They are to help the banks and through them the people of the United States, and whether they make money or not has nothing to do with the success or failure of the system.

Discount Rates

Now, as to the effect on discount rates. You have seen the Federal Reserve rates steadily falling. You have seen the discount rates between one bank and another steadily falling. You have seen the commercial rates steadily falling since the banks were opened on November 16th, and in my judgment that was largely caused by the good effects of the Reserve system. I believe the ultimate effect of that system is going to make lower, more secure and more stable rates for the people, and if we can get that from our system we are accomplishing something that the people of this country have been waiting for for many years.

Now, the Federal Reserve Banks have the power to establish or initiate discount rates. The Federal Reserve Board has the power to finally determine what those rates shall be. If at any time the people are complaining that the Federal Reserve banks are not making proper rates, the Federal Reserve Board has power to fix the discount rates as between them and the member banks, as it sees fit, and while such power may rarely have to be exercised, it will be exercised when necessary, it will surely see fit to exercise that power, not alone for the benefit of the member banks, but for the interests of all the people of the United States.

Now, what are the true functions of the Federal Reserve banks? Some say they are only emergency banks, never to be resorted to except in times of distress. Others think they are only commercial banks, which compete at all times with member banks. Their duty is not only to meet emergencies when they arise, their duty is to go boldly forward and prevent emergencies from arising; and while primarily their relations are with the member banks, they have power, under the control of the Federal Reserve Board, to go into the open market and compete with the member banks if and when such competition is for the public interest.

Now, I have heard some complaints of the Federal Reserve banks. Some bank presidents come in and say: "We have no commercial paper of the kind you men will take." Now, I always tell those presidents: "Look over the portfolio and tell me what paper you have got." And he runs off the list and we find that very many are rediscountable at the Federal Reserve banks. He simply did not know. And I want to say if any bank president finds that most of his notes are not rediscountable at the Federal banks, he had better call his directors together and turn his bank into a commercial bank.

Federal Reserve Board

Some complaints have been made as to some of the regulations issued by the Federal Reserve Board. If you knew the difficulties in framing regulations you would know the difficulties before the Federal Reserve Board. We are constantly striving to make our regulations simpler. I think none of you will have reason to complain of the simplicity of the regulations if you will just give us a little time.

Some bank presidents say they are losing money because the reserve deposits were deposited with reserve agents before, and they now lose interest on them. If any bank president will take a piece of paper and a pencil and figure out his reserves under the Reserve Act and what the amount of cash is that is released under the new law, he will find, in my opinion, that he can make much more than any interest he might have got on deposit with a reserve agent.

Another important question is the question of the admission of the State banks, and the Federal Reserve Board is giving serious attention to that. There are differences of opinion. Some say the State banks should not be allowed to come into the system unless they give up all the powers given them by their States. On the other hand, the State banks say they have a right to retain their powers, as long as they comply with the requirements of the Federal Reserve Act.

Some complain that the State banks cannot withdraw from the Federal Reserve System after entry. I have heard very eminent lawyers say that once they got in they could get out, and I have heard other eminent lawers say that once in they could never get out. (Laughter.) But I want to say that once a State bank joins the system it will find its advantages so great that it will never look behind to see whether the door is opened or closed.

There are many other questions I wish I had time to go into. But I will just speak of a few. Some people feel, for example, that having the directors of class A representing the banks is going to militate against the system, because they say those gentlemen can never forget that they represent banks, and they will be neglectful of their duty to the people of this great country. Well, I am not prepared to accept the doctrine until I see the evil demonstrated, and I have not seen it yet. The directors of these banks, class A directors, are eminent, able men, and they never will forget that they are representing the people of the United States as well as the banks. The class B directors, representing commerce, agriculture, and industry, directly represent the people; so do the government directors; so you have six out of nine directors representing the people, even if the three bank directors were recreant to their trust. But I have faith that the nine directors of every Federal Reserve bank will be faithful to their trust, faithful to the interests of the member banks on one hand, and faithful on the other hand to the Reserve banks and the people of the United States.

There are other objections I have seen raised. There is the objection as to the relations of the Secretary of the Treasury with the Federal Reserve banks; that the Secretary of the Treasury has the right at will to make deposits in banks or remove deposits; but, my friends, I think you will, with little reflection, see there is very little to the objection. Some gentlemen feel that the Secretary with enormous funds can put these funds in any reserve bank and neglect the other banks. But this government is built up on a system of checks and balances. The Secretary has the right to put his deposits wherever he wishes, but if some future Secretary of the Treasury years hence should put the deposits in a Reserve Bank where they ought not to have been put, the Federal Reserve Board has a right to take that money and redistribute it through rediscounts among the Federal Reserve banks. There you have system of checks and balances.

It has been certainly a pleasure to be here tonight and to talk to you briefly on this subject. I want, before I close, to say that the people of the Untied States are entitled to the best banking system in the world, and I make the prediction that we have got that system and that ultimately under that system our great country will be the financial center of the world's clearings, and that will redound to the great benefit not only of our government, not only of our banks, both state and national, but will redound to the greatest good to the greatest number of the people of the United States. (Prolonged applause.)