AT THE CROSSROADS

Address of

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AT THE CROSSROADS

The title of my remarks here this morning has considerable flexibility. It conveniently suggests that the speaker may choose any one of several lines for his discussion. When applied to this audience and this occasion it suggests that the very fundamental business in which you are engaged, the business that is called banking, is itself standing at a point from which it may go up one road or down another. In fact, I had considered labeling my remarks "Commercial Banking at the Crossroads." That sounded a little too dramatic, however, to be followed up by the things I want to say, and besides, it seemed to imply that I would be prepared to present a clearly marked map showing the road which the banks will, and under the circumstances ought to take, in adapting themselves to changing and evolutionary conditions.

Or I could give the subject another twist by making ~~the~~ to this audience unnecessary confession that my remarks on banking problems do not spring from any intimate personal experience in the banking field, but have been gathered, instead, from a post of observation at the crossroads of the money and credit streams of the country.

I think that it may be useful at this time to ask ourselves the searching questions: What are banks for? Why do they exist? Do they earn their keep? and then: What must they do in order to be worth preserving as a part of our economic machinery? For one thing is certain: in the long run - and not so very long at that - only those institutions can survive that serve a real economic need and do so with reasonable efficiency and at reasonable cost to the community.

Let us analyze, therefore, the problem of what purpose the banking system serves.

Sighting back along the path which credit institutions in the United States have traveled, it is clear that the commercial banking system as we know it has developed for three general reasons: it furnishes liquid and transferable funds, probably as much more efficient than cash, as cash is more efficient than barter as a means of serving commerce and industry; it provides the facilities, through extension of credit, for converting future returns into present funds; and finally, as agencies for handling community savings, the banks play an important part in the process of capital formation.

We could transact our business on a cash basis by using currency, instead of bank credit. Many countries do, to a much greater extent than we. But our system is more efficient. We save the business community hundreds of millions a year by making funds transferable instantly all over the country. Our economy has become adapted to this way of doing business and therein lies one worthwhile function of the banks. But in order to serve this function banking funds must be of unquestionable soundness. This faith in banks was rudely shaken in the not distant years. It has now been restored. We are concerned to preserve it.

In connection with its second function of converting future returns into present funds -- the function of extending credit -- fundamental changes have occurred in the country's life that vitally affect the methods by which banks must serve their communities.

The integration of industry has opened up the capital markets to lines of business that once depended on banks for loans. Short-time commercial loans are becoming less and less available as a means of extending bank credit.

Investments in bonds and other securities become increasingly important as the opportunity for normal loans appears to be diminishing.

The continuance of the growth of the American banking system in its present form depends to a considerable degree upon the efficiency with which banks are able to adjust themselves to these changed conditions.

We are all concerned now with the statements so frequently heard, that the banks today are not fully and courageously meeting the credit needs of business, - particularly of "small business," of which so much has been said and written in recent weeks. Probably the picture as many present it is overdrawn. But enough is being said to indicate that all of us - you who are on the main streets of credit firing line, we who are temporarily entrusted with responsibility in government or state supervisory and examining authorities, - should re-examine and re-appraise our policies to make sure that the vast credit resources of the nation are being efficiently used and meet the country's needs through the banking system.

It seems to me that every force and influence that affects the banker is pushing him to extend credit where credit is needed, and where it can safely be granted - the control of a vast reservoir of lendable funds, the desire to replenish earnings, and the banker's natural ambition to assist in the smooth functioning of the national economy.

The banks must not only serve the credit needs of the country efficiently, but must convince the country that they are doing so, if they are to escape a continued limitation of their lending field due to increasing competition of public or semi-public agencies.

Speaking for the Federal Reserve System and, I believe, for the other supervising and examining agencies, it is our concern to help the banks function freely and effectively in performing these services. That is the motive which has led the three Federal agencies recently to study their own policies, particularly in bank examination, to try to find out whether there is anything in bank examination policy which unncecessarily restricts banks from making sound loans. And if the Iowa Bankers' Association or any of its members have ideas and suggestions on that subject, the people in Washington would be very glad to hear from you.

A moment ago I mentioned the changes that have occurred in the composition of assets of commercial banks. The past decade has seen radical changes. Customer loans, at the end of 1928, comprised 45 percent of all assets of Federal Reserve member banks. Now they comprise less than 30 percent. Brokers' loans on open-market paper used to be the first line of secondary reserves, but now these loans are relatively unimportant. On the other hand, during the decade Government security holdings of member banks have increased from 9 percent of total assets to 26 percent. More than one-fourth of banking resources has been lent to the Government to be passed on to trade and industry through public activities. There may be room for improvement over that process, through more active direct lending by banks to industry and agriculture.

Government intervention in emergency conditions, when private credit was all but non-existent, was inevitable and essential. But now that private credit is once more restored -- are there not fields in mortgage loans, both farm and urban, in commodity credit, and in other fields where banks could take over the lending from the Government? If such fields are found, and some banks are finding them, then the Government will be relieved of a part of its debt -- and the banks will profit both by the growth of their business and by the increased rate of return.

There is, however, no reason to expect a large increase in the demand for short-time commercial loans. Banking practices will have to be modified and adjusted to different standards. This does not mean lower standards, for emphasis should always be put on high quality and soundness.

I am not sure how much of the problem they have solved, but many banks, instead of requiring that loans be limited to short-term working capital and repayable in 3 to 6 months, are finding a more lucrative field among long-term borrowers whose loans can be amortized and paid back over a period of years.

In this connection I have in mind loans of the type that are insured by the F.H.A. which relate the length of the loan and the type of payment to the purpose for which the loan is made. Many bankers report to us that they are adapting this principle to industrial purposes so that loans are made for longer time with provision for repayment from income over a period of years.

Others have entered the field of personal loans and consumer credit, a small loan business heretofore handled largely by a specialized type of financial institution. In certain parts of the country commercial banks are now finding this a substantial outlet, so that both they and the small borrower stand to profit by this new development. In the past, the banks' participation in this field has generally been indirect and at small profit, that is, through middlemen who were in a position to shop around and secure credit at wholesale rates.

And then there is the matter of investment in securities. Instead of considering bonds as something to be held only temporarily and sold at a profit, commercial banks recognize to an increasing extent that they are in part investment institutions, and handle investment accounts according to the principles that are followed by other investment institutions, such as life insurance companies and trust accounts.

But some of you will say that banks are not the same as these other investment institutions, that they have liabilities payable on demand which they must be prepared to meet. In this connection there have also been important changes in the past decade or two which may justify a deviation from the standards and principles of the past. Certain important changes in our financial organization make it far safer than it formerly was to invest in long-term assets.

For one thing, over the past 20 years the banks have acquired a vast volume of time deposits which represent savings and are not generally subject to abrupt withdrawal, so long as faith in banks persists.

Second, deposit insurance safeguards banks against runs, particularly by small depositors. The bulk of time and savings depositors are fully protected.

Third, the Federal Reserve has liberalized its credit facilities. You may recall that Regulation A has now been made so comprehensive that it permits a member to rediscount paper based on almost any legitimate credit need. Moreover, as long as a bank has sound investments, it can always borrow at the Federal.

Many of the restrictions of a more or less technical nature imposed by law on banks ten years ago have now been removed. This makes it possible for banks to adapt themselves to the long-time changes that I have pointed out and to be an active part of our mechanism for financing commerce and industry.

To sum up: the economic need for banks is clear. In order to be assured of continued successful operation, however, banks will have to accommodate themselves to changed needs of commerce, agriculture and industry. They will have to be a source of strength rather than of weakness in our progress toward ironing out booms and depressions.

The prospects are that banks will do those things and that, in return, society will be glad to have them earn a return on their capital sufficient to attract an adequate volume of funds into the banking system.

Now I hope you will be patient with me while I digress - go down another one of the speaker's crossroads - to talk briefly about the agricultural situation. It would hardly be reasonable for me to come into this, the greatest farm state in the land, and be silent about it.

Perhaps in no other part of the country is the vitality of our banking institutions so intimately related to agriculture. This is not news to you, for you can all too easily remember the relatively prosperous decade of the twenties when these great agricultural states on the banks of the Missouri suffered an unremitting epidemic of bank failures.

During the 12 years from 1921 to 1932 there were 10,808 bank failures in the United States, with combined deposits of nearly 5 billion dollars. Depositors lost about 2 billions in these failures, to say nothing of the great loss to the community as a whole resulting from confusion and general dislocation. These are appalling figures and the wonder is that our capitalism ever survived such a blow. The fact that we did survive, and have now regained much of our lost ground, speaks well for the depth of American resources and the character of the American people. And it speaks particularly well for the enduring hardihood of the American farmer. For year after year he fought in the front-line trenches. He had to, for the trenches came right into his own barnyard.

As I have already indicated, the bankers through this section had to bear a considerable portion of the burden. These 7 states here in the west North Central area normally produce one-half of the nation's wheat, one-third of its corn, and one-third of its pork. From 1921 to 1932 they produced more than one-third of all our bank failures, failures that accounted for one-fifth of the deposits in all the banks that were forced to close their doors.

I am not the one to discuss with you the details of the present agriculture programs; I want to paint the backdrop with a broad brush, in what I have to say.

Farm income, as well as national income, for 1938 will be considerably below 1937. The farmer's index of exchange value, that is, the ratio of the price the farmer gets for a unit of what he sells to the price he pays for a unit of what he buys, has already dropped from 97 to 75 during the past year. It really is a shocking commentary on our economic system that this decline in farmer purchasing power is caused, in part, by over-generous production.

In the background, fundamental changes have been taking place in the organization of American agriculture, not just recently, but steadily for decades. Time will permit no analysis of these long-time trends, and only sketchy comment on the immediate situation. The struggle to maintain farm income in the face of an increasing price disparity is important from every consideration of national welfare.

The men in positions of responsibility who are striving, with the cooperation of the vast majority of the farmers, to hold the ground agriculture has gained in the face of almost insurmountable difficulties, are fighting your fight as well as their own. They are entitled to intelligent cooperation.

Speaking to the United States Chamber of Commerce at Washington last month, I compared the farmer's supply problems with the inventory problems of business.

It is only natural that businessmen should try to absorb much of the shock of depression through adjustments in production, inventories and payrolls. As individuals who want to keep their capital intact, that is about all they can do. But the combined effect of reduction in output, inventories and payrolls plays havoc with farm and food prices. That is bound to be true; the attempt, on the one hand, to keep prices from sagging and, on the other, to reduce out-of-pocket costs, obviously reduces the flow of income into the hands of those who buy the farmers' produce.

Traditionally the farmer has had no escape. Indeed, he has had no conceded right of escape from the enormous swings in the prices of farm products. Both the deadening lethargy of a recession and the abnormal stimulation of a boom have fallen squarely upon his prices.

In recent years, however, considerable progress has been made in setting up democratic machinery that will shift a portion of the readjustment process from price to supply. I suggest that the successful operation of this machinery is in the general interest. It helps the farmer, it helps the businessman who must depend in part on farm purchasing power, and it helps you - the bankers.

A lot of criticism has been directed against recent farm programs, right here in Iowa, on the ground that they were "programs of scarcity." I would agree with them if they were general criticisms, that is, if they aimed not only at the farm program, but struck also at manufacturers who, when they no longer need production, shut down their plants, and turn their laborers out to rustle for themselves, or to go on public relief until work starts up again. Or if the criticism also took in a labor policy which, taking a lesson from business, successfully limits production in quest of the maximum pay per hour.

As a matter of fact, none of these conditions can satisfy the thoughtful man as long as there are human needs unfilled. But the indictment rests against the entire economic system which fails to spread the power to buy in proportion to need and willingness to work. The genius of the American people will not be content while underconsumption and unemployment are companions. The farmers of the nation will do their part toward working out a better order. They always have done their part. But it is unfair to ask the farmers to play the economic game under one set of rules while industry and labor play under another. The farmer wants to produce generously and without restraint; it goes against his grain not to; but as long as these are the rules, he and his family will probably insist that they be allowed to live under them too.

We have almost unlimited human and material resources. The central problem is to put them to work, and to keep them working; to match our ability to produce with an effective capacity to acquire and consume. If it is solved, the material gains of the next 100 years may be startling indeed. And the progress of a less material nature may be even more significant. But if this problem is not solved, the possibilities for destruction, as the depression has shown, are equally great.

This basic problem, with its intimate consequences in every walk of life, fundamentally concerns the health of the banking structure. Given good management, banks do not get into trouble unless economic activity slows down and values melt from their investments. I do not think the problem will solve itself. In spite of disappointments and discouragements, civilized man is going to keep on striving, with every power at his command, to master the machine he has created. I should like to close with the thought that the group gathered here today, representing Iowa business leadership, can contribute mightily if its members will give their sober, independent and constructive attention to this vital question.

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