The Federal Reserve Act

BY

Hon. ROBERT L. OWEN

UNITED STATES SENATOR OF OKLAHOMA
CHAIRMAN OF THE UNITED STATES SENATE COMMITTEE
ON BANKING AND CURRENCY

PUBLISHED FOR THE AUTHOR

THE FEDERAL RESERVE ACT

ITS ORIGIN AND PRINCIPLES

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A REMINISCENCE

THE Federal Reserve Act has now so completely demonstrated its value, and is so widely approved by the business men of America and of the world, that I have yielded to the suggestion that I should write a short sketch of its origin and principles, as a personal reminiscence, having no time at present to write a full history of this Act.

The backbone of the Federal Reserve Act is:

1. A quick available supply of elastic currency for business men;

2. Issued and controlled by the Government;

3. Against adequate security, consisting of gold, commodity or commercial bills or acceptances, and U. S. bonds.

4. Under an interest charge high enough to prevent inflation by compelling contraction.

In 1890 I had established the First National Bank of Muskogee, Oklahoma, was its president for ten years, and in 1893 witnessed the panic that took place at that time. This bank, like very many other banks, lost fifty per cent of its deposits within as many days because of the panic, which frightened people and caused them to withdraw their funds for hoarding throughout the United States and led creditors to strenuously press their debtors for settlement. Money suddenly appreciated in value, so that property measured in money fell in value in some cases to half of its previously estimated value.

This enabled thousands of creditors to take over the property of thousands of debtors on a basis that was ruinous to debtors, causing the bankruptcy of hundreds of thousands of people; causing a violent dislocation of business; and throwing out of employment vast numbers of people and inflicting injuries which required years to repair in the industrial and commercial life of the nation.

Thousands of millions of dollars were lost and many more thousands of millions, the normal earnings of a prosperous, active people, were left unmade during the next five comparatively idle years.

This panic demonstrated the complete instability of the financial system of America and the hazards which business men had to meet under a grossly defective banking system. A very large part of the American people believed that the panic ensued from the industrial depression and shrinkage of values due to the demonetization of silver, and a violent agitation arose for the free and unlimited coinage of silver at "sixteen to one."

The depression was, in fact, world-wide, and the purchasing power of many nations was affected. The McKinley Bill had just passed, obstructing imports and therefore exports; Russia, Rumania, France, Spain, Portugal, Switzerland, had raised their customs duties, also with like effect. A severe crisis had arisen in Australia and in Argentina, and civil war in Brazil, Chile, and other South and Central American states—all of which interfered with the purchasing power of nations. The spirit of enterprise was prostrated. People hoarded their money, withdrew their bank deposits. The *currency of checks and drafts* with which men met their ordinary obligations *was diminished fifty per cent* in the United States, thus diminishing this ephemeral currency which at that time probably averaged a thousand million dollars.

The remedy proposed by the Democrats was the remonetization of silver; the Republicans refused to grant this, but craftily and unfairly expanded the paper currency of the national banks some five hundred millions by authorizing the banks to issue currency against two-per-cent bonds at a profit to the banks of approximately one and one-half per cent per annum on such issue by the Amendment of the National Bank Act in 1900. This, of course, was no remedy, for the currency remained inelastic altho expanded.

In 1896, at the Democratic Convention at Chicago, as a member of the Committee on Resolutions, I strenuously urged a plank pledging the Democratic Party to protect the country from financial panics but failed to obtain support. I advocated, as a resolution before the Committee on Resolutions, that United States bonds might, in times of threatened panic, be made convertible into Treasury notes to serve as currency as a source of quick supply of money to offset the withdrawal of currency for hoarding by frightened depositors; in effect, elastic currency.

I failed to convince the Committee of its wisdom, but made a second attempt and obtained the support of Hon. Charles S. Thomas, of Colorado; Hon. William J. Bryan, of Nebraska, and Hon. Allen Thurman, Jr., of Ohio, and the Committee adopted the proposed resolution. On a reconsideration, however, at the request of Senator George, of Mississippi, who strenuously opposed it, the Committee eliminated the proposal from the National Platform (Messrs. Thomas, Bryan, and Thurman having withdrawn their support) on the plea that it was novel, untried, and might add to the political difficulties of the Party in the coming campaign.

THE ELASTIC CURRENCY OF EUROPE AND CANADA

In the summer of 1898 I went to Europe and studied the question in London, Paris, and Berlin, talking to the Governors of the Bank of England, the Directors of the Reichsbank of Berlin, as to their method of protecting the country from panic, and in the summer of 1899 I undertook a propaganda, by written articles and addresses, showing how England, Germany, France, and Canada protected their business interests from financial panic, and pointing out available remedies for the United States. I placed some of these proposals in the *Congressional Record* of February 25, 1908 (page 2450), and pointed out the means by which the Bank of England and the Bank of Germany, the Bank of France and the Banks of Canada, prevented and abated panic. From one of these arguments, dated September 26, 1899, I take the following (p. 2452):

THE BANK OF ENGLAND

"The Bank of England avoids panics by the following method:

"This Bank holds the ultimate reserve of all the banks of the United Kingdom. The reserve constitutes the only available cash reserve against $3,500,000,000 in deposits. This reserve amounts to a sum ranging from $130,000,000 to $150,000,000, or about four per cent. of the deposits net. The Bank of England has a great advantage in having all the reserve concentrated in the hand of one concern charged with the duty (by the force of public opinion) of maintaining this reserve above the danger-point.

"First, The instant this reserve begins to diminish by gold export the Bank of England raises the rate of interest. This tends to check gold exports, to cause gold imports, and usually brings idle gold from the Continent. If, in ordinary times, gold is not attracted it is usually because there is loanable money on Lombard Street content with a lower rate. In this event the Bank of England sells consols for cash and buys them back on time, which has the effect of absorbing the loanable money on the street and thus making the rate effective in attracting gold.

"Second, When local credit is violently disturbed, and for that reason the rate might not attract idle capital held by European bankers, the Bank of England borrows gold directly, as it did from the Bank of France when the Baring liquidation was anticipated.

"Third, The Bank of England when panic threatens lends with great freedom to all legitimate borrowers, so as to relieve the pressure and relieve alarm as far as possible. For example: When Overend, Gurney &

Co. failed in 1866, the Bank of England loaned in one day $20,000,000 and in one week $50,000,000 to the depletion of the cash in the banking department.

"Fourth, When the cash is about exhausted in the banking department and the closing of the bank becomes imminent, the administrative government of Great Britain has always, through the prime minister, by letter, advised the Bank of England to issue notes (legal-tender, money) against other securities than gold (to which the excess issue was confined by the act of 1844). This was done in 1847, in 1857, and in 1866, with the result that the panic in each case was controlled instantly.

"The method of the Bank of England in raising the rate and borrowing gold is not adaptable to the United States, for the reason that the element of time and distance and absence of concentration are substantial barriers to such devices; *but the issue of notes against proper securities can be made easily applicable to the United States by an act authorizing the United States Treasury to* *issue Treasury notes against proper security deposited by the banks in times of stringency with adequate provision for retiring such notes when the panic is over.*

THE BANK OF GERMANY

"The Imperial Bank of Germany is substantially a state institution. The state gets all the benefit over and above a low rate of interest to the stockholders. The bank is controlled and dominated by the uniform rate of interest. It has substantially a monopoly in the issue of paper money. It carries in its vaults a large amount of gold and silver, averaging $200,000,000 in gold and silver, principally gold. It is protected against panic, and Germany is protected against panic, and the commercial stability of the German Empire secured by giving this bank the right *to issue currency not only against gold, but also against the securities* held by the Imperial Bank, *consisting of bills, due within ninety days or less*, and *secured generally by three and at least by two* *persons known to be solvent. It may issue even in excess* of these limitations *by paying a tax* to the German Empire *of five per cent* per annum *on such over-issue. The result is that a panic in Germany is impossible,* that the normal rate of interest is between three and four per cent, *commercial stability is secured,* and *their enterprises and manufactures are making themselves felt throughout the civilized world.*

"The store of gold held by the Imperial Bank of Germany is protected as in England:

"First, By raising the rate.

"Second, By favorable assay to foreign gold, by giving six to eight interest days to shippers, and other little devices favoring the shipment of gold to Berlin.

"Third, The powerful influence of the bank is exerted on the bankers of Berlin to prevent their shipping gold, which is generally effective.

"Fourth, While the bank does not refuse to pay gold on demand, persons asking for gold for shipment feel that when the bank says 'yes' it really means 'no.'

"The only features of the German legislation apparently available in the United States are *issuing currency against securities and issuing emergency currency under the penalty of a tax, either one of which would appear sufficient to protect the United States from panic, and both of which should be adopted.*

THE BANK OF FRANCE

"The Bank of France, which is practically under state control, carries the largest gold and silver reserve in Europe. Its gold was, October 13, 1898, $369,000,000; its silver was $246,000,000, making a total of $615,000,000.

"The duty of the governor of this bank is to watch that '*the bank performs its duty to the state and toward the commerce and industry of the country.*' The banks of the United States *owe a duty to the state and toward the commerce and industry of the country which the law should enable and require them to perform.*

"This *bank is protected against panic by the authority* under the law of 1897 *to issue legal-tender notes* to the amount of $1,000,000,000, of which it has issued $739,000,000. [The Bank of France thus retained an elastic margin of $261,000,000 which it could issue if needed, while the people had in pocket over $700,000,000 of currency—about $100 per family, and had no reason to make a run on the Bank of France.]

"It hoards its gold and silver not by raising the rate, but by other devices. First, in case of an exchange unfavorable to France, the Bank of France pays out small gold coins which by use are slightly under weight and therefore not suitable for export. In case of strong demand money brokers buy up full-weight napoleons, and sell them for export, and ultimately the bank feels the withdrawal, but it costs something to take gold from France in this manner, and the method opposes a mechanical obstruction to the withdrawal of gold. Second, if a request is made of the Bank of France for a large amount of gold for export the request must be submitted to the directors, who impose a charge just at a point which is usually prohibitive. Third, in case of need the Bank of France can protect its gold hoard by paying out five-franc silver pieces as legal tender under the law, and this provision of course abundantly protects the gold held by the bank against direct withdrawal.

"There is a vast difference between the business methods of France and the business methods of the United States. The French people by long custom still maintain and do nearly all their business in cash, and checks are comparatively little used in commercial life. The consequence is that the people have acquired and use a very large amount of currency in gold and silver, including $739,000,000 in notes of the Bank of France.

"The Bank of France not being compelled to pay gold on demand, though it does do so for domestic purposes, does not need to raise the rate of interest to protect its gold. For this reason, while the bank rate from February, 1889, to October, 1897, was raised by the Bank of England fifty-three times, and by the Imperial Bank of Germany twenty-six times, *it was only raised by the Bank of France once.* It is the policy of the Bank of France *to let the French people have money at the unvarying rate of three per cent, believing that stability in the rate of interest gives stability to commercial enterprise and promotes the welfare of the 'commerce and industry of the country,' which is a chief duty of the bank.*

"The very large surplus in coin of the Bank of France prevents the loss of confidence which leads to panic, and the bank has so large a margin of note issue, with disposition to extend every reasonable demand, and France itself has so large a supply of internal currency in circulation, and the banking deposits being relatively small, that there is no danger there of panic in times of peace.

THE BANK OF CANADA

"Even the banks of our nearest neighbor, the Dominion of Canada, have a method which *expands and contracts* the circulation as much as twenty per cent during the three months in each year when the crops of forest and field are moving.

"*Their notes may be issued to the extent of their unimpaired capital paid up.*

"The notes form a prior lien on the assets and are secured by a five-per-cent guaranty fund. The notes must be redeemed at any part of the Dominion. No reserve is actually required by law, but the cash reserve for redemption has actually averaged in gold and legal tenders for some years ten per cent about. Under the law, forty per cent of the reserves must be in Dominion legal tenders, which, of course, take care of such paper to that extent. There is a double liability of stockholders, a special liability of directors, elaborate regulations, frequent printed reports, etc. The striking feature is that in the history of these banks the guaranty fund of five per cent for the security of their notes has never been depleted, and that *this method offers a method which the United States might safely* *use for expanding the currency."—Cong. Rec.*, p. 2453.

The vital point of the English system was the issuance of *legal-tender* bank notes by the Bank of England against securities and gold, and lending these notes at interest. This was permitted by a Ministerial Permit in 1847, 1857, and 1866, with the result that the panic in London in each case was instantly controlled (*Hist. Bk. Eng.*, Andréadês, 336, 349, 350).

The German method, to which I called attention at that time (1899), consisted in issuing currency against securities under a penalty of a tax of five per cent on the issue to the extent it exceeded its fixed gold security, and lending these bank notes at interest, and I recommended at that time (1899) the following remedy:

THE REMEDY IN THE UNITED STATES

"The remedy for panics in the United States which suggests itself is:

"First, *Establish Postal Savings-Banks*, in which 'timid' depositors with inactive accounts may place their money, because at present by sudden hoarding in times of excitement they constitute the greatest danger to the stability of banks and therefore to the stability of commerce.

"Second, Issue to such depositors in the postal savings-banks, in lieu of their deposits, a bond, of long term, with liberal option as to period of redemption by the Government, bearing a low rate and issued in small denominations, available for currency, and make such bonds legal tender. In this way such deposits would become a source of strength instead of weakness.

"Third, *Authorize the Treasury of the United States to issue Treasury notes to banks depositing bonds of a fixed character, Federal, state, or municipal, where the standing of such bonds is thoroughly assured*, leaving the determination of their character with the Secretary of the Treasury. *In this case a charge should be made against the banks drawing the notes by a tax in excess of the amount of interest borne by such bonds, so as to secure the prompt redemption and repayment of the advances.*"—*Cong. Rec.*, February 25, 1908; p. 2453.

Since this recommendation was made the principles I then proposed have been adopted by the United States:

First, The Postal Savings-Banks have been established to absorb the deposits of timid depositors. Act of June 25, 1910, 36 Stats., 814.

Second, The Aldrich-Vreeland Bill (May 30, 1908), recognizing the principle of

(a) Issuing bank notes,

(b) At interest,

(c) Against adequate securities,

although with most serious obstacles, were placed in the way of getting the currency (35 Stats., 546).

Third, The Federal Reserve Act of December 23, 1913 (35 Stats., 251), was passed, having been engineered through the United States Senate under my management as Chairman of the Committee on Banking and Currency, perfected these principles by providing

(1) A quick supply of Treasury Federal Reserve Notes (money);

(2) Issued and controlled by the Government;

(3) Against adequate security, including commodity bills;

(4) Under an interest charge to prevent inflation; and

(5) Making these notes (money) easily available at any time or place in the United States where a business

man fairly entitled to credit wanted currency.

United States bonds may be used now as a basis of issuing Federal Reserve Notes, under an interest charge fixed by the authorities of the United States.

I advised the country at that time (1899)

"That the currency could be quickly and safely expanded by issuing Treasury notes against standard securities put up as collateral with the Treasury of the United States. In this manner the sudden withdrawal of deposits and the shrinkage of the narrow margin of currency available to the banks could be supplemented as above stated without forcing into liquidation, at such an unfortunate time, any borrower. An issue of this kind could be made under proper safeguards with a sliding scale of interest against the party drawing Treasury notes on such collateral and the redemption of such securities when the Government desired it."—Page 2454, *Cong. Rec.* (1908).

At that time I made the following comment (*Ibid.*, p. 2454):

"It is the duty of the United States to provide a means by which periodic panics which shake the American Republic and do it enormous injury shall be stopped. They are easy to prevent. The remedy is perfectly simple. Provide a means for quickly expanding the currency when financial fear threatens the country. Provide a means by which the timid depositor who rushes on the banker and demands his money shall not frighten that banker out of his wits. Provide a means by which that banker can, upon the strength of adequate security, obtain a temporary accommodation of money with which to meet his frightened depositors. In a time of panic a man cannot borrow money if he puts up gold dollars as collateral, for the manifest reason that it is not security, but currency, which is then required. The banker has not the currency to lend, and he cannot lend that which he has not, no matter what the security. You cannot then borrow on Government bonds if you put up $10,000 for $1,000. It is the duty of the United States to protect the commercial life of its citizens against this senseless, unreasoning, destructive fear that seizes the depositor when he has been sufficiently hypnotized by the metropolitan press with its indiscreet suggestions."

On February 6, 1900 (*Congressional Record*, page 1534), Senator James K. Jones offered an amendment to the then pending Aldrich Bill, contemplating the amendment to the National Bank Act, which I drew as follows:

"That the Secretary of the Treasury is hereby directed to have printed and to keep on hand United States Treasury notes under a special account to be called the 'emergency circulation fund.' Such notes shall be full legal tender. Any citizen of the United States shall have the right to deposit United States bonds under rules and regulations to be prescribed by the Secretary of the Treasury, and to receive from such fund ninety per cent of the face value of such bonds in United States Treasury notes, and shall have the right at any time within twelve months to redeem such bonds by repaying in United States Treasury notes the amount so received by him on account of such bonds, with interest at the rate of six per cent per annum on such amount. Failure to redeem such bonds within the limit of twelve months shall operate as a forfeiture of such bonds to the United States, and such bonds shall be sold to the highest bidder in the open market, and the balance, after the payment of the principal of the amount advanced, the interest on the same, and the expenses, shall be paid to the former owner of such bonds. Any moneys received from such sale may be exchanged with other moneys in the Treasury, so that this fund shall consist alone of Treasury notes. The principal of all sums so advanced when repaid shall be returned to the 'emergency circulation fund,' and all interest upon such sums shall be passed to the credit of the Treasury under miscellaneous receipts."

Here again was presented the vital principles of (a) quick money, Government notes (b) against adequate security, (c) loaned by the Government at interest high enough to prevent inflation.

Senator Aldrich, then in charge of the Bill, declined to accept this amendment or to improve upon it (1900).

The panic of 1907 ensued, leaving American business men and banks unprotected, and Senator Jones wrote to me, as follows, calling my attention to the amendment which he had proposed and suggesting that it would have prevented the panic of 1907, if it had been adopted:

"(LAW OFFICES OF JAMES K. JONES AND JAMES K. JONES, JR., 621, 622 COLORADO BUILDING. TELEPHONE MAIN 638)

"WASHINGTON, D. C., *February 11, 1908.*

"HON. ROBERT L. OWEN,
UNITED STATES SENATE,
CITY.

"DEAR SENATOR:

"I inclose a copy of tne amendment which I offered to the financial bill on February 6, 1900.—*Congressional Record*, p. 1534.

"You will, of course, recall the fact that you prepared the original draft of this proposed amendment, which I introduced in almost, if not in exactly, the form submitted by you. I think you will find the debate on that bill at that time quite interesting.

"If that amendment had been adopted at that time and it had been written in the law, it would, in my opinion, have prevented the late panic.

"I am glad to see that at last the principle of emergency currency properly secured is recognized and that the Committee on Finance of the Senate indorse it.

"Congratulating you on your early connection with this idea, I am

Very sincerely yours,

"JAMES K. JONES."

—*Cong. Record*, Feb. 25, 1908, p. 2429.

THE PANIC OF 1907

After the panic of 1907 occurred Senator Aldrich brought in a proposed remedy, afterward known as the "Aldrich - Vreeland Law," and in his address to the Senate February 10, 1908 (*Cong. Rec.*, p. 1755), he pointed out that the panic

"Was the most acute and disastrous in its immediate consequences of any which has occurred in the history of the country."

"That 'the shrinkage in values of securities and property, and the losses from injury to business resulting from and incident to the crisis, amounted to thousands of millions of dollars';

"That 'a complete disruption of the exchanges between cities and communities throughout the country took place';

"That 'it is impossible to estimate the losses which were inflicted by this suspension of payments by the banks, and the resultant interruptions of exchanges,' etc., etc.;

"That 'there was financial embarrassment on every hand, and *an impossibility of securing the proper funds* to move crops or to carry on the ordinary business of the country';

"That 'the suspension or disarrangement of business operations threw thousands of men out of employment and reduced the wages of the employed';

"That 'if the business interests of the country are left defenseless through the inaction of Congress, the most serious consequences may follow.'"

Senator Aldrich, as Chairman of the Committee on Finance, thereupon urged the passage of Senate

Bill 3023, to amend the National Banking laws. This bill provided for the establishment of National Currency Associations, and it was approved May 30, 1908 (35th Stats., 546).

These National Currency Associations, to be composed of *not less* than ten national banks in number, and each association having a capital and surplus of *at least* five millions of dollars, were to be authorized as corporate bodies. They were authorized *to expand the circulation* by the approval of the Comptroller of the Currency to an amount *not exceeding* seventy-five per cent of the cash value of the securities or commercial paper deposited under the direction and control of the Secretary of the Treasury. The notes were to be bank notes, and *many restrictions* were placed upon the issuance of these notes. For instance:

"No association should be authorized to issue circulative notes based on commercial paper in excess of thirty per cent of it sunimpaired capital and surplus, and

"The commercial paper was to include only notes representing actual commercial transactions, with two responsible names, and not exceeding four months to run. Such notes should not exceed ninety per cent market value of qualified bonds, and

"The total amount of circulating notes outstanding of any national banking association, including notes secured by United States bonds, as provided by law, and notes secured otherwise than by deposit of such bonds, shall not at any time exceed the amount of its unimpaired capital and surplus."

The whole system was under the further sweeping provision that under no circumstances should the gross amount of circulative notes issued by all the banks in the United States, under this Act, exceed five hundred million dollars.

It was further provided that the notes should be *distributed as equitably* as practicable between the various sections of the country. A very impractical provision in time of panic.

Furthermore, the national banking associations issuing such circulating notes, proposed by the Act, were required to pay for the first month a *tax of five per cent* per annum upon such notes in circulation, with one per cent per annum for each month thereafter until *a tax of ten per cent* per annum was reached.

The Bill provided for the withdrawal of national bank notes based upon bonds to the extent of nine million dollars a month, and a cancellation of the authorized new circulative notes.

OBJECTIONS TO THE ALDRICH-VREELAND BILL

I strongly objected on the floor of the Senate (February 25, 1908) to the various obstructions in the way of quick-circulating notes, on the ground that the method was unreasonable, cumbersome, and defeated the object of preventing panic, although useful in abating a panic after its occurrence.

"That these notes were pretended to be national bank notes, but in reality were United States notes because practically guaranteed by the United States.

"Because it would take six thousand six hundred different plates to print these notes [a different note for each bank] instead of one plate.

"Because the high rate of interest would make these notes available only after a panic had occurred. No bank in sound condition and free from the fear of a panic would take the trouble to call a meeting of the directors of a national currency association and make the appeal necessary to obtain these circulating notes and put up their securities on a charge of five per cent up to ten per cent for the use of such notes, unless a panic had already taken place."

I called the attention of Senator Aldrich to the interesting fact that the issuance of circulating notes based upon securities at a reasonable rate of interest had been proposed on February 6, 1900, in an amendment which I had drawn and which was offered by Senator James K. Jones and which was rejected by Mr. Aldrich, and that his refusal of this proposal had left the country unprotected against the panic of 1907. I pointed out also that the only value of his present proposal (Sen. 3023), in February, 1908, was that it did provide circulating notes against security under an interest charge high enough to prevent inflation, but that it was insufficient in amount, because the panic of 1893 had required a very much larger sum of currency, clearing-house certificates, cashiers' checks, pay checks, etc., over $1,000,000,000, to meet the demand for currency, and that his Bill was defective just to the extent that it proposed obstructions to the free delivery of such circulating notes, and to the ease with which people might obtain them.

After I had made this indictment of the neglect of Senator Aldrich to adopt these principles in 1900, I said (*Cong. Rec.*, p. 2429):

"I pause to say that, if any Senator [looking at Mr. Aldrich] wishes to interrupt me at any time, it will not disconcert me in the least.

"The Senator from Rhode Island would have saved his country and millions of its people the enormous shrinkage in values of securities and property and the loss from injury to business resulting from and incidental to the crisis, amounting, as he himself now declares, to 'thousands of millions of dollars.'

"He would have prevented 'the suspension or disarrangement of business operations which threw thousands of men out of employment and reduced the wages of those who were still employed.'

"He would have prevented the fear and distrust which has now paralyzed and makes unproductive the energies of hundreds of thousands of men and holds idle many thousands of factories and business enterprises."

Senator Aldrich did not interrupt me and made no defense against this charge.

I pointed out at that time (page 2432):

1. That the committee bill limited the issue to five hundred million dollars of emergency notes, which had been demonstrated by the Chairman himself to be insufficient in volume, and imposed restrictions which would prevent any but a fractional part of that issue, and in addition closed every door to relief until after the Secretary of the Treasury should have declared an emergency, which I insisted should be left to the bank making application and not to the Treasury, because a bank may be put in a panic within twenty-four hours, and nobody can know this as well as the bank officers.

2. I objected to six thousand six hundred varieties of national bank notes when these notes should be

United States Treasury notes in one form.

3. I objected that the national banks were not permitted to take advantage of the Bill unless they came within certain rigidly described classes, thus limiting the efficiency of the proposed remedy and preventing its full and free exercise. For example:

4. No national bank which has less circulating notes outstanding than forty per cent of its capital was permitted to have the benefit of the Act.

5. No national bank with a surplus of less than twenty per cent was permitted to have relief.

6. No national bank in any event was to have any relief in emergency notes exceeding a gross amount of its outstanding notes in excess of the capital and surplus of such bank.

7. Even under these vexatious limitations the national banks within the classes described were only permitted to have relief of a limited amount of these emergency notes apportioned off to each of the several states regardless of the national exigency.

8. Moreover, no state bank, no trust company, no savings-bank, was permitted to have the benefit of this remedy against panic, although these institutions at that time held two-thirds of the banking capital of the United States, and had less than four per cent currency reserve, and were therefore to that extent dangerous to our financial stability.

All these objections, made in 1908, were remedied in the Federal Reserve Act in 1913.

I demanded (page 2435) that the volume of emergency notes should not be limited except by the actual requirements of our commerce.

This has been accomplished.

I demanded that these notes should not be national bank notes, but should be Treasury notes based upon the securities and the credit of the banks, but in addition (being Treasury notes) supported by the taxing power of the people of the United States.

This was accomplished in the Federal Reserve Act.

I advocated at that time the retirement of the bond-secured national bank notes and the issuance in lieu thereof of Treasury notes payable in gold (page 2436).

The Federal Reserve Act provided the gradual retirement of the bonds and national bank notes by substituting Federal Reserve notes.

In 1908 I urged also the issuance of Treasury notes in lieu of gold certificates, and that the gold thus released should be added to the reserve fund in the division of redemption. This has been accomplished, under the Federal Reserve Act. Federal Reserve notes are now issued in lieu of gold, and such gold to the extent of many hundreds of millions of dollars has passed into the hands of the Federal Reserve banks in the custody of Federal Reserve agents and made available for this very purpose (page 2436).

The Committee (Aldrich) Bill (1908) permitted railroad bonds to be used as a basis of the emergency circulative notes, and did not provide that privilege for United States bonds. Against this I vigorously protested (page 2441). The Federal Reserve Act corrected this by providing that United States bonds might be used as a basis for obtaining Federal Reserve notes, and does not permit railroad bonds to be so used.

I further insisted in 1908 upon a readjustment of the cash reserves of the banks so that they would be real reserves and actually available, as they were not under the then existing statute (page 2444). This was corrected in the Federal Reserve Act.

I stated at that time the principles which should govern the statutes on banking, as follows:

"It should always be kept in mind that it is not the welfare of the bank, nor the welfare of the depositor which is the main object to be attained, but it is the prevention of panic, the protection of our commerce, the stability of business conditions, and the maintenance in active operation of the productive energies of the nation which is the question of vital importance."

The Aldrich-Vreeland Act did not accomplish this result, yet it did have the great virtue of recognizing the broad principle which I had advocated in 1899 of

Making elastic currency available,
On adequate security;
On an interest charge to prevent inflation.

The vital defects of the Aldrich-Vreeland Emergency Currency Act consisted in putting the system in the control of the banks and making the currency difficult of access and expensive.

AMENDMENTS TO ALDRICH-VREELAND ACT, 1913 AND 1914

On December 23, 1913, the Federal Reserve Act, Section 27, extended the Aldrich-Vreeland Act, subject to the modifications of the Federal Reserve Act, to June 30, 1915, and with the important amendment that "the tax on circulating notes, secured otherwise than by bonds of the United States, shall pay for the first three months a tax of *three per centum* per annum upon the average amount of such of their notes in circulation as are based upon the deposit of such securities, and afterwards an additional tax rate of one-half of one per centum per annum for each month *until a tax of six per centum* per annum is reached, and thereafter such tax of six per centum per annum upon the average amount of such notes."

I had recommended a lower rate of interest on February 25, 1908, as a substitute for the Aldrich Bill, putting the interest at six per cent for the first twelve months (*Cong. Rec.*, page 2445), and a lower rate was provided in the Federal Reserve Act Amendment of from 3 per cent to 6 per cent.

On July 31, 1914, when the European war broke out, I offered an amendment to the Aldrich-Vreeland Act which was adopted that day by unanimous consent, as follows:

"Provided further that whenever in his judgment he may deem it desirable the Secretary of the Treasury shall have power *to suspend the limitations imposed by Section 1 and Section 3 of the Act referred to* in this Section, which prescribed that such additional circulation secured otherwise than by bonds of the United States shall be issued *only* to national banks having circulating notes outstanding secured by the deposit of bonds of the United States to an amount not less than forty per cent of the capital stock of such banks, and *may permit national* *banks* during the period for which such provisions are suspended *to issue additional circulation* under the terms and conditions of the Act referred to" (page 13067).

This amendment was in accordance with the recommendations which I had made on February 25, 1908, and which were not accepted at that time.

In the House of Representatives a further amendment was offered and adopted to authorize the Secretary

"*To suspend also the conditions and limitations of Section 5 of said Act*,—that is, *to suspend the provision that the total amount of circulating notes* outstanding secured by United States bonds, as now provided by law, and notes secured otherwise than by deposit of such bonds, *shall not* at any time *exceed the amount of its unimpaired capital and surplus* and to authorize *the suspension of the limitation of the circulating notes or emergency notes to five hundred million dollars.*"

Both of these conditions, which I had objected to on February 25, 1908 (pages 2433 and 2435), were in this way corrected.

The House added a further provision authorizing the Secretary of the Treasury to extend the benefits of the Act to all qualified state banks and trust companies which have joined the Federal Reserve System or which may contract to join within fifteen days after the passage of the Act.

The demand for recognizing the state banks and trust companies in the issuance of emergency notes I had made on February 25, 1908 (*Cong. Rec.*, page 2436), and it was here provided to this extent.

The House amended the bill, as stated, on August 4, 1914, and the Senate immediately accepted the

House amendments with a proviso that national banks should not issue more notes than 125 per cent of capital and surplus.

I had taken this matter up with the Treasury Department on Friday morning, July 31, 1914, agreed upon the form of amendment with the Treasury Department, and called the Banking and Currency Committee together and obtained a unanimous report in favor of the amendment, and the bill passed unanimously through both Houses with the amendments above indicated.

The amendments in the House were brought about by numerous conferences between the Committees of the Senate and the House of Representatives, and all these amendments were actively urged by such distinguished bankers as Frank A.

Vanderlip, president of National City Bank, New York, and Chas. C. Glover, president Riggs National Bank, Washington, and others.

The Treasury immediately sent out a very large amount of circulating notes under the Aldrich-Vreeland Act, and a total issue was made amounting to $386,444,215, all of which was retired by July 1st, 1915 (except $200,000, later retired), which served to protect the country in a very important way against the threat of a panic due to the European war.

THE MONETARY COMMISSION PLAN, 1912

The Aldrich - Vreeland Act, approved May 30, 1908, established the National Monetary Commission of nine Senators and nine members of the House, to inquire into and report to Congress at the earliest practicable date,

"What changes are necessary or desirable in the Monetary System of the United States, or in the laws relating to banking and currency," etc.

On January 19, 1912, the National Monetary Commission made its report to Congress with a proposed bill to incorporate the "National Reserve Association of the United States" (Senate Doc. 243, 62d, 2d).

This bill provided for the "National Reserve Association" with a capital of one hundred millions paid in, and two hundred millions to be subscribed before commencing business, the total capital to be equal to twenty per cent. of the capital of the member banks, its head office in Washington. It had the usual corporate powers.

National banks *were required* to subscribe to this stock. Yet the bankers who approved this bill insisted afterwards that national banks should *not* be required to subscribe to the Government-controlled Federal Reserve Banks. The bill provided an organization committee composed of the Secretary of the Treasury, the Secretary of Commerce and Labor, and the Comptroller of the Currency. The Association was to have fifteen branches in as many districts.

1. The National Reserve Association was to be under the control of a board of directors, consisting of fifteen directors to be elected, one by the board of directors of each branch of the National Reserve Association;

2. Fifteen additional directors elected in the same way to represent

the agricultural, commercial, industrial, and other interests of the districts.

3. Nine additional directors were to be elected by a voting representative chosen by the board of directors of the various branches, each of whom should cast a number of votes equal to the number of shares in the National Reserve Association held in the branch which he represented.

4. There were to be seven ex-officio members of the board of directors, namely: the governor of the National Reserve Association, who should be Chairman of the Board; two deputy governors of the National Reserve Association, the Secretary of the Treasury, the Secretary of Agriculture, the Secretary of Commerce and Labor, and the Comptroller of the Currency.

The executive officers were to consist of the governor, two deputy governors, a secretary, and such subordinate officers as might be provided for in the by-laws.

The effect of this plan was to place absolutely in the hands of the banks the control of the reserve system. And to fix this stupendous power in the hands of five men in New York City representing a Board of forty-six persons, forty-two of whom were to be chosen by the banks and four of whom were to represent the Government of the United States. The Bill proposed to exempt the Reserve Association and the local associations from local and state taxations except as to real estate. In each branch association the manager and deputy manager were to be appointed from the districts by the governor of the

Association with the approval of the executive committee and the board of directors of the branch, and subject to removal at any time by the governor with the approval of the executive committee of the National Reserve Association. The local associations were authorized, for a commission, to guarantee commercial paper for rediscount at the branches of the National Reserve Association.

It was provided that any local association *might function as a clearing-house* by a vote of three-fourths of its members with the approval of the National Reserve Association.

The Federal Reserve Banks were intended by the Federal Reserve Act to function as clearing houses and clear checks at par, but by the present Federal Reserve Board they only serve as collection agencies of checks and clear very lamely. Some day this will be corrected and the Act administered more advantageously for business men and depositors.

It was proposed that the National Reserve Association should be the principal fiscal agent of the United States, and that the Government should thereupon deposit all its general funds with said Association and its branches, and thereafter all receipts of the Government, exclusive of trust funds, should be deposited with said Association and its branches, and all disbursements by the Government should be made through said Association and its branches.

Section 24 provided that the Government of the United States and the banks holding stock in the National Reserve Association should be the only depositors in said Association.

Section 25 provided that the Association *should pay no interest on deposits.*

Section 26 authorized the Association to rediscount for its member banks commercial bills, but not on bills based on investment securities. Discounted bills should not have a maturity of more than twenty-eight days, nor exceed the capital of the bank for which rediscounts were made, nor exceed ten per cent of the unimpaired capital of the member bank. Bills up to four months were approved for discount with the guarantee of the local association. The National Association was authorized, with the approval of the Secretary of the Treasury, to discount the obligation of a member bank endorsed by its local association, provided the loan did not exceed three-fourths of the actual value of collateral securities pledged.

Section 30 provided that the Association should have the authority to fix its rate of discount throughout the United States.

Section 31 authorized national banks *to issue acceptances* not exceeding four months properly secured, based on commercial transactions, the total acceptances not to exceed one-half of the capital and surplus of the accepting bank.

Section 32 authorized the Reserve Association to purchase such acceptances with not exceeding ninety days to run.

Sections 33 and 34 authorized the Association to invest in Government bonds and Treasury notes and deal in gold coin and bullion.

Section 35 authorized the National Reserve Association to purchase and sell commercial paper or bills of exchange rising out of commercial transactions and payable in foreign countries, provided the bills do not exceed ninety days, have two responsible signatures, the last a subscribing bank.

Section 36 authorized the Reserve Association *to open and maintain banking accounts in foreign countries* and establish agencies in foreign countries for the purpose of handling foreign bills and checks. The member banks were authorized to count their deposits with the Reserve Association as legal reserves. The Reserve requirements were lowered by making no reserve necessary on deposits maturing more than thirty days from date.

Section 40 authorized national banks to loan not more than thirty per cent of their time deposits upon real estate, but not to exceed fifty per cent of the actual value of the real property, but excluding reserve agents from this privilege.

Section 41 provided that the National Reserve Association should cover all demand liabilities, including deposits and circulating notes to the extent of fifty per cent in gold or lawful money, with a proviso that whenever and so long as such reserve should fall and remain below fifty per cent the Reserve Association should pay a special tax upon the deficiency of reserve at a rate increasing in proportion to such deficiency, as follows:

For each two and a half per cent below the required reserve a tax shall be levied of one and a half per cent per annum, and this elasticity ceased when the gold reserve fell to one-third of the outstanding notes.

In computing the demand liabilities of the National Reserve Association a sum equal to one-half of the amount of United States bonds held by the Association which have been purchased from national banks, and which have previously been deposited by such banks to secure their circulating notes, should be deducted from the amount of such liabilities.

Section 48 forbade national banks to reissue any further national bank notes, and

Section 49 gave the National Reserve Association the right to offer to purchase at par and accrued interest the two-per-cent bonds held by subscribing national banks and deposited to secure their circulating notes, the National Reserve Association to take over the bonds and assume the responsibility for the redemption of bank notes. The National Reserve Association was thereupon authorized to issue,—

"Its own notes as the outstanding notes secured by such bonds," and

> "May issue further notes from time to time to meet business requirements, being the policy of the United States to retire as rapidly as possible, consistent with the public interests, bond-secured circulation, and to substitute therefor notes of the National Reserve Association of a character and secured and redeemed in the manner provided for in this Act."

Section 50 required the note issues to be covered by legal reserves of from thirty-three and one-third to fifty per cent, and by notes or bills of exchange arising out of commercial transactions or obligations of the United States.

Section 51 provided that any notes of the National Reserve Association in circulation at any time in excess of nine hundred million dollars which are not covered by an equal amount of lawful money, gold bullion, or foreign gold coin held by said Association, shall pay a special tax at the rate of one and one-half per cent per annum, and any notes in excess of one billion two hundred million dollars, not so covered, shall pay a special tax at the rate of five per cent per annum, provided that in computing said amounts the aggregate amount of any national bank notes then outstanding shall be included.

The notes of the Reserve Associa-

tion were to be available for member banks as reserves.

The notes *were to be received at par* in payment of all taxes, exercises, and other dues to the United States, and for all salaries and other debts and demands owing by the United States to individuals, firms, corporations, or associations, except obligations of the Government specifically payable in gold, and for all debts due from or by one bank or trust company to another, and for all obligations due to any bank or trust company; in other words, LEGAL TENDER, except for specific gold contracts of the United States.

Section 55 directed the Secretary of the Treasury to exchange the two-per-cent bonds of the United States bearing a circulation privilege for three-per-cent bonds without the circulation privilege, payable fifty years from date, and the National Reserve Association was required to hold the three-per-cent bonds during the period of its corporate existence, with the right to sell at the option of the Treasury, after five years, not more than fifty million dollars of such bonds annually, the United States reserving the right to pay off such bonds at any time.

Section 56 required the National Reserve Association to pay the Government a special franchise tax of one and a half per cent annually during the period of its charter upon an amount equal to the par value of such United States bonds transferred to it by the subscribing bank.

The effect of this provision was that the United States would pay three per cent and get back one and a half per cent, paying one and a half per cent interest net annually for the exchange of its credit for the credit of the Association, *a net annual profit* on $900,000,000 of $13,500,000 *to the bank at the expense of the United States.*

Section 57 authorized banking corporations to be organized for the transaction of foreign banking business.

When this Act was presented to the Congress of the United States an active propaganda ensued throughout the United States to obtain for it the public approval; meetings were held in various cities of the United States under the patronage of the American Bankers' Association. Senator Aldrich made many public addresses in its favor, but Congress took no action because there was a very resolute opposition in Congress toward turning over the entire control of the credit system of the United States to private hands and practically uncontrolled by the National Government. The most serious objections to the Aldrich Bill were these:

1. The entire banking powers of the United States were to be concentrated in the executive officers (private persons), who would be located in New York City, and this power would be sufficient to coerce every member bank and large business in America.

It was desirable, on the contrary, that the control of the system should be in the hands of the Government of the United States, and, second, that the reserve centers should be distributed and not concentrated in one city where a small clique could control the system.

2. So long as the Reserve Association issued its own bank notes it followed as a corollary that the Association would control its own notes as it saw fit, and thereby could control the currency of the country and thereby control the credits of the country regardless of the will of the American people, *since the Government under the proposal would not have been in control.* The measure, however, did have some valuable features; it did provide for the gradual retirement of the national bank notes.

It did provide for acceptances, domestic and foreign.

It did provide for a currency which was elastic and would accommodate itself to the demands of commerce (always provided the gentlemen in control permitted it).

BUT, it was a *Central All-Controlling Bank* in *Private Hands.*

THE DEMOCRATIC CURRENCY REFORM OF 1913

In the fall of 1912 Hon. Woodrow Wilson was elected President of the United States upon a platform opposing a central bank, favoring the taking of the banking business out of the control of the so-called "money trust" or "credit trust" whose existence had been demonstrated by the Pujo investigation, and declaring the doctrine

"Banks exist for the accommodation of the public and not for the control of business. All legislation on the subject of banking and currency should have for its purpose the securing of these accommodations on terms of absolute security to the public and have complete protection from the misuse of the power that wealth gives to those who possess it."

As I had given this matter careful study in 1898 and had called the attention of the country to the methods by which Great Britain, Germany, France, and other countries protected their business people against financial panic and by which they stabilized business credits, and had elaborately set these principles forth in the Senate in February, 1908, I desired to be able to write these principles in the statutes of the United States, and I therefore initiated a determined movement to reorganize the Democratic party control of the United States Senate and among other things to have myself put at the head of a Committee on Banking and Currency, in order that I might have the opportunity of framing the

Federal Reserve Act along sound lines free from selfish interests.

The Senate was reorganized accordingly; there was formed a Committee on Committees, of which I became a member, the Committee on Finance was divided, the Committee on Banking and Currency established, I was made Chairman of this Committee, and immediately organized a sub-Committee to study this question in co-operation with the Committee of the House, which was giving attention to this question at the same time.

During the preceding winter (1912–13), Hon. Carter Glass, Chairman of the Committee on Banking and Currency of the House of Representatives, had given this matter vigorous attention, and had made a preliminary draft which he had submitted to President-elect Wilson. I was advised that this draft had met with the tentative approval of the President. Mr. Glass gave me a copy of his draft and his notes thereon which I have preserved. I, too, made a draft incorporating the principles I had advanced in 1908, and these two proposals became the basis of discussion in framing the Federal Reserve Bill which finally became the Federal Reserve Act.

The Glass tentative draft avoided the establishment of a central bank with branches, and provided twenty Federal Reserve district banks under control, however, of a Federal Reserve Board, WITH FORTY OUT OF FORTY-THREE MEMBERS CHOSEN BY THE BANKS.

Section 10 of this draft provided for a Federal Reserve Board, consisting of forty members chosen by the member banks and their stockholders, and the Secretary of the Treasury, the Comptroller of the Currency, and the Attorney-General of the United States. Mr. Glass, however, proposed to amend this draft to alter this provision so that the Federal Reserve Board should be selected by the directors of the National Reserve banks, the directors of the Federal Reserve banks being selected by the member banks and their shareholders, either directly or indirectly.

I was strongly opposed to either provision because it would *not* give to the United States control of the system. In effect this control of the system I regarded as practically the same as the Aldrich Bill, which would have put the management of the system in the hands of persons chosen to represent the banks, and I insisted that the control of the system was a governing function to be exercised alone by the Government of the United States. About this feature I felt great anxiety, because a powerful impression had been created that the banks of the country would not enter a Government-controlled system, would not take stock in the reserve banks, and would not put their reserves in the reserve banks unless they could control the Federal Reserve Board.

Their representations with regard to this had made a serious impression on Mr. Glass and on others in authority.

Mr. Glass and myself discussed the matter very freely and fully, but could not reach an agreement. As far as he felt it safe to go was to have a Federal Reserve Board of seven, four members of which were to be chosen by the Government and three by the banks.

Upon this vital difference we determined to appeal to the President. We had a hearing one night at the White House, in the Cabinet Room, Mr. Glass urging his view and I pressing the proposal that the Government should control the appointment of every member of this Board. After a discussion of two hours, approximately, *the President coincided with my contention that the Government should control every member of the Board on the ground that it was the function of the Government to supervise this system and no individual, however respectable, should be on this Board representing private interests.*

Secretary McAdoo was present at this interview and agreed with the view which I presented.

When, shortly afterwards, it became apparent that the banks would not be able to refuse to enter the system because of this provision, Mr. Glass gave it a very cordial support, and when we introduced a bill identical in terms in the Senate and in the House this Government control was provided for (S. 2639. H. R. 6454).

I had printed for the use of the Senate explanatory notes and in connection with the section providing for the Federal Reserve Board I answered the objection of the American Banking Association to Government control. I pointed out that the directors of the Reichsbank of Germany were appointed by the Government and not by the stockholders of the bank, and that the Bank of France had its managers, governors, and sub-governors appointed by the Government of France.

The Glass draft, Section 21, followed the Monetary Commission Bill and provided that all moneys of the general fund of the Treasury should, after six months, be deposited in the National Reserve banks and disbursed through such banks.

This I was unwilling to agree to, believing that the Government should retain complete control of its receipts and disbursements as a further check on the reserve banks by the Government.

On this point I received valuable suggestions from Hon. Geo. H. Shibly, who briefed the case for me.

The Reserve Act preserved the independence of the Treasury in accordance with my contention.

Section 23 of the original proposal by Mr. Glass authorized the National Reserve banks to receive from the Federal Reserve Board Federal Reserve notes, but these notes were to be the bank notes of the Federal Reserve banks as in the Monetary Commission Bill, and not the notes of the United States Government.

I objected to this provision, insisting that the notes should be United States Treasury notes and treated as such, for the reason that in this way the United States Government would be able *to control* these notes and the banks would not be able to control them, and Senate Bill 2639, and House Bill 6454, introduced June 26, 1913, by Mr. Glass and myself, made such notes the obligations of the

United States, to be issued at the discretion of the Federal Reserve Board solely for the purpose of making advances to Federal Reserve banks (Section 17).

On this point I had the active assistance of Hon. W. J. Bryan, Secretary of State.

Between June and September many discussions took place with regard to this bill. Finally, on August 29, 1913, Mr. Glass reintroduced the measure of H. R. 7837, and reported it September 9, 1913, and it passed the House September 18th.

On the 2d of September, 1913, anticipating the passage by the House of this Bill, I opened the hearings in the Senate upon H. R. 7837, before the Committee on Banking and Currency, so that the Bill if amended would be amended as the matter of the House Bill, it being the same as Senate 3099, which I had introduced on September 9, 1913, and thus several weeks' time saved in its parliamentary management.

It resulted in a substitute bill which after conference became The Federal Reserve Act.

The hearings on this bill before the Senate Committee filled three large volumes of 3,259 pages, and were not concluded until October 27, 1913.

The Committee made very resolute efforts to ascertain as fully as possible the views of bankers and business men with regard to this bill.

The most distinguished bankers, business men and financiers in the country gave the Committee their views, some of which were very useful in refining the Bill.

I spent days in New York discussing this measure with leading bankers in order to be thoroughly assured of their point of view and not to omit any suggestions of value or to insert in the bill any provisions which would be injurious either to the banks or to our business people, but, as I explained to them, I was considering the matter as a public servant from the standpoint of the interests of the people of the United States, of the manufacturer and merchant and producer and consumer, and not from the standpoint merely of the banker.

On one occasion I spent the entire day from nine o'clock in the morning until nine o'clock at night talking to the Legislative Committee of the American Bankers' Association in New York City.

I recall spending seven consecutive hours discussing with Mr. Paul Warburg the question of whether the Reserve notes should be the notes of the United States Government or bank notes, he taking the position that they should be notes of the Federal Reserve banks and not United States Treasury notes, he contending that these notes would be the obligations of the United States and would weaken the credit of the United States when the United States came to borrow money from the banks or from the people. I took the position that the currency of the country ought to have behind it the taxing power of the nation, that the United States should control the currency, and that private persons should not control the currency, and that the Treasury notes would mobilize capital so that it would be easier for the Government to negotiate its loans with such notes operating as a medium for transfer of credits conveniently through the banks which would be stabilized by this system.

Mr. Warburg supported the principal proposals of the Aldrich Central Bank plan and opposed those of the Federal Reserve Act (*North Amer. Rev.*, Oct., 1913, p. 527).

On December 13, 1913, Senator Root proposed to amend Section 16 and make the Federal Reserve notes "bank notes," and he denounced the Federal Reserve notes because they were the notes of the United States Government, and said that the Act

> "Is authority for the increase, practically, of what we call greenbacks,"

and urged that the Federal Reserve notes were unsound and extremely dangerous.

He contended that it meant not elasticity, but *uncontrolled expansion*, and said,

"It provides a currency which may be increased, always increased, but not a currency for which the Bill contains any provision compelling reduction."

I pointed out on December 15, 1913, in my reply to Mr. Root (*Cong. Rec.*, 899) that these notes could not expand or remain expanded beyond the requirements of our commerce, because, unless a bank needed currency, it would not call for these notes, and as soon as the need for currency was past the bank would return the currency to the Reserve Bank and the Reserve Bank would return such currency to the Federal Reserve agents. The automatic redemption of these notes is expressly provided for in the Act. The extent of this issue was absolutely in the control of the authorities of the United States Government, and the fact that these notes were available everywhere has enabled the people of the United States to meet the present demands of the Government of the United States (1918) for gigantic bond issues and enormous taxes required in the greatest war of all history.

That these notes should not be discredited as unsound I made clear at that time by pointing out the various safeguards to these notes and their validity and that the following securities were behind these notes:

First, A short-time promise-to-pay of a business man in good standing, based on commodities and for which his entire fortune was responsible.

Second, The endorsement of a member bank in good standing.

Third, The stock of such bank in the Federal Reserve bank.

Fourth, The reserve balance of such member bank in the Reserve bank.

Fifth, The double liability of stockholders of the member bank endorsing the note.

Sixth, The capital and surplus of the Federal Reserve bank obtaining the note.

Seventh, A minimum gold reserve of forty per cent. behind such notes.

Eighth, The liability of member banks for the obligation of its own Federal Reserve banks.

Ninth, The double liability of stockholders of all member banks.

Tenth, The mutual liability of all Federal Reserve banks for the debts of one another.

Eleventh, The taxing power of the

people of the United States to meet the obligations of the United States.

No such line of securities was ever provided for any note issue in the history of the world. These notes have not expanded beyond the actual requirements of commerce, and the expansion is absolutely within the control of the Government of the United States.

The present assets of these banks exceed five thousand million dollars. The Federal Reserve notes in circulation amount to $2,562,517,000, secured by $1,146,646,000 in gold held jointly by the Federal Reserve banks and Federal Reserve agents, and $2,116,238,000 in commercial paper not including the other assets of the Federal Reserve banks. In addition, the Federal Reserve Board holds a gold settlement fund of $433,885,000 belonging to the Federal Reserve banks. (November 15, 1918.) Total gold reserves, $2,056,777,000.

In the October, 1913, *North American Review*, p. 567, I said of the proposed system, "It will give the United States the most gigantic and masterful system of the world." The stress of the great European war has demonstrated the correctness of this prophecy.

A serious contention over this Act turned upon the question:

1. Should there be a central bank?

I voiced the opinion of those who desired the banks to be distributed throughout the United States in districts independent of one another, but joined together so as to be co-operative without the dominance of one by the other. Twelve banks were established.

2. Another vital issue was who should control this system — the banks or the people of the United States? I steadily insisted that the control of the banking system of the United States was a governing function and should be controlled by the representatives of the people of the United States and should not be controlled by private persons, whatever their respectability. The system was put under Government control.

3. It was contended, as by Mr. Warburg, that these notes should be the notes of corporations instead of notes of the United States. I firmly insisted that these notes should be the notes of the United States under the control of the Government and based on the taxing power, and that when these were loaned to the banks

they should be adequately secured by gold in fixed ratio and by United States bonds or commercial bills. The Federal Reserve notes were made Government notes.

4. Some wished one bank, or as few as possible; others, from eight to twelve.

In my own Committee I was confronted with the most serious divergences of opinion with regard to some of these vital questions, and found it desirable at last to take the bill before the Democratic Conference. It was there discussed for about three weeks, in which I defended the points in the bill for which I stood, finally receiving the approval of the Democratic Conference and being sustained, as far as I now recall, on every vital point in the bill. It passed the Senate, was submitted to Conference, and in an acceptable form was reported as a substitute for the House Bill on December 19, 1913; was submitted to conference and became a law, and received the approval of the President on December 23, 1913, "As a Christmas gift to the American people."

The changes of importance made by the Senate in the bill, as it passed the House, are shown in a special print of December 1, 1913, in the Senate of the United States.

The number of Federal Reserve banks permissible was increased from ten to twelve. The national banks were required, and the state banks and trust companies were permitted, to become members. The shareholder of every Federal Reserve bank was made responsible equally and ratably, and not one for another, for all contracts, debts and engagements.

National banks failing to signify their acceptance within sixty days were forbidden to act as Reserve agents, and those failing within a year to become members were required to surrender their charters. The usual charter rights were granted to the Reserve banks. The six directors of each Federal Reserve bank to be chosen by the member banks were required to be elected on a plan which I framed by a *preferential ballot*, which automatically coheres a majority of those voting on one ballot and prevents the need of succeeding elections to obtain a majority vote. The three Government directors, including the Federal Reserve agent, are appointed by the Federal Reserve Board.

It was expressly provided in the Act as amended that nothing in the Act should be construed as taking away any powers vested by law in the Secretary of the Treasury which relate to the supervision, management, and control of the Treasury Department and Bureaus under such Department.

This was thought necessary to prevent a possibility of interference with the functions of the Treasury. The Comptroller of the Currency was put in charge of all Federal Reserve notes.

The reserves of the member banks were by the Act and the amendments of June, 1917, subjected to a gradual change, so that after three years the reserves in country districts were put at seven per cent of its demand deposits and three per cent of its time deposits. In a reserve city, at ten per cent of its demand deposits and three per cent of its time deposits. In central reserve cities, at thirteen per cent of its demand deposits and three per cent of its time deposits, to be carried with the Federal Reserve banks, leaving the member banks at liberty to carry such additional reserves as they may see fit.

Previously to the passage of the Reserve Act a large part of the so-called reserves in country banks and in reserve cities were not available in actual cash, but were held as open accounts in city banks with other reserve agents, and were not available in times of stringency.

An important proposed amendment in Section 13 was to authorize a Reserve bank to discount acceptances based on domestic shipment of goods, as well as imports and exports up to one-half of the paid-up capital stock and surplus of the bank for which the rediscounts were made, and to authorize any national bank to accept drafts or bills of exchange drawn upon it growing out of domestic shipments of goods having not more than six months' sight to run. This provision was at that time, however, disapproved by the Secretary of the Treasury, and the House Committee rejected it in conference. I was much disappointed by this defeat of domestic acceptances.

At a later date, September 7, 1916, it was inserted in the Federal Reserve Act, so that now national banks can issue acceptances on domestic shipments.

At the time of the passage of the Federal Reserve Act the Secretary of the Treasury disapproved of permitting the Federal Reserve banks to exchange Federal Reserve notes for gold, but under the provision that a Federal Reserve bank may at any time reduce its liability for outstanding Federal Reserve notes by depositing gold with the Federal Reserve agent, the banks did accomplish this in fact by exchanging the Federal Reserve notes for gold and depositing the gold with the Federal Reserve agents, which had the effect of placing to their credit with the Federal Reserve agent gold against Federal Reserve notes emitted through them.

Afterwards this was changed so that the Federal Reserve banks were permitted directly to exchange Federal Reserve notes for gold, and in this way they have added hundreds of millions of dollars to the gold available behind the Federal Reserve notes. I strongly stood for this gold concentration in the Reserve Bank System.

When the Federal Reserve Act was signed I was given a copy of the Act on vellum, in duplicate, with the signatures of the Government officials participating in the Act.

The President presented me with one of the gold pens with which he signed the Act, and wrote me the following letter:

"THE WHITE HOUSE

"*December 23, 1913.*

"HON. ROBERT L. OWEN,
UNITED STATES SENATE,
WASHINGTON, D. C.

"MY DEAR SENATOR:

"Now that the fight has come to a successful issue, may I not extend to you my most sincere and heartfelt congratulations, and also tell you how sincerely I admire the way in which you have conducted a very difficult and trying piece of business? The whole country owes you a debt of gratitude and admiration. It has been a pleasure to be associated with you in so great a piece of constructive legislation.

"Cordially and sincerely yours,

"WOODROW WILSON."

The main principles of the Federal Reserve Act are (1) the issuance of elastic currency, Treasury notes, supported by a large gold reserve, and by sound commercial credits and banking credits; (2) issued and controlled by the Government, (3) easily available to banks and to business men, (4) under an interest charge to prevent inflation by compelling contraction, (5) distributing bank reserves in twelve banks to serve commerce instead of concentrating them in New York to serve the Stock Exchange.

This in effect puts behind the individual credit of the farmer, merchant, manufacturer, shipper, and business man the credit of the United States, and furnishes him with elastic currency whose validity cannot be questioned, in exchange for his own notes, enabling him to meet his current obligations without difficulty and providing an ever-present supply of sound currency for business needs.

It gives assurance to the business men of the country that they never need fear a currency famine.

It assures them absolutely against the danger of financial panic, due to hoarding of currency or sudden denial of legitimate credit.

It does not promise them protection against waste, improvidence, or carelessness in conducting business; it does not protect them against over-production or under-consumption; it does not give complete protection against industrial depression, which may be due to these causes or to other causes. The protection of the country against industrial depressions is very largely safeguarded by this Act, but other steps by Government are essential if industrial depression in the future is to be entirely avoided. This is another story—the story of reconstruction, of stabilizing industry and commerce by added safeguards and the regulated constant employment of labor.

The management of the Federal Reserve banks by the six directors elected by the member banks and the three directors chosen by the Governmentally controlled Federal Reserve

Board has proven satisfactory to the Government and to the country.

The refinements of the Federal Reserve Act were brought about by the co-operation of a great many able men who participated in the deliberations whose names and evidence will be found in the hearings of the two Committees. After Mr. Glass and myself introduced the bill in June, 1913, it received altogether over eight hundred amendments, nearly all of which related merely to language and punctuation, the changing of words back and forth, and matters of that character, which were unimportant. Hon. Carter Glass was entitled to very great credit for his able and admirable work on this measure. The members of the Committees on Banking and Currency of the United States Senate and House of Representatives gave it the most assiduous attention from April to December 23, 1913, and are entitled to the highest measure of praise.

I am especially grateful to Hon. Henry F. Hollis (N. H.), to Hon. John Shafroth (Col.), and to Hon. Atlee Pomerene (Ohio) of the Committee for their valuable services.

The bill had the sympathetic support and earnest co-operation of President Wilson, of Secretary Bryan, of Secretary McAdoo, and Hon. John Skelton Williams, the assistance by suggestion of many prominent bankers and business men, and from time to time has been amended since, as experience has shown how it may be improved in its mechanism and operation. I particularly appreciated the valuable assistance of Hon. Samuel Untermyer of New York, who gave me many useful suggestions.

The expansion of the Federal Reserve banks under this Act has surprised and delighted the country.

Except for this Act the United States could not have adequately financed this war, and the Government of the United States would have faced a serious panic at the beginning of the war.

APPENDIX A

STATEMENT OF COMBINED RESOURCES AND LIABILITIES OF THE FEDERAL RESERVE BANKS AT CLOSE OF BUSINESS, NOVEMBER 1, 1918

Resources	November 15, 1918	
Gold in vault and in transit...	$375,527,000	
Gold settlement fund, F. R. Board....................	433,885,000	
Gold with foreign agencies.....	5,829,000	
Total gold held by banks..	815,241,000	
Gold with F. R. Agents.......	1,116,579,000	
Gold redemption fund.........	74,957,000	
Total gold reserves........		$2,056,777,000
Legal-tender notes, silver, etc...		53,039,000
Total reserves............		$2,109,816,000

COMBINED RESOURCES AND LIABILITIES.—*Con.*

Bills discounted: Secured by Govt. war obligations......	$1,358,532,000	
Bills discounted: All other....	439,276,000	
Bills bought in open market...	377,877,000	
Total bills on hand.......		2,175,685,000
U. S. Government long-term securities..................		29,478,000
U. S. Government short-term securities..................		93,449,000
All other earning assets........		28,000
Total earning assets.......		2,298,640,000
Uncollected items (deduct from gross deposits).............		717,785,000
5% Redemption fund against F. R. bank notes...........		4,008,000
All other resources............		18,169,000
Total Resources...........		$5,148,418,000
LIABILITIES		
Capital paid in................		79,903,000
Surplus......................		1,134,000
Government deposits..........	$246,401,000	
Due to members—Reserve acct.	1,449,949,000	
Collection items..............	573,727,000	
Other deposits, including foreign Government credits.........	113,385,000	
Total gross deposits.......		2,383,462,000
F. R. notes in actual circulation		2,562,517,000
F. R. bank notes in circulation, —net liability..............		72,930,000
All other liabilities............		48,472,000
Total Liabilities...........		$5,148,418,000
Ratio of total reserves to net deposit and F. R. note liabilities combined..............		49.9%
Ratio of gold reserves to F. R. notes in actual circulation after setting aside 35% against net deposit liabilities........		59.6%

On the final passage of the Act in the Senate, 47 Democratic Senators voted for it, none against it, while 7 Republican Senators voted for it and 34 voted against it:

In the House of Representatives 248 Democrats voted for it and only one against, while 38 Republican members voted for it and 85 Republican Representatives voted against it.

Nearly all of the Republicans voted for amendments suggested by the Central Bank Bill of the Monetary Commission, but every one of these hostile amendments was defeated in the Senate and in the House.

Hon. John Skelton Williams, Comptroller of the Currency, in a public statement recently said, in regard to the Federal Reserve Act:

"Every business man, banker and capitalist knows what it is and what it has done. It is the best financial system the world has ever seen. It has made this Nation and Government an impregnable financial force and the strongest the mind of man has devised. . . . THAT ONE MEASURE WON THE WAR. It enabled our finances to endure, without a quiver, every shock and strain. It gave us the power to help our allies instantly and without stint when their need was sorest, with a help most needed."

The opportunity to take part in framing this Act I have deeply appreciated. I am glad to yield to the suggestions of various friends and dictate this short reminiscence.

I hope the little volume may prove of value in making the simple principles of the Reserve Act more clear:

THE FEDERAL RESERVE ACT

1. A quick supply of elastic money, easily available;
2. Under Government control;
3. Secured by gold, commercial bills and U. S. bonds;
4. Under an interest charge to compel contraction and prevent inflation.

ROBERT L. OWEN.

Nov. 15, 1918.

THE END