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THE
NINTH FEDERAL
RESERVE BANK

IN RELATION TO
THE BUSINESS OF
THE NORTHWEST



ADDRESS OF
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The Ninth Federal Reserve Bank in Relation to the Business of The Northwest

After more than 60 years of debate, experimentation and discussion, there at last has been created in the United States a banking system which I do not hesitate to say places this country on a parity with the principal nations of the old world. So far as any single measure can, it satisfies the best opinion of banking experts, economists and financiers. I would not assert that it is perfect at all points or that it is not susceptible of beneficial amendment. So great a piece of constructive legislation was necessarily the product of argument and compromise. It is my sincere conviction that the Federal reserve act, while not yet perfect at all points, embodies all of the important principles and provides the facilities which have so long been demanded by our best financial and economic opinion in the United States. My view of the system which was established by the signing of the act on December 23, 1913, and which was placed in operation through the opening of 12 Federal reserve banks on November 16, last, is a hopeful one. I think we have already attained in the act a firm and sure foundation upon which to rear one of the best, one of the safest and one of the most solid financial structures that can be found in the world. My view is that the defects which have so far become apparent are of a minor character, and none of them of such a kind that they cannot be remedied by the simple process of amendment at any of the successive sessions of Congress. In a country such as this it would be quite hopeless to anticipate that any measure of this importance could be made so perfect at the time of its enactment, as not to require minor alterations and changes thereafter.

Personnel of Board Commands Respect.

It is with some hesitation that I attempt to discuss the operations of the Ninth District Federal Reserve bank. It is an institution that at this time is only a little more than 60 days old. Many of its important functions are still to be defined by the interpretations and instructions

of the Federal Reserve board. The regulations of the board that have so far been issued have shown a most admirable spirit and while they are not great in number they clearly indicate that its personnel is such as to command respect and confidence and that its decisions will not be arrived at hastily and will only be issued to the respective banks after it has been determined that they represent the best and soundest thought. Those who are somewhat impatient at the lack of interpretive decision upon many important points which have not yet been touched, have only to consider that every regulation and every decision of the Federal Reserve board at this time constitutes a precedent that will rule perhaps for many years to come. Such regulations could not be hastily conceived and satisfy the critical judgment of the many able bankers in the United States. A conception of the very great importance of these early rulings and decisions, with respect to the future conduct of this great financial system, is sufficient to indicate the gravity of the problems that daily confront the Federal Reserve board and to convey an adequate impression of the immense amount of work which now rests upon their shoulders. It is my belief that the Federal Reserve board is imbued with the most sincere and patriotic desire that this new banking system be so adjusted at all points as to perform a real and constructive service to the public of the United States.

Reserve System First of Its Kind.

The banking system which has been established is unique. It is erroneous to take the view that the Government has merely acquired supervision of a more comprehensive character over the banks of the country. The true situation is quite different, much more important and much better calculated to serve the people of the United States in a practical and beneficial way. The Federal Government was a supervising agency over all national banks before the Federal reserve act was adopted. It has now become not alone a supervising agency but a partner of the member banks of the new system. Where the member banks have supplied approximately \$250,000,000 of funds now in possession of the Federal reserve system, the Government has in turn provided a kind and degree of protection to all banks which was never before known in this country. Where the banks have, without option, contributed to the capital stock of the Federal reserve bank of their district,

the Federal Government has without reservation released from their former hoards of dead cash, such an amount of money which is now entering the commercial field in the form of loanable funds, as to make it quite unimportant whether the Federal reserve banks ever pay their dividends. A profit to the respective member banks in interest upon what was formerly dead cash should be considered in the light of a dividend resulting from the establishment of the new system. No element of protection to depositors has been sacrificed in reducing the formerly high reserve requirements and the banks have been provided with a better degree of safety than before at the cost of a less proportion of dead cash. I might add that I have no fear that the Ninth Federal Reserve bank will not be fully able to meet its dividend requirements and its reasonable expenses even in its first year. It was founded to perform a service to the public and while it was in no sense created as a profit-making institution, it will at the same time take its moderate earnings in increasing proportion, as its practical service ability to commerce, industry and agriculture is extended.

Mutual Feeling Should Be of Great Benefit.

The mutual relation between the Federal Government and the member banks of the reserve system should be of the greatest benefit upon both sides. The Federal Government has been brought into a more intimate and appreciative relation to the banks than before. As it extends to the member banks the new and important advantages which have been provided, it will in turn come into a better and a more intimate and detailed knowledge of the practical requirements of business in this country. The attitude of the Government is one of helpfulness which has been met by a commendable spirit of co-operation on the part of the member banks. It was essential to the success of the new system that the mutuality of the new relationship be recognized on both sides, and there is no doubt but that this has been successfully accomplished and constitutes in all probability the best and surest safeguard for the success of the new system in the future. When the idea has been dispelled from the minds of bankers that their interests are antagonistic to those of the general Government, and when the general Government has appreciated that the greatest degree of public service can be rendered through close and intelligent co-operation with

the commercial banks, there has been laid the foundation of an understanding which cannot fail to be of great practical benefit to every man engaged in commerce, in manufactures, and in agriculture.

Basic Principles.

Two important principles, involved in the operation of the new Federal reserve banks, have particular application in the relations of the Ninth Federal Reserve bank to the banks of its district, comprising a part of Michigan, a part of Wisconsin, Minnesota, North Dakota, South Dakota and Montana. They are as follows:

1. The practical functions of the Ninth Federal Reserve bank in relation to its member banks, must be performed at all times in consideration of the nation-wide purposes which lie back of the founding of the new banking system, and cannot yield wholly to the influence of district, state or local conditions.

2. In such degree as the Ninth Federal Reserve bank continuously exhausts its resources in meeting the requests of its own member banks or in attempting to stimulate activities local to its own district or to the states or localities therein, it places itself in danger of impairing its serviceability in times of stress, danger or panic.

Provides Safe and Adequate Protection.

The purpose of this bank is not to unduly stimulate or accentuate agricultural and commercial prosperity. Its foundation purpose is that of providing safe and adequate protection to every member bank through the mobilization of reserves and the creation of a discount market for commercial paper. The second of the two principles that I have stated should be interpreted in the light of the fact that the resources of the Ninth Federal Reserve bank promise to be entirely adequate at all times to any reasonable demands of this district. While undue stimulation and the creation of an artificial prosperity must be avoided, it is the business of this bank to meet the fair and reasonable demands of its member banks and while exercising necessary conservatism, it must offer to commerce, industry and agriculture, such a degree of support as will serve as a substantial protection against high

money rates, stringency, sudden or unusual stress, or panic.

The thought that was in the minds of business and financial leaders in advocating the adoption of a reconstructed banking system was not primarily that we needed a better system for the benefit of banks alone. It is well known that banks themselves have weathered periods of panic better than have the business concerns and enterprises that were affected by tight money and reduced markets. During the panic of 1907 the losses to the farmers of the Northwest in the item of barley alone were probably greater than the combined losses of the banks. During that period of rapidly falling prices it was necessary for the farmers to market a large part of the year's product of their farms. Their cereal crops and also their live stock sold at prices much below normal and it is entirely safe to estimate that in the immediate northwestern territory the total of such panic losses was not less than \$5,000,000. There is no method by which a satisfactory estimate of the losses to commercial business may be arrived at.

Establishes Co-operative Relation.

The purpose of the Government is to prevent such losses to business and agriculture in the future, insofar as this may be possible, and the method it has chosen is that of establishing a better and more intelligent co-operative relation with the commercial banks, both national and state. It seeks to guarantee to the farmer and the business man that he will be able to pursue his activities, while he is exercising due conservatism and judgment, under the encouraging influences of a favorable money market and with freedom from suddenly fluctuating rates of interest and the dangerous results of sudden periods of stress.

The method employed by the Government in solving this problem was wise and judicious. It has created no more new machinery than was necessary to bring about harmony and complete understanding between the existing banks of the United States. It has laid the banks under no new and unusual restrictions and where it has somewhat altered their former methods of operation, it has granted them valuable compensations. While it has granted the Federal reserve banks a degree of authority that might permit them to compete in some measure with the commercial banks, it has so worded this grant of authority and

surrounded it with such conditions that the thought of actual competition with member banks does not enter the minds of those charged with the administration of the new system, except as an emergency measure. It is my opinion that when the time comes that any degree of competition does actually exist, the circumstances will be such that the member banks will justify and support their Federal reserve bank in such action as it may take.

The Ninth Federal Reserve bank was not founded to produce revenue for itself or create a surplus for the benefit of the Government. It was founded to serve business through existing commercial banks. Its main purpose was to provide safety and protection. The method chosen is that of establishing a harmonious and co-operative relationship with all the banks of its district. Through this it has been possible to provide new and much needed facilities for the furthering of sound business enterprises and for the better encouragement of commerce, industry and agriculture. There should not be any disposition to restrict or curtail member banks in the granting of just and reasonable accommodation. In no other way can the Ninth Federal Reserve bank accomplish the constructive work that lies before it.

There is a clear dividing line between the performance of the fair and reasonable functions thus indicated and a policy that involves a deliberate seeking for new business, or ventures into fields of operation that involve direct competition or create new and unusual conditions affecting member or other banks.

Not Intended to Force Down Money Rates.

It is natural that those who have welcomed the founding of the new banking system have sometimes spoken of it with undue enthusiasm and credited to it possibilities which are outside of its real purpose. The view that it is to produce cheap money is erroneous. Such a purpose has never been seriously considered since the Congress of the United States first undertook the formulation of the new system. It is a trite but effective answer to such an argument to say that "Money is worth what it is worth," and no artificial conditions produced in any locality of the United States, or the nation as a whole, can create an interest rate which is out of line and not in equitable relation to the money rates of the great financial centers

of the world. The current rate in the United States cannot be wholly determined by the United States itself, as the recent conditions created by the great European conflict bear witness.

It is a reasonable view, and one which will undoubtedly be realized, that the influence of the Federal reserve banks will at all times tend to preserve money rates at a level which is fair, reasonable and just, in view of all of the conditions in the United States and the relation of those conditions to circumstances, events and developments at other financial centers and in other parts of the world.

In giving practical effect to the underlying ideas and principles on which the new banking system and the Ninth Federal Reserve bank have been founded, the governing power of the new system, represented by the Federal Reserve board in Washington, has formulated certain definitions which have to do with the direct relations of all Federal reserve banks with the commercial banks of their respective districts.

Quick Assets the Paper Eligible to Rediscount.

I desire to call to your attention the emphasis which the Federal Reserve board has placed upon the element of liquidity in the acceptance of paper for rediscount. Regulation No. 2 of the Federal Reserve board rigorously excludes from the privilege of rediscount any paper covering what it terms "merely investments." It emphasizes the principle that the degree to which the investment element enters into the purposes behind the application for the loan to a very considerable extent controls the eligibility of the paper to rediscount.

It is evident that the purpose of the Federal Reserve board in this regulation is to draw the line between the paper made for the purpose of carrying on purely commercial activities—that is to say, the processes which have to do with the creation of a product out of raw materials and the continuance of this operation to a point where the product has been sold in commerce—and the paper which may not be drawn wholly and exclusively for these purposes, but may have behind it a purpose to increase the permanent investment value of the farm or business, its capacity for production, or its working funds. The principle involved is that goods in process of sale to the consumer, whether they be growing crops of the farm-

er, the stocks of commercial firms in process of reaching the consumer, or the partially manufactured goods of the industrial concern which are undergoing the process of completion and sale to the purchaser, represent values which are within easy distance of realization.

The maturity of the processes through which the unfinished product is to be made a finished product and turned into cash, is commonly short. The loan based upon such a process is naturally a self-liquidating loan because it is founded upon the secondary stages of a process which is already in operation, and which moves rapidly and surely to its completion, at which time the loan acquires its own maturity, and automatically liquidates itself from the proceeds of sale.

The lack of the investment element and the self-liquidating character of the paper are therefore the principal factors which must govern the ability of the Ninth Federal Reserve bank to rediscount for its members and these general principles should apply to all such rediscounts, although the nature of the banking business is such that the exercise of discretion is necessary. No single general rule could be formulated which would cover each particular kind of paper held by the member banks.

The subject of rediscounts divides itself naturally into three divisions: The duty of defining the general lines along which rediscounts may be made devolves upon and has been assumed by the Federal Reserve board. It then becomes the duty of the 12 units of the banking system to interpret these general regulations in the terms of the kind and character of business done in their respective districts and the requirements of their respective member banks. Following this, there devolves upon the member banks of this and other districts, the obligation to strictly apply the regulations of the Federal board to all paper which they contemplate offering for rediscount, since the responsibility is laid upon them to guarantee the eligibility of such paper, and to endorse it.

Crop Moving Period the Test.

The practical serviceability of the Ninth Federal Reserve bank to the district which it represents will undoubtedly have its best demonstration during the periods of seasonal stress, such as the crop-moving period in the fall, when the demands upon the banking resources of the district are heavy. To enable the northwestern crop to

move promptly and expeditiously to its markets is of the greatest importance and asserts an effect upon all lines of business. The facilities provided in the Ninth Federal Reserve bank are admirably adapted to the accomplishment of this purpose, but not to this purpose alone. During the intervening periods of the year there will undoubtedly be an annually increasing opportunity to serve business and agriculture by enabling the member banks of the new system to more adequately and more promptly meet the credit requirements of their own localities.

Make for Stability.

While it may never prove to be true that the average man on the street will be able to point to any tangible, direct benefit to himself through the creation of this system, it will unquestionably prove true that every wage earner will find that the establishment of the bank has so guaranteed the commercial safety of his employing concern, if it is safely and conservatively managed, that he will be less exposed than before to violent fluctuations in the demand for labor. The salaried man has the same interest in the new system. Business men, big and little, have the assurance that so long as their enterprises are well and safely managed, their credit will not be restricted. These are new and exceedingly valuable elements in the daily activities of the people of this northwestern country. In such measures as the commercial banks are granted an adequate degree of safety and protection, an added element of safety and protection has been passed along from such member banks to all of their customers who are operating along conservative lines. These benefits pass in turn to those who are employed in such businesses, whether they be officers, salaried employes or wage earners.

While the Ninth Federal Reserve bank is not authorized to transact any business with individuals and may not have the ability to make its helpful influence felt directly by the individual concern, it still has the ability to directly influence the growth and prosperity of every sound business by making it possible for every such business to obtain from the commercial banks of the district such credit facilities as it may be entitled to. The ability of business to obtain such facilities at all times is more important and is better calculated to serve the upbuilding of this northwestern country in the long run than any

direct and artificial stimulus or advantages. The Federal reserve system and the Ninth Federal Reserve bank exist as a second line of defense for all who are engaged in business or who rely upon business enterprises or agriculture for their personal employment and profit, through providing the member commercial banks with facilities which they have not before had, and in giving to them an ability to meet all reasonable demands upon them.

Plan for Clearing Balances.

The period since the opening of the Ninth Regional bank is so short that it is not possible at this time to define the scope or nature of its activities along several very important lines, the most important of which is the assumption of clearing functions for the member banks of its district and participation in the clearing operations which are proposed for the United States as a whole, through the medium of the 12 reserve banks. The problems that are here involved are of very great magnitude, but are mainly of an administrative or mechanical character. There is one important question, however, which is of especial importance and not capable of easy solution. The creation of 12 clearing centers, each having its own relations with each of the other 11 centers, will immediately raise a serious problem with respect to the settlement of clearing balances. Under the usual methods, the shipment of currency would undoubtedly be necessary in order to offset these balances and adjust accounts as between the various Federal reserve banks. Such a system would involve a constant inflow and a constant outflow of shipments from each Federal reserve bank, together with large expense for express and clerical help. Some simpler and better method should be evolved, if possible, and I have taken the liberty of suggesting to the Federal Reserve board that out of the very large total which it has been proposed that the Government, acting through the Secretary of the Treasury, deposit with the respective Federal reserve banks, that there be set aside the sum of \$100,000,000 or thereabouts, to be held in the custody of a clearing house division in Washington, operating under the direct supervision of the Federal Reserve board. It is proposed that this special fund be apportioned pro rata among the various Federal reserve banks, under which process the Ninth bank in Minneapolis have a credit balance of \$5,000,000, or more. It would then become a

simple and comparatively inexpensive matter to offset the clearing balances by a process of bookkeeping in Washington without the necessity of making currency shipments. There would still remain out of the funds which the Government will probably have available for deposit in the Federal reserve banks a total which should be ample to meet any emergency requirements that might arise. I can see no particular purpose in the deposit of large Government funds in the Ninth Federal Reserve bank except at periods of unusual stress, since the ordinary resources of the bank promise to be ample to more than meet current requirements. The deposit of an excess amount over and above the natural requirements of the bank would simply throw upon the Federal reserve bank receiving such deposits an added cost for the storage and safekeeping of such funds which would be tied up, and would be serving no practical purpose. The adjustment of all of the details in connection with this important problem of clearings will prove difficult and will require time. It is therefore probable that the transfer of clearing functions from the present banks and clearing houses to the new Federal reserve system will not be immediate and will not be attempted until this and other serious problems are successfully met and solved.

Many Problems to Be Solved.

There still remain other important questions, having to do with the operation of these new banks. Numerous points are being brought to the attention of the Federal Reserve board daily, and as that body has opportunity to give them requisite consideration, we are receiving their instructions. It would be quite hopeless to assume that this great mass of interpretative work can immediately be taken care of by the Federal board. The natural result will be that each Federal reserve bank will restrict itself at first to its more necessary and important functions and will not come into the full measure of its activities until after the lapse of a period of perhaps several years.

To have accomplished so much within so short a period as that elapsing since the middle of last November, is a compliment alike to those who are at the head of this new system and to those who are the executives of the numerous member banks. Without a sincere spirit of co-operation,

such a result would not have been possible. The Ninth Federal Reserve bank is today meeting the requirements of its member banks in continually increasing volume and a recent statement of its loans and discounts showed that while its proportionate importance as compared with the Federal reserve system as a whole, is only about one-twentieth, its then outstanding accommodations to its member banks constituted approximately one-eighth of the total loans and discounts shown on the consolidated statement of the Federal reserve board.

Must More Than Fulfill Requirements of Act.

I wish to place great emphasis upon the public service which these banks are destined to perform. Merely to satisfy the technical requirements as indicated in the act will not entitle them to the full confidence of the public. Their purpose was not alone to make banking a safe business but to provide and guarantee safe conditions under which the business man and farmer may continue their activities. It is not to be assumed that the creation of this system has made panics impossible, but it has at least done away with the characteristic and very dangerous form of panic which has been common in the United States, arising out of a disturbed condition of public confidence. Such panic periods as that of the fall of 1907 will not occur again. The old isolated and detached condition of the banks of the country has been abolished in favor of a new condition under which the great resources represented by the banking reserves have been mobilized in the custody of the Federal reserve banks and made available in times of necessity for every bank according to its just requirements. Banks have been brought into harmonious relation, one with another, with the promise that they will hereafter be able to pursue their respective operations with a degree of safety previously unknown. There is no longer any reason why any conservative and well managed bank should fail and it is probable that the very fact that banks have thus been brought into contact one with another will almost immediately result in a slow but very sure advance in banking standards and the spread of better banking methods. The very small and distant bank is now in touch with the largest and best institutions in the financial centers. This contact will inevitably have an

educational value through permitting the observant manager of the small bank to acquire a better knowledge of the methods employed by the older and stronger institutions.

Credit Facilities Proportionate to Growth.

Business in the Northwest does not need or demand any special favors or unusual advantages. To continue its very encouraging growth at an even more rapid rate than before it demands only to know that credit facilities will be proportionate to its increasing demands and adequate to the requirements of sound and constructive expansion. Such facilities the Ninth Federal Reserve bank will provide.

There is no part of the United States at this time where there was less of the element of emergency to be met through the founding of the Federal reserve banks. In some parts of the country these banks at the outset were face to face with very grave and serious problems of saving agriculture and business from loss and danger. No such situation exists in the Northwest.

At the same time it is encouraging to know that there is no part of the United States where the founding of such a bank and the creation of these new facilities will better serve the good of the people. The Northwest is fully able to utilize these new advantages in the support of an agricultural and commercial development which is rapid, sound and healthy. The discount market established by the Ninth Regional bank will create new credit facilities for expanding business, as they are demanded. These facilities will assist and encourage the activities of farmers and business men and thus further the forward movement in the states that are included within the ninth Federal reserve district.

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