

"A Bit of Information and Advice for the Home Folks".

(An address to the Annual Convention of the
Cotton States Merchants Association,
at Memphis, Tenn., on August 26, 1926.)

by

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Mr. Chairman and Friends:

CARDED

I can't begin to tell you how glad I am to be back home or how gratifying it is to have the privilege of meeting and talking with my home folks again.

During the three years that I have been in Washington, serving as a member of the Federal Reserve Board, my work has been quite interesting, my colleagues most congenial and my home life very happy, but at that there have been times when I have been mighty homesick and I frequently find myself thinking of, and trying to figure out, the many perplexing problems that I know are peculiar to our own beloved section of the country.

The study of national and international business and finance, together with watching the fluctuations in the money markets both at home and abroad is as fascinating as was the reading of romances like "Ivanhoe", "Robin Hood" and the "Count of Monte Cristo" in my younger days. Then, too, the routine work of the Board itself, the constant and persistent effort that is being made to adjust the machinery of the Federal Reserve System to meet the more or less frequent changes and the gradual evolution that is taking place in the business of the nation is in itself an inspiration, and I can say that I get a great deal of pleasure and satisfaction from my work. But all the time, along with these matters, there is constantly before me the questions - How are the many changes in business and financial methods affecting my home territory, and how are our people meeting these changes?

Just a few days ago I received a letter from the President of one of the large and important banking institutions in New York which I am going to read to you. The letter referred to reads as follows:

"New York, July 30, 1926.

"Dear Mr. James:

"In the last few years, as you know, a radical change has taken place in the purchasing methods of the retailers, distributors and consumers of commodities and manufactured articles. Whereas formerly, with very few exceptions, it was the custom to anticipate the demands of the ultimate consumers by forward buying, it is now the exception rather than the rule when purchases are made in excess of an amount necessary to supply the immediate demand. This practice has come to be characterized by the colloquial term of "hand-to-mouth" buying. On all sides are heard expressions of approval and disapproval of this practice.

"The manufacturers contend that it is becoming increasingly difficult for them to anticipate the demands that may be made upon their output. And in many instances the manufacturer's choice is between piling up an inventory of manufactured goods or executing orders as received at increased costs.

"On the other hand, retailers and distributors claim that with the present high efficiency of the railway transportation systems of the country it is possible for them to secure quickly such articles as may be necessary to meet the demands of their customers, and that because of that fact they see no reason for their carrying a large and expensive inventory.

"Others advise that because of the radical and frequently occurring changes in styles it would be the height of folly for them to make purchases other than are necessary in the routine conduct of their business.

"It is quite evident that it will be necessary for either the manufacturers or the distributors to make such readjustments in their methods of operation as will meet present conditions. This adjustment has, in fact, begun.

"What the solution of the problem may be is to me very perplexing. A reduction in the volume of mass production on the part of the manufacturer, resulting as it would in the majority of cases in increased costs, would not seem to be the only method of reaching the fundamental difficulties in the situation. And on the other hand, in view of the uncertainty of the consumers' demands

due to changes in styles, and the valid objections to piling up inventories, it would not seem reasonable to expect retailers, distributors and others to do any great amount of forward buying with the consequent possibility of having their shelves stocked with unsaleable or unusable merchandise.

"I should appreciate greatly your letting me have the benefit of your thoughts in regard to this problem. To what extent can and should "hand-to-mouth" buying be overcome? Should this practice be accepted as a permanent condition, and if so, what adjustments are necessary and what are the effects to be expected? These are among the questions on which I should greatly value your opinion. I feel sure that if I can secure the opinions of a number of well-informed men such as yourself I may be in a position where I can bring to the attention of the thinking business men of the country an intelligent discussion of the subject."

(Signed)
President"

In reply to this communication, I wrote the gentleman as follows:

"Washington, D.C., August 7, 1926.

"Dear Mr. Blank:

"Your very interesting letter of July 30th addressed to me as President of the Wm. R. Moore Dry Goods Company, Memphis, Tenn., having been forwarded, reached me here this morning.

"There have, as I see it, been many various factors contributing to the growth of the so-called "hand-to-mouth" buying of merchandise and no satisfactory solution of the problem can be found without due consideration of them all. In addition to the things you mention, we have a marked difference between the past and present in the matter of credits, for instance, the shifting from credits based on "inventories" to "receivables" in one form or another. Then, too, there is the development of the "mail order houses", "department stores", "chain stores" and other forms of competition that have grown up, in a very large degree, to take the place of the old fashioned "jobber" and "retailer". The passing of the cross roads country merchant has quite a bearing on this problem.

"Still another factor that must be taken into consideration is the shifting of the population from farms and country to the cities and along with it the change in the buying power of the average person due (a) to frequent distribution of funds through payrolls, and (b) the almost "full employment of labor" that has prevailed in this country for the past five or perhaps ten years. All through this "evolution" in merchandising the old law of the "survival of the fittest" has been at work and now the manufacturer and the distributor

are feeling its effects. Both are facing increasing overhead and other costs on one hand and diminishing profits on the other.

"Frankly, I do not know what the outcome will be. I cannot say which method of distribution (because of the superiority of the service) will survive, but I do venture the assertion that this question cannot be answered until the newer methods shall have passed through a rather long period of depression and unemployment in this country.

"Under existing circumstances and conditions I feel that it is wisdom on the part of the distributors to pursue a "hand-to-mouth" policy in buying merchandise. A quick "turn-over" minimizes both expense and risk and is, therefore, most commendable.

"Assuring you that I appreciate the compliment paid me in asking my opinion, I am,

Yours very truly,

(Signed) Geo.R.James".

I have brought this correspondence to your attention believing that it brings up subjects in which you as merchants have a very vital interest. I am sure that you will agree with the New York banker that "a radical change has taken place in the purchasing methods of the retailers, distributors and consumers of commodities and manufactured articles" in the last few years. I am sure also that you will agree with me that the growth of mail order houses, department stores and chain stores has been little less than remarkable since the ending of the world war. Every live merchant in the country must have noted the very remarkable increase in instalment buying and perhaps there is no development of recent years that has a more important bearing on this question of distributing merchandise than does the practice of buying and selling on the instalment plan.

In the belief that Shakespeare was right when he said "There is good in everything", I have given a great deal of thought and study to this matter of instalment buying and I confess that there are many features of it which I can and do commend. On the other hand, I cannot refrain from a feeling

that to a very great extent the practice is being carried to excess, - in fact, to an extent that I regard as extremely dangerous. I cannot help but view with alarm the steady increase in the debts of the individuals and institutions that make up this great nation of ours. One statistician has made the statement that if every man, woman and child could maintain their present earnings and incomes for a period of two years and that during the same period nothing whatsoever should be expended for current necessities or for anything other than to liquidate the present indebtedness, the end of the period would show the people still very much in debt.

This strikes me as a most serious situation, for, as I pointed out in my letter to the New York banker, during the time this increase in indebtedness was taking place this country has been enjoying nearer full employment of labor and manufacturing capacity of industry than at any time ever recorded in history. During the period, the figures representing the business activity of this country both as to production, employment, prices and wages as well as the debts have been going up, and I want to call your attention to the fact that nobody ever got hurt going up, - even the aviators get along all right while their machines are moving skyward.

The thing that perturbs me is what must inevitably happen when the trend is the other way. What are we doing now to prepare ourselves for the decline? In other words, we have been mounting the hill in a rather smooth running machine - taking a joy ride if you please - speeding on with little thought as to what may be the condition of the road beyond the brow of the hill.

I wonder how many people there are today who know whether or not their "brakes" are in working order? I think if we view the records

of the numerous automobile accidents we would find that the case was an inability to stop in time rather than to breaking down in the movement forward.

The answer to the question "Is instalment buying good or bad" depends upon the individual. For one who fails to budget his income and expenses and who does not provide a cash reserve of not less than twenty per cent of his total indebtedness, instalment buying is certainly very very bad; in fact, in my opinion it is a very dangerous procedure. But whether one is using the instalment plan of buying or not, I still want to emphasize with all the force available the advisability and desirability of everybody making a budget of his income and expenses not only for his business affairs but for himself as an individual. See for a certainty whether or not your income exceeds your expenses and provides for your commitments, and then when you have finished that job for your ourselves and your own business, do a little figuring along the same lines for your communities. As in the case of individuals or business concerns, no community can be permanently prosperous unless it receives for its products more money than it pays out for purchases made in other communities, and sets up a "reserve" out of the favorable balance.

Business throughout the country at the present time is good. Taking the United States as a whole, it is a country wherein prosperity prevails to a very remarkable degree. Just how long this prosperity can and will prevail, I do not believe any one can tell. I hope it may continue for a long time, but no matter whether the duration of the present prosperity continues for a long or short period, now is the time when the wise man is paying his debts and is getting his house in

order for whatever may follow in the business world.

By all means look to your reserves. There is nothing more important either to an individual or a business concern than is this matter of providing and maintaining a cash reserve, and especially is this true of those who use credit. Every banking institution is required by law to maintain a cash reserve against its deposits, but even if there were no law on the subject, no good banker would for a moment think of running his bank without adequate reserves. Good bankers carry not only the reserves required by law but maintain reserves far in excess of the legal requirements.

Maintaining a cash reserve is just as important to the business house or to the individual who uses credit as it is to a bank. The best managed banks require their borrowing customers to carry a balance usually amounting to twenty per cent of the loan. These balances are nothing more or less than reserves. I know there are many banks (usually those known as country banks) that do not make this requirement of their customers but who endeavor to make up for the absence of these balances by charging a higher rate of interest. Now the fact is, there is no difference in dollars and cents between what the customer actually pays for his accommodation whether he borrows from a city bank which requires a twenty per cent balance and charges a six per cent rate of interest or borrows from a country bank which makes no such requirements and charges seven and one-half per cent, but my friends there is a very vital difference both to the bank and to the customer; the position of either or both being very much stronger when the proper reserves are carried. The man who carries a good balance with a bank never has any trouble getting ac-

commodation when he needs it and if one could only see and appreciate the difference in attitude on the part of the banker towards his customers when the customer has a large balance and when he has no balance, I am sure no further argument would be needed.

The greatest and strongest banking system the world has ever known is your Federal Reserve System, the very foundation of which is the reserves of its member banks. I say YOUR Federal Reserve System, because it was created by and is a very vital part of your Government, - "That Government of the people, by the people, for the people". The fact that the Government stands squarely behind the notes of the reserve banks, which notes play such an important part in providing a currency for the nation, gives you as part of the public a most decided interest in, if not ownership of, the Federal reserve banks and the System.

While the Federal Reserve System deals with the public only through its member banks, the very purpose for which it was created was to be of service to the agriculture, industry and commerce of the nation functioning, if you please, through the member banks which in turn are the custodians of the cash reserves of the people.

The Federal reserve banks were not established to make money. The law provides that for the money the member banks subscribe to the capital of the Federal reserve banks there shall be paid interest at the rate of six per cent per annum. After this dividend or interest is taken care of and the expenses of operating the reserve banks are paid, the balance of the earnings go to the Treasury of the United States.

The law permits the Federal reserve banks to perform certain services for the member banks without charge and at the expense of the reserve banks because it was believed that the reserve banks could reduce

the costs of performing these services, and I can tell you that the services now rendered by the Federal reserve banks are performed at a saving in cost that is far greater than was originally anticipated. The cost of the collection of checks, transfer of funds, and handling of currency by the Federal Reserve System is only a small percentage of what those functions cost when performed by individual banks. The economies that are possible through mass production applies with equal force in the Federal Reserve System as it does in the plants of the Ford Motor Company.

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

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

Because of my interest in and love for my own home territory, it hurts me terribly to tell you that the South, and this particular section of it especially, is far behind the rest of the country in availing itself of the security, facilities and benefits of the Federal Reserve

System. In the territory served by the Memphis Branch of the Federal Reserve Bank of St. Louis (that is to say, in West Tennessee, Northern Mississippi and Eastern Arkansas) there is the smallest percentage of member banks to banks in the territory of any section of the United States. In this territory, less than fifteen per cent of the banks are members of the Federal Reserve System, whereas, in the great State of New York seventy per cent of all the banks are members of the System. Of course, all of the national banks and practically all of the big State banks in the cities are members of the System.

As a member of the Federal Reserve Board, a good part of my time has been taken up in studying the question of why so many banks in our territory do not belong to the Federal Reserve System, but I am still unable to get anything like a satisfactory answer to the problem. The fact is that when I try to sum up the reasons I have heard for banks not being members of the System, I am reminded of the old story about the Arabian sheik who was noted for being rather thrifty, and one who looked after his business closely and carefully. One day a neighbor sent over to him and asked to borrow a piece of rope. In answer to this request he said that he was sorry he could not let him have the rope because he was using it to tie up his milk. To this the neighbor very indignantly asked - "Whoever heard of tying up milk with a rope?" The old sheik replied - "My friend, when you dont want to do anything, one excuse is just as good as another".

One of the popular answers to my inquiry as to why the nonmember banks do not join the Federal Reserve System, has been that the System does not pay any interest on reserves, whereas, by keeping their reserves with some city correspondent bank they receive interest on their balances;

in consequence, in the one case they get no return on their reserve balances, in the other, they make a profit. This statement always brings to my mind the story of the two negroes who were passing a graveyard. One of them could read and the other couldn't. The educated fellow was entertaining his companion by reading the epitaphs on the tombstones. Finally they came to one which said "He is not dead but sleepeth". The ignorant fellow said "Umph, big boy, that white man ain't foolin' nobody 'cept hisse".

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

I could go into details in explaining to you just why this suggestion is offered but my time is too limited and I will only say in this connection that if there are any bankers in the audience they know what I am talking about, and if you who are not bankers ever want to talk to a man who is supposed to be a banker and this same subject comes up, you may be absolutely certain that if he is anything of a good banker at all he will know in his heart that what I am saying is absolutely true.

Another reason frequently offered by country bankers in the South for not joining the Federal Reserve System is that they are denied the right to charge exchange when remitting for their checks. One so-called banker asked in my presence on one occasion "What right has the Federal Reserve System to deny my bank the right to charge exchange?" To this I very promptly answered by asking him the question - "What right have you to de-

duct anything when paying a customer's check that is presented either over the counter or through a Federal reserve bank?"

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

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

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

In this, the Eighth or St. Louis Federal Reserve District, there are all told 3073 banks. Of this number 619 are member banks, and 2454 nonmember State banks. Of the nonmember banks 2036 are on the par list. They voluntarily remit to the reserve banks at par for checks on them that are collected through the Federal Reserve System. 418 nonmember banks (only $13\frac{1}{2}$ per cent of the banks in the entire district)

still stand out for their "right" (?) to collect exchange.

As you doubtless know, the Federal Reserve Bank of St. Louis has, in addition to the home office, branches at Louisville, Little Rock and Memphis, and the territory is divided accordingly. In that part of the district served by the home, or St. Louis, office, over 95 per cent of the nonmember banks remit to the reserve bank at par. In the part served by the Louisville Branch 97 per cent remit at par. In the part served by Little Rock 62 per cent remit at par. In that territory served by the Memphis Branch only 29 per cent of the nonmember banks remit at par. As I said before, less than fifteen per cent of the banks in the territory covered by the Memphis Branch are members of the System. Can you wonder that I feel humiliated when this situation and these figures are up for consideration?

Next to the Memphis territory in the ratio of banks not on the par list, comes the Atlanta District, and you who read the newspapers know what recently happened to a chain of nonmember banks with more than a hundred members, in that District.

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

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

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

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

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

There have been a great many bank failures in the United States during the past few years. A small percentage of them - and a small per-

centage only - have been members of the Federal Reserve System, but NOT ONE SINGLE ONE OF THEM failed that had lived up to the letter and spirit of the law and the rules and regulations of the Federal Reserve Board.

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

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

I have a good many friends in the banking business in this territory and it is possible that some of them may not like what I am saying to you now, but in that event I can only say that I am sorry. I feel that it is my duty as a public servant to call your attention to such matters as these in which I have a real responsibility.

The views and opinions I have expressed are my own and should not be taken as representing those of the other members of the Federal Reserve Board. What I have said to you is in the hope that my remarks may help you in this time of peace to prepare for war.

I thank you.