The Federal Reserve Act

CHARLES S. HAMLIN

GOVERNOR FEDERAL RESERVE BANK

NEW YORK STATE BANKERS

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ADDRESS BEFORE
THE NEW YORK STATE BANKERS
ASSOCIATION CONVENTION
SARATOGA SPRINGS, NEW YORK
JUNE 25th, 1915

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This Address was Ordered Printed
and Distributed by the
New York State Bankers Association
in Convention Assembled
June 25th, 1915

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MR. PRESIDENT, Members of the New York State Bankers' Association, Ladies and Gentlemen: It is a pleasure to me to be able to be here this morning and to talk over briefly with you banking matters, particularly the matter of the Federal Reserve Act and the Federal Reserve System.

It was originally intended that my distinguished associate, Mr. Warburg, should come here, and I am sure it is to the deep regret of all of you that at the last moment he found it impossible because of personal reasons to do so. Accordingly he asked me if I would try to fill his place. Well, I had taken a vacation, or started on one—I had four days last summer and two days the summer before—and had laid out a very interesting trip, among other places I intended to go to New London to see the Harvard-Yale race this afternoon—but I told Mr. Warburg I would be delighted to try and fill his place; and I felt that I was making a sacrifice in doing so. But when I read in last evening's papers the very brief synopsis of Governor Strong's able address I felt that I had made a greater sacrifice in not being here to hear that address than in all the pleasure I could possibly have had by witnessing the collegiate boat race.

In discussing the question of the Federal Reserve System it must be apparent that we should welcome a broader basis than is afforded by the National Banking System. While the Federal Reserve System is perfectly homogeneous, while it has been carried out with the greatest success by the member banks, the National

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banks alone, I certainly think that any one interested in the past of this country will welcome the addition to the System of the State banks and the trust companies. In this Federal Reserve District the banking power of the National banks is about seventeen hundred and seventy-nine million dollars, but with the State banks and the trust companies it is well over two billions of dollars in banking power. Therefore, I think it must be evident that the broader the base the more substantial the edifice; and I can say, in behalf of the Federal Reserve Board, that we shall welcome to our membership the State banks and Trust companies of the United States; we will be delighted to have them come into the system. I have seen evidences that some people think that in some way or another the Federal Reserve Board is attempting to coerce the State banks and the trust companies into joining the System. Nothing could be farther from the truth. The System is, as I have said, perfectly homogeneous; its success cannot possibly depend upon the entrance into it of the State banks and the Trust companies, but their entrance will add greatly to the scope of the System and we earnestly hope that every one of the great strong State banks and Trust companies will find it for their own interest to join. We have arranged our regulations so that if at any moment they or any of them think it is not for their interest to remain with us they can give the requisite notice and withdraw; but I am going to make the prediction here to-day that no State bank or Trust company that enters the System will look backward to see whether the door is open or whether it is shut, but that they will find it to be for their best interest as well as to the interest of the Federal Reserve System to continue in its membership.

Banking conditions were never sounder in the history of the United States than they are to-day. We see an

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unprecedented excess reserve in National banks; on May 1, 1915, it amounted to 727 millions. There is presumably also a very large excess of reserves in the State banks and in the Trust companies; perhaps, as Governor Strong said, not so large as that in the National banks, but there is certainly a foundation, National and State, which would support an almost illimitable extension of credit. Indeed, I believe we could extend our credits to four or five or six billions of dollars, if necessary, for the accommodation of our people, the customers of the banks. That very condition of soundness, however, should be a signal to the banks of the United States to go slowly, to conserve their resources for the great work before us in the line of financing of our trade with South America and Central America, and perhaps also in giving credits to our customers on the continent who need those credits to-day. I believe that in this time of great banking resources we should look forward with confidence to the future. I believe that a great and growing future is right on the threshold, but we must approach it conservatively for the best interests not alone of the banks, but of the people of the United States.

I cannot help looking back, as I stand here, to the events of last fall. You will remember very well the occasion when Sir George Paish came over here from London to confer with the Secretary of the Treasury and the Federal Reserve Board. We found, upon investigation, that in our current transactions we were very largely indebted to Great Britain and the continent; in fact, that we owed four or five or six hundred million dollars in obligations which must be paid in gold. There was plenty of gold in the United States, but it was scattered. One of the first things that the Federal Reserve Board had to consider was the raising of a fund of a hundred million dollars in gold. We were called

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upon to raise that vast amount and we appealed to the banks of the United States, and, with the patriotism that has always characterized the banks of the United States, they promptly responded and gave us indeed a larger sum than we asked for. I believe if we had asked for two hundred millions they would just as promptly have given it. Now, that was the means of giving confidence to the American people, satisfying the people, and assuring the peoples of the world that the people of the United States could and would pay every obligation they owed, properly payable in gold, in that metal. While we were discussing these matters, and they were somewhat long drawn out, we realized that the tide was turning, and finally conditions became unmistakable, and you all know what happened. In place of the uncertainty as to how we should discharge our current obligations there arose the uncertainty as to how the citizens of foreign nations could discharge their obligations to us. We had unprecedented exports, naturally contracted imports; and our foreign customers can pay us only in one of four ways: (1) They can send us gold, and that to-day is impracticable and I hardly think it would be to the advantage of the United States to have a flood of gold flowing in; (2) They can send us goods, but of course under present conditions we can hardly expect that, as our imports have greatly decreased; and (3) Running along the line of least resistance, they can send us back our securities. I think that is being done to-day, and I believe it is one of the best things for the country that it is being done because we have the resources to buy back our securities. I think that is one way in which our enormous surplus can very profitably be spent. The fourth method of payment is for us to establish credits here to assist our foreign customers to pay their current indebtedness to us.

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I think all these international problems must satisfy us that international trade means trade upon both sides. It means buying as well as selling. A government could not shut off its imports and continue to export. If the United States was in a position to stop imports and continue these enormous exports it would so derange foreign exchanges that in a very few years we would have practically all of the gold in the world. Of course, long before that happened the inflow of gold would so raise our prices that it would necessarily derange our export trade. So I say that in the long run every bale of goods exported from the United States must be paid for by a bale of goods imported from that foreign country into the United States, or imported from some other foreign country for its account. It is only balances that are or could possibly be paid for in gold, in the long run. When, therefore, we extend our foreign trade we must realize that we have to buy as well as to sell. Do you know, gentlemen, that we have a great and wonderful opportunity to-day in South America? We have recently had a Pan-American Financial Congress, in which eighteen Nations were represented besides the United States. I think you can appreciate the necessity for closer trade relations with these Republics when I say to you that each year Canada buys more from the United States than does Mexico, Central America, Cuba, the West Indies and South America combined! You see what a wonderful opportunity there is to increase this trade. But, of course, if we give the credits that are essential to increasing our South American trade, and if we give the credits that seem essential to maintaining our great export trade with the continent of Europe, we must realize that in the long run those credits must be paid by imports of goods from those countries or by the return of our own securities held by those countries abroad. I think there was never a time when we were better able to finance those nations, to the great ulti-

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mate profit of the people of the United States, than to-day.

As I have said, we were never in a more favorable position than we are to-day to increase our foreign trade, to finance our domestic trade, and to grant the credit to foreign countries which their interests seem to demand. This favorable position, in large measure, in my opinion, is due to the Federal Reserve Act—due to that act in its lowering of reserve requirements, in its consolidation of reserves; in its provision for the rediscount of commercial paper, making such paper for the first time truly liquid; and in its provision for a real elastic currency through the issue of federal reserve notes. To-day our country rests in profound banking security, it realizes that we have a system that is probably one of the soundest banking systems in the civilized world. What better proof of the soundness of the system could we have than is illustrated by the sinking of the Lusitania. Why, when the news of that awful calamity reached here it hardly created any pressure on banking conditions. Yet at other times in the history of our country a catastrophy of that kind would almost have precipitated a crisis upon us as severe as the financial crisis of 1907.

But although we are rejoicing in our surplus reserves and in the general soundness of our condition we want to remember that the Federal Reserve Act did not add one dollar to our circulation. It created no money It created, however, additional credit through the use of existing stocks of money. Nor should we forget that while on May 1, 1915, the last date that I have from the Comptroller's reports, we had an excess reserve of over 727 millions in the National banks, yet if that had been computed under the old law it would have been only 158 millions, and this would have been a lower reserve than

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we had in the critical time of the panic in 1907. On May 1, 1915, the Central Reserve cities under the Federal Reserve System showed a surplus reserve of 145 millions, but if you computed that under the old law there would have been an actual reserve deficit of three million dollars. On the same date the Reserve city banks held surplus reserves of 224 millions; but computed under the old law it would have shown a deficit of 12 millions. So that much of the favorable condition we are enjoying to-day is by reason of the lower reserve requirements of the Federal Reserve Act. I think those requirements were sensible, wise and judicious, but I want to make it plain that we have not created money although we have created new credit by the operation of the Federal Reserve System.

Now, that system is simplicity itself. The act is long and necessarily has to do with a great many details, but the underlying features of the act are simple and easily understood. Before stating in brief what the system is I want to tell you some of the evils of the old system as a result of which the Federal Reserve System was enacted into law. In the first place, under the old system we had approximately 7,500 National banks. They were independent units, each had its own independent resources, and there was no possibility of joint action legally among the banks, nor could they bring their reserves together; there was no interdependence of reserves except through deposits with reserve agents, and that was an element of danger rather than of strength. We had these 7,500 National banks, 7,500 independent units. To the layman when you speak of reserves you naturally think of something that is brought together for a purpose, to be used in case of an emergency. Well, that would be the idea of a reserve on the continent of Europe, but unfortunately that was not consistent with the wording of the National Banking Act. These re-

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serves were practically hermetically sealed up. True they were called reserves, but they could not be used as reserves. If a bank dipped into its reserves for thirty days nothing but the forbearance of the Comptroller would prevent a receiver from taking possession of the bank. The business men of the country asking credit and being refused were in the position of a hungry man near to starvation looking through a plate glass window at every delicacy in the way of food and seeing it labelled "This is for your exclusive benefit. You may look at it, you may enjoy its delicious odor, but under no possibility can you be permitted even to taste of it." Such was the condition of the reserves of the United States under the National Banking Act. Now, what was the result? In times of stringency each bank had to protect itself; had to call in its loans and to refuse to make new ones. That piled up its reserves, and their customers had to take care of themselves as well as they could. This naturally increased the stringency, and then followed the spectacle of individuals hoarding their money. I think it is safe to say that you never see the hoarding of money by individuals in any country unless it follows hoarding by the banks. I think there is no more gruesome spectacle than the hoarding of banks in commercial crises, followed by the hoarding of individuals. If you take away from the banks the necessity of hoarding their reserves you necessarily put an end to hoarding in the United States by individuals. The National banks of this country were like an army going into action without a single officer or battalion or regiment or brigade, and naturally, in the lack of co-operative action, it would be impossible properly to take care of the interests of the people. The banks, as you know, discounted commercial paper. They took the paper, and when they had taken it and made an investment in that paper it was absolutely dead until it was resurrected at the time of maturity. When the

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banks discounted that paper they tenderly lowered it into their vaults with almost funereal ceremony, and if a bank president, with somewhat ghoulish propensity, should take those notes out of the vaults before maturity and try to sell them the finger of suspicion would be pointed at him and at his directors. As a result, the banks were forced to send their money to the large financial centers and there it was invested in call loans upon Stock Exchange collateral. But when the time came to realize on those loans it was often found that their boasted liquidity had disappeared and when in times of emergency we tried to realize the liquidity we found it resembled the liquidity of solid ice rather than the liquidity of water. You remember how last year, in 1914, when you tried to realize on these collaterals the Stock Exchanges quietly closed their doors.

We also had the National bank notes; notes intended to represent the expansion of the trade and commerce of the United States, notes supposed to be elastic and to rise and fall with the demands of commerce and agriculture. But there was very little elasticity in the National bank notes, because they had nothing to do with the movements of trade and commerce, as they were tied to government bonds, and these bonds fluctuated entirely apart from the movement of trade and commerce. The measure of the National bank circulation, therefore, depended on the fluctuations of the bonds rather on any needs of the business or commercial demand. Thus we tied notes representing the expansion and progress of the trade of the country, to Government bonds representing past destruction of trade and commerce, and we had the extraordinary spectacle of the business development of the twentieth century chained to government bonds which represented the destruction of trade and commerce of the nineteenth century. There may have been a reason for that strange union in the

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nineteenth century in that we had to sell our Government bonds, but there is no reason for such union in the twentieth century and I hope that the provision of this Act for the gradual elimination of the National bank notes will be successful. Japan paid us the great compliment of trying the system that we had, but after a couple of years she sent it to the scrap heap.

Under the old law our banks could not finance our foreign trade because they were given no power to loan their credit in the form of acceptances. The result was that foreign banks and bankers had to finance our trade and they got the profits. For example, we buy enormous quantities of raw silk and manufactured silk from the Orient. Those goods are hurried over to our Pacific ports, and taken to the eastern part of the United States on special trains. Yet the bill that is drawn in payment for those goods goes clear through the United States to foreign countries, later be returned that our purchasers may discharge their obligations. But under the Federal Reserve Act that is a thing of the past. The power to loan credit through acceptances is a grant of power to our bankers which will enable us to finance our foreign trade for ourselves.

The Federal Reserve Act is simple—the underlying features of it—and easily understood. In the first place, it does not disturb the National banks at all. Incidentally it gives them increased power. It simply takes the country and divides it up into twelve districts, and the National banks that happened to be located in each of those districts unite to form a new institution called the Federal Reserve Bank; they supply the capital—6 per cent. of their capital and surplus—and they have to turn over to that Bank a proportion of their legal reserves, roughly from 35 to 37 per cent., and the Bank holds those assets so turned over by the National banks—and

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by the State banks and Trust companies when they come in. As I say, we have twelve districts, in each of which there is a Federal Reserve Bank. The stockholders of the Federal Reserve Bank are the member banks who come in, and every dollar contributed to the Federal Reserve Bank is the money of the member banks—that is, until the Government has made deposits, which, of course, sooner or later it will do.

Now there you have an extremely simple situation. Twelve Federal Reserve Banks looming up like financial mountains, with capital, individually, varying from $5,000,000 to a little over $20,000,000 in the case of the Federal Reserve Bank of New York, and the total capital up to date is a little over $107,000,000; only half of that sum, however, has been called, and it is doubtful when or whether the balance will have to be called.

There is a great difference in these Federal Reserve districts in population and in area. Some economists believe that the so-called Aldrich Act would have been better for the United States. That, as you know, created one central bank to be located in the city of Washington, with branches scattered all over the United States. There were defects in that bill. In the first place, it was controlled entirely by the banking interests. I do not mean to say that that is necessarily a financial defect, but in the popular mind it was a defect and I think the people felt that there should be more of governmental control. In any event, that act was never brought to a vote in the Congress. But to those who advocate one huge central bank I just want for a moment to say that we have now twelve huge central banks and that they are absolutely independent banks but co-ordinated through the Federal Reserve Board. So that we have twelve independent banks instead of one, and I think we have secured more than we could

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possibly have gained by the establishment of one huge central bank in Washington.

To give you an idea of what the Federal Reserve System covers I will take two illustrations: One representing population and the other area. The Federal Reserve Bank of Chicago is located in a district having a population of over 12,000,000. That is greater than the combined population of Norway, Sweden and Switzerland. Now considering area, in the district covered by the Federal Reserve Bank of San Francisco you could put all of continental Great Britain, France, Italy and Germany, and you would still have left over an area larger than all of New England excepting the State of Maine. So you get a conception, from the point of view of area and population, what these districts include.

The member banks in these districts turn over ultimately about 40 per cent. of their reserves to the Federal Reserve Banks, which latter have received already something over $300,000,000 in reserves and $50,000,000 in capital. Later on, these reserves, when they are paid in will amount to at least another $100,000,000, and, if the law is amended to permit the National banks to put all their reserves into the Federal Reserve Banks, as I hope it will be, there will be an almost illimitable fund in those banks. I believe the member banks should be permitted to place all their reserves with the Federal Reserve Banks if they desire to do so. If that is done it will mean a massing of gold in the United States which will place this country's banking system at the very front as the most powerful system in the world. In Germany they have increased the reserves in the Imperial Bank something like a billion marks in a year by an appeal to the patriotism of the people who were asked to turn over their gold to the bank in return for the bank's notes which are not at the present time

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redeemable in gold. I am sure the patriotism and far-sightedness of the American people would induce them gladly to follow the same policy and turn over their gold holdings to the Federal Reserve Banks. Then we would have, as I say, the strongest banking system in the world. This would inure not only to the advantage of the government, but to the banks and to the people generally.

Now, as we have seen, the Federal Reserve Banks hold over $350,000,000, which is largely in gold. The government also has a right to make deposits with those banks, and that will very largely increase their assets. An important point to remember, furthermore, is that every dollar held by these Federal Reserve Banks—and it will be an enormous sum in the near future—is subject to a trust. It is held in trust for the benefit of the commerce, agriculture and industries of the United States. I think you will see what it means to the people of the United States to have these enormous sums set apart for their exclusive benefit.

The Federal Reserve Board has recently given authority to the Federal Reserve Banks to establish a low rate on very short maturities. That sounds the death knell to the call loan, which was the corner stone, almost, of the old system. To-day the call loan no longer is the center of interest. Under the old system it was the very barometer of our banking condition. It was the center ring of the circus, so to speak. Under the Federal Reserve System, however, and especially under the recent regulation as to short maturities, the call loan no longer is the center ring of the circus, but it is relegated to a side tent along with the bearded lady and the fat boy. We may look upon it with curiosity or even with interest, but never again will its fluctuations bring fright and uncertainty as to banking conditions in the United States.

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These Federal Reserve Banks each have Boards of Directors consisting of nine members. Six of those directors are elected by the member banks: Three directly representing banking interests, and three representing business and agricultural interests. The Federal Reserve Board, representing the Government, appoints the other three directors, one of whom acts as the chairman of the board; but you will see that the effective control of those banks is in the hands of the stockholders, the member banks; every dollar contributed—leaving out of question the government deposits—is contributed by the member banks, and they are the parties which control the operation of these banks. The Government has three representatives and naturally they represent the interest of the Government in that the Government proposes to make deposits of large sums. The Government also loans to these banks its obligations in the way of Federal Reserve notes and rightly it should have representatives on the Board. If, however, there is any criticism of the Federal Reserve System as operated through the Federal Reserve Banks it will fall on the six directors whose business it is to run those banks for the best interest not only of the member banks, the stockholders, but, as well, for the people, their customers. Of course, these banks are under a kind of Government control. So is the Imperial Bank of Germany, so is the Bank of France, but the stockholders, the member banks, act just as if they were individuals, they are responsible for the conduct of the banks subject only to the general regulatory power of the Federal Reserve Board, and they are entitled to the chief credit for the successful working out of the banking problems.

The Federal Reserve Board, as you know, is stationed in Washington; it has five appointive members, with the Secretary of the Treasury and the Comptroller of the Currency as ex-officio members. Now, they have

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very great powers of control. The general control of all the Federal Reserve Banks is in their hands, and they have thus an indirect control over the member banks. They have the power, for example, ultimately to determine the discount rate. They have the power of removal for cause of any officer or director, but the cause must be made known in writing. They have the power to define commercial paper and to determine what paper is eligible for re-discount under the act. They have other powers as to the regulation of acceptances and open market powers. They also have the power in certain contingencies to suspend any and all reserve requirements of the act. I think you will see when you take into consideration this power to suspend the reserve requirements and the power to issue Federal Reserve notes and the control over the issue of them, that we never again need fear a general financial panic in the United States. If any panic should ever visit this country again and see this system in operation I think it would like the Arab silently fold its tents and steal away. It may be that the act may need some amendment, it may be that there are certain things in it that we can amend and improve, but I think all agree—even those who wanted to see one central bank established—that we have taken a long step in the right direction and one which will inure to the greatest advantage to the people of the United States.

We also have a Federal Advisory Council, consisting of one member from each district elected by the banks. That council has important functions. It has the right to come to Washington and discuss with the Board various questions; and we do consult with them, and they give us information and suggestions of the greatest value.

Now how is it that the Federal Reserve System cures the three or four defects that I pointed out in the old

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system? In the first place, it lowers the reserve requirements. Speaking personally, I should be glad to see the amount of the reserves left to the discretion of the Board of Directors of any bank. Of course, for the issue of notes a reserve is required. Furthermore, it has provided for the discount of commercial paper, making that paper absolutely liquid. That certainly is a great advantage. A bank can loan money on commercial paper. It can eat its cake and have it too, because it loans the money and takes the paper and yet that paper is just as good as gold because at any time it can turn it into gold or cash by simply going across the street with it to the Federal Reserve Bank. Thus, you see, banks no longer need carry excessive reserves above their legal requirement. It has also provided a system of elastic currency—the Federal Reserve notes—notes which at all times have behind them 100 per cent. in rediscounted commercial paper or 100 per cent. in gold or lawful money. That gives absolute power to the Federal Reserve Banks to take care of the expanding business needs of the people of the United States.

Some people fear that that may lead to inflation. If they mean by inflation the ordinary legitimate expansion of trade, why those notes can keep up with that expansion and take care of it. But I can see no danger of undue inflation. The obligation to carry 40 per cent. of reserves in gold and the realization that every one of those notes has 100 cents on the dollar either in commercial paper or in gold deposited with the Federal Reserve agent is I think a sufficient reason why we need fear no possible inflation. In the contrary, when we have had our business expansion and there is a recession I think you will find that those notes will automatically be redeemed.

The Federal Reserve Act has also given new power to the National banks in that it has enabled them to estab-

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lish branches abroad, and that means much in the development of our trade. We have authorized the establishment of branches in Argentine, in Brazil, and in Panama and in several other places. The Federal Reserve Banks are also given authority to discount the acceptances, which National banks are permitted to take in foreign trade; they also can appoint agents and correspondents in foreign countries to buy and sell bills of exchange arising out of commercial transactions; in addition they have power to deal in gold coin or bullion at home or abroad. I think you will see, taken in connection with the discount power, the control they will have in the way of regulating our inflow and outflow of precious metals.

There are many other points concerning which I wish I had the time to speak here to-day, but I do want especially to say a word about the admission of State banks and Trust companies into the Federal Reserve System. Their coming in is, as I have said, entirely voluntary. That does not mean that we do not want them. We do want them. We have gone to the very extreme in stating that we will even accept the examination of their State authorities, as far as possible, where those examinations we are satisfied are sound and proper. The State superintendents of banks in several of the States have already promised us their cordial co-operation. So a State bank or a Trust company can come into the System and feel assured that their examination will be the State examination, in co-operation with the Federal Reserve representatives. We expect to act in the most friendly co-operation with the various State examination authorities.

We have also provided in our regulations that a State bank or Trust company that enters the Federal Reserve System can, by giving notice of one year, withdraw from it, receiving back its payment in of capital and its re-

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serve deposits. I think that should be a guarantee to every State bank and Trust company that the Board has gone to the very limit in making it advantageous for them to come into the Federal Reserve System. It is entirely voluntary, but we beg you to come in; and, if you find that it is not for your interest to come in, why the System will nevertheless go on successfully. It cannot have as broad a base without the co-operation of the State banks and Trust companies, but still it will have one broad enough to be of wonderful advantage to the whole American people.

There are some criticisms of the Federal Reserve System that I will touch upon for a moment. Some bank presidents drop in at Washington and say: We will lose interest on our reserve deposits, and we feel that we will not get anything to compensate us for that loss. Now to any man that feels that way I simply reply: Will you ascertain the amount of released reserves that you have under the Federal Reserve System; these reserves you could have deposited at two per cent. interest with reserve agents; the part of these released reserves, however, that goes into capital payments to the Federal Reserve Bank will yield you three times the two per cent. that you were getting from Reserve Agents because you will get six per cent. on them from the Federal Reserve Bank. Moreover, if you take the released reserves and loan them out at six per cent. or still better, bank upon them and compare the result you will find that you are much better off under the Federal Reserve System than you were under the old system.

Then some bank presidents come in and say: We have no paper that is rediscountable with the Federal Reserve Bank and any way there is so much red tape about it that we can never use the facilities of the Federal Reserve Banks. To those men we simply say: Go over your portfolio and you will find that there is a great deal

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of paper that would be gladly rediscounted by the Federal Reserve Bank if you would only make it plain that you wanted to rediscount it. If, however, there is any bank president who has no paper eligible for re-discount in a Federal Reserve Bank that man ought to call his directors together and make his institution a real commercial bank.

Then some complain because our Federal Reserve banks are not all earning dividends. I think a large majority or perhaps all are earning their expenses, and some of them are making dividends. But, gentlemen, how could you expect a system of this size, suppose it was a railroad or a large industrial corporation, in four or five months to start in and meet all its expenses and pay dividends. That would be unreasonable, wouldn't it? Yet I predict that there is not a bank in the System that will not easily earn its expenses, and it will earn dividends just as soon as business starts up and the banks perform the functions for which they were created. But even if nothing was earned and if you had to pay by assessment the entire expense of the Federal Reserve System, still it would be good insurance for you to do it. I was in the West some time ago and talked with the chairman of the board out there as to how much the profits of the banks would be lowered if they had to pay by assessment the whole of the expense of the Federal Reserve Bank of San Francisco, and he did some figuring and he computed that the profits would be lowered only by an infinitive part of one per cent! Now I think if you will compute that in the other districts you will see that it is one of the lowest rates of insurance that any person or any corporation has ever been able to obtain in the United States.

In closing I want to impress upon our National bank friends who are member banks the necessity of establishing cordial relations with the Federal Reserve Bank.

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We have in this district men of the highest character and the greatest ability who are managing and directing these banks. I need not say a word about the ability of Mr. Strong, the Governor of the Federal Reserve Bank of New York; you heard him yesterday, and of course you knew him well before; nor need I point out the great ability of Mr. Jay, the chairman of your Board of Directors; and all the other directors are men of similar calibre, men like my friend Mr. Peabody, men who devote themselves through a purely public interest in trying to make this great institution a success. Now those men want to see you, they want you to drop in and see them. You ought to begin and rediscount with them; you ought to learn how it is done. Those men have certain rules and methods as to discounting, and you ought to go in and see them and find out what they are. If you lived out in the country and you should say to yourself that your children may be ill some time and you might want to send for a doctor, and therefore you bought an automobile, would you leave that automobile standing in your garage house with a book of instructions and say to yourself that if any of the family become ill and you should want to send in for the doctor you need only take the book of instructions and follow what it says and start the machine. If you did that your child or your wife would be dead long before you got to the doctor, or possibly long before you broke down on the road. No, you would learn how to run the automobile before such necessity could arise. Now so it is with the Federal Reserve System. You want to learn what it is, you want to know about it, and I can assure you that you will spend an interesting morning if you pay a visit to the officers of the Federal Reserve Bank and learn in practice how their discounting is done.

Gentlemen, I wish to thank you for the attention that you have given me, and I earnestly hope that I may have

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the privilege of addressing this Association again in the future, and I am going to make the prediction that the Federal Reserve System will be not only a great success, but that under its operation sooner or later the United States will become the great financial center of the world (applause).

PRESIDENT PERKINS: Gentlemen, it is impossible for me to adequately express my appreciation to Mr. Hamlin for his address. I believe that in combination with the address of Mr. Strong yesterday we have had at this convention two of the strongest talks upon the Federal Reserve System that could have been given.

Now I believe we will never have a better opportunity to freely and openly discuss this subject than we have today. I think if any gentleman present has any question in his mind that he would like to have cleared up this is an excellent chance for it because he can ask these gentlemen anything that is not clear to him and I am sure it will be elucidated to his satisfaction.

F. E. JOHNSON, of Cattaraugus: I have been greatly delighted with Governor Hamlin's address, as I also was with the address of Governor Strong yesterday; and, inasmuch as this matter is open for discussion, I would like to ask for a little information. The first question that I would like to ask is: Does Governor Hamlin believe that country banks, State or National, small banks I would say, members of the System, would be entitled to and would be granted favors in the way of loans proportionate to those which the large banks in the great cities would get? In other words, would a bank in the country the average loans of which were perhaps only one or two hundred dollars, be as readily accommodated in the rediscount of paper of that denomination as the banks in the large cities whose average

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loans are ten or twenty thousand dollars? Furthermore, if I am not mistaken as to the reserve law, it entitles banks to rediscount paper of feed men and millers, but it does not permit of the rediscounting of paper that was given by a farmer for a mowing machine or a reaper. Now how is that?

MR. HAMLIN: If I were that banker I would drop in and talk to the officials of the Federal Reserve Bank. The question that you put is a most practical one in the administration of the bank, and I will ask Governor Strong to suppose that you have called in upon him and have asked him the question, and to reason it out with you right here and now before us. I think that would be most interesting.

MR. STRONG: It is possibly all right for me to refer to language used in a game with which some of you may be familiar. I feel as though Governor Hamlin had "passed me the buck" (laughter). In answer to the first question that Mr. Johnson asked, I would call his attention to the fact that when country bankers have been borrowing money in the past they have borrowed from their correspondents in the reserve and the central reserve cities. That is to say, if his correspondent in New York is the Chase National Bank, why he has sent his paper there and borrowed his money there. Now I have no doubt that so long as his relation with the Chase National Bank continues he will have those facilities there. But the Chase National Bank, the National City Bank, and the great city banks have not been borrowers in the past; they have been the lenders to the country banks, and under the operation of the System we are going to take the place to some extent of the city banks, and while the law provides that the extension of accommodation by the National Reserve Bank shall be fairly proportioned we doubt if the banks of the great cities

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were ever very largely borrowers of the Federal Reserve Bank. In fact, up to the present time although we have acted on some 148 applications only two of those applications have been made by the large banks in New York City.

The other point that Mr. Johnson raises in regard to loans made for the purchase of farming machinery, it is hard to draw the line between what expense to a farmer constitutes production and what constitutes investment. Certainly, if he buys a scythe he is entitled to count that as part of the cost of producing his crop. If he buys some large piece of machinery which is likely to remain in operation on his farm for ten or fifteen years, that is almost as much an investment as a windmill would be or an irrigation system possibly. I think the member bank is required in each instance to use his discretion as to whether the purpose for which the money is borrowed is really an investment, a permanent addition to the plant or to the farm, or whether it is simply one of the annual expenditures which count as part of the cost of producing his crop. If it is the latter, then the note given for the loan is eligible for rediscount at the Federal Reserve Bank. The test of eligibility applied by the last regulation of the Federal Reserve Board is in most instances made by a statement of the condition of the borrower, which is shown by a statement given by the bank. But the exception is made in the case of farmers' paper that no statement is required; the bank officers must use their judgment, and their certificate of the eligibility of the paper is to be accepted by the officers of the Federal Reserve Bank.

MR. JOHNSON: Thank you very much. I think my questions have been satisfactorily answered.

MR. STRONG: I may add that the smallest note we have discounted was $25.40, and the largest note hap-

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pened to be $200,000. As I recall, the average of the notes discounted by the Bank of France is less than $25. The question of the size of the note does not enter into it at all. We will take any paper that is eligible and discount it at the same rate (applause).

PRESIDENT PERKINS: Gentlemen, this is good stuff. Now, I think there must be others here who have questions to ask, and I hope they will feel perfectly free to ask them.

F. E. LYFORD, of Waverly: I have seen the statement made that the Federal Reserve Banks can issue notes to the extent of $800,000,000. Now I would like to ask this question: If that is the case what would be the necessity of calling for the additional deposit of reserves? Would it be needed? Would anything beyond that sum be needed for future rediscount?

MR. HAMLIN: Of course, the answer to that question is that that is the law as to reserve deposits. As to capital, however, there has been a call only for 50 per cent. That is a very different question, and I see no reason for any present need of making an additional call—speaking unofficially, of course. As to your question, however, I will say that the Board will give it most careful consideration.

MR. LYFORD: That was the thought that I had in mind: That if that was the condition the law could be amended so that that vast sum of money need not be held idle.

MR. HAMLIN: I think your estimate is rather high as to the present possible issue of Federal Reserve notes. I should put it at between 400 and 500 millions at the present time.

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MR. LYFORD: The matter interested me because if the country banks should pay in 5 per cent. more and the other banks pay in their proportion why you would have a sum running up to two or three billions of dollars.

MR. HAMLIN: I think you are rather overestimating the possibility of the present issue of Federal Reserve notes.

BENJAMIN E. SMYTHE, of Bronxville: Mr. Hamlin referred to the fact that the regulations are so liberal in the Federal Reserve System that they are willing to accept the State Banking Department's examinations under certain conditions. Now, in many States the State banks have a privilege which the National banks do not have, and the Trust companies also have privileges that neither the State nor the National banks have. I would like to inquire what would be the idea of the Board as to bringing all of these privileges together—that is, giving to all equal privileges?

MR. HAMLIN: If course, that is a question of law. The act first provides for the admission of State banks and Trust companies, and then it lays down certain conditions with which they must comply. The Board has determined that it has no power to impose any conditions except what the act itself imposes. The result is that a State bank or Trust company undoubtedly can become a member bank and retain the powers that it has under its State charter except where such powers are inconsistent necessarily with the mandates of the Federal Reserve Act. The question which you very sensibly raise I suppose is whether at the same time the National bank act could not be liberalized so that some additional powers could be given to National banks to put them more nearly on a parity with State banks and Trust companies?

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MR. SMYTHE: Yes.

MR. HAMLIN: Personally, speaking for myself alone, I should greatly favor that; but of course that is a matter that Congress will undoubtedly be asked to take up and consider.

JOSEPH STANLEY-BROWN, of New York: I would like to make an inquiry of Governor Hamlin concerning the equalization of loans by the Federal Reserve Banks. For instance, the city of Atlanta, where they have loaned up to a certain percentage of their deposits, and Richmond, to 81 per cent. of the deposits, as I understand. There is quite a difference there in the matter of the loans made by the Reserve Banks, as I understand. Now, if that is a fact, what method would Mr. Hamlin suggest should be employed to equalize those loans to other Federal Reserve Banks?

MR. HAMLIN: Of course, the Federal Reserve Banks are independent banks, so far as their primary work is concerned. At the present time there is greater need for assistance in the South and Southwest than there is in the extreme West and Middle West. If at any time a Federal Reserve Bank feels that it wants any assistance from one of its brother Federal Reserve Banks it simply goes to that bank and makes an arrangement for the rediscounting of its discounted paper. That can be done with the consent of the Federal Reserve Board; the Board by five affirmative votes could force the rediscounting between the Federal Reserve Banks, but I think experience has already shown that the banks are glad to co-operate in every way and that any one bank that wants a rediscount can get it; for every bank that wants a re-discount there are three or four that are glad to give it. So I think that will work out perfectly well in practice.

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C. W. BARRON, of New York: I have understood that of late the Washington authorities have been quite insistent in their arguments to the State banks and Trust companies to join in the Federal Reserve System. I would inquire from Mr. Hamlin if he would tell us briefly what the arguments are which are advanced to the State banks and Trust companies why they should come in. That is one of the things that I came here to hear discussed.

MR. HAMLIN: Of course, the primary fact is that Congress has given the State banks and Trust companies the right to come under the System; and, if they become a member bank, of course they share in all the benefits of the system in the consolidated reserves and in the privilege of rediscount that any member bank would have.

We believe, and we hope that the banks will see that it is for their benefit to come into the system and to get the benefit of liquidity for their commercial paper which can be realized only in a very indirect way through the member banks for the benefit of a non-member bank. We feel that if there is any advantage in a National bank being a member of the system there will be an equal advantage in a State bank or a Trust company coming in and thereby becoming part of that system with a vested right to partake of its benefits: that is, the consolidation of reserves, and the rediscount privilege.

Of course, it would take a long time to go into the history of this thing, but briefly there was opposition at first to permitting the State banks to come in at all, and that opposition was widespread. But Congress felt that it would be the proper thing to do, to let them in, and so it has made this provision by which they can come in. We feel certain that they will derive advantages from

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coming in, because we are sure that the Federal System is a good thing for the National banks and that it would be a good thing for the State banks and the Trust companies; and they would have the right that the National banks have, to obtain rediscounts equitably as between the other member banks and they would have their commercial paper made more liquid.

I think, sir, those are the principal reasons that have been advanced why the State banks and Trust companies should come in.

MR. BARRON:,Has the Board stated the amount of reserves now held, and whether in the aggregate they will be increased under the System?

MR. HAMLIN: The assets of the Federal Reserve banks now exceed 350 millions; the total reserves of all banks in the United States is being computed, but I could not give you the figures as yet.

Now, if the gentleman will permit me, I would like to ask him a question: Could you state, based upon 727 millions of excess reserves of the National banks what you would put the State banks and Trust companies reserves at? Have you any information on that point?

MR. BARRON: Of course, the figures vary for the different institutions and in the different States. The Trust companies keep closer to their reserves. It is like comparing two things that are unequal. You know, of course, that in New York City the Trust companies and the State banks contribute the most credit. In other words, the National banking system is quite in the minority in the banking power of this country today. It is so the whole country over—that the National bank-

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ing system is not "it." Of course, that is all right, because the National banks are owned by the widows and orphans, you know, while the business men own the others (laughter).

M. F. WOODBURY, of Hornell: I would like to ask a question of Mr. Hamlin. Do you not think it would serve to popularize the Federal Reserve Banking System if the notes issued by the Federal Reserve Banks could be counted in the reserves of the nation? What was the idea in excluding them? Supposing we have a lot of reserve notes, we are not allowed to carry them and count them in our regular reserves in making our report to the government. Why is that so? What was the reason for framing the law in that way?

MR. HAMLIN: I do not think I can tell you offhand, because that was gotten at in so many different shapes and it was in one day and out the next day; but I think that is a very intelligent question and one that ought to be very carefully considered as to the possibility perhaps of some amendment of the act in the future. I should not care to express any opinion on this at the present time.

MR. WOODBURY: It seems to me quite inconsistent for the government to go to work and issue that currency and put it in circulation, as you might say; and it would seem to me that it would popularize the system very much if the notes so issued could be counted in the reserves.

JOHN WILLIAMS, of New York: Mr. Hamlin, when a State bank or Trust company applies for membership in the system is it privileged to make domestic acceptances, as is provided by the State law?

MR. HAMLIN: I have heard that question discussed

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pro and con for about three days lately, and I am afraid it is a question that I cannot answer officially today. It has not been definitely settled. I think there are very strong arguments on either side, but as that is now before the Federal Reserve Board I could not answer the question at this time.

MR. WILLIAMS: There is nothing in the law prohibiting a bank from making a domestic acceptance, is there, except that it provides that a bank can make foreign acceptances?

MR. HAMLIN: Oh, I thought you were referring to the other question, whether a bank by becoming a member bank would be restricted in the matter of its acceptances.

MR. WILLIAMS: No. I was inquiring whether a State bank or a Trust company waives the right that it has under the State law to make domestic acceptances. Is it privileged to continue doing that when it becomes a member of the Federal Reserve System?

MR. HAMLIN: We have not discussed that particular question, but with my views of State rights I should be inclined to say that they would not lose that privilege, or at the best, that they would be subject only to such reasonable limitations as would be cordially accepted.

MR. STRONG: May I take the floor to say that the same inquiry has been made by a number of New York institutions. A Trust company in New York State enjoys the right to accept domestic acceptances. The terms of the law contemplate that the right to accept in transactions growing out of the importation and the exportation of goods shall be conferred upon "Member Banks" which is the phrase used in the law. I think the law meant

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National banks in that case and did not intend in any way to attempt to interfere with or modify the privileges enjoyed by the State banks. You will find nowhere in the act any prohibition against a State bank which takes membership in the system continuing to exercise such powers as a State bank has given to it to accept domestic transactions.

As a matter of fact, this question is about to be certified to Governor Hamlin from New York for a ruling, and we hope to have a ruling that will be favorable to such institutions.

Now I think I have passed the buck back to Governor Hamlin (laughter and applause).

MR. HAMLIN: I realized that it was coming.

J. CLARENCE RASBACH, of Canastota: What is the use of a State bank coming in so long as the National banks throughout the country are doing a lot of insurance work protecting the entire banking interests of the United States?

PRESIDENT PERKINS: "Let George do it" (laughter).

MR. HAMLIN: I would rather discuss that assuming this were the year 1907 and not the year 1915. I think the answer would suggest itself to the gentleman then. We should see confidence and protection to the member banks and their customers, while it would be a bold man who would maintain that an individual nonmember bank might not be sorely peeved by its customers. There certainly, however, would be no general credit collapse.

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