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THE RELATION OF THE COUNTRY BANKER TO THE FEDERAL RESERVE BANK

(An address before the Kentucky Bankers Association
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by

Geo. R. James

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MR. CHAIRMAN, LADIES AND GENTLEMEN:

As a member of the Federal Reserve Board, nothing has given me as much concern as does "The Relation of the Country Banker to the Federal Reserve Bank", and my one regret is that so few of the country bankers have availed themselves of the privilege and opportunity of becoming members. I say this because of my regard for and my unbounded faith in the Federal Reserve System. I feel that all of you agree with me in the belief that it is the greatest and strongest banking system in the world and that its usefulness, soundness and success have been demonstrated both in times of war and in times of peace.

In considering its functions, I always try to look at the System not from the viewpoint of a banker altogether, but more from the standpoint of the public. For, while the System deals with the public almost entirely through its member banks, the question of how the public would be benefited was of paramount interest and vital importance in its creation and its continued existence depends entirely on whether or not the public *is* benefited. I, therefore, regard the public's interest in, and the public's opinion of, the System as the one great consideration.

I do not share the opinion one frequently hears to the effect that the Federal Reserve System is an independent organization and that it is owned by the member banks. I feel that the public has quite as much interest in the Federal reserve banks as have the member banks themselves. This public interest centers in our Government. "That Government of the people, by the people, for the people", and of which the Federal Reserve System is a vital part.

As a citizen, the country banker, whether his bank is or is not a member of the Federal Reserve System, has an interest in the System growing out of his citizenship.

True, the reserve deposits of the member banks may well be said to be the foundation of the Federal Reserve System, and it is also true that the capital stock of the reserve banks was supplied by the member banks. But we must not overlook the fact that the Act of Congress, under which the System was established, provided at the outset that "Should the total subscriptions by banks and the public to the stock of said Federal reserve banks, or any one or more of them, be, in the judgment of the Organization Committee, insufficient to provide the amount of capital stock required therefor, then and in that event the said Organization Committee shall allot to the United States such an amount of said stock as said Committee shall determine."

Then, too, let us for a moment consider "The Division of Earnings of the reserve banks". The Act says -

> "After all necessary expenses of a Federal reserve bank have been paid or provided for, the stockholders shall be entitled to receive an annual dividend of six per centum on the paid-in capital stock, which dividend shall be cumulative. After the aforesaid dividend claims have been fully met, the net earnings shall be paid to the United States as a franchise tax except that the whole of such net earnings, including those for the year ending December thirty-first, nineteen hundred and eighteen, shall be paid into a surplus fund until it

shall amount to one hundred per centum of the subscribed capital stock of such bank, and thereafter ten per centum of such net earnings shall be paid into the surplus.

"The net earnings derived by the United States from Federal reserve banks shall, in the discretion of the Secretary, be used to supplement the gold reserve held against outstanding United States notes, or shall be applied to the reduction of the outstanding bonded indebtedness of the United States under regulations to be prescribed by the Secretary of the Treasury. Should a Federal reserve bank be dissolved or go into liquidation, any surplus remaining, after the payment of all debts, dividend requirements as hereinbefore provided, and the par value of the stock, shall be paid to and become the property of the United States and shall be similarly applied".

The application, under these provisions of the law, of the earnings of the System in the past, results in the capital account of the Reserve System being one-third under the ownership of the member banks and two-thirds (representing the surplus) belonging to the Treasury of the United States.

Neither must we forget the fact that the Government stands squarely behind the notes of the reserve banks, which notes play such an important part in providing a currency for the nation. Even though by any combination of circumstances all of the gold held by the System should be taken away and out of the country, still these notes backed by the integrity of our Government would be worth one hundred cents on the dollar.

It is perfectly clear to my mind that the reserve banks were not created to make money either for themselves or for the member banks beyond the six per cent interest on the money invested in the capital stock. It is equally clear that the System was designed to be an aid to agriculture, industry and commerce,- or, in other words, the public, although, as I said before, it functions through its member banks.

The law does permit the Federal reserve banks to perform certain services for the member banks without charge and at the expense of the reserve banks because it was believed that the reserve banks could reduce the costs of performing these services, and I can tell you that the services now rendered by the Federal reserve banks are performed at a saving in cost that is far greater than was originally anticipated. The cost of the collection of checks, transfer of funds, and handling of currency by the Federal Reserve System is only a small percentage of what those functions cost when performed by individual banks. The economies that are possible through mass production apply with equal force in the Federal Reserve System as they do in the plants of the Ford Motor Company.

The major earnings of the Federal reserve banks arise out of the interest charged member banks when the member banks borrow. They are increased or diminished only as the requirements of the member banks dictate. And, perhaps it may be important to state that the facilities of the Federal Reserve System are available for the smallest and for the largest member banks on exactly the same terms and conditions.

I am giving you this information because I think it is just and right that you should know that the so-called free service which the Federal Reserve System renders to its members is in the last analysis given at the expense of the public, and I feel that this great American public should be in a position to inquire (1) whether or not it is getting the benefit of these services, and (2) if not, why not?

A good part of my time has been taken up in the study of the question "why so many banks do not belong to the Federal Reserve System", but I am still unable to get anything like a satisfactory answer to this problem. The fact is that when I sum up the replies I have seen or heard

I reach the conclusion that an alibi or an excuse has been offered in lieu of reasons.

It appears to me that a good many bankers, like a great many business men and individuals, have the habit of looking at everything through a pair of spectacles with the dollar sign on one lens and the personal pronoun "I" on the other. Their vision is both narrow and distorted and this perhaps accounts for the attempt so many people make to go through life on the principle "How much can I get and how little can I give!" Oh, what a terrible mistake they make! If they would only take off the spectacles and get a clear, broad view of this wonderful universe they would see that those who have achieved the greatest success operated on the one and only principle of service which is just the opposite.

No matter what one's avocation may be, to be successful he must have for his first and most important consideration the interest of the customers. Not "how much can I <u>get</u>" but "how much can I <u>give</u>" and "how much can I <u>do</u>" to extend my service to the greatest number of people.

One of the popular answers to the inquiry as to why non-member banks do not join the Federal Reserve System has been that the System does not pay interest on reserve deposits, whereas, by keeping their reserves with some city correspondent bank they do receive interest on their balances; in consequence, in the one case they get no return on their reserve balances, in the other, they make a profit. This statement always brings to my mind the story of the two negroes who were passing a graveyard. One of them could read and the other couldn't. The educated fellow was entertaining his companion by reading the epitaphs on the tombstones. Finally, they came to one which said "He is not dead, but sleepeth". The ignorant fellow said - "Umph, big boy, that white man ain't fooling nobody 'cept hissef."

My good friend Dr. Tait Butler once said that the greatest agricultural implement ever invented was a lead pencil, so to a banker who springs that sort of an answer as his reason for not joining the Federal Reserve System, I offer the suggestion that he get himself a supply of lead pencils not to use as agricultural implements but to sharpen and use in analyzing his own affairs.

I could go into details in explaining to you just why this suggestion is offered but my time is too limited and I will only say in this connection that the city banks who act as correspondents for country banks have quite a way of requiring "commensurate balances" and there are mighty few of them but what make a profit out of the country banks account.

Every now and then we have the suggestion offered that the reserve banks should give immediate credit for items deposited with them by their members on the theory that "it would not cost the System anything to do so", but any one who holds this view is very greatly mistaken. Experience has shown that member banks borrow from the reserve banks almost entirely for the purpose of replenishing their required reserve balances and the moment their balances at the reserve banks are in excess of the legal requirements the excess is immediately used to retire the borrowings.

If you will notice the "Report of Condition of the Federal Reserve Banks" published weekly in the leading newspapers of the country, you will find that the item listed in the assets as "Total Bills Discounted" very closely approximates the amount of the item listed in the liabilities as "Deferred Availability Items". In other words, the direct borrowings of member banks, except for infrequent peak periods, offset the "float".

To give "immediate credit" would cut the earning assets of the reserve banks very materially. Calculated on the last report available, it would mean approximately fifty per cent. To replace these "direct borrowings" by purchases in the open market would cause inflation that I should regard as both unthinkable and unpardonable and it would also work a tremendous hardship on the commercial banks of the country by unnaturally forcing a reduction in rates. Possibly the effect upon the country banks would be less noticeable at the start than would be the effect upon the larger city banks, but you may be certain it would reach even the smallest and most remote banks through competition in one form or another.

It is extremely difficult, if not impossible, to get accurately the effect "giving immediate credit" at the reserve banks would have on general interest rates but my guess is that it would cause a reduction of more than one per cent. So, from the standpoint of the commercial banks only and without regard to or for the Reserve System, see what price would be paid for getting this immediate credit. Say a bank with $200,000.00 of deposits and loans amounting say to $150,000.00, - such a bank might reasonably be expected to have something less than $5,000.00 of items in process of collection, which at four per cent - the present rediscount rate - would mean that "immediate credit" resulted in a saving of $200.00. But as an offset to this, consider the meaning to that bank of the forced reduction in interest rates to its customers. If the reduction was one per cent it would make a net loss of $1,300.00 to the bank. This is among those things that should be considered and figured on with a very sharp pencil.

Another reason frequently offered by country bankers in the South for not joining the Federal Reserve System is that they are denied the right to charge exchange when remitting for their checks. One so-called banker asked in my presence on one occasion "What right has the Federal Reserve System to deny my bank the right to charge exchange?" To this I very promptly answered by asking him the question - "What right have you to deduct anything when paying a customer's check that is presented either over the counter or through a Federal reserve bank?"

It is true that in the old days prior to the establishment of the Federal Reserve System it was necessary for banks, in order to pay their customers' checks when the payee of the check lived at a distant point, either to ship the currency or else maintain balances with correspondent banks against which they could draw and, of course, in either case this costs money and the banks were entitled to collect for the service. But with the coming of the Federal Reserve System this situation changed. The cost of shipping currency is absorbed by the reserve bank and it is not only less expensive but it is safer and more convenient for a bank to pay the checks of its customer when they are presented through a reserve bank than when presented by the customer at the teller's window.

Anyhow, the Supreme Court of the United States has settled the question and has established the "right", once and for all, of the requirement that member banks shall remit at par for all checks sent for collection through the reserve banks.

Furthermore, this right and principle has been recognized by ninety per cent of all banks in the United States, and today every bank in the First, Second and Third Federal Reserve Districts is a member bank or is on the par lists of the reserve banks.

I understand there are only 16 out of the 458 banks in the State of Kentucky not on the "par remitting list" and I congratulate the people of your State accordingly.

It seems quite possible that some country banks have been kept out of the Federal Reserve System because they did not want to disrupt their relationship with their city correspondents. The chances are that the relationship has been and is most pleasant and in the main satisfying, but, as I see it, joining the Federal Reserve System does not mean that this relationship should be broken, not by any means, although it would make a change in the nature of the relationship and a change which in my opinion can and should be of advantage to both parties. Undoubtedly, the city correspondent bank can and will find a way for rendering a service that will fully justify the country bank in carrying a balance. I do not for a minute advocate cutting out the city correspondent, but I do urge the country banker to make available for his community every facility the Government provides as an aid to the business of the country.

Another thing, I wonder if the bankers, particularly the country bankers, realize what a great change has taken place and is now taking place in the business methods and conditions of this entire country? Think of the evolution in methods of transportation in the past twenty-five to thirty years. Think of the passing of the ox cart, the horse and buggy and the steamboats. Recall for the moment the coming of automobiles, and good roads, the increased use of the telephone and the inauguration of the rural postal service. Then think of the development of chain stores and the growth of large department stores in cities and what these are doing to the cross-roads storekeeper and the small town merchant.

Don't overlook the shifting of the population from farms to cities, and keep your eye on the cooperative movement and its effect on the marketing of agricultural products.

All of these things have a direct bearing and must be taken into account when you are figuring on whether or not it pays to belong to the Federal Reserve System, and it would be well to take notice of them whether you consider joining the System or not for they are vital factors in your future, - you may be certain of that.

After all, as I see it, the changes that are taking place in both the business and social life of the nation are only the working out of nature's law of the survival of the fittest. The American public not only demands but it is entitled to the best and the individual or the organization that provides the best service is the one who will survive. And this applies to banking just as well as it does to any other line of business.

You who read the newspapers know what recently happened to a chain of nonmember banks with more than a hundred members in the Atlanta District.

That outfit, headed by the Bankers Trust Company, was not affiliated with the Federal Reserve System. On the contrary, they were against the System; they were leaders in the fight against "par clearance of checks", and declined to keep their reserves in a reserve bank. When the strain came and the need of their reserves developed because of a decrease in the deposits of some of the banks in the chain, those reserves were not available and the crash followed. The banks involved were small, it is true, and the damage measured in dollars was relatively light, but think, my friends, of the tragedies that followed in those hundred and more communities whose hard-earned savings were wiped out.

It seems to me most deplorable that such a large proportion of our people should be denied the financial protection and benefits created for them by the Government, simply because a large group of so-called bankers are asleep on the job.

Already the Atlanta Constitution, one of the great newspapers of the South, is discussing the urgency of forcing by law all commercial banking institutions into a National System under Federal supervision. Certainly the discussions of branch banking and the failure to pass in the last two sessions of Congress the so-called McFadden Bill, designed to check the growth of branch banking in this country, should cause the officers of independent unit banks to wake up and endeavor to give the communities that are dependent upon them for banking facilities every advantage in banking service that is now available.

Every State bank with requisite capitalization and proper management is not only entitled to membership in the Federal Reserve System but has been and is constantly being invited to join the System. I have told you what I thought of the reasons I have heard for not joining. I wonder what will happen when the depositing customers begin to study the situation and to ask questions?

I do not for one moment mean to say that being a member of the Federal Reserve System guarantees deposits, nor does it insure the public and the depositors against dishonest or incompetent banking, but I do say that WHEN a bank is a member of the Federal Reserve System and its business is conducted within the limitations and restrictions laid down by the law and the rules and regulations of the Federal Reserve Board, THAT BANK CANNOT FAIL.

There have been a great many bank failures in the United States during the past few years. A small percentage of them - and a small percentage only - have been members of the Federal Reserve System, but NOT ONE SINGLE ONE OF THEM failed that had lived up to the letter and spirit of the law and the rules and regulations of the Federal

Reserve Board.

Another thing; a very careful analysis of the earnings of the something like thirty thousand banks in the United States shows that the member banks who live up to the letter and the spirit of the law and the rules and regulations relating to the Federal Reserve System make more money on the capital invested than do those banks on the average that are not members of the System.

As a result of my study of this great problem, I am willing to say that it is my judgment that if and when a commercial bank finds out that it cannot make money for its stockholders as a member in good standing of the Federal Reserve System, then the best thing that bank can do in the interest of its depositors, its stockholders and its community is to liquidate and get out of the way for certainly there are too many banks in this day and time for the business now available.

Let me, in conclusion, urge you to look upon the law and the rules and regulations of the Federal Reserve Board not as restrictive measures, intended to harass and handicap, but as a standard of good banking, for, after all, that is exactly what they are.

It may seem to the nonmember country banker that the requirements of the reserve banks, relative to the paper that is to be discounted, are difficult to meet, but let me assure you that [illegible] is not the case. It is like it was when I began to realize that if I was to keep peace in my family I would have to buy an automobile. I just hated to give up my horses, and then, too, I feared that I never would be able to operate a car. One day I realized how many people there were driving cars, then said to myself surely if other people can learn I can too, and with the determination to run an automobile or die in the attempt, my fears vanished, and I soon found that after all it was a very easy and simple matter, and I was in this way enabled to again take my place on the public highways.

Don't be afraid to ask your borrowing customers for a statement or to insist that they carry a balance with you as a reserve against the loan. Surely you carry reserves against your obligations to your depositors, not because it is the law but because it is good banking. Good for you as well as the depositor. It is equally good for you and for your borrowing customer to require him to keep a reserve.

Don't stick to the antiquated methods of getting your accommodations for seasonal needs just because it seems to be the easy way. I learned as a boy at Sunday School that the easy route was not the road to salvation.

The future of the country banker will rest upon his ability to meet changed conditions by adopting the new methods. His road is not going to be an easy one by any means. Most likely it is and will be full of ruts, but right here let me remind you that the only difference between a rut and a grave is that one is longer and the other deeper.

Study your position and do not be ashamed to acknowledge mistakes or to learn from the experiences of others. As Mr. Hubbard once said, "While we are green we are growing and when we think we are ripe we are beginning to get rotten".

My last and possibly most important suggestion is that you keep in mind the slogan of your own great Commonwealth - "United we stand; divided we fall". And then, if you have not already done so, join the Federal Reserve System.

I thank you.