ADDRESS OF

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OF THE

FEDERAL RESERVE BOARD

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IN THESE times, when we are so deeply stirred and bewildered by the unhappy fate that has overtaken Europe, when it is so hard and well nigh impossible to understand the path along which man is progressing, nothing will help us more toward finding our bearings than the study of ancient history. The more fully we understand that, for thousands of years, human problems have remained fundamentally the same, the more nearly we succeed in attaining a judicial and sympathetic understanding of the tragic struggle of our race. Human problems and human nature indeed do not appear to have changed since the time of Themistocles' speech on "National Preparedness," delivered 2,400 years ago, of which Plutarch tells us, urging the building of a strong navy, or since his confidential message to the Persian King, Xerxes, informing him after the battle of Salamis, that the "allies" were going to attack the Dardanelles. We are told this message caused Xerxes to evacuate Greece in order to rush back for the protection of his bridge across the Hellespont.

When reading a sketch of the life of Lucullus, I was surprised to find myself suddenly thinking of the Federal Reserve Act. Lucullus had been sent to Egypt, Libya and Crete. Plutarch tells us:

"He also made Cyrene, and finding it in confusion * * * he restored it to order, and fixed its constitution, * * *. They asked him, it would seem, to write laws for them, and to mould their people into some form of sound government, whereupon he said *that it was hard to be a law-giver for them when they were having such good fortune. In* *fact, nothing is more ungovernable than a man reputed to be prosperous; and, on the other hand, nothing is more receptive of authority than a man who is humbled by misfortune."*

So, you see, even in those days they required a 1907 in order to be ready for some sound legislation.

The following evening I took up the life of Camillus, and came upon this incident:

After a protracted siege, Camillus had taken the City of Veii. He had vowed that, if he should take the city, he would consecrate the tenth part of the booty to the Delphian god. But, after the city had been taken, he apparently forgot his vow. At a later time, however, he referred the matter to the Senate, and, the seers announcing that the gods were angry, the Senate voted that every soldier under oath should return one-tenth of his share—

"The soldiers were filled with indignation * * *. However, all of them brought in the necessary portion, and it was decided to make a bowl of massive gold and send it to Delphi. *Now there was a scarcity of gold in the city, and the magistrates knew not whence it could be had.* So the women, of their own accord, determined to give the gold ornaments which they wore upon their persons for the offering, and these amounted to eight talents weight. The women were fittingly rewarded by the Senate, which voted that thereafter, when women died, a suitable eulogy should be spoken over them, as over men. For it was not customary before that time, when a woman died, that a public encomium should be pronounced."

When I read this chapter, it struck me that the "votes for women" movement was already showing strength in the year 376 B. C. The Romans, however, were by far shrewder than the men of our generation, inasmuch as they at least secured a good and valid consideration for what they conceded.

The next thought that came to me in connection with this story was that even the question of the "gold reserve" is not modern, but that 2,000 years ago the same problem, how to withdraw gold from circulation and use it for the general good, confronted our forefathers. Seriously speaking, the incident cannot but remind us of the gold now being given up to the Banque de France and the Reichsbank by the people of France and Germany.

Like Lucullus in Cyrene, the advent of the Federal Reserve System came at a time of acute adversity. Its operation, however, had so excellent an effect and the resulting changes were developed with such speed that many are now forgetful of its benefits. When, some months ago, we were near the brink of a most serious international complication, few people stopped to consider the fact that we were not then subjected, through fear of panic, to any convulsions, such as we should inevitably have experienced before the establishment of the Federal Reserve Banks. I shall not tire you by enumerating the benefits of the system. I believe that those who think already know them; while those who do not think will learn to know them from actual experience. That will be conspicuously the case when excess reserves are next reduced and when higher rates for money again prevail.

I could wish, for many reasons, that it might have been possible to open the Federal Reserve Banks before the war began and that *they* might have furnished the about $380,000,000 of notes that were issued under the Aldrich-Vreeland Act, as amended by the Federal Reserve Act. The functions of Federal Reserve Banks in general and our present policy would then be better understood and there would be less talk about our earning capacity and the necessity of preserving the prestige of our Federal Reserve Banks by earning dividends. Had the Federal Reserve Banks been in operation when the war began and had *they* issued all the currency required last autumn, the rediscounts underlying these notes, at 5% interest, would have produced a return of about $4,500,000, or about the sum required to cover running expenses and dividends of all Federal Reserve Banks for a year.

If the Federal Reserve Banks had put out this circulation and secured this return, would anyone suggest at this time that our banks should now make efforts to employ their money?

Would not everyone agree that this present period of excessive ease of money was the proper moment for the reserve banks to withdraw their reserve money from active employment?

Earning capacity must never be considered the test of the efficiency of Federal Reserve Banks. Personally, I should have felt heartily ashamed had all our banks, considering the circumstances under which they began operations, earned their dividends in the past year. Such an earning, with all it implied, would have been a proof that they had completely misunderstood their proper functions and obligations.

It must be conceded, however, that only men who have been trained in banking or who have given close study to the question will fully understand that failure to earn dividends does not mean the impairment of the prestige of a Federal Reserve Bank as it would that of a member bank. It cannot, moreover, be denied that the banking instincts of those in charge of the banks will always remain—if only subconsciously—sensitive on this score.

For these reasons, it may well prove advisable to reduce the proportion of the paid-in capital of the Federal Reserve Banks so as to reduce, as far as possible, the conscious and subconscious pressure to force the funds of Federal Reserve Banks into actual employment at times when these funds should properly be withdrawn or held idle. Unless in times of great ease of money Federal Reserve Banks withdraw the bulk of their money from actual employment, they cannot possibly be prepared to have their funds available at the turn of the tide when their beneficial powers should make themselves felt.

It is apparent, therefore, that the smaller we can consistently make the dividend requirement and the operating expenses of the Federal Reserve Banks, the better protected the system will be in time of trial.

But, on the other hand, we dare not consider the item of expense when it involves questions of safety. One of the heavy items of expense, for instance, is that of printing Federal Reserve Notes. A large supply of such notes, ready whenever required, is, however, a most fundamental safeguard, and the steady issue of Federal Reserve notes resulting in an accumulation of gold and gold certificates in the hands of Federal Reserve Agents will form an important element of strength in times of need.

The Federal Reserve Banks have now in the hands of Federal Reserve Agents some $135,000,000 of gold and lawful money which, in case of a growing demand for rediscount by the member banks, may be freed by a process of redemption and substitution of commercial paper. This gold may be turned, as a free asset, into the vaults of the Federal Reserve Banks and may thus form the basis for an additional note issue of $200,000.000. It has been claimed by some of our critics that this process spells inflation. Nothing could be more unwarranted than such assertion. As long as there are deposited with the Federal Reserve Agents ten dollars of gold for each ten dollars issued in Federal Reserve Notes there is neither inflation nor contraction, but simply a substitution of one gold certificate for another. But the beneficial effect will be shown when demand will spring up for additional circulation, when, as a result, this demand will be satisfied, not by paying out currency which may serve as reserve, but by issuing the Federal Reserve Note which has been created for this very purpose. This process ought to be furthered by all member banks and even non-member banks, for it is being carried on for their own protection. There is no such thing as the interest of a Federal Reserve Bank as against the interest of member banks. As yet, I fear, this is not sufficiently understood. The Federal Reserve Bank is the member banks'; it is your bank, your fire engine, constructed for your greater protection. You have paid for it and you are operating it. We are to be considered as your fire marshals. It is our function to see to it that the machinery is in good order and that conditions are such that fires may not too easily occur or spread too fast and too far. But yours is the engine, and yours is the fire!!

It is to your interest that your engine should not become rusty or obsolete, but that it remain a well-oiled and efficient instrument. In other words, Federal Reserve Banks must remain active banks operating in certain fields with a varying degree of intensity.

If they are to exercise effectually the functions for which they have been created, access to these fields of operations must be given them ungrudgingly. They cannot protect you unless they can secure for themselves the strategic position without which they cannot act as regulators warding off interest rates both too high and too low and creating for the entire country a basis for a healthy development on a safe and solid foundation.

It is to your interest to see the Federal Reserve Banks as strong as they possibly can be. It staggers the imagination to think what the future may have in store for the development of American banking. With Europe's foremost financial powers limited to their own field, with the United States turned into a creditor nation of all the world, the boundaries of the field that lies open for us are determined only by our own power of safe expansion. The scope of our banking facilities will ultimately be limited by the amount of gold that we can muster as the foundation of our banking and credit structure. Gold that is carried in the pockets of the people, gold that accumulates as excess reserves in the member banks' vaults, does not afford the maximum service that the country is entitled to expect. Excess balances and idle gold should accumulate in the Federal Reserve Banks. They should not control $300,000,000 of gold, as they do now, or $450,000,000, as they will after another year, but they should control a billion or two of gold. The stronger the Federal Reserve Banks become, the stronger will be the country and the greater its chance to fulfill with safety and efficiency the functions of a world banker. The basis of this development must be confidence. Unless the member banks are profoundly convinced that their balances are as safe with the Federal Reserve Banks as they are in their own vaults—beside being more useful and efficient there—and unless they are convinced that the Federal Reserve Banks will not abuse their vast resources for inflation of credit or for the purpose of aggressively competing with the member banks, the full growth of the system, and with that the full growth of American banking, cannot be developed.

I believe that I may say with confidence that both the Federal Reserve Banks and the Federal Reserve Board are fully alive to the duty and responsibility that rest upon them in this respect and that they will do their share of the work as they trust, not only the member banks, but those not now members, will do theirs.

Believing in the bankers' sense of public duty, and animated by the motive of creating the broadest possible foundation for the development of a strong and united banking system in the United States, the Board has gone to the utmost limits of liberality in determining conditions for the admission of State institutions. In order to achieve this aim, it found itself in the difficult position of having to concede to these State banks and trust companies conditions which, in certain respects, give them a distinct advantage over national bank members. It is the hope and aim of the Board to see the powers of national banks liberalized, still, for the time being, it remains a fact that State institutions entering our system are at an advantage. Such of them as are strong and conservative may come in practically with all the powers now enjoyed by them, and, in addition, may leave the system if they do not like it. Still they hesitate. As Lucullus said: "in times of prosperity, it is hard to legislate.", and Walter Bagehot, the British economist, expresses the same thought in slightly more modern language when he says:

"Political economy is only an absorbing topic when a nation is, financially and industrially, uneasy."

Let me ask those of the State institutions that are proud of their independent standing: is it quite fair to let your neighbors pay for the expense of the fire department when, in case of fire, you know you will count on the benefits of the general protection and when, as a matter of fact, you enjoy every day the advantage of the greater security provided by your neighbors? Let me tell them, at the same time, that insurance companies are generally willing to take risks while applicants are young and conditions serene but are not very eager to write new insurance when the "quake" is on. Let me ask you, too, is it conservative banking for State banks to reduce reserve requirements, as authorized by many State laws in consequence of the establishment of the Federal Reserve System, if these State banks do not enter the system? Should not State banks remaining outside the system, as a matter of prudence, continue to observe the old reserve requirements?

The thought is often expressed that "at the time of the next crisis the State banks will all come in." I think it may be safe to say that they will find that many will then come in *after* the next period of anxiety. This is not meant as a threat, but I am afraid it will be a physical impossibility to take them all in during such a period of stress. Examinations take time, and many State banks will not look as strong during a critical period as they may look today. Moreover, the Federal Reserve Banks will find it difficult, in fairness to their own members, then to burden themselves with banks that might add an element of weakness, remembering that, in times of sunshine and peace, such institutions had refused to contribute their share to the work of protecting the entire community.

And now, permit me to relate to you one last reminiscence from ancient history. Aristotle, in defining the elements of liberty, gives us this definition: "One element of liberty is: to govern and in turn to be governed. The other is: to live according to one's inclinations." I do not think that any modern writer has ever given a more interesting or a more original definition of liberty. Liberty without restriction is anarchy; submission to restriction arbitrarily imposed produces a slavish surrender of human rights. Between the two lies true liberty which means the exercise of our own free will and powers within the limitations which, for the protection of our liberty, we have agreed to impose and enforce amongst ourselves.

Our Federal Reserve System is to be considered from this point of view. For your own safety and liberty you have created this law and created the necessary organization for its enforcement. You have elected your government, and appointed your directors and officers. Do not think now of these administrative organs as something imposed upon you by others, but only as something of your own creation. This system, permitting you "to govern and in turn to be governed," as Aristotle puts it, is an expression and a safeguard of liberty.

You create your own traffic laws and clothe the traffic policeman with authority. As long as we obey the law, we consider him a means of protection and we resent him as a restraining influence—only when we exceed the speed limit. While the Federal Reserve System is in its early stages there must, of necessity, be a great deal of regulatory work. But I sincerely hope that the writing of regulations will soon become an occasional or incidental function of the Federal Reserve Board, and that traffic rules in banking will have become no more unusual or irritating than the raising of the hand of the traffic policeman.

As for myself, I am not in accord with the school of thought that believes that law and government's sole function is to regulate. I believe that the function of government is not only to regulate but to construct, and I believe that I am expressing the feeling of my colleagues of the Federal Reserve Board and of the men in charge of the Federal Reserve Banks when I say that we are looking forward to the time when all our energies may be applied, not to regulation, but to helpful co-operation in the general work of construction.