

FEDERAL RESERVE BANK
OF DALLAS

Dallas, Texas,

June 12th, 1920.

TO THE PRESIDENT OF THE BANK ADDRESSED:

There appeared in the Dallas News of June 11th, 1920, an editorial on the subject of The Advancing Cost of Bank Credit, which, while apparently directed to the people, carries with it a message of such great importance to the banking fraternity that we have obtained some reprints of it and I am taking the liberty of inclosing one herewith for your information.

The soundness of the views expressed in this editorial are unquestioned and bear out, to a certain extent, the views expressed by us in our Circular No. 17, under date of May 7th, 1920, wherein we urged our member banks to curtail their borrowings from the Federal Reserve Bank and elsewhere, for what might be termed non-essential purposes, in order that all available and necessary credit might be extended to encourage and aid the agricultural and live stock production of this district.

It is generally recognized that both money and market conditions are such as to warrant or justify some increase over pre-war rates on loans, but we feel sure that the thoughtful banker will see the utter unwisdom of imposing any undue burden on the industry and commerce of the country. His own interest, and that of the community in general, will best be subserved by an attitude of friendly consideration for the productive interests of the District.

Only through increased production of the necessities can we hope for any reduction, or even stabilization, of our present high prices of food and clothing, or for any increase in the actual wealth of our nation, for in its last analysis all wealth has its origin in nature and its products.

On the banker, because of his far-reaching influence, devolves the greatest responsibility in connection with the stimulation of increased production, and we earnestly urge you to cooperate with us and to use that influence whenever and wherever possible.

The war is over, but we still have before us, to as great or even greater extent than ever before, the patriotic duty of producing food, clothing and other necessities for our people.

May we not count upon your assistance?

Yours very earnestly,

vz-cc

A handwritten signature in cursive script, reading "R. L. Van Zandt".
Governor.

The Dallas Morning News

Friday, June 11, 1920.

THE ADVANCING COST OF BANK CREDIT.

It seems to have become the policy of banks to advance their discount rates commensurately with the advances made in the rediscount rates of the Federal Reserve Banks. Some of them seem not to have been content to limit their advances to the advances made by the Federal Reserve Banks, but to have made the action of the Federal Reserve Banks a pretext to widen the previously existing difference between the discount and the rediscount rates. We use the word pretext for the reason that the action of a Federal Reserve Bank in increasing its rediscount rates does not necessarily warrant member banks in making any increase, whatever. The idea that it does, which idea seems to govern the policy of member banks, betrays a most surprising misconception of the purposes and functions of the Federal Reserve System.

It was not the purpose in creating the Federal Reserve System to enable the member banks to make a profit out of their rediscount operations. Nor was it the purpose even to enlarge their opportunities for increasing their earnings in any way. The salient purpose was to create and maintain a reservoir of credit for use in times of stress. Whenever rediscount rates are advanced, therefore, it is done chiefly to husband the resources of the Federal Reserve Banks. Under normal conditions, the rates of a central bank, in countries which have long had them, are higher than the open market rates, so that banks which rediscount lose instead of gain by the operation; and properly so, since the effect is to restrict the use of credit, which is the purpose of the central bank in advancing its rediscount rates. It is obvious that if member banks are to make a profit on their rediscount operations they will be under no inducement to contract the volume of credit, and hence the purpose of the Federal Reserve Bank in advancing its rediscount rates will be somewhat balked, if not defeated.

That there is a species of profi-

teering in advancing discount rates on no other warrant than the fact that the Federal Reserve Banks have advanced their rediscount rates will become apparent on a moment's reflection. For it is but a small percentage—about 12 per cent, we believe—of the loans made by member banks are rediscounted at the Federal Reserve Banks. In other words, about 88 per cent of their loans are made from their own funds, so that when they advance their discount rates commensurately with an advance made in the rediscount rates of the Federal Reserve Banks they are merely increasing their profits on nearly 90 per cent of the loans they make at the advanced rates. Thus what they in reality do is to put a "replacement value" on their funds, but without, however, always replacing them; so that they have even less excuse than the dealers in sugar for adopting that thrifty rule of pricing. If the member banks had all of their loanable funds outstanding, or even any very large percentage of them, it might be both just and expedient to make additional loans at the rates of the Federal Reserve Banks, or even at rates higher than those of the Federal Reserve Banks. But when they make their rates advance with those of the Federal Reserve Banks without being under the necessity of rediscounting the loans made at those advanced rates, it is evident that they are merely exploiting an opportunity which arises from an unhealthful condition of finance and industry. There is the less excuse for doing this in the fact that the Federal Reserve Act has freed for use a great deal of the money which the old law required them to keep in their vaults. Since a greater percentage of their funds is thus made available for lending, they can make their rates lower and still make their discount operations as profitable as they were before the institution of the Federal Reserve System.

The action of the banks throughout the country in advancing their discount rates has engendered no little dissatisfaction, and that dissatisfaction vents itself in complaints against the Federal Reserve Banks. That this is an injustice to those institutions is made clear by what has been said.