October 29, 1925.

Hon. Benjamin Strong, Governor,
Federal Reserve Bank,
New York City.

Dear Ben:

I shall be very much pleased if you will give the enclosed letter to Dr. Schacht.

I hoped to see him when I was last in New York, but your secretary told me that it was doubtful as to when he would return there and as I had to be in St. Louis, I could wait no longer.

Thanking you for your kindness, I am,

Yours sincerely,

SWF ID
b) A. W. Forbey e
7
Forbey, Haldeman &
White
St. Louis
1925
ROBERT S BARLOW

53 STATE STREET

BOSTON MASS

THANKS FOR YOUR LETTER PLEASE CONSULT HILL CONFIDENTIALLY

BUT DO NOT SOUND CURTIS SHOULD LIKE A GUESS AS TO HIS PRESENT

EARNINGS

PIERRE JAY

Prepaid

October 24, 1914.
CONFIDENTIAL

May 26, 1922.

Dear Mr. Mansfield:

At last I seem able to undertake answering an accumulation of mail, and especially your kind letter of May 12. Owing to my own indisposition and to some pressing engagements of Mr. Strivings, we have been unable to arrange a meeting before June first, when I hope to spend the day with him and discuss your letters, which I have read with much interest.

Permit me now to comment at some length upon the various matters touched upon in your letter of May 11 to Mr. Strivings, and I shall do so somewhat in the order in which you dictated your letter.

First, permit me to say that I am grateful to you for the kind expressions contained in your letter. If I am ignorant of the matters in which you are deeply interested it is due to no lack of interest or sympathy. I am eager to have light and welcome the opportunity for meetings with you and others of different experience from my own, for that purpose. You will, I hope, understand that I took my position in the Federal Reserve Bank of New York at some sacrifice to myself in order to have some small part in making the Federal Reserve System a success. That was my only object in doing so. I am glad to feel that both you and Mr. Strivings understand that, as well as my earnest desire to assist in working out the problem of farm credits.

The Federal Reserve System, as you say, is in a sense a cooperative organization designed among other things to furnish credit to its members, the banks. I think, considering all that has transpired, that its operations have in general been successful. On the other hand, I am willing to admit that, as with all other human instruments, especially new and untried ones, it may have made a mistake here and there; but unfortunately it has been charged with many mistakes of which it has not been guilty, and some of these charges have, I am afraid, misled the very people whom we are most anxious to serve, among others, the farmers.
The Federal Reserve System has about 10,000 members. Those members carry their reserves with the reserve banks and in time of need borrow from the reserve banks just as they formerly did from their correspondents in the reserve and central reserve cities, only for much larger amounts. The Federal reserve banks have not and should not have the right to require any of these members to make any specific loan nor to decline to make any specific loan. Were the reserve banks or the Reserve Board to have conferred upon them the power to direct the members as to what loans they should or should not make, it would result in the creation of a financial autocracy in the United States beyond anything ever witnessed in the history of banking, and one which the people of the country would not tolerate. Therefore, I think it must be definitely borne in mind that where the credit requirements of a given community are not met as they should be, the difficulty lies at the point of contact between the commercial bank and its customer rather than between the Federal reserve bank and its members or the Federal reserve bank and borrowers generally.

The Federal reserve banks are not voluntary lenders of money as are their member banks. A Federal reserve bank is called upon to make loans to a member when that member has already made loans to a point where its reserves become impaired. In other words, the loans made by the reserve banks are simply for the purpose of restoring the impaired reserves of member banks. Therefore, the lending operations of the reserve banks are in effect ex post facto - they take place after the member bank has concluded its lending operations - and they cannot be made in such a way as to anticipate the needs of the member bank. This is very little realized and is one of the necessary elements of the reserve banking system, such as we have, and such as prevails in those countries where the central bank which holds the reserves of other banks, does not directly do business with the public.

You will also, I hope, understand what a great misfortune it is that so small a proportion of the banks of the country, that is, about one-third of the total number, are members of the System. Many cases have come to our attention, like the one mentioned in your letter, where credit is needed, where the borrower is good, where the
The community will be served by extending the credit, but where it can not be had either because the banks of the community are not members of the Federal Reserve System, or possibly, where one or two of them are, but have already borrowed so heavily from the reserve bank that they dare not borrow any more.

As to the specific case that you mention; it is difficult to deal with a report of that character without investigation and without knowing the parties. If you will give me the name of the farmer and the name of his banker, I will be very glad to take the matter up with my friends in the San Francisco reserve bank and ask them to investigate it. But please do not overlook the important fact that the reserve bank could not itself make that loan to the farmer who needed it, and should not be able to make the loan, and that it has no power to direct any member bank to do so, and has even no influence which would be effective in inducing a nonmember bank to do so.

It has frequently been stated to me that complaint is made in the West that our investors are lending vast sums abroad when our farmers are unable to get the credit they need. It is true that our citizens are lending very large amounts abroad, but it must be borne in mind that it is those very loans which have enabled the farmers of this country to continue to market their crops at satisfactory prices not only abroad but at home. To the extent that the proceeds are used by the borrowers to buy foodstuffs, cotton, meats, etc., in this country, the effect is directly felt upon the farm; where the credit is however employed for the purchase of manufactured and other goods it has resulted in giving employment to hundreds of thousands of workmen who would otherwise be out of work but who are now enabled to support their families in comfort and to make customary purchases of the necessities of life, including those produced upon the farm. I feel very sure that had these loans not been made, the gradual recovery of business which is now taking place throughout the country would have been so retarded as to have greatly embarrassed the farmers generally in working out of their difficulties.

It is true, as you say, that our Federal Reserve System was to a considerable extent devised along lines which facilitated the extension of short time commercial as distinguished from long time agricultural credit. The need for this limitation has
expressed in the experience of banking countries the world over. The bank which issues the currency, if permitted to create credit for long periods without a definite and certain process of liquidation by which that credit will be extinguished, is simply inviting inflation and ultimate disaster. The principle which has controlled the issue of bank notes upon the security of the assets of the bank, that is, upon its loans and discounts, is one which must be scrupulously observed and safeguarded if banks of issue are to avoid becoming instruments of inflation. The principle is a simple one indeed. It is in effect that every loan made by the bank of issue shall represent a transaction involving the sale of goods, so that the proceeds of the sale shall be applied to liquidating the credit and retiring as rapidly as the goods go into consumption. The abandonment of that sound principle by the banks of issue of the Continent of Europe is one of the causes of the breakdown of the monetary systems of Europe; and surely no one wishes us — in the face of the disastrous example now before our eyes — to abandon the principles which have always been recognized as controlling the policies of the banks of issue. I can well understand the feeling of the farmers generally that the Federal Reserve Act is incomplete from their standpoint, but, on the other hand, their own interests demand that the country's currency shall be kept sound and fortified against any disaster, such as has been witnessed in those countries of Europe which have not been able to escape the calamity of currency inflation. Later in this letter I shall take the liberty of suggesting more definitely what I think could and should be done if you and others who are deeply interested in the matter would lend your influence toward bringing it about. I am very sure from the terms of your letter that a proposal to have the Federal Reserve banks purchase bonds upon the security of warehouse certificates representing agricultural and other produce, would not appeal to you if you were once convinced that it would be the entering wedge to break down the Federal Reserve System in the performance of its true function. On that account I am asking you to consider the suggestion outlined later in this letter.

As to the extent of the authority of the Federal Reserve Board over the regional banks, it can hardly be much greater than it is; were it to be enlarged beyond
present terms of the Act, I believe that there would be danger in course of time that the Federal Reserve System would become a part of the government machine, would develop a bureaucratic and inefficient management, and might later become a political instrument with capacity for much harm to the welfare of the country. This is a dogmatic statement of my own belief, but it is based upon experience since the establishment of the System.

As to the political and economic pressure to which you refer, I really feel that you may have been misled by some of our critics. The Federal reserve banks, and especially the Federal Reserve Board, have been the objects of the most ridiculous and fantastic charges. It has been our policy in the New York bank, and I think this is true generally of the other reserve banks, to make no public answer to these charges, but to respond fully and accurately to all inquiries made by the Federal Reserve Board, by the duly authorized officers of the government, and by the Congress. The official documents bearing upon some of these controversies I believe have been placed in the hands of a great many people, and they have given a more correct picture of the System, of its policies, and its management than could be done in any other way. With this I am taking the liberty of sending you a printed volume of the Hearings before the Joint Commission of Agricultural Inquiry in Washington, which contains a statement that I made and which I would much appreciate your reading.

I know of no case where any one has been punished for criticizing the System, and know of no method by which such punishment could in fact be administered. The case to which you refer has never come to my attention, and if you will be good enough to send me the papers, I will see if I can get the facts and send them to you. As to the difficulty which you experienced yourself, will you not be good enough to write me fully what the circumstances were and who were concerned in it, and again I will be glad to take it up with my friends in San Francisco, although as you realize, there is some delicacy in an officer of one reserve bank interfering in any way with the affairs of another reserve bank.

I am familiar with the action of the Federal Advisory Council, quoted in your letter. Do you think, however, that that is an indictment of the Federal
Is it not simply pointing out a defect in our credit system, for which the Federal Reserve System is not in any way responsible.

You are absolutely correct in your statement that no one is so deeply interested as is the farmer in our having an absolutely sound currency. The debasement of the currency does more harm and injustice to the man who lives upon a narrow margin of earnings than upon any other class. In a period of inflation, an artificial buying power is created which lasts only until the day of collapse comes. Habits of extravagance are developed which bring about artificially high prices. When the collapse arrives, wage earners are thrown out of employment, their buying power is restricted, and then the burden of loss principally falls upon those who produce the articles of most general consumption — that is, upon the farmers. Therefore, I am led to believe that the farmer's own interest would be distinctly injured were the Federal Reserve System to undertake to extend credits for periods as long as three years, tying up their resources in that way, and issuing currency against such loans. Such currency should only be issued against instruments representing actual transactions in goods which automatically liquidate the credits for which the currency was issued, as described above. In a nut-shell that is the whole story. The proposal to lengthen the period for which we can make loans has been brought forward time and again and I have always opposed it and have always suggested an alternative course which I believe is sound, which will meet the farmer's needs and which will protect the Federal Reserve System, but at the same time will place a portion of its resources at the service of the farming community. Let me now indicate in more detail just what I have in mind:

1. Some means must be found to induce State banks, which are qualified, to become members of the Federal Reserve System.

2. Some means must be found to furnish the farmer and the live stock man with credit for periods of from six months to three years without necessitating the reserve banks extending credit for periods exceeding six months.

As to the first, I am not yet prepared to suggest a plan by which this may be brought about, although legislation, I am told, is in course of preparation for
The purpose of facilitating the admission of State banks to membership which have not the required capital. There seem to be two alternative methods of bringing about the desired result: One is to make membership in the System so attractive that State banks will take advantage of the opportunity to join - in some respects it is not of sufficient advantage to them, or at least they do not believe that it is. The other method would be some form of compulsion such as a prohibitive tax, or something of that sort, upon the same principle which was applied to the circulation of notes of State banks. I personally do not like the second method. It is undemocratic and would raise a storm of protest; and on the whole I believe that we must rely upon making membership in the System sufficiently attractive to induce the State banks to become members.

As to the second, I would recommend that the Federal Farm Loan System should at once be empowered to establish separate farm credit departments for the purpose of making loans of from six months to three years to National and State banks and to cattle loan companies and cooperative marketing associations, so that those types of loaning institutions could and would in turn make loans for like periods to their farmer and live stock customers. The Federal Farm Loan System might require slightly more capital than at present, but the larger portion of the funds could be raised by the sale of debentures secured by these loans, the debentures to mature in say from one to three years, according to the requirements of the farm loan banks. There should be no difficulty in marketing these debentures. Banks in the money centers which have surplus funds are always looking for short time investments that are sound and pay a reasonable return, and there are large classes of individual investors and corporations that are constantly in the market for that type of investment.

In order that the seasonal demands which would likely reach a peak in both the spring and the fall might not necessitate constant borrowings for a maximum amount through sales of debentures thus leaving idle funds for a portion of the year with the Federal Farm Loan System, it has seemed to me that the farm loan banks should be permitted to discount this paper with the Federal reserve banks whenever the paper
reached within six months of maturity. Thus the Federal reserve banks would take off of the hands of the farm loan banks, as required, all the paper of six months maturity or less, at a time of the year when otherwise the demands upon the farm loan banks might be excessive and might require sales of debentures in excess of the normal mean requirements of the farmers for long time accommodation.

This is a very simple plan, does not require the establishment of a brand new and elaborate organization, can be inaugurated without delay, brings both of the credit organizations, that is, the Farm Loan System and the Federal Reserve System, into cooperation, and avoids tying up the resources of the Federal reserve banks in long time paper, which is contrary to sound principles for a bank which issues currency.

Loans of the character above described would seem in fact to cover the needs of the grain, hay, vegetable and cotton farmers, who require credit for not over a year, or very little over a year at the outside; the live stock breeder who requires credit for a maximum of say three years; the live stock fattener who requires credit for from one to two years; the orchard man who at times requires credit for say up to three years; and the dairyman who in the East requires credit for from nine months to one year.

Another point which I think is overlooked in some other plans which I have seen described, lies in the indirect result of a plan such as I have outlined above. There is no doubt that to-day there is a general lack of adequate short-term banking credit throughout many sections of the West and South. This is evidenced by the exceedingly high rates of interest frequently charged for bank loans. If the farmer's needs for periods exceeding six months and up to three years are financed out of the existing resources of local banks, who in turn must borrow from the Federal reserve bank, there will be no real addition to the credit resources of the districts concerned. If, as by this plan, investment funds can be drawn into those localities through the sale of debentures in the money centers, it will release a considerable amount of local banking credit now employed in loans to farmers, and tend to create a flow of capital from investors and the money lending centers to the borrowing sections.
The plan contemplates no separate system of banking credit for the farmer. He gets his credit from the local bank or loan company where he has always gotten it. It does, however, create two avenues of credit relief for the local bank or loan company; one is the farm loan system for the longer time loans; the other is the Federal Reserve System for the shorter time loans. It is, however, essential that the State banks should more largely become members of the Federal Reserve System.

Were it possible for me to do so, I would like to discuss this subject with you personally. In fact, I am tempted to suggest that we might indeed meet in Chicago, or some convenient central point, for that purpose. There is nothing to be accomplished by the perpetuation of misunderstandings, and my whole effort, as I think you will gather from the record which I am sending under separate cover, has been directed towards suggesting something of value in the way of legislation which will produce real results. There has been so much controversy on this subject that I think I must ask you to hold this letter in confidence. It expresses my own point of view, but it will do no good to have these views given publicity beyond what they were given at the time I appeared before the Commission. You may be sure, however, that I understand some of these problems very much better than possibly you realize, that I am deeply sympathetic with the point of view which you represent, and wish most earnestly to do something to assist.

In conclusion, I understand that the Congress has just passed a bill providing for the appointment of a sixth member to the Federal Reserve Board, and I gather that it is generally understood that this new member shall be especially representative of the interest of the farmers. It is unfortunate that a provision was attached limiting the powers of the reserve banks in the matter of their bank buildings. Those buildings are urgently needed for the security of the business and for its economical operation. If the sixth member is to be appointed upon the Federal Reserve Board, I feel very strongly that the interests of the farmers will not necessarily be served by appointing an actual tiller of the soil. The new appointee should be a man of broad experience and point of view from the agricultural section, who has had exper-
May 26, 19__

I am in lending to farmers, rather than in farming. I make this suggestion in the interest of the object which you yourself desire to serve.

I am most grateful to you for writing me and for sending me a copy of your letter to Mr. Strivings. Please do not hesitate to write me further and at any time, and command me in any way you desire. I beg to remain,

Yours sincerely,

Benj. Strong,
Governor.

George A. Mansfield, Esq.,
Medford, Oregon.

BS. MM