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Annual Address

of

President Paul M. Warburg

American Acceptance Council

New York, January 19, 1923

AMERICAN ACCEPTANCE COUNCIL
120 Broadway New York

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COMPLIMENTS OF

PAUL M. WARBURG

CHAIRMAN, INTERNATIONAL ACCEPTANCE BANK, INC.

THIRTY-ONE PINE STREET

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AS we grow older, anniversary celebrations are apt to become pretty perfunctory and empty events, unless we use them as milestones whence to survey whether or not the road we have covered led us in the right direction, and whether the year's march has registered fruitful results or wasted opportunities. A conscientious review of that sort helps us to find our bearings and to adjust our course for the stretch ahead. It is with such thoughts in mind that I believe we should approach the annual meetings of the Acceptance Council.

As stated in the beginning of my last annual address, the volume of American acceptance business must, of necessity, rise and fall with the increase and decrease of America's foreign trade. It is true that since the point of deepest stagnation America's foreign commerce has evidenced some recovery, and America's acceptance banking has shown a proportionate moderate growth. From April, 1922, to November, 1922, it is estimated that the aggregate of our acceptances outstanding increased from $480,000,000 to about $600,000,000, and it is to be assumed that since the latter date a further substantial increase has taken place. But this is still far below the highest point reached in earlier years, and it is apparent to us all that as long as the Old World does not emerge from its present disturbed condition international credit and trade will remain crippled, and our acceptance facilities will not be able to unfold to their fullest possible degree of usefulness. There is, unhappily, very little that we might add to our

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last year's statement concerning Europe's financial and economic problems. Our analysis of that situation and our forecast of the inevitable consequences of a continuation of the policies then pursued have, unfortunately, proved entirely too true. Many of us had hoped that the point of culmination was at last close at hand and that the new year would soon lead us out of the darkness. Unfortunately, it seems that the longed-for turn of the road is still far out of sight. The only encouraging feature is that whereas in the past the problem was so befogged that it was impossible for the people to understand it, the issue now is clear-cut. Europe, and we with her, stand at the cross-roads, and must choose whether we wish to live under the sign of Mars or Mercury; whether our path shall lead towards a restoration of peace based upon fairness and sound economic principles, or whether, in disregard of them, political and misguided national thought shall lead us into a condition of continued unrest and decline. The ultimate ruler of the world is the will of the masses. From this point of view it may possibly mean progress that the problem has now assumed so clearly circumscribed a form that the people can readily grasp it and in due course may impose their will upon their floundering leaders.

You may remember that at our last meeting, on May 5th, 1922, I suggested that at the proper time our Council might go before Congress and ask for an amendment to the Federal Reserve Act, which would give the Federal Re-

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serve Board power to extend permission for a certain number of years to member banks to accept finance drafts drawn by foreign banks, with a view to stabilizing the exchanges of such European countries as were completing, or engaging to complete, their fiscal and financial rehabilitation. These drafts were to be drawn under the auspices or guaranty of the respective Central Banks or Treasuries of the countries involved upon conditions adapted to each particular case. I had in mind then that the first to avail themselves of a facility of this sort might be such countries as England, Sweden, and Holland, whose fiscal and trade conditions would seem to warrant an early return to a frank and unadulterated gold standard. You may have observed, however, that the same thought occurred to a committee of international financial experts called in by the German Government in November last. The Dutch and Swiss experts, Messrs. Vissering and Dubois, writing a minority report, recommended as an essential feature of their plans the formation of a syndicate of American, English, Dutch, Swedish, and Swiss banks and bankers, which would grant, in the currencies of their countries, acceptance credits aggregating a total of five hundred million marks gold. R. H. Brand, who headed the majority report (signed by him, J. Maynard Keynes, Gustav Cassel, and the American, Jeremiah W. Jenks), stated in a special memorandum that, provided a moratorium be granted upon conditions inspiring confidence as to Germany's future, and provided the Bank of

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England would approve, it might be possible to prevail upon British bankers to participate in such an *acceptance credit* to the extent of possibly five million Pounds Sterling.

The proposition, like many others, did not lead to any tangible result; but the incident clearly showed that, sooner or later, acceptance credits will be called upon to play an important part in the solution of Europe's exchange problems. I am glad, therefore, that eight months ago we were the first (ahead even of our European fellow-bankers) to point to these possibilities, and to pave the way for an early discussion of our own opportunities and duties in the premises. The present unfortunate turn in European affairs must not discourage us or cause us to abandon constructive thoughts; for no matter how protracted the process of convalescence may be, the day is bound to come when our help will be required for the purpose of putting the patient back on his feet. If such acceptance credits were proposed to-day American banks and bankers could not participate, because such acceptances would be ineligible for purchase by the Federal Reserve Banks, and because National Banks could not lawfully create such acceptances. Unless we set out to secure the necessary powers from Congress, it is to be feared that European bankers, in dealing with cases of this sort, may find themselves forced to proceed without us; or else—if Europe should be unable to "carry on" alone—the healing process of the world might needlessly be delayed at the price of prolonged suf-

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fering both here and abroad. It would seem, therefore, that the time is at hand when the Council should take up with the Federal Reserve Board this question of finance bills, so that a suitable amendment may be prepared and enacted in the near future. In transactions of this sort our country would have a very deep interest, particularly the agricultural sections.

In the year under review the Federal Reserve Board took two very important steps—of which the Acceptance Council had been a strong advocate—indeed, we might well say, the moving spirit. I am referring, first, to the Board's revision of its acceptance regulations conferring larger discretionary power on member banks in accepting for overseas transactions, and upon the Federal Reserve Banks in determining the eligibility of such bankers acceptances; and, second, to the Board's ruling relative to purchase by Federal Reserve Banks of trade acceptances in the open market, and the establishment of open market rates therefor (as distinguished from re-discount rates). As years go by both these measures will prove of the highest significance. We may assert without fear of contradiction that the first of the two measures has already proved its worth. It has been quite generally acclaimed in foreign countries as a vast step towards simplifying our methods and towards freeing us from the shackles of discouraging red tape. We may add that while, as the consequence of the new policy, there has been less waste of time and energy in bickering about the form, there has been no relaxation in

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watching the substance of the transactions. In the long run experience will prove that not only is there greater facility, but also greater safety in this new policy of looking to the essence of the underlying transaction rather than to the outward observance of rules and regulations.

The ready purchase by Federal Reserve Banks of trade acceptances in the open market is the most important event in the history of this type of paper in the United States. The true significance of this will make itself felt only as our so-called open market begins more fully to exercise the important function of acting as the balance wheel between banks and Federal Reserve Banks. In the months gone by, with our discount rates temporarily out of gear, with re-discount rates ranging from 4 to 4½% at the several Federal Reserve Banks, and an open market rate for bankers acceptances of about 4 to 4¼%, there has been little room for an attractive open market rate for trade acceptances. Until the supply of short-term U. S. Treasury Notes and Certificates, with their tax-exempt features, is substantially reduced, the development of the open market for both bankers and trade acceptances will have an uphill fight. As a matter of plain logic, the present rate for bankers acceptances of about 4 to 4⅛% would seem too high as compared with the open market rate for commercial paper of about 4½ to 4¾%; for the charge of even the most modest acceptance commission would bring the cost of an acceptance credit to our

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strongest houses above that of borrowing on their single-name notes. Our acceptance rate looks high also when compared with the British rate of about 2½%, with which we have to compete in world markets, even though the fluctuations of Sterling exchange and the premium to be paid on forward Sterling for cover at maturity add substantially to the cost of the use of Sterling credits. Assuming that the demand for commercial credit is not intensive enough at this time to warrant the expectation of a substantial hardening of the market rates for single-name paper, the alternative, in order to cure these anomalous conditions, would be a lowering of the open market rate for bankers' acceptances. It would be an easy and perfectly practicable matter for Federal Reserve Banks to reduce the rate at which they purchase bankers acceptances to well below 4%. But if they went too far in that direction they would have to fear the effect on the open market; for important banks might then be tempted to neglect the purchase of acceptances even more than they do today. In other words, the so-called open market would become still further narrowed, and the Federal Reserve Banks might become almost the only buyers. In such a case the result might be an increase in their holdings of acceptances, and a reduction in their holdings of Government securities, while, conversely, the banks might reduce their acceptance holdings and increase their holdings in Government securities. This dilemma will continue to exist as long as the Treasury must raise billions on

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short-term borrowings, and as long as tax-exempt Treasury Certificates must, therefore, compete with bankers acceptances as the classic investment for liquid banking funds. Add to this the problem, often discussed by us, of the daily settlement dealings on the New York Stock Exchange, and their unhappy effect on the development of a free discount market, and the conclusion seems inevitable that for the next years to come the progress of acceptance banking in the United States is likely to labor under a very severe handicap. In spite of these conditions—the seriousness of which it would be foolish to deny—it should not be impossible to secure progress if we can succeed in enlisting the interest of our large banks, and if we can make them understand the deep significance of this problem with regard to the proper and effective functioning of the entire Federal Reserve System. That would seem to be one of the outstanding tasks of the Acceptance Council for the coming year.

In order to tackle this problem successfully it will have to be approached from the broad point of view of "the discount and open market policy of the Federal Reserve System," and I trust you will bear with me if tonight I venture to enter upon a more intimate discussion of that topic.

Is the Federal Reserve System an active or a passive organ? Is it the hammer that hits or the anvil that stands waiting to receive the blow? I wonder how many of all the members of Congress that have discussed or denounced

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the Federal Reserve System in recent months would be able to give a quick and fairly matured and intelligent reply to that question. Indeed, I am not over-confident that an excessively large number of business men or bankers would be prepared, offhand, to give a satisfactory response. Some would probably assert that the System should always be hammer; others, that it should generally be anvil; and the most thoughtful would say that it is hammer or anvil, according to the strategic position of its discount rates in their relation to the interest rates ruling in the open markets of the country. The latter thesis would sound fairly convincing; but what would they answer if asked to define more clearly what this "strategic position" should be? It may be assumed that they would reply that the discount rates should be high enough to make re-discounting for profit unattractive, and low enough not to make it prohibitive. That, too, would sound well; but can anybody say that—with an open market rate for single-name commercial paper of, let us say, 5%—a Federal Reserve re-discount rate of 5% would be prohibitive for a $25,000 country bank charging from 7 to 10%? Indeed, for some of them a re-discount rate of 5% might in that case still offer a very real inducement for re-discounting for the sake of making a profitable turn, while, on the other hand, conceivably, such a bank rate might prove to be "strategically" well chosen with regard to dealings with strong banks in large centers. Conversely, if the Federal Reserve rate were raised to a point where

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it would have a safe and proper relation to the rates charged by some small country banks, it would become entirely prohibitive for the large financial institutions.

Uniform Federal Reserve re-discount rates are, therefore, always likely to act as hammer at one end and as anvil at the other, and the more heterogeneous the elements comprised in a Federal Reserve district, the more acute that difficulty will be.

The "strategic position" alone does not, therefore, appear to furnish a convincing answer. Some students may suggest, however, that the Federal Reserve System is hammer or anvil according to whether its discount rates are effective or ineffective, active or inactive. That sounds plausible enough; but what does it mean? I assume we are to understand that rediscount rates are to be considered as active—and, therefore, evidences of a hammer policy—when the Federal Reserve Banks show a substantial volume of individual re-discount transactions, or when the combined operations of the Federal Reserve Banks show a marked increase or decrease in the total of bills discounted. But such an assumption would be wholly fallacious.

We might have perfectly stationary Federal Reserve rates with substantial liquidation of Federal Reserve assets in one district offsetting substantial expansion in another. Thus, we might witness a large volume of individual rediscounting transactions during a period of "anvil policy." Indeed, in times when, generally, money rates would harden, the Federal Reserve

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System might show a very large increase in its holdings just because it might have pursued an "anvil policy," leaving its own rates unchanged when market rates might have advanced. Conversely, by moving up its rates energetically, the Federal Reserve System might keep its investments stationary, and prevent expansion. In other words, we might witness a "hammer policy" with the aggregate of re-discounts unchanged, and an "anvil policy" with investments rising or falling. Active or inactive rates, judged by the single test of volume of business, may, therefore, not be considered as true evidences of a "hammer" or "anvil policy" of the Federal Reserve System.

It would be amusing to continue this question and answer game; but we have pursued it far enough to attack our problem from another angle. The Federal Reserve System, if properly exercising the function for which it was designed, should act as a guide and stabilizer of the interest rate policy of the country. It is true that when things take a natural and healthy course the pilots of the Federal Reserve System, like good physicians, would doubtless hold that little or no active interference would be the wisest method. That, however, would not modify the view that to act as guide and regulator should be essentially a hammer and not an anvil function.

But a country doctor, forced to leave one single prescription to serve for months to come as the sole remedy for an entire family, from the old grandfather down to the baby, would

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not be faced with a more difficult task than confronts the administrators of the Federal Reserve System when they are to determine one single re-discount rate to be applied at the same time to one hundred million dollar concerns in large cities and twenty-five thousand dollar banks in small country towns. Our country doctor, in the case above described, could do no better than to leave the medicine on the table and rely on the common sense of his patients as to when to take it, and in what doses, no matter whether one would have to use it against pneumonia, another against measles or indigestion, and a third against the sufferings of old age. The medicine could not be improved for the benefit of one for fear of doing greater harm to the other. This analogy, extreme and ridiculous as it may appear, fits our case entirely, and it leads us to the following conclusions: In a country with districts as heterogeneous as ours the automatic re-discount rate is a very unsatisfactory instrument—inadequate for the doctor, who gets out of touch with his patients, and dangerous in the hands of the patient to whose initiative and discretion its use is surrendered. The best result cannot be expected where the decision lies so overwhelmingly in the hands of those to be treated. It is true that the Federal Reserve Board might attempt to combat this weakness by seeking to guide the banks in the proper exercise of this initiative and discretion. With this end in view, it is urged that the Federal Reserve Board establish some simple principles for the guid-

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ance of the banks in the intelligent use of the re-discount facilities of the Federal Reserve Banks, bearing in mind, however, that for the large banks a different code of banking ethics must be laid down in this regard from that to be observed by the small ones. We shall revert to this phase of the problem a little later.

But even if the Federal Reserve Board should succeed in establishing such principles and in seeing them broadly accepted, the re-discount rate would remain a totally inadequate instrument to lean upon as the sole means of maintaining a reasonably close contact with the money market, or of exerting a fairly effective control of the general banking situation. If such contact and influence are to be assured, the Federal Reserve Banks must be able to rely on an additional and better medium, in the free use of which initiative and discretion rests entirely with them. This instrument lies in a carefully planned and free exercise of their power to carry on open market operations.

Central banking is essentially a European art, which we have studied and adapted to our own particular needs. While we must beware of copying our teachers too slavishly, and without adequate consideration of the differences that exist between conditions here and abroad, it remains useful for us from time to time to re-examine the Old World's best banking standards and traditions, and to weigh how far it has become possible and desirable for us to make them our own.

Aside from the greater homogeneousness pre-

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vailing in leading European countries, we know that they are served by a comparatively small number of huge branch-banking systems, and that bankers acceptances and trade bills (to the exclusion of single-name paper) form the bulk of their portfolios. This makes for a more uniform and a more closely knit rate fabric, one that a Central bank rate can fit more tightly and influence more easily than ours. The problems of single-name paper, of thousands of local miniature banklets, and of daily settlements on the Stock Exchange are foreign to these countries of the Old World, while with us they are the main roots of our difficulties.

As guiding stars for our small banks European banking traditions can, therefore, serve us little; they may give us important suggestions, however, when studying the problems of our larger financial institutions. For them it may be interesting to observe that the proudest British and French banks do not re-discount with their Central banks in normal times. The daily balancing between such banks and their Central banks is accomplished by the use of their available cash balances and through open market operations, which include loans to bill and money brokers, purchases or sales of acceptance or Treasury bills, etc.

The underlying idea of modern banking is that—barring extraordinary national or international demands—cash or deposit money withdrawn from one bank will turn up in another. In other words, if one bank loses, the other gains; and if funds are withdrawn from one

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city they turn up in another. Fluid funds seek liquid investments; one bank calls loans, the other seeks them; one bank collects its maturing bills, the other increases its holdings of acceptances; one liquidates Treasury bills, the other purchases them; and when this equalizing process is interrupted—because locally or nationally all banks are losing deposits at the same time—the Central bank will periodically increase its share in these liquid loans and investments while the banks of the country in the aggregate will have decreased their holdings.

A strong, proud bank in England or France would feel humiliated if in normal times it were forced to borrow directly from its Central bank, because, forsooth, it had not maintained a supply of liquid loans and investments large enough to meet by means of its balances and open market operations any demands made upon it. In other words, normally the strongest banks in such countries would draw funds from the open market, either through calling loans or selling liquid assets from their portfolios. If, as a result of the operations of all the banks, the open market should become overloaded, *the market* would then resort to the Central bank, i. e., the bill brokers would sell acceptances to, or borrow from, note-issuing Central institutions. However, it would not have been the individual bank in that case that had taken recourse to the Central bank, but the market as a whole.

This is the highest standard of banking in normal times. Banks of smaller size, private

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firms, and the larger banks, in case of extraordinary strains, will send to the Central bank their short maturities, thus, when necessary, anticipating their collections by a few days. (In France and Germany this collection of maturing bills through the Central banks is carried on quite regularly even by the largest banks.)

I have gone into a hasty description of this phase of European banking because I believe an important lesson may be gathered from it for our own problems.

During the War our banks were coaxed into subscribing liberally to our Government bond issues, and to re-discounting freely with the Federal Reserve Banks. It was heralded as a bank's patriotic duty to overcome its hesitation to borrow from the Federal Reserve Bank. It must be admitted that it is a far cry from that viewpoint to the one I am now advocating: that the stronger a bank, the greater should be its reluctance to re-discount with a Federal Reserve Bank, unless it were justified by exceptional reasons.

The Federal Reserve System is not only a balance wheel for normal times; it is also an emergency organization for abnormal demands. Where it is a question of dealing with the latter it may be a public service and a duty to be rendered by the strongest banks to step in and lend their credit so as to ease, or even save, the situation by re-discounting with the Federal Reserve Bank. But what we are discussing is the policy to be pursued by our strong banks in normal times. If for their day by day trans-

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actions they could be persuaded to follow more closely the British procedure, they would be doing a wise and useful thing for themselves, and a helpful thing for the entire country. For it is only through a country-wide free use of standardized paper, namely, prime bankers acceptances, that genuine fluidity of money and credit of the highest type can be obtained. Only when we shall have a country-wide open discount market, absorbing the idle funds from one bank or section, in order to make them available for covering the shortage of another, shall we have a perfect banking system, one closely in touch with its Central organization, and easily responding to its touch. For by increasing or decreasing its open market investments the Federal Reserve System can of its own initiative exercise a strong regulatory effect; it can exercise its hammer functions without violently jerking up and down ineffective rediscount rates, and it can accomplish this by comparatively small transactions. It must not be overlooked that when the Federal Reserve System increases or decreases its aggregate of investments it thereby expands, contracts, or reestablishes the reserves of the member banks. It exercises, therefore, a very far-reaching effect, because by its operations it may lengthen or shorten the reserve base which supports and controls the size of the inverted pyramid of bank loans that rests upon it.

The very description of the far-reaching influence of these operations leads to two inevitable conclusions: *First,* that in exercising

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their open market powers Federal Reserve Banks must not be moved by a desire to secure larger revenues, but that they must be actuated solely by the aim of having the Federal Reserve System act as a stabilizing balance wheel in the best possible manner; *second,* that these operations cannot be left to the discretion of each individual bank, but must be carried on under one joint and definite plan of action embracing all the Federal Reserve Banks. It is tempting further to explore this phase of the problem, but more than in the activities of the Federal Reserve System we are interested tonight in the part to be played by the member banks. Returning to them, let me ask the question: Would it be imposing an undue burden upon our strong banks if they were to co-operate in developing the open market for bankers acceptances in the manner we have discussed? I do not think so. The Federal Reserve Act reduced reserve requirements very substantially. If, from the reports to the Comptroller of the Currency of March 10, 1922, we take ten large national banks with aggregate net demand deposits of $1,946.478,555 and total time deposits of $102,040,388, we find that the required lawful reserve on that date, figured under the present law, amounted to $256,103,422. Under the law that existed prior to the enactment of the Federal Reserve law, as amended, the same institutions with the same aggregate deposits would have shown net deposits requiring reserves of $2,001,276,907, and the legal reserve required to be maintained actually in vault would have been

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$500,319,227. Thus we see a release of reserve aggregating approximately $250,000,000 for ten large banks selected at random. It would not seem, under these conditions, that it would be a very severe hardship if large, first-class institutions should adopt the policy of investing a fair proportion of their released reserves in bankers and trade acceptances, and in loans on such paper to bill brokers—investments which, in world banking centers, are generally regarded as the equivalent of reserve,—even though the return might be a little lower than might be obtained from single-name paper purchased, Stock Exchange loans, or other less liquid investments. The sacrifice involved would be very small, whilst by widening the open market, these banks would render an important service in perfecting the efficiency of the Federal Reserve System, which, in the final analysis, is the backbone of their own strength.

If the strongest of the first-class banks were to adopt as their ultimate code of banking ethics the ideal that the proudest amongst them normally would not re-discount with the Federal Reserve Banks except for special reasons; if the less powerful banks of that class were to aspire to re-discount normally with Federal Reserve Banks only their short maturities, this would result in leaving the re-discounting of the longer maturities almost exclusively the field for the small banks, and it would be primarily to meet their requirements and conditions that the ninety-day re-discount policy, and that for the longer maturities would have to be deter-

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mined. We would thus simplify our problem, and bring it into a form where it could be properly understood, and where the adoption of an effective rate policy would offer much less complexity for the Federal Reserve System.

For the small banks we would lay down a very different code of ethics than for the large banks. Where to the latter we ventured to suggest that they use their re-discount facilities as sparingly as possible (and if so, by re-discounting primarily the very short maturities), we would say to the small country banks: "Use your re-discount facilities unhesitatingly and freely in certain seasonal periods with these restrictions only: don't exceed a reasonable limit indicated by a safe proportion to your own resources; don't borrow all the year around; liquidate your re-discounts with the Federal Reserve System entirely, at least once every year, when the seasonal demand is over; for the Federal Reserve System is not designed to furnish you permanently with additional working capital, or—to put it another way—to permit you chronically to encroach upon your reserves by being a perpetual borrower from the System."

There are, then, two entirely different codes of ethics governing the relations of member banks to the Federal Reserve Banks; it would follow, as a matter of simple logic, that there should also be different rate policies. The present policy of trying to have one shoe fit them all: bankers acceptances, trade acceptances, fifteen-day and six-months paper practically all in one pot, seems to be the expression of an "anvil

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policy"—and of a very soft anvil, at that. The wish to see uniform re-discount rates established for all types of paper, for all maturities, and for all districts in this heterogeneous country of ours, is, to my mind, a much mistaken aspiration. Re-discount rates may differ particularly with regard to maturities, and in given circumstances, also according to types and local conditions; on the other hand, it is the open market rate for standardized prime acceptances that should be fairly uniform all over the country.

To sum it up once more: If, in our mind's eye, we should eliminate the open market functions of the Federal Reserve Banks, we would then have a system where at some thirty Federal Reserve Banks and branches the local member banks would delve haphazard into the general reserve pot—arbitrarily, at poorly fitting re-discount rates, according to their individual whim and requirements,—while, as supplementary and principal stabilizer, they would rely upon the call money market of the New York Stock Exchange, an instrument without any direct connection with the Federal Reserve System. As against that, visualize a call money market based on bankers acceptances and government certificates, directly connected with the Federal Reserve System, and reaching through a network of bill brokers and discount corporations, as we foresee it, every bank worth the name in the country. The first would give us a jerky and wholly unsatisfactory system. The Federal Reserve Banks have made large strides in the direction of the second; indeed, without

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the intelligent and consistent work done by them in this regard, since the very early beginning of their operations, the System could not have functioned as excellently as it did, and as it does today. We are, however, still far remote from our ultimate goal, and it is all-important that we should keep our ideal clear before our eyes even though we know that it will take time, patience and consistent planning to get there.

Bankers acceptances, properly developed to their fullest degree of usefulness, would serve as equalizers of money rates, and the agricultural sections could profit from them in a much larger measure than heretofore. When the country bank, with the aid of the Federal Reserve Bank's re-discount facilities, has carried the making and harvesting of the crop, the financing of the crop's distribution ought to become to a growing degree the function of bankers acceptances, thus liquidating the local country bank's re-discount operations. But the crop cannot be financed by such acceptances until, with a clear title, it is properly warehoused and graded. A country-wide net of modern warehouse facilities are of vastly greater importance in this regard than new sources of credit. There is credit enough available for the marketing of the crops if a clear title and proper grading can be furnished, and if there is a responsible borrower. Great headway has been made in this regard, but more remains to be done. About these phases we shall have the privilege of hearing more fully, I trust, from both Mr. Kent and

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Mr. Howard. It is all important that the farming sections, and their representatives in Congress, be made to comprehend that a properly developed open discount market will operate to their benefit to a larger degree than that of any other group. Only when this fact is thoroughly understood will the stupid prejudice be broken down that an open market rate for bankers acceptances (guaranteed paper) lower than that for single-name (unguaranteed) paper embodies a special advantage for the big fellow at the expense of the small one. The reverse is true; nothing will have a stronger influence towards stabilizing and lowering interest rates for the entire country than a fully developed discount market.

The time has come, I believe, when the entire problem just discussed, of re-discount ethics and their effect on the rate policy, should be studied very closely, and when the American Acceptance Council might well undertake a campaign of education bearing upon that problem. Such a campaign might stimulate the interest of our banks and enlist their support, and at the same time promote a better understanding on the part of the public at large and of our friends and enemies in the Congress.

At present agitators—some ignorant, some perverse, some spiteful (for personal or political reasons)—have managed to make mountains of charges out of molehills of small errors, and in certain sections of the country they have succeeded in making the System the target of distrust and attack, whereas it deserved only the

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unreserved gratitude of all of the people for unequalled services rendered.

As long as the world-wide economic maladjustment continues we are likely to witness such attacks; they are the age-worn, primitive form of venting resentment against inevitable suffering by making somebody the "goat." Finance, in such circumstances, has ever been the pet target of the demagogues. The Federal Reserve System will, therefore, always remain an easy mark for the politicians, but never as easy as today, when the world at large is off the gold standard, when gold has lost its restraining and regulatory power, and when the policy of the Federal Reserve System, to the superficial observer, is likely to appear arbitrary and dictatorial rather than dictated by the pressure of economic forces. To this phase Governor Strong has pointed in his recent admirable address delivered before the American Farm Bureau Federation at Chicago.

In normal times, when countries consider themselves bound by their sacred pledges to pay their obligations in gold, Central banking systems are hammers; but the hands that wield them are guided, almost automatically, by the supreme forces of world production and consumption; by the flow between countries of goods, of people, and of credit. It is when the interplay of these forces becomes unbalanced that, in normal times, the flow of gold sets in as a regulator (settling the debit balance between nations), and as it unfavorably affects the reserves of the country losing the yellow metal,

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it calls for prompt counter measures, viz., changes in discount rates. At present the free flow of credit, goods, and people is still heavily obstructed, and until these elementary forces are permitted once more to function normally, King Gold, the ultimate master regulator, cannot be put back on his throne, and economic chaos must continue.

That we emerged from this bedlam as soon as we did, and with no greater suffering, is largely due to the fact that, owing to force of fortunate circumstances, we had been able to subject ourselves to the straitjacket of the gold standard at an early moment. It was not an arbitrary whim of the Federal Reserve Board that imposed higher interest rates in order to break inflation, but it was the shrinkage of our gold reserves, down to the safety limits imposed by the law, which forced the hands of the Board. Had it not been for the prudence forced upon us by our consciousness of the obligation to redeem our pledges in gold, we would have continued to inflate just the same as did the many other countries which since have paid, and are paying today, the terrible penalties we have escaped. Financially, we are strong today because we did not succumb to siren songs urging the artificial bolstering up of exchanges, or government bonds, or commodities. Things were left to find their own bottom, and in due course prices adjusted themselves to their natural economic levels. And, as with goods, so it was with money. As liquidation proceeded, reserves rose, and the price for money came down. That

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under such circumstances the advent of easier money, lower discount rates, and the return to par of our government securities, inevitable consequences of a completed process of liquidation, should have been hailed as an achievement of a party administration was a grave and highly regrettable error, which we hope will never again be repeated. Claims of that sort threaten to make political events out of every change in the discount rate. The members of the Council, I know, regretted deeply the intrusion of class interests into the System last spring because it involved the violation of an elementary principle. They have more recently had a second bitter disappointment in the sacrificing of Governor Harding, especially as his failure of reappointment came in the face of a year of unwarranted political attacks upon him. No matter how good the new appointees, another fundamental principle of a sound system of banks of issue, that it should be free from political interference, has been abandoned. It is to be feared that service on the Federal Reserve Board in the future may be considered a hazard rather than a high honor, and that this will exercise a disastrous influence in years to come on those who might otherwise be willing to accept the financial sacrifice which membership on the Board entails. In this connection it may be interesting to note that although in the recent attacks on the System, both in and out of Congress, it was often asserted that the bankers were intent on controlling the System, no bankers of importance, as far as I know, sought

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appointment since August 9, when Governor Harding's term expired, nor was any particular banker urged for appointment by bankers organizations. Such action as they took was directed to further, not personalities, but a principle—that the System should be kept free from political interference.

The Farm Bloc has had its "march into the Ruhr." Now that it has won, what will be the result?

My own conviction is that, faced with the alternative of debauching the country or preserving for the Federal Reserve System the high principles on which alone it can remain secure; faced with the immense responsibility of administering at this time the gold and credit reserve of the entire world, members of the Board—farmer or banker—will end by forgetting what party or class they were elected to represent and pull together in the only direction that, in the long run, can bring individual satisfaction to them, and peace, progress, and prosperity to the country as a whole. It is in this spirit that, I am sure, the Acceptance Council will continue to place its services gladly and unreservedly at the disposal of the Federal Reserve System as it did in the past.

For the Federal Reserve System there is only one course to pursue, and that is to keep its standard high, to place its case before the people, and to do its duty unafraid. While it should go to the utmost limit in aiding the agricultural classes—as far as it can be done without compromising sound principles, and

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without harming the farmer by encouraging him to indulge in speculation (and some of the amendments now before Congress are to be welcomed in that spirit)—it must openly meet the vagaries of the soft money prophets and of those who profess to believe that excess production can be made to find its market by easy domestic credit. The farmer is beginning to understand that there are deeper causes for his ills than can be explained by slanders on the Federal Reserve System and Wall Street finance. He is beginning to see that it is the exportable surplus that, in the final analysis, fixes the price for the staples he has to sell; that for his sales he must compete with producing countries with lower standards of living, some affected with acute unemployment; while in whatever he buys, including transportation, he pays for goods and services produced upon a scale of prices governed by the highest standard of living of the world, protected by laws that impede the normal inflow of goods and men, resulting in the present actual shortage of manual labor. He is beginning to realize that, in these circumstances, he must not seek a cure in soft money and credit inflation, which would boost the things he buys—protected goods and protected labor—much higher than the things he sells, for which the price is determined by free world markets. He is awakening to the realization that relief must be sought in building up the standard of living, and with that, the purchasing power of broken-down countries, rather than in undermining and bringing down our own. Sooner or

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later the farmer will perceive that it is labor much rather than credit that is at the root of the maladjustment of prices afflicting him at this time, and that it is the "Capitol" much rather than "capital" that stands in the way of a solution. Unless by a less self-centered and more generous attitude towards Europe we help in lifting the Old World out of its desperate straits, it seems inevitable that the present maladjustment will lead to a tug-of-war between agriculture and labor.

The country at large will stand by the Federal Reserve, and if need be, protect it at the polls, if it is efficiently managed, and if the man in the street is made to understand its aims its struggles, and dangers. In order to be strong and efficient, the Federal Reserve System needs the whole-hearted co-operation of the banks; in order to survive in safety and independence it must have the sympathetic understanding and eager support of the people. In both directions lies the path of useful service for the American Acceptance Council in the coming year.

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