President Haines: We will now proceed with the program as arranged, and the next is an address on "The Federal Reserve System," by Mr. Benjamin Strong, Jr., Governor of the Federal Reserve Bank of New York.

THE FEDERAL RESERVE SYSTEM.
Mr. Benjamin Strong, Jr., Governor of the Federal Reserve Bank of New York.

Mr. President and Gentlemen: I am sure that Congressman Fowler will not object to my calling your attention to an error in the printing of the program. It seems that I am called upon to address you in regard to some features of an economic monstrosity. (Laughter.)

Now, unfortunately the gentlemen who were charged with the duty of engaging officers for the Reserve Bank failed to take into consideration that certain qualifications not usually required for bankers apparently were required for these positions. They should have selected men with some talent for speechmaking. Our duties at the office in New York have been rather arduous, and rather than devote considerable time to careful preparation of addresses in regard to the Reserve Bank, we have thought best to ask the bankers who are good enough to invite us to address them to let us make very informal talks in regard to the work that is being done, and I will therefore ask your indulgence if the matters that I want to talk about this afternoon are very informally dealt with.

Congressman Fowler. I am sure, will not object to my referring to one or two words only of his remarks. Discussion of banking legislation in this country, as I recall, has been pretty active for the last eight or ten years. If we are to have the real discussion that Congressman Fowler suggests, I am afraid we will now have no time for anything but banking discussion, judging, at least, by the activity that has prevailed since 1907 in efforts to get better banking law. He refers to a remark, possibly unfortunate, that this new law is 70 per cent. good. My memory of one such remark was that it was 90 per cent. good. And Congressman Fowler considers it 70 per cent. bad. I think he is mistaken.

These last seven years of discussion, in which Congressman Fowler himself participated very actively and himself contributed toward a better understanding of the problem, if it did nothing else, convinced the people of this country that our problem was a very different one from any that existed in Europe. We have in the United States over 25,000 banking institutions. They are scattered over an area equal to pretty much all of Europe. Conditions are different in the different parts of the country and at least two-thirds or three-fourths of those institutions are governed by the laws of forty-eight different States. I think at least we owe a great deal of thanks to those men who devoted themselves, with tangible results, not reduced to percentages, however,
The Seaboard National Bank of the City of New York

earnestly solicits deposits from New Jersey Bankers. Personal attention on the part of the officers is given to all accounts.

Capital .......................... $1,000,000
Surplus and Profits (earned) ....... 2,825,000
Deposits .......................... 35,000,000

S. G. BAYNE, President
C. C. THOMPSON, Vice-President
W. K. L. EVERETT, Cashier
J. C. RICHARDS, Assistant Cashier
O. M. JEFFERDS, Assistant Cashier

The Federal Reserve Banks must be prepared to make their resources available when needed, to the commerce, industry and agriculture of the country, to facilitate production, manufacture or distribution. That is the language that is employed in the regulation itself. Their resources must, however, be kept liquid. Therefore, except for a limited amount of agricultural paper, all notes rediscounted must mature within ninety days and must be taken up by the banks which indorse them, whether they are paid by the makers or not. But the act and the regulation require that the original borrower's financial condition shall also reasonably evidence his ability to meet his current liabilities promptly. Stated negatively, this means
that a Federal Reserve Bank may not discount a member bank's paper which represents, or is based on lands, buildings, machinery to other customers, open accounts, or on investment securities or on goods carried merely for speculative purposes. Such paper does not contain the element of self-liquidation, as it does not represent goods in any of the stages of production, manufacture and distribution. The paper which in form evidences most satisfactorily that it is self-liquidating is a note, bill or accepted draft, representing the obligation of the purchaser to the seller for money.

Let me say that there seems to be a good deal of misunderstanding as to what might be called trade paper. Too many of the member banks are under the impression that they must in applying for discounts submit only paper on which there are two obligations to pay, a maker and an endorser. That is not a fact. The test of the eligibility of a note, which I will refer to later, is not of that character.

This paper may represent wealth in any of the stages of production, manufacture and distribution, and its payment is directly related to the sale of the goods. But the development in this country of the open credit granted by merchants and manufacturers, and of the system of cash discounts, offering advantages to purchasers with ample capital, has reduced the volume of self-liquidating paper and substituted for it the promissory note on which working capital is obtained in order to carry on commercial transactions, and its payment is related to the sale of goods.

The provisions of the act and the regulation contemplate the rediscount of the latter class of paper at Federal Reserve Banks and it has so far constituted the vast majority in volume of the paper which our bank has thus far discounted.

In the case of the ordinary promissory note with or without endorsements, however, shall the member bank determine whether it is eligible for rediscount with its Federal Reserve Bank? This is most difficult in the case of notes discounted by individuals. In such cases it would be advantageous to ascertain first the business of the discount. If he is engaged in commerce, industry or agriculture, it may be eligible. If he is not so engaged, it is not eligible unless he uses the proceeds of the note for the purpose for which their proceeds are to be used. If the proceeds are to be used for seed, fertilizer, feed, stock or current operating expenses, it is eligible, but it is not eligible if they are to be used for lands, buildings or machinery of a permanent nature.

Eligibility and credit, of course, are not to be confused. All notes discounted by individuals are not necessarily eligible, and some are not, according to the purpose for which their proceeds are to be used.

A renewal is an indication that the debt is not self-liquidating. But the regulation makes the statement of the concern to see if it has a reasonable excess of quick assets over current liabilities. But if Smith, a lawyer or physician, merely borrows for household expenses or for any purpose not commercial, industrial or agricultural, to be used or not, it is not eligible for rediscount. If the proceeds are to be used for hire purchase, they are in need of funds.

In examining the statements furnished us in New York by the member banks of our district I think there were something like seventy-five or eighty banks that reported that they had little or no paper that was eligible for rediscount. We wrote each of those banks a letter asking them to either send an officer of the bank to see us, or to write us and give a description of the character of the paper which they had in their portfolios. We found on examination and in conversation with the officers that we saw, that hardly any of those that replied had less than 50 per cent. of eligible paper in their portfolios; but their reports were based upon a conception of what the regulation meant that was not accurate.

Many banks have been accustomed to borrowing on lands, buildings, machinery to other customers, open accounts, or on investment securities or on goods carried merely for speculative purposes. In such cases it would be advantageous to ascertain first the business of the discount. If he is engaged in commerce, industry or agriculture, it may be eligible. If he is not so engaged, it is not eligible unless he uses the proceeds of the note for the purpose for which their proceeds are to be used. If the proceeds are to be used for seed, fertilizer, feed, stock or current operating expenses, it is eligible, but it is not eligible if they are to be used for lands, buildings or machinery of a permanent nature.

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Fourth Street National Bank
OF PHILADELPHIA

Capital - - $3,000,000
Surplus and Profits - 6,800,000

E. F. SHANBACKER, President
JAMES HAY, Vice-President
FRANK G. ROGERS, Vice-President
R. J. CLARK, Cashier

Exceptional Facilities for Making Collections Throughout the World

ACCOUNTS INVITED

maturity. We charge it to the bank's account on our books the day it matures. It is not our practice to permit a member bank to take up paper before the date of maturity except in special cases where the maker of the note has been permitted by the member bank to anticipate his note. In such cases we have generally allowed a rebate of interest at one per cent. below the current rate for such maturity at the date the note is taken up. Member banks offering notes for rediscount should examine them carefully to see that they are in good order. One of the most difficult matters to deal with in the bank has been the large amount of paper that appears with various technical irregularities. Too many of them altogether indicate that carelessness prevails in observing prudent rules as to the way notes are drawn, dated and filled in. And such little irritation as has developed from those discounting transactions that we have had with the member banks is almost entirely due to the existence of this carelessness in the way paper is permitted to be drawn by the customers of the member bank.

Due to what I personally regard as an unfortunate provision of the act it is also necessary to require a special endorsement on the paper discounted, which includes a waiver of demand, notice and protest. I may say that the Governors of the twelve Reserve Banks have already recommended that that provision be eliminated from the statute if possible, but the practice now followed, of sending notes well in advance of maturity to the member bank for collection, will dispel any doubt as to whether endorsers will be held by presentation and demand at the proper time.

Now I would like to say a few words generally about the attitude of the member banks towards the Federal Reserve system. There is some danger that the work of organizing and developing the banks will be retarded by two classes of bankers; on the one hand those that are liable to make extravagant claims for what the banks can do and express possibly unfounded fears and criticisms. It takes time to do the work that is now being undertaken by the Federal Reserve Board and by the officers of these banks, and according to my view the development of the system will not be as successful as it should be if unwarranted expectations of immediate completion of work are developed or an attempt is made to progress too rapidly without due regard to the real interests of the member banks, both those who are present members and those state institutions which are in fact potential members of the future.

There is also some danger in the development of unenlightened and uninformed criticism. I do not want to go into that particularly just now. You have all heard it. I would like to feel that those who are affected by the development of these banks are at least patient enough and loyal enough to give those men who are doing the work an opportunity to demonstrate by experience with the system what it can do rather than condemn it before any experience at all can be had with it. (Applause.)

Another feature of the attitude of the member banks that personally I deplore —it is a natural one, possibly—is a tendency to regard the Federal Reserve banks as departments of the government. I am sure you will not consider that I am dealing with this matter in a trifling way when I say that some of the bankers who have called at our office have evidenced considerable uneasiness when they came in to talk to Mr. Jay or myself, such, for instance, as they might display in calling upon some high officer of the government. Now that is all wrong. Member bankers must bear in mind that they own these banks. Every dollar of their assets belongs to the member banks. Two-thirds of the directors they have elected themselves; and the officers of the banks are appointed by those directors; and speaking for our bank I have no hesitation in saying that if that bank is not properly managed it is largely the fault...
of the member banks of that district for not electing proper directors or seeing that proper officers were elected. The disposition to regard the banks as a department of the government is, however, fairly natural, bearing to a feature of the Federal Reserve Act that is quite unique in legislation in this country. Banking legislation in this country, as Congressman Fowler has suggested, has been discussed and passed somewhat upon the theory that the banks needed regulating. Just as the railroads needed regulating. In the case of the railroads, statutes and regulations were passed and adopted and a special body was created by Congress to administer this law. Unfortunately the American people are altogether too prone to point out evils existing in our economic life, to cry for the passage of some law, rejoice over its enactment, and then subside into a happy lethargy, thinking that the passage of the law has accomplished everything, that it will work some revolution. As a matter of fact the accomplishment of that revolution in the Federal Reserve system depends upon the administration and to a great extent on the case of the Federal Reserve Act. It is quite a new plan of retirement which they are issued. The government therefore placed the Treasury Department in the management of the affair. These twelve Reserve banks have complete organization only. They had no clerks, they had no machinery, they had no credit information except what could be gathered from the banks that participated in the management of the affairs. These twelve Reserve banks have complete organization, they have credit information; they have stored in Washington already $100,000,000 of notes, and on July 1st they will have $300,000,000, and the supply will be kept at about $500,000,000 or over. And I think sight has been lost of the fact that these Reserve banks have over $250,000,000 of untouched cash assets. Sometimes it is a little difficult to be patient with criticism that compares the facilities that existed last August, say, with those that existed this year with these twelve banks in full operation.

Now just one word in conclusion of a more personal character. The men who are managing these twelve banks—and I am now well acquainted with nearly all of them believe that they are performing a public duty. It may be that they are mistaken in that idea, but I do not think so. And I feel that they are entitled to have the support of the banks for whom they are really working; and that support tomorrow will be best evidenced by patience in waiting for results. It may also be expressed by a statement of my personal views as to what should be done in regard to facilities for the admission of State banks to membership. No reform of our banking methods in this country will be complete and satisfactory to the country until it includes all banks, at least all banks that do commercial banking in one comprehensive system. I firmly believe that if such regulation can be issued it will be open to the State banks of the country as fair, not evidencing an intention to buy their allegiance, and, on the other hand, not evidencing an intention to bar their admission, that we can then afford to let them work out that particular feature of the problem themselves. Our duty will be to make the system attractive to them and wait for them to come in if they want to.

Gentlemen, I am sorry to have taken so much of your time. You have listened very carefully. Permit me to thank the bankers of this State for extending to us an invitation to address them on this very important matter.

The Chair desires to announce the names of the members of the Nominating Committee—Charles H. Laird, Jr., J. W. Lush and Wessels Van Blurcum.

And the Resolutions Committee—W. H. Taylor, F. A. Phillips and F. M. Riley.

We will proceed with the program with an address on “Bank Publicity,” by Fred W. Ellsworth, of the Guaranty Trust Company of New York.