

**Making Ready
for
New Financial Tests**

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MAKING READY FOR NEW FINANCIAL TESTS

It is but little more than three years since the Federal Reserve Act was passed, and but little more than two years since the Federal Reserve Board was organized and the Federal Reserve Banks put into operation. Yet, as one looks back to things as they were before we initiated our new experiment in American banking, it seems that it was another world, or at least another age in the life of our country, so much that is new and fundamental has happened in this short space of time; so much of history has been undone and so much of new history has been made, not least of all by our own country, and especially in the domain of business, banking, and finance.

When the Federal Reserve Act was passed—and it was passed only after much deliberation and years of careful preparation and forethought—problems of internal or domestic banking were mostly in the minds of the friends of banking reform. Certain pretty definite needs had made themselves felt through years of oft-repeated experience for which the country felt that the time had at last come when some protection and remedy must be found. Let me enumerate the principal of these needs very briefly. They were:

1. To provide currency and credit to meet the recurring seasonal fluctuations, especially those growing out of our crop moving requirements;
2. To provide a system of elastic reserves, currency, and credits to protect us against collapses of prices and values, emergencies and panics, and insure that sound business would always be able to maintain itself in a condition of solvency,

and any critical or dangerous situation always be sure of support and relief.

3. To provide a more complete system of clearing and exchange by a simplification of the clearings business of the country, which would give to the check, which is the American method of payment, a wider currency and an easier flow from one end of the country to the other.

4. To provide for American business a constant and firm undertone of stability by maintaining under all likely conditions an atmosphere of confidence in the stability of the country's credit structure, and a feeling of certainty that whatever might come we would be found in shape to take care of ourselves.

5. Beyond these was the vague general purpose of liberalizing credit conditions, of breaking up whatever control of credit was believed, or as a matter of fact might be said, to exist, and

6. To introduce our country in a modest and necessary way into the field of international finance and banking.

How completely these requirements, which at the time the Reserve Act was enacted were thought to comprise all of the essential elements of any thoroughgoing American banking reform, have been met, the record of the past two years and a half effectually discloses. The business and financial history of the United States under the dispensation of the Federal Reserve System is a complete vindication of the wisdom which drafted the Federal Reserve Act. I think bankers and business men, even those who had doubts when the new system was being formulated, are now ready to concede this. The evils that a community escapes in a business and financial

way it takes little reckoning of. The security and immunity that it enjoys through a well-contrived banking system it is apt to take for granted. But it cannot be doubted that the pace that American industry and business have taken and sustained during the past two years and a half, the rapidity with which they have developed in every part of the country and in every line of activity to meet each new need and opportunity, whether national or international, the confidence that they have felt in their own strength and buoyancy, will, when we come to see this remarkable period in the economic and financial history of our nation in its proper perspective, constitute one of the most interesting chapters in the history of banking since the world entered upon its modern career. When you recollect what a collapse of prices and credit followed the threatened break of our relations with England some twenty years ago, growing out of the controversy with reference to the Venezuela boundary; when you recollect the many other occasions on which the financial markets of the country were on the verge of a serious breakdown, following a comparatively trivial strain in our foreign relations, and then recall how many times during the past two years we have been in the most delicate positions internationally, latterly frequently on the verge of war, and yet have hardly felt a serious financial ripple or shock, we get some idea and measure of the feeling of security and confidence that the Federal Reserve System has inspired in every nook and corner of the country.

In the course of these two years and a half, we have lived through at least fifty years in a business sense. In the field of international banking and finance particularly, we are already at the place where in any reasonable forecast there was no ground for believing we would be, short of from one to two generations. It should not strike us as strange, therefore, if

in looking at our banking problems and organization at the present time, we should come to the conclusion that, fully and completely as the financial tests which were in mind three years ago have been met by our new banking organization, there are yet other and newer tests, equal in importance, and perhaps more than equal in difficulty, to any that were in mind at the time the Federal Reserve Act was framed. New tests are daily emerging, and the question of our ability to meet them is naturally and properly causing us some concern. No country, it is safe to predict, will experience such far-reaching changes in its situation as a result of the war as the United States. Indeed, changes in our position relative to other countries in the world of commerce and finance such as might not have been expected to come, in the ordinary course, within less than two or three decades, are already upon us. I think it may therefore be of some interest and value to you in orienting yourselves, to look beyond the immediate interests of your own locality for a little space, and see what the minds of those of us who are charged with the responsibility of looking broadly and as far ahead as we can, conceive to be some of the new tests that are awaiting us, and what we are proposing in the way of the revision or extension of our new banking system in order that it shall be as ready for the new, as it has already shown itself to have been for the old, tests.

The Reserve Act, in some of its leading provisions, clearly looked forward to the time when our country would have a more or less important work to do in the field of foreign banking. For the first time since the enactment of the National Bank Act, provision was made for the granting of acceptance credits by National banks for the purpose of facilitating

American commerce. This new and valuable field of banking operation has already been entered upon by our banks to a very gratifying extent, and promises much for the future. Absolutely accurate statistics are not available, but competent estimates place the volume of acceptances granted by American banks on behalf either of American or foreign customers, at over \$300,000,000. The Federal Reserve Banks have done much to facilitate the growth of active operations by providing a market in which member banks could always dispose of their acceptances at the going market rates. At times they have held as much as \$126,000,000 of acceptance paper.

The Federal Reserve Act also looked forward to the day when the banking organization of the United States would have to exercise an influence in the market for foreign exchange. It therefore authorized the Federal Reserve Banks to establish foreign agencies and appoint correspondents for the purpose of engaging in the purchase and sale of foreign bills, dealings in bullion, etc. But it was probably not expected at the time the Act was passed that foreign operations would bulk very large in the activities either of the Federal Reserve Banks or of their member banks, for a good while to come. Just latterly we have felt that the time was approaching when the Federal Reserve Banks might safely be encouraged to enter upon this new and important, but also difficult and, under present conditions, venturesome branch of banking. But it is becoming clearer every day that more in the way of facilities for foreign banking is needed than the Reserve Act provided. Indeed, in taking stock of our total banking needs and capabilities, it seems certain that we have got to expect larger and more serious operations both in the

field of domestic banking and in the field of foreign banking than any man would have dared to imagine a short while ago. Circumstances connected with the war have, not only for the time being but presumably for all time to come, given to problems of international finance and banking an importance such as they could not otherwise have attained. The whole world has latterly been growing into close commercial and financial dependence upon the United States, and during this time we have been experiencing an accession to our banking and financial power such as has never been experienced by any other country in a like period of time.

In the course of two years and a half, the banks of the United States, chiefly serving the needs of American industry and commerce, have expanded their credit to an amount of over four thousand millions of dollars. In brief, our position in international finance and banking has been completely reversed. From being that of a debtor nation, it has become that of a creditor nation, with prospects of a growing and unlimited extension of its creditor position.

With banking and financial power, of course, come banking and financial responsibility. We should, therefore, take careful stock of our power and of the new responsibilities which events are imposing upon us, in order that we may devise methods of direction and control such as will insure that our new power may be of advantage to ourselves and of assistance to the rest of the world. The more our situation is studied, the more it discloses the many new elements of strength which are within our reach and which, if brought under control, will make us a mighty force and influence in the affairs of the world.

Let me review a few of the outstanding facts, which are perfectly familiar to you, but which may not be in your minds at the moment. The vast volume of our export trade has, of course, been the immediate cause of the revolution in our financial position.

1. RETURN OF AMERICAN SECURITIES

We have "repatriated," as it were, about \$2,500,000,000 of American securities hitherto held in Europe. England particularly, in the effort to maintain sterling exchange in the American market in settlement of her unprecedented trade balance, has been obliged to mobilize her holdings of American securities for sale or pledge with us. It would be hard to overestimate the importance to us of this return of our securities. No one can tell what the state of the American investment or speculative market would have been had it not been for the happy circumstance that so large a portion of the swelling profits of American industry during the past two years was being provided with so safe an outlet as was provided by the resale to us in such huge volume from abroad of our own most seasoned securities. I think it will be concluded, when the financial history of this period is written, that one of the best of safety valves was thus provided us at the very outset, when we were beginning to travel the rapidly swelling tide of credit and prices. The thing that probably saved us from a deluge of speculative enterprise before we were in a position to get our real bearings, was this enormous volume of American securities in which so considerable a part of our surplus was able to find natural and safe lodgment.

2. FOREIGN LOANS.

We have also extended credits to Europe to approximately the amount of \$2,500,000,000. Of this amount, over \$2,000,000,000 has gone to European government borrowers, the remainder to industrial and commercial borrowers in Europe; but in either case, credit to the enormous volume of \$2,500,000,000 has been supplied by the American market to support the gigantic financial operations in progress in Europe. Nothing comparable to this has ever before been undertaken or accomplished in the history of modern finance in any country. Never before have borrowing nations been able successfully to place such a vast volume of their securities in a foreign market. You cannot parallel our achievement even in the history of English and French banking and finance combined. It is amazing that the financial market in a country which has hitherto been closely preoccupied with the development of its own resources and which has built up its banking organization to take care of its domestic needs, has been able so quickly and so successfully to accommodate its point of view to its new opportunities and its new obligations, and to the necessities of its great customers across the sea, and to have absorbed with so little of difficulty and disturbance, and with, as yet, so little visible sign of indigestion, the enormous aggregate of foreign government obligations which have been placed upon the American market.

It is true, and ought not to be overlooked in passing, that we have been very much helped in this enterprise by the sagacious plans and clever methods of the financiers of the borrowing governments. They have by skilled and proven ways sought to prepare not only the financial mind of this country for favorable reception of their projected borrowings, but the

financial soil, as it were, as well, and have thus helped us to help them. It has become almost a byword in Federal Reserve precincts that whenever there is a rapid succession of heavy shipments of gold to this country, it foreshadows the establishment of a new foreign credit. The American financial market had long since shown itself peculiarly responsive to "suggestion," and by none was this better understood than by those who have undertaken to lead the American market into adventures in the field of foreign finance during the past two years. Whenever new negotiations have been impending, the market has been made ready by an easing of credit conditions through heavy gold shipments, and a softening of rates, so as to make the proposed loan, when offered here, look attractive and look especially attractive to the banker with a considerable margin of unemployed credit at a time when commercial rates were ruling low.

Easy rates are apt to beget financial trouble and mischief by relaxing in some degree the ordinary and necessary restraints of banking prudence. Many an occasion has exemplified this in our country, especially when the tide of prosperity was running high. Only very recently was it exemplified when the plan of establishing a credit in our market in the form of Treasury Bills was projected. Cast in a form which was particularly calculated to appeal to the banker as a remunerative short term investment, and issued as they were to be in large, not to say unlimited, amount, and moreover in circumstances which carried and which could carry no assurance of their definite and early retirement from the American market, the Treasury Bills threatened an invasion of the field of American banking credit, and the commitment of our banks to operations of a character and scope which it was not

unreasonable to expect must sooner or later be attended with serious difficulties and possible dangers, which ought, if possible, to be forestalled. The Federal Reserve Board, charged as it is under the Reserve Act with the duty of establishing "a more effective supervision of banking in the United States," therefore undertook to offer some advice to the banks, or perhaps it would be better said, undertook to interpose an objection to the step that was in contemplation. We did it because the thought in our minds has always been America first, and the preservation of the American banking system primarily for American needs, future as well as present. We felt that the injection into our banks of some hundreds of millions of foreign government obligations, no matter what their outward form and how unquestionable the quality of their security, would threaten an impairment of the liquid condition of the banks of the country at a time, and in view of coming conditions, when it was all-important that they should be maintained in a condition of exceptionally liquid strength.

Some of us also saw, or thought we saw, that the contemplated form of financing marked the beginning of the process which has been followed during the past two years in England—and for that matter in all of the great belligerent countries—and which has led to the most monstrous inflation of banking credit that any comparable section of the world has ever experienced. I refer to the steady feeding into the banks of vast quantities of government securities, mostly short-term, in the form of Treasury Bills and Exchequer Bonds, purchased and paid for by the banks not out of idle investment funds, but by the creation and extension of new credit for this specific purpose. Take the statement of any of the great British banks, not excepting even the Bank

of England, and you will find that there has been an enormous addition on the side of their resources, since the war began, to the item "investments" (chiefly in the form of government securities), offset on the liability side of the account by an approximately commensurate increase in the item "deposits." In brief, the methods of finance which have been followed have largely involved the banks, and practically amounted to a swapping of banking credit for public credit. The great body of new banking credit thus created, and circulated, as it has been and is, by the familiar means of the check, has acted upon prices in exactly the same way as any other kind of currency. In the course of the two and a half years since the beginning of the war, according to the most competent indices of price changes, average prices in England have risen by close to 100%. By comparison with England, the advance of prices latterly much complained of in this country has been slow, amounting to about 40%, but the advances of prices both in this country and England are due to much the same causes—the vast increases in the amount of circulating medium, of which the familiar form of banking credit has been one of the most important.

Both the British and American public have been slow to grasp the connection between the upward movement of prices and the increased volume of banking credit not called for by a corresponding extension of underlying industrial activity. But the meaning and cause of what has been going on and more particularly the connection between prices and inflation, have not escaped the attention of careful observers. Referring to the increased holdings of Treasury Bills and of government securities by the banks as the cause of banking infla-

tion and the rise of prices, the London Economist recently* condemned the process as "bad finance forced on the banks by the Government," while "sound finance takes money out of the pockets of the people instead of increasing its balances, and so reduces purchasing power and helps to check the rise in prices."

3. GOLD IMPORTS.

Finally, what has been perhaps the most dramatic episode in the whole series of financial movements induced by the war, is the tremendous inpouring of gold into the country. This movement is so rapid and continuous that it requires some vigilance to keep up with the statistics. From week to week, and sometimes from day to day, we have to revise our figures in Washington. We have received from Europe since the beginning of the war \$1,200,000,000, † we have exported about \$300,000,000, leaving us, therefore, with an estimated increase of our total gold holdings of about \$900,000,000, an amount larger than we had ever hitherto added in any ten-year period. This means an increase in the gold stock of the country of over 50%. Nothing like this has ever been experienced by any other country. The movement is not yet at an end. If the war runs on another year, there is no telling how many more millions of Europe's gold we shall have to add to our stock.

Part of this gold, some \$600,000,000, perhaps as much as two-thirds of the total, has found its way into the banks and

*Issue of September 9th, 1916, page 435; also, *ibid.*, "When banks buy securities from the Government, they and the Government between them create so much new 'cash,' which is passed on by the Government to the contractors and others to whom it owes money, and paid in by them to their banks, and so increases the public's bank balance."

†The amount has since (Mar. 9) increased to \$1,354,592,000.

has there provided the basis for a great expansion of credit, an addition to the reserve of credit which was created when the Federal Reserve Act with its reduction of reserve requirements for the National Banks went into effect. Approximately one-third of the new gold has found its way into the general channels of circulation. With what results? With the result, among others, as already pointed out, that there has been an enormous expansion of currency and credit and a consequent inflation of prices. Do you realize that in the past two years and a half the commercial banks of the country have expanded their credit by more than \$4,000,000,000, as evidenced by the growth of their net deposits? This growth is nothing short of stupendous, but it has come about so quietly and apparently so naturally (because on a gold basis) that only those whose business it is to watch the trend of things and to take reckoning of what is going on, have any adequate comprehension of what has been happening and what it portends for our economic and financial condition, unless we realize its seriousness and undertake the new extension and amplification of our banking machinery which is imperatively needed to enable us to cope with the situation.

The problem of controlling this new gold, this more than \$900,000,000 of gold which we have added to our monetary stock (that is, after subtracting the few hundred millions which we have shipped out of the country) the problem of properly relating this gold to our financial system, more particularly of tying it to our banking structure, is one of the most urgent and important, but fortunately not one of the most difficult problems that confronts us at the moment. Do you realize that we have in circulation at the present time as hand to hand currency, paying the butcher's and baker's bills, al-

most \$1,000,000,000 of gold, chiefly, of course, in the form of the gold certificate? Do you realize that gold has become so abundant and cheap in this country that it is one of the commonest forms of circulation—the currency which you bankers are paying out over your counters in millions of dollars from day to day, thus helping to keep it scattered in the pockets of the people when more of it ought to be kept where it can be more freely and easily availed of as the basis of banking operations? Do you realize that you are doing this at a time when financial responsibilities are beginning to pile themselves high upon the country—and I say this without any thought of a possible war, imminent as that possibility must be regarded—but simply assuming that things will move on in a more or less steady course? Do you realize that we are doing all this at a time when we should be preparing for the great work of reconstruction, industrial and financial, with which the world will be confronted after the war, a work in which we rightly will be called upon to do our large and considerable part?

OUR GOLD PROBLEM

It is this situation which makes our gold problem. That problem, as it presents itself to us at the present time and with the prospect of further importations of gold, is how more effectually to control this gold, so as to check the expansion of credit and the inflation of prices that is going on, to the distress and hardship of all classes of people who are dependent upon fixed incomes, whether wages, salary, interest, or rent; that on the one hand; and on the other hand, to prepare ourselves for the day when the gold will have to be returned. We shall not be able to keep all of it, even if we want to, but

we shall not want to keep more than a fraction of it if we are wise. We have paid for this gold with good American commodities. Good American labor has gone into the production of the things in payment for which this gold has come to us. More gold than the country needs in order to establish and maintain an adequate foundation for its banking structure, is an expensive form of luxury, if not waste. Our business and industry have expanded and our credit, of course, has had to expand to keep pace with them. The whole volume of our banking credit, we may believe, has been permanently enlarged, for it is a fact attested over and over again by the banking history of our country, that we never go backwards. We always go forwards, sometimes by leaps and bounds, sometimes slowly and steadily, but forwards always. There can be no question, therefore, but that some of the more than \$1,000,000,000 of new gold will find its permanent resting place in this country. But some of it, much of it, will have to go back, and against the day of its return we ought to be preparing. I have come here tonight chiefly to tell you that, as the situation is, we are not adequately prepared to do this, and to present to you some of the ideas and plans of those of us whose business it is to worry about these problems as to what the preparation should be and what proposals in particular we have made to Congress with the hope that they will speedily be enacted into law.

It has been said by some of the financial prophets that the country is getting morbid and hysterical on the subject of gold, and some have hinted that the authorities of the Federal Reserve System were mainly responsible for this state of mind. Others have predicted that at the close of the war gold would be demonetized in Europe. If there were any substantial rea-

son for accepting that prediction, we ought, of course, not to go on taking more gold. We certainly don't want to increase our stock of a commodity which is going to have no use when the war is over except in the melting pot of the jeweler. Indeed, if there were any serious ground for apprehension as to whether or not gold would continue to be the leading monetary metal of the world when the war is over, we, as the largest single possessor of this metal, ought, in a fair and not over-selfish consideration of our interest, to exert our influence to see that it is not demonetized. The likelihood of that, however, seems so remote that it would seem hardly worth discussion were it not that the suggestion has been so frequently made.

As a theoretical proposition, and dealing with the question in the abstract, a system of refined barter and exchange under which gold could be pretty much dispensed with or at any rate its use much economized, can be easily conceived. But the financial and commercial world of Europe is going to be in no mood to make unnecessary financial experiments when the war is over. Europe will have so many problems of more pressing urgency than the alteration of her monetary practices; she will have so much uncertainty to cope with at best, without undertaking changes in monetary standards, that we may expect the tradition will live that there is but one metal in the modern world which will answer the requirement of a money of universal account, and that every effort will be put forth by the countries which have been obliged to suspend gold payments during the war to re-establish the gold standard in fact as well as in name, through colossal operations in the restoration of credit, the refunding of debts, and the retirement of their paper issues. It is noteworthy that England has been making the most determined and heroic struggles to main-

tain the integrity of the pound sterling in appearance, if not in literal fact. Notwithstanding the enactment of a law immediately after the outbreak of the war under which the Bank of England was given authority to dilute, so to speak, the security back of the five-pound note, which, as things previously were, could be issued only against an equivalent amount of gold bullion, the Bank has not availed itself of that privilege up to the present moment, and there is no indication that it will. The British Treasury has put out a great issue of paper currency on its own account, but the five-pound Bank of England note, which is the basis of England's banking structure, continues to be what it was before, substantially a gold certificate. There seems to be little occasion, therefore, in a discussion of our gold problem, to take very seriously the suggested possibility of a demonetization of gold,—all the less so, since looking at it from a practical and selfish point of view, England, or the English dominions, are the largest producers of gold in the world. Of the near \$500,000,000 annually taken out of the mines of the world, about \$300,000,000, or 60%, represent the product of England's overseas dominions.

What then are we doing to mobilize our mounting stock of gold; to put it where it can be laid hold of when the moment for its use comes, and to hold it out of unnecessary and harmful use until that moment arrives? To do these things is what reserve banks are for; but our Federal Reserve Banks cannot be reservoirs of credit unless they are reservoirs of gold. Gold is in an immediate sense the symbol and measure of banking power. It is the basis of banking credit because it is the only universally recognized ultimate reserve. It has little or no necessary use apart from its banking use. Its principal place, therefore, is in the banks and chiefly, of

course, in those banks whose business it is to guard and manage the country's banking reserve. This means, under our system, the Federal Reserve Banks.

What then, it ought to be asked, is the condition of the Federal Reserve Banks at the present time?

I doubt whether you bankers have given this matter the attention that you should in your own interest. I am afraid that you are taking too much for granted: "The Federal Reserve Act has been passed; the Federal Reserve Board and the Federal Reserve Banks are there; the Federal Reserve Governors are on the job; nothing can therefore happen." Gentlemen, I have sometimes felt that there was danger of your putting too much reliance in the Federal Reserve System. Saying this as I mean it, is, of course, no disparagement of the rare merits of the System; it is rather a criticism of your complacency under the System. The Federal Reserve System is certainly a wonderfully well contrived system. No existing reserve system is better conceived. Events have already shown that it possesses a magic quality in the estimate of the people. I am glad to believe that this is so; but I must yet remind you that magic, however essential an element in any adequate American financial system, is after all not all there is to finance, even in America. You have been told by some who have spoken on behalf of the new System that financial breakdowns and commercial distress are things of the past, and cannot occur under the Federal Reserve System. I regret that I cannot subscribe to this doctrine. There is no method by which you can effectually protect the community against all of the consequences of the business carelessness, extravagance, and foolishness of some of its leaders. But you can do much under a well organized financial system to localize financial

troubles proceeding from local conditions, and prevent them from developing into a general conflagration and collapse. The more powerful your reserve system, and the more far-sighted and competent its direction and control, the more you can do to save the great body of the people many of the worst and most distressing consequences of the disturbances and shocks seemingly incident to the modern organization and conduct of business, with its myriad intricate inter-relationships and its sensitive and delicately balanced credit system. That is why we whose business it is to see that the industry and enterprise of the country shall enjoy all the protection and security that can be gotten from a strong and compact banking organization, are desirous of seeing the Federal Reserve System made stronger, more powerful, more certainly and confidently equal to the great and difficult work which will fall—indeed is already falling—to our country in the international readjustments of trade, finance, and industry already in progress as a result of the war, and destined to grow in complexity and magnitude as time goes on.

What then is the situation of the Reserve Banks at the present time in reference to the total gold stock of the country?

GOLD POSITION OF FEDERAL RESERVE BANKS: ITS INADEQUACY

We have in the country today something over 3000 millions of gold, of which about one-seventh is under the immediate control of the Federal Reserve Banks. That is the total amount of gold they have with which to operate today. No, I have overstated it. That is the amount of gold that the Re-

serve Banks have, but their gold is also their member banks' gold. What the member banks give to their Reserve Banks shows on the books of the latter as a deposit credit, and under the terms of the law the Reserve Banks are required to maintain against the liability thus created a gold reserve of not less than 35%; so that after the reserve of 35% against reserve deposits has been set apart and the reserve of 40% against the small, at present almost negligible volume of Federal reserve notes which have been issued on the pledge of commercial paper, they have what in the way of free gold? The twelve Federal Reserve Banks have about \$275,000,000 of free gold at the present time.* That is about one-fourth of the gold that this country has added to its monetary stock during the past two and a half years by importation from Europe. That is to say, the Federal Reserve Banks have but \$275,000,000 of free gold to provide for the return of the gold that Europe has temporarily sent us, because forced to do so; because brought, so to speak, financially to her knees in the effort to maintain exchange; \$275,000,000 of gold with which to support the new credit and the new currency which we shall need when the great process of international readjustment is on after the war, to say nothing of vast demands for credit and currency that, in our present critical circumstances, might be precipitated on the country overnight. While we may devoutly hope and pray that no complete rupture may come in our European relations such as will precipitate war, hope and prayer alone will not protect us either against the

*This figure does not include the gold now "deposited" by Federal Reserve Banks against Federal reserve notes issued to them, and which might be withdrawn by the banks by the substitution of an adequate amount of "eligible paper," because gold thus received in exchange for Federal reserve notes and held for their redemption ought not, in making an estimate of the normal capacity of the Reserve Banks, to be treated as part of their regular resources.

occurrence of the event or against its consequences should it occur. If the disastrous hour comes, we must be financially prepared as well as prepared in other ways. Yes, more so; for good finance is the first step in any program of effective preparation. I repeat the question, therefore, is \$275,000,000 of free gold in the hands of the twelve Federal Reserve Banks adequate?

No; positively and emphatically no; and above all no, when there is such a vast fund of gold in the hands of the banks and the public to be tapped—almost 1000 millions in circulation where it is of no immediate banking value—and further, when it presents such a comparatively simple problem to devise safe and proper ways and means of drawing some of this gold into the Federal Reserve System, where it can be held against the day of its need, either to meet European demands for the return of gold after the war, or to take care of any extraordinary credit or currency demands which may arise in this country, either as the result of a further and more serious breakdown of our international relations, or through war; or supposing we escape both of these things, for use in the immensely delicate and difficult and long-drawn-out process of trade and industrial readjustment after the war.

There is nothing new or problematical about the demands that will arise from this source, for such dislocations of industry and commerce, such breaking up of old-established relationships in trade and finance as not only Europe but the whole world has been experiencing, will entail more gigantic problems of industrial and financial reconstruction than the world or any part of it has ever had to face—more colossal than those which confronted Europe at the close of the Napoleonic wars, or the United States at the close of our Civil

War. We know as a matter of history that it took fifteen years for the world of commerce and industry to recover its economic equilibrium after the Napoleonic wars. The commercial history of this country or of England, or of France, shows that the period was marked by ups and downs, and why? During the war and partly as a consequence of it, the economic conditions and relationships of these countries had completely changed. So it will be after the present war, and largely as a consequence of it. We don't know what sort of Germany is going to emerge from the trenches. We don't know what sort of a new and different Russia, France, or England is going to rise up after this war. We don't know how much confusion in trade and industry will be produced by the desire of the fighting nations to get back quickly and by all available means into the field of international trade and finance. Much less do we know whether we are going to be assured of a position of dominance in the commerce and finance of the future as we have in the immediate past. There is, however, one thing that we can definitely predict, and that is that this will be a world of extreme uncertainty. We ought, therefore, to prepare. It would be foolish to tie our expectations to any single theory of what is going to happen, because we have seen things coming to pass week by week in the past two years which no one could have predicted. The more should the preparation be made and be thoroughly made, since it can be so easily made. Consider what our embarrassment would be if Europe should undertake to get back some \$500,000,000 of the gold she has sent us, to put under her inflated credit structure. All the great note-issuing banks of Europe have expanded their circulation enormously; the Imperial Bank of Germany over 200%, France slightly less, Russia twice as much. Do you doubt that the ambitious German will not be quick to realize

that no country can hope to have a firm footing in international trade whose exchange is a speculative quantity, and that they will make every effort to get the Reichsmark back into the position of a stable unit, and that for this purpose they must have gold, and that they must go to get gold where gold is? Do you realize that circumstances have made us the only considerable free gold market in the world, and that if we intend, as some way we must, that ours shall be a brilliant and permanent career in the field of international banking, there is only one way to maintain it, and that is to say to every one who has established a credit in the American market, your credit is as good as gold, because it is the special business of the Federal Reserve Banks to make it so, and to be in a position at all times to supply gold as it is demanded, without evasion, excuse, delay, or embarrassment. The determination and the ability to do these things is what made England, in the past, a great gold market and the world's banker.

How rapid the outflow of gold from this country will be after the war, no one can, of course, foretell; but that outflow there will be, is certain; and that the burden of providing for it will fall on the Federal Reserve Banks, is also certain. But their position in comparison with our total gold wealth and the probable calls which will be made upon it, is not one of the strength it should be. It is one of insufficiency—it would be going too far to say weakness, but inadequacy at any rate. I would not have you believe that it is a mere passion for big-ness that is animating us. I would have you believe, however, that it is a passion for preparation and efficiency. But no matter how efficient the management of the Federal Reserve Banks may be, if the Banks have not the resources in the form and in the amount and at the time when they are wanted, to

that extent they are inadequate, and the one thing that a Federal Reserve Bank must not be is inadequate. The Federal Reserve Banks have been set up to brace the whole structure of American credit, and since by circumstance we are in the field of foreign banking, not because of our seeking or desiring but by reason of a world catastrophe of unparalleled character, we must prepare ourselves to enter upon our new heritage and assume its full responsibilities.

PREPARATION

What then should be the extent of the preparation? I believe our position would be satisfactory for a while at any rate, or until things were of bigger dimensions and looked to be of more serious portent than they do even at the moment, if the Federal Reserve Banks were equipped with \$500,000,000 of free gold. By free gold, as I am now using the term, I mean that after setting apart the necessary reserves of 35% against their member bank deposits, and after investing the necessary \$150,000,000 at current rates in order to make their expenses and pay their dividends—for you will not deny that these are healthy considerations in any going business concern, even in the case of a Federal Reserve Bank, which is not primarily or in any important sense a profit-making institution—we ought, I say, after doing these things, to have gold enough to have \$500,000,000 with which to operate. If we had that amount, see what our position would be. Without being obliged to take any extreme or even unusual protective measures in the way of high discount rates, which would have the effect of telling Europe to keep away from the American market, we could afford to give up say as much as \$250,000,000 of gold, and yet

have left some \$250,000,000 which could be used as the basis for the extension of credit or the issue of currency to the aggregate of some six or seven hundreds of millions of dollars, when the occasion arose. This means that the Reserve Banks should be given reserve deposits of roughly \$1,000,000,000; in brief, that instead of having one-seventh of the total gold supply of the country, they ought to have at least one-third.

Someone may say that I am overlooking the strength of the position the country is in because of the heavy investments it has made in European securities to protect itself. I am not overlooking the fact that there are some \$40,000,000 of European obligations held in our markets that run off this year; some \$385,000,000 or \$400,000,000 that run off next year; some \$400,000,000 or more in 1919; and some \$500,000,000 or more in 1920. The experience of the past two years has shown that securities of an international character such as the American securities which have come back to us, are in some sort an international currency. No doubt the bonds and notes which we are acquiring from England and France can be used as an effective method of international payment, and as a method of staving off, if we need to, or think it desirable, and if we cannot help ourselves in any other way, undue demands for gold. Our holding of European short term obligations is certainly to be regarded as a kind of belt of protective armor.

But why should we want to keep our circulation charged with \$1,000,000,000 of expensive metal which has cost us good labor and good commodities, when it will be much more needed elsewhere in the world, and be of very much more value not only for the countries that will get it, but for us who will wish to trade with them on a stable and orderly financial basis. It might be argued that our Reserve Banks can do as the great

European banks have done and protect the gold supply by raising discount rates. That is the method the Bank of England has employed frequently and with much effect in the past. Whenever gold was flowing out of the London market more rapidly than the Bank of England thought proper, the Bank raised its rate so high as to discourage those seeking gold in London. My contention is that we do not want this great mass of superfluous gold with which we are now inundated, nor do we want a further inflation of prices such as has gone on in the past two years, if we can comfortably control and check it. We want so much gold in the country—with a suitable margin of safety—as will enable us to stabilize our foreign exchanges and to maintain dollar exchange and the position of the American money market on an unequivocal and unassailable gold basis, and in addition take care of natural and normal growth in American business, expanding as we hope and believe it will in the years which are immediately ahead of us; and finally, and not least important, enough to enable us to ease the slowing-down process through which our industry may have to go, and the return to a more normal level of prices after the war. Prices are not going to stay where they are at the present time, either in this country or in Europe. There is bound to be a letting-down of the price level to a more normal state. We don't want the letting-down and the slowing-down process to come too suddenly or to be too drastic. We don't want the American community to experience in too acute a form the pains that come from price reversals and price revisions. We want to have the Reserve Banks in such a condition of strength, therefore, that when the inevitable price contraction is on, they can intervene with a helping hand so as to make it easy and gentle and gradual.

AMENDING THE RESERVE ACT

The situation which I have sketched, I think you will agree, almost suggests the remedy. The remedy, of course, is partly, yes mainly, by way of legislation; by way of amendment to the Federal Reserve Act. It might be otherwise, but any other method is probably too slow in our present critical circumstances. Last September, Congress passed an amendment to the Federal Reserve Act under which member banks were released from the necessity of carrying any specific portion of their reserves in their own vaults. The amendment virtually said to the banks, you may put the whole of your reserve in your Reserve Banks, and it will count as your reserve just as if the money were in your own vaults. Some of the larger banks have shown a disposition to co-operate in building up the strength of the Reserve Banks by maintaining increased deposits with them. But most of you have waited, as bankers are apt to wait, and so no very extensive change has taken place in the condition of the Reserve Banks. This experience has shown afresh that it is difficult, if not impossible, to get effective action unless it is group action, and that it is next to impossible to get group action in such a case except under the pressure of severe financial necessity or the compulsion of law. We never should have had the Federal Reserve System if membership had been voluntary. If you doubt that, look at the action of those banks for which membership is voluntary. Until events which are as inexorable as, or perhaps more inexorable than statute law come to pass, as they certainly will—events that will make economic pressure the compulsion which will force in those who are now waiting—we may expect to have few accessions to our voluntary membership. So in this matter of maintaining increased balances

with Reserve Banks. Every one is waiting for every one else, and time is going by. The short cut then, is to put all on the same basis by requiring alike those who would like to and those who are holding back, to do what all should. In other words, by prescription of law to cause the transfer of a larger part of the gold of the member banks to the custody of the Federal Reserve System.

That is the purpose and the substance of an amendment which the Federal Reserve Board has proposed to Congress, and which has had the favorable consideration of the Banking and Currency Committees of the two Houses. Under the terms of the Federal Reserve Act, as they now stand, country banks are required to maintain reserves of 12%, reserve city banks of 15%, and central reserve city banks of 18%. Reserves of 5, 6, and 7% must be maintained by each of these three classes of banks respectively with their Federal Reserve Banks. The remainder of their required reserves they are free to carry either in their own vaults or with the Federal Reserve Bank. The amendment recommended by the Federal Reserve Board proposes that henceforth the reserve *proper* of the member banks of the Federal Reserve System shall all be carried in the shape of a cash balance with the Federal Reserve Bank. In order that this reserve shall be adequate, it is proposed to raise the percentages of the balances required to be maintained by member banks with Federal Reserve Banks from 5 to 7% for country banks, from 6 to 10% for reserve city banks, and from 7 to 13% for central reserve city banks. The gold thus concentrated in the Federal Reserve Banks is intended to constitute the American banking reserve, so far as the National banks and the members of the Federal Reserve System are concerned. Such additional cash

as the banks may need to carry for the purpose of enabling them to meet the currency calls of their customers, will simply be regarded as till money. The amendment submitted by the Board fixed an obligatory amount of 5% of its demand deposits as the minimum amount of cash to be carried by member banks in their own hands for this purpose. Let me say that the Board was divided on this feature of the proposed amendment. Some of us felt that the matter of making suitable provision for cash on hand could safely be left to the discretion of the banks. Some banks could probably get along with less than 5% of cash for currency disbursements; others, serving the needs of rural communities or subject to heavy demands for payroll disbursements, would find 5% inadequate. The House Committee has reported the Board's amendment with this requirement omitted. If, therefore, the bill in that form is enacted into law, member banks will be required to maintain reserves of 7, 10, and 13% respectively with their Reserve Banks, and will be allowed to determine according to their sense of prudence and interest the amount of cash they will carry in hand.

What will this amendment accomplish? On first consideration you may think it somewhat radical and revolutionary. It is, however, not so. The Federal Reserve Act itself looked forward distinctly to just some such result as this. It provided in its original form that after the shifting of reserves was complete, and our old system of redeposited and fictitious reserves maintained with Reserve agents was terminated—as it will be in November of this year—a certain percentage of the required reserves of member banks might be maintained at their option, either in their own vaults or in the Federal Reserve Bank. What the Board's proposed amendment substan-

tially provides is that the so-called "optional" reserves shall be converted into obligatory reserves maintained with the Federal Reserve Bank.

If the Board's amendment is enacted, it will add to the gold holdings, or rather to the reserve deposits of Federal Reserve Banks, some \$300,000,000 or more. It will therefore bring up the total reserve deposits of the Federal Reserve Banks to near \$1,000,000,000, not quite that now, but as things are going, it will not be long before it reaches that point. After setting apart the required reserves of 35%, or \$350,000,000, and after allowing \$150,000,000 for necessary investments to provide earnings and dividends at what may be expected to be normal rates in the future, the banks will have left some \$500,000,000 of free gold. And all that will have been done to bring about this important change will be the taking of a part of the gold now held by member banks in vault, and the placing of it in the Reserve Banks.

The Board has also submitted an amendment to provide that henceforth the Federal Reserve note, which is not now directly issuable in exchange for gold, may be directly issued. If that amendment is passed, we hope that our member banks will give us such additional gold as they may have in exchange for Federal reserve notes. The Federal reserve note is in every respect an acceptable form of currency for domestic uses. Nothing better could be desired. It is, and in all ordinary circumstances would continue to be, the practical equivalent of a gold certificate, secured as it is by an almost equivalent amount of gold in the hands of the Federal Reserve Agent. If member banks, under the Board's proposed amendment should come forward and exchange their additional gold and gold certificates for Federal reserve notes, after increas-

ing their cash balances with their Federal Reserve Banks to the required amounts, it would add some two or three hundreds of millions of dollars to the holdings, not of the Federal Reserve Banks proper, but at any rate of the Federal Reserve *System*, in the hands of the Federal Reserve Agents, where it would constitute a secondary reserve or second line of defense for use on extraordinary occasions. While gold thus held is not in the eye of the law part of the Banks' gold, and does not show as such in the Reserve Banks' condition statement, the Board has given careful thought to the matter of how gold thus impounded with the Federal Reserve Agent could, in case of necessity, be mobilized into the hands of the Bank and become available as a basis for extraordinary banking operations should a situation arise which called for more banking strength than the Banks possessed. But until such an occasion arose, the Federal reserve note would remain the practical equivalent of a gold certificate.

EFFECT OF AMENDMENTS

Generally speaking, these amendments which have been proposed by the Federal Reserve Board have been well received by those who have taken time to study them. They have been approved in principle by the Federal Advisory Council. Some critics, however, have shown a disposition to find fault with them. They seem to think they find in them some evidence of an inflationary disposition and a weakening of the base of the credit structure of the National banks. Such, however, is not the case. Indeed, the very reverse is the truth. There will be no appreciable change in the amount of the actual gold reserve of the member banks of the Federal

Reserve System in consequence of the amendments. Do you realize what our actual reserve situation is at the present time? How much or how little gold there is as a basis of the near \$10,000,000,000 of National banks' deposits? I am talking of real reserve, not nominal reserve, therefore I am not including silver and other forms of currency or money which the law allows to be counted as reserve. I am talking of gold, the only thing that, in a country which expects to have a position of solidity and usefulness in the world of larger banking affairs, is reserve, no matter what the law may say. Calling something reserve does not make it reserve. Not statute law but economic law and the custom of commerce, establish what is reserve in a commercial and financial sense. The custom of commerce does not recognize the American silver dollar or the American greenback. It recognizes only gold, according to weight and fineness.

There is at the present time gold in the vaults of the Federal Reserve Banks and their member banks, providing cover to the extent of 9.7% against the deposit liabilities of the member banks to their customers. Under the changes the Board is proposing and which I have briefly presented, the situation in its final elements would be substantially unaltered. The Federal Reserve System would hold gold in the hands of the Federal Reserve Banks and gold in the hands of the Federal Reserve Agents, received in exchange for the Federal reserve notes which it is expected member banks would carry in place of gold, to the aggregate amount of some 9.7% against member banks' deposit liabilities. It is an altogether mistaken inference, therefore, that there would be a weakening of the strength and solidity of our credit structure. There would be but a change in the location of the gold reserve. It will be taken

from 7,500 or more National and other member banks scattered through the country, and concentrated in twelve Reserve Banks, charged with the business of administering it with such caution and circumspection that there shall never be a moment's serious doubt as to the solvency of every dollar of credit issued by a member of the Federal Reserve System and bottomed upon good security. This gold, moreover, being mobilized, it would result that if and when an occasion arose when it was necessary to invoke the whole potential strength of our system of elastic reserves and elastic currency, the gold would be where it could be of highest use. We should be able to grant credit or currency to member banks as their customers might require, or as the Government might temporarily need should we get into war, to the extent of some seven or eight hundred millions or more, without any dangerous impairment of the condition of the Federal Reserve Banks, or without touching the "secondary" reserve of gold impounded with the Federal Reserve Agents.

PREPARATION BUT NOT INFLATION

Capacity to issue some seven or eight hundred millions of dollars of reserve credits or additional currency is certainly much; but do you think that an expansive power of three-quarters of a billion dollars is too much for a country with a bank deposit structure, in the aggregate, of some \$25,000,000,000? Some who have studied our new situation and its many different possibilities of indeterminate extent and unpredictable character, think that this amount is not enough; and it must be admitted that in such matters a good deal is to be said for the view that the only way to be sure of having enough is to begin with planning to have more than enough, for credit and

financial crises have proved again and again that there is a psychological protection of inestimable value in mere magnitude of preparation; what everybody knows he can get if he needs it, he is less likely to want until and unless he actually does need it. But I believe it would be straining the matter unnecessarily at the present time, in enlarging the resources of the Federal Reserve Banks, to go beyond the limit contemplated in the proposed amendment of the Federal Reserve Board for the revision of our reserve practices; for, as I have already hinted, some people, mostly theorists to be sure, are already showing some signs of nervousness at the size and growth of the expansive powers of the Federal Reserve Banks. We do not yet fully understand in this country, as we shall in time, that any effective system of elastic reserve credit implies possibilities of misuse and inflation if incompetently directed. You cannot have an effective system of reserve banking, however, without taking that chance. I trust I need not assure you, in view of the known policies and record of the Reserve Board and Banks during their first two and a half years, that no set of men could be more alive to these possibilities than the men who are associated together in the administration of the Federal Reserve System. Individually and collectively we recognize to the fullest extent, that we are in the business of *reserve banking*; that our responsibility is first and last to give constant and vigilant attention to the maintenance of the country's banking reserve in a sound and solid condition. It may be true that the average American banker, like the average American legislator, is an expansionist, or even an inflationist, by temperament if not by conviction and precept. Many a banker, it must be admitted, too, who decries inflation in the abstract will practice it in the concrete when the opportunity and the temptation are present.

Very well, then, you may ask, what guarantees can be given that this will not likewise be true of the Federal Reserve bankers? Will not they also be carried along by the pervasive optimism of the country from time to time into the field of inflation? You may remind me that this was the prediction made by Senator Root at the time that the Federal Reserve Act was on its passage. "Bankers," said he, speaking of the American spirit of optimism, "will not be free from it. They are human. The members of the Federal Reserve Board will not be free from it. They are human. The regional bankers will not be free from it. They are human."* Of course the men of the Federal Reserve Banks and the Federal Reserve Board are human. The country would not have it otherwise. They are engaged in a very human work, and could not do it as it should be done unless they brought heart as well as talent to the work. But hope and sympathy need be no barrier to wisdom and character. Men, even bankers, must be able to be large and liberal in their impulses without being weak or foolish. They must be able, even in America, to be optimists without at the same time being inflationists. The truth of these statements is, I believe, being demonstrated every day in the history and the administration of the Federal Reserve System.

Senator Root and many others have overlooked, I think,

*"The psychology of inflation is interesting and it is well understood. No phenomenon exhibited by human nature has been the subject of more thorough, careful, and earnest study than that presented by the great multitude of individuals making up the business world in any country in the process of gradual inflation. It is as constant as the fundamental qualities of humanity, and it differs in different countries only in degree, according to the hopefulness and optimism or the natural conservatism and caution of the people. . . . Bankers are not free from it. They are human. The members of the Federal Reserve Board will not be free from it. They are human. Regional bankers will not be free from it. They are human." (From speech of Senator Elihu Root, U. S. Senate, Dec. 13, 1913.)

one very important difference between the point of view of the ordinary commercial banker and that of the Federal Reserve banker. The Federal Reserve Banks are not primarily money making institutions. Their managers are not therefore under the steady and insistent pressure of the ordinary banker to make profits. The business of the Federal Reserve Banks is to provide and maintain conditions under which their member banks may do their business well and the country enjoy all of the prosperity and safety that can come from a carefully controlled and administered system of reserve banking. It was therefore a wise provision of the law that the dividends which Federal Reserve Banks might distribute to their member bank stockholders were limited to 6%. This removed from these banks the ordinary business temptation to make money. It is becoming a current maxim among the Federal Reserve Banks that not the amount of business they do but the amount of good and wholesome influence they exert in adjusting the volume of reserve credit to the necessary scope of current business conditions, is the proper test of the wisdom and efficiency of their management. The fact is that the Reserve System has been the only considerable and organized influence which has been exerted during the past two years to temper the sweep of the inflationary optimism which has been growing and at times has been rampant in the country; and if the System could have done more in this direction, it would have done it. Some few weeks ago, when money conditions looked superficially so easy as to require no particular thought for the future, the Federal Reserve Banks undertook to exercise a counteracting influence by allowing their investments to run off and by absorbing in exchange for them some of the redundant gold of their member banks. They knew full well that the momentary "ease" was more or less artificial, and that it

was therefore their duty to exert a corrective influence against it. If they had been in a position to have fed into the market by degrees \$100,000,000 of investments in exchange for gold, instead of a mere \$23,000,000, and thus more effectually to have put on the brakes against any undue stimulation and expansion, they would have done it. Indeed the Reserve Board has been so alive to the importance of the System's being able to exercise a restraining influence from time to time in the face of the swelling tide of gold, that it has included among the amendments it has proposed to Congress one under which the Board would be given authority in extraordinary circumstances, by affirmative vote of not less than five of its members, to raise the required reserves of member banks by as much as one-fifth.

If the Federal Reserve Board had been in a position during the past two years to exercise an influence such as the authority proposed to be conferred on the Board by this amendment contemplates, it is probable that the country could have been spared much of the inflation of credit and prices which has been in progress. Many letters have come to the Board from large bankers all over the country, regretting that there was not some method by which this inflation could be checked. They felt themselves powerless to accomplish much by their individual action. "If I maintain my reserves at 20 or 25% when the law simply requires 15 or 18%, I cannot be sure that my competitor across the street will do the same. The probability is that he will not, and that he will expand to take the business I turn away, and at times when my earnings are not high, by reason of low rates, I must therefore yield and expand to the limit of the law so long as I can get good and safe paper." So the reasoning has run. In matters of that

character, competition between banks usually works downwards and toward a weakening of the general condition. What the Board desired to be in a position to accomplish by the amendment in question, was to equalize competitive conditions among the banks in the matter of reserves, at times and under conditions such as we have been going through, when the country was being inundated by a plethora of gold, and when, as experience has repeatedly shown, it is not safe and wise to trust to the individual sense of prudence of the banks.

The amendment, however, is not finding favor, and I think it is safe to say that you will not be subject to any new "interference" with what many of you have been doing or want to do. Let me say also that it is my individual judgment that if the amendment were passed it would be extremely improbable that the Reserve Board would ever make use of the full authority contemplated by it. But it would at any rate give the Board a very effective talking point. If, after taking counsel of the Federal Advisory Council, the Board had come to the conclusion that there should be a slowing down, its advice would probably have been heeded because it would have been understood by the banks that the Board would be in a position to enforce its views. The amendment would certainly have established a new and unusual authority over banking. But these are unusual times, and they have brought with them utterly new and unusual conditions and needs. And after all, is it illogical for a Board which is given the authority to reduce reserve requirements in the face of a crisis of stringency to be given the power to raise them in the face of a crisis of prosperity? I think not. You may not agree with me, however, in this; but you will at least agree that the proposed amendment shows that the Reserve Board was and is

alive to the danger of the inflation of banking credit and was seeking to devise an enlargement of its power to check it. So far, at least, the Board was not living down to Senator Root's prediction of what was to be expected.

Indeed, and quite to the contrary, the Board has recently been criticized by high authority across the seas for its conservatism and its undertaking to advise the observance of a policy of conservatism by the member banks of the country. Sir Edward Holden, Chairman of the London City and Midland Bank, Limited, in his address at the annual meeting of the stockholders of his bank, recently complained: "After the Allies had so handsomely contributed to the gold reserves of the United States, thus facilitating the exportation of American commodities to the extent of £1,913,000,000 between July, 1914, and November 30, 1916, it seems difficult to understand why the Federal Reserve Board should have endeavoured to place difficulties in the way of American bankers creating further loans."* Sir Edward figured that "The additional loaning power due to the large imports of gold from the Allies, taken on an average ratio of 15%, would be over £1,400,000,000, and even on the old ratios of 25%, 25%, and 15%, i. e. an average of 22%, the loaning power would be nearly £1,000,000,000,** whereas the Allied Governments had received only about £430,000,000, or two-fold the amount of gold they had sent.

It is a sufficient answer to Sir Edward, in connection with the present discussion, to state that our new banking system under the leadership of the Federal Reserve Banks is not a

*The Economist, London, January 27, 1917; page 154

**The Economist, London, January 27, 1917; page 153.

venture in financial alchemy, nor a return to the philosophy of wildcat banking. Inflation is not therefore its purpose, nor the measure of its usefulness. No doubt as a mere mathematical or bookkeeping proposition or as an enterprise in the manufacture of credit, we might do or have done as Sir Edward has suggested, and blown up the balloon of credit. But nobody, feeling a serious concern for the welfare and safety of American credit and business and the welfare of the average American consumer and workman first, can doubt for a moment that such a wild expansion of credit would be one of the most hazardous and senseless enterprises in which our banking system could engage.

Fortunately, however, our Reserve System has been given a constitution and a character which render it as nearly immune to such temptations as possible. The Reserve Banks are quasi-governmental institutions, invested with large public responsibilities. The Federal Reserve Board recognizes that it itself and the Reserve Banks are trustees not for a part, but for the whole, of the American business, working, and consuming public. Neither needless contraction on the one hand nor ill-advised expansion on the other, is anything that need ever be feared of the Federal Reserve Board, no matter who may constitute its personnel. Two years and a half of constant contact with the Federal Reserve System since the day of its organization satisfy me that the joint sense of responsibility and prudence of the Board and the Reserve Banks is the best protection of the System against abuse, and the best guarantee equally and at once against the realization of Senator Root's fears of inflation on the one side, or Sir Edward Holden's desires for inflation on the other.

I have talked with freedom and frankness regarding a variety of factors and conditions vitally affecting the position of the American banking system, particularly as the factors and conditions reflect themselves in the position of the Federal Reserve Banks. I thought it could not be without interest to you to see how these questions are approached from the point of view of the Federal Reserve Board. I have talked with what may seem to you to have been tedious length concerning gold as a controlling factor in our banking situation, but I would not leave you with the impression that we are in any sense alarmed. We are, however, impatient for a more competent control of our great stock of gold by the Federal Reserve System, and feel that the present time is opportune for legislation. Great changes in the financial systems or practices of countries are usually made only as the result of severe experiences or in anticipation of threatening disturbances. Without our terrible revulsion of 1907, we should probably not have had the thoroughgoing banking reform which was subsequently put through. Many of the changes which were made in the structure of our banking organization by the Federal Reserve Act were done grudgingly at the time, but few now question their necessity and wisdom. Both European and American experience during the past two years and a half have demonstrated beyond the possibility of doubt the immense value of concentration and co-ordination of financial resources in the modern world, and of centralization and control of direction when they are properly safeguarded against abuse.

Let us not forget that we are all at the moment concerned in building up a new American banking system. It is a com-

mon enterprise—a common enterprise beyond what you perhaps realize in the ordinary course of your business. Some of us are silent partners in the work, others active partners, but partners we are, all of us. It is therefore for all of us to learn how we can most effectively work together so as to make our new system attain its full potentialities as the financial basis of the American business and industrial system.

We speak of the Federal Reserve System as though it were full-made. We speak of the Federal Reserve Act as though that Act had created a system full-grown. Such is, however, far from the fact. The most that any legislation can do is to lay foundations—to open the way. That it takes years of experience to make and mature a great banking system, is evidenced by the banking history of England. The English banking system has long been the admiration of the world, and yet the banking laws of England are perhaps the simplest that can be found in the legislation of any country—quite without restrictions of any character save one, and that one of little importance. Custom, practice, and traditions with binding force equal to or greater than that of law, have made the English system what it is. Such, however, has not been our way. Our way has mostly been the way of legislation. But our new banking system will never become a great banking system unless we, too, have customs, practices, and traditions; new ways of looking at things and new ways of doing things, as well as a matchless piece of banking legislation, in order to meet the requirements of our expanding country and the requirements of a war-worn world which will lean upon us—young, strong, and robust as we are—for the help that civilization must have if it is to be reconstituted in

Europe. No country in modern times has ever been confronted with such an opportunity for distinguished world service as ours, no democracy has ever been given such an opportunity to show what democracy can do when it is alive and aroused and guerdoned not for the purposes of self-glorification or aggrandizement, but for the purpose of service and help.