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ABSTRACT OF SPEECH DELIVERED BY CHARLES S. HAMLIN, GOVERNOR OF THE
FEDERAL RESERVE BOARD, BEFORE THE CHAMBER OF COMMERCE OF THE UNITED
STATES, WASHINGTON, D. C., FEBRUARY 4, 1915.

The twelve Federal reserve banks, under the new banking system, were opened on November 16, 1914. Although barely ten weeks have elapsed since their opening, much has been accomplished in the way of placing the operation of our banking system on a secure, firm foundation.

We can better understand what the new system is if we consider the conditions which existed under the old system, under which there were approximately seventy-five hundred independent banks, and seventy-five hundred independent reserves. Although called reserves, they could not in fact be used except in violation of law, and if at any time they happened to fall below the legal limit, the bank was legally required to suspend business until they were restored, and nothing but the forbearance of the Comptroller of the Currency could save the bank from being placed in the hands of a receiver in case the depleted reserves were not restored.

I have said that these reserves were all independent; there was, however, a certain interdependence caused by the deposit of a certain portion of the reserves with reserve agents in reserve cities, but this interdependence was one rather of danger than of security.

Furthermore, when the banks had performed their function of discounting notes, the notes discounted remained in the bank vaults, buried beyond hope of resurrection until maturity, and if a bank were to take these notes out of its vaults and rediscount them, such an act tended to make people distrust its condition.

In addition, the national bank currency issued by the banks was chained to Government bonds. When contraction was necessary, it was difficult to secure it; when expansion was needed, it was slow and

cumbersome, often taking effect only after the necessity had passed away. In fact these national bank notes often increased when they should have decreased and, conversely, decreased when they should have increased.

It was certainly a strange anomaly to link together the national currency, supposedly responsive to the needs of expanding business, with Government bonds representing war and other necessities of the past. Yet this is what the former system did; the extension of the trade and commerce of the 20th century was indissolubly linked with the evidences of the destruction of trade and commerce of the 19th century. While there may have been some justification for this strange alliance in the 19th century, there is surely none in this 20th century, and it is earnestly to be hoped that the method provided in the Federal Reserve Act for retiring the national bank currency and substituting the new Federal reserve notes may prove efficacious.

The old banking system rested in effect upon the call loan. The bank had to have liquid assets and the call loan was the only liquid asset. How liquid such assets were was seen by the panic of 1907, and again in 1914, when the closing of the stock exchanges took from such loans the only semblance of liquidity they had.

The dependence of our banking system upon assets which were liquid only when liquidity was not needed, and which were unsaleable at times when liquid assets were needed, has resulted in a banking system which financial experts pronounce as one of the worst in the world and utterly unsuited to the financial needs of the United States.

The United States is entitled to the best banking system in the world and I believe the Federal reserve system, just established, will fully meet its needs.

The extraordinary events just prior to the opening of the Federal

reserve banks are familiar to all. The steady exportation of our gold, the unprecedented^{ly}/high rates for foreign exchange, the derangement of our export trade caused by the war, the constantly increasing balances against us on current international commercial transactions, the piling up of reserves by many banks throughout the country at a time when they should have drawn upon them, and, finally, the hoarding of gold by both banks and individuals,- culminated in a condition probably the most ominous in the history of our country.

How our^{new}/banking system was able to meet this dangerous situation, and how successfully we emerged from it, constitutes an epoch in the financial history of the world. A slight study of the situation will reveal some of the difficulties and what was done to overcome them.

During the calendar year 1914 there was exported from the United States gold to the amount of over 222 millions; during the same period there was imported over 57 millions, the net exports amounting to about 165 millions. For the same period the production of gold in the United States amounted approximately to 92 millions. The total stock of gold held by the Treasury, the banks and in circulation on January 1, 1914 was estimated to be approximately 1904 millions, while on January 1, 1915 it was estimated to be about 1815 millions,- a decrease of 89 millions.

When it is considered that the United States was able to export 165 millions of gold in the calendar year and yet reduce its total gold by only 89 millions,- a decrease of only four and six tenths per centum,- some idea of the strength of the United States in gold holdings and gold production will be conveyed.

Certain unusual relief measures were also undertaken and successfully accomplished which, in connection with the operations of the Federal reserve system, turned the tide and brought about confidence in place of fear, and financial stability in place of unsound monetary

conditions.

Among these measures was the deposit, by the Secretary of the Treasury, of crop moving funds of about 37 millions of dollars in banks in different parts of the country, all of which was promptly returned, together with over 267 thousand dollars in interest. In addition, the Secretary of the Treasury issued and shipped to various banks about 380 millions of dollars of Aldrich-Vreeland emergency currency, of which all but about 67 millions has already been redeemed. This latter measure of relief was made possible by the Federal Reserve Act which amended the so-called Aldrich-Vreeland Act by lowering the tax imposed upon the notes and increasing the limit of issue. *The redemption of these notes was also facilitated by the Federal Reserve notes*

These measures gave much relief to the situation, but much was left to be done to place our finances on an absolutely sound basis.

A careful investigation into the international indebtedness of our people abroad showed that our current indebtedness was about 500 millions of dollars, all payable in gold. To take care of this situation pending the revival of our export trade, a gold fund of over 100 millions of dollars was subscribed by the banks, national and State, in the reserve cities. This fund quickly demonstrated the desire and ability of our people to pay all their foreign obligations, properly payable in gold, in that metal, and this, too, in face of the fact that a large indebtedness owed us from abroad could not be liquidated because of the moratorium in England and other foreign countries.

As the result of the opening of the Federal reserve system and of these relief measures, confidence quickly took the place of uncertainty, and little gold had to be shipped out of the country. In a comparatively short space of time our increasing exports took the place of gold, which otherwise must have been shipped. Foreign exchange fell to the importing point and our country became a creditor instead of a debtor

on current commercial exchanges.

In order to relieve the situation in the South, a cotton fund of 135 millions of dollars was subscribed, so that the agriculturists who were producing cotton were enabled to make long time loans based on cotton security. As was the case with the gold fund, but little of this fund was used, but the fact that it existed was a powerful incentive to a restoration of confidence and it accomplished its work successfully.

The establishment of the Federal reserve system has been, as I have said, a potent cause in our financial recovery, and it is well to point out upon what theory the system is based and what it has already accomplished.

In the first place it established lower reserve requirements, thus releasing an enormous amount of cash as a basis for future credit operations. It mobilized a material proportion of the reserves of the banks in the Federal reserve banks, thus furnishing a fund from which banks could be assisted in rediscounting commercial paper. Thus commercial paper, which previously had to be held in the vaults of the bank until maturity, can now be used as a basis for rediscounts at Federal reserve banks, and this paper has now become a liquid asset, far more liquid than the call loan on the stock exchange.

An elastic note issue was also provided for, secured by a 40 per cent gold reserve and by commercial paper up to the face value of the notes issued. Thus we have at hand a really elastic currency rising and falling in response to the needs of agriculture, commerce and industry. Acceptances in the import and export trade are also permitted to be discounted by Federal reserve banks, and the member banks for the first time were authorized to accept bills drawn upon such transactions.

It can be stated with confidence that under the Federal reserve system we shall see no more financial panics. The member banks no

longer need to keep a dollar in excess of their lawful reserves. They can even check against and withdraw their reserves deposited in the Federal reserve banks, under regulations of the Federal Reserve Board, which latter Board can suspend any and all reserve requirements of the Act, when deemed necessary.

Under the Federal reserve system the member banks have to furnish the capital for the Federal reserve banks, and deposit a material part of their reserves in said banks. Every dollar of this amount is held in trust for agriculture, commerce and industry of the United States, and is forever removed from the call loan market. In addition, every dollar deposited by the Government with the Federal reserve banks, over and above what is checked against for paying Government debts, is impressed with a similar trust for the same purposes.

The transfer of capital and reserve deposits was made by the member banks without the slightest trouble and without the slightest confusion in business. Many feared that these transfers could not be accomplished without calling in loans and otherwise injuring legitimate business, but this fear was quickly dispelled when it was found how easily and simply the transfer was made. The Federal Reserve Board requested the banks to make these payments, as far as possible, out of their own vaults, and also, as far as possible, in gold, and the banks cheerfully complied with this request, so that at the present time a very large proportion of the assets of the Federal reserve banks consists of gold or gold certificates.

Up to the present time, very little recourse has been had to the Federal reserve banks by the member banks, the amount of discounts and the issue of Federal reserve notes being very small. There is no necessity, however, at the present time for such assistance on the part of the Federal reserve banks except in certain portions of the country, but within a few months, undoubtedly, these banks will be drawn upon to a very large extent by the member banks.

The fear has been expressed that the Federal reserve banks will have difficulty in earning enough money to pay their expenses and the dividends on their capital stock. I believe this fear to be groundless, but if it were not groundless, it would not mean that the Federal reserve system is a failure. The founders of the system established these banks not to make money but to serve as helpers of the member banks, and through them to insure to the people of the United States security, stability and reasonable rates for advancements and accommodations, through discount and open market operations.

How far the system has already gone in helping the people of the United States will be seen from the fact that just prior to the opening of the reserve banks the rates on commercial paper in the large financial centres were 6 per cent or over, and very difficult to obtain, while in other parts of the country they were much higher. At the present time, however, these rates have declined at least 25 per cent and everything points to more nearly uniform rates of discount over the whole country.

Much has been said about the true function of the Federal reserve banks. Some claim that they are purely emergency banks, while others seem to feel that they are ordinary commercial banks which should at all times compete with the member banks. Neither of these extremes, however, represent the real function of the Federal reserve banks. Their duty is not alone to meet emergencies, but, so far as possible, to prevent emergencies from arising, and while ordinarily they do not and are not intended to compete with commercial banks, yet occasions may arise where such competition, through the exercise of their open market powers, will be necessary for the protection of the people of the United States. It is often said that the Federal reserve banks are bankers' banks, but this is true only to the extent that they deal primarily with the member banks. Their true function, however, as above stated, is to protect

the interests of the people, acting through the banks, but ^{in case of} ~~in case of~~ emergency, acting outside of the banks.

The power of fixing the discount rates which has been vested in the Federal reserve banks, subject to review and determination of the Federal Reserve Board, is a power which must be exercised for the benefit of the whole people, and the final responsibility for its exercise rests with the Federal Reserve Board.

3 From time to time complaints are heard as to the operation of the Federal reserve banks. Some bankers claim that they lose interest on reserve deposits in Federal reserve banks, which prior to the establishment of the system were deposited with reserve agents; also that they lose interest on the capital of the reserve banks furnished by them. A slight reflection, however, will show that these complaints are more imaginary than real, for the lower reserves established under the Act has released a very large amount of cash and this cash would sustain banking operations which will produce a profit far above any possible loss of interest on their capital or reserve deposits.

It should not be forgotten, moreover, that the stockholding banks are entitled to 6 per cent interest on their investments for the capital of these banks, and, as I have before stated, I do not doubt but that this interest will be earned.

Complaint is also made as to some of the regulations which have been issued by the Federal Reserve Board, especially those relating to discounts of commercial paper. It has been the constant effort of the Federal Reserve Board to simplify its regulations, and new regulations have been issued covering commercial paper which I believe will do away with many, if not all, of the objections heretofore raised. The Board appreciates that the custom of merchants must be cautiously changed, and should not be subjected to a sudden disarrangement.

Another important question which is before the Board is the admission of State banks into the Federal reserve system. Complaint has been made that the State banks once having joined the system cannot withdraw. On the other hand, it is pointed out that the system established is a national system and that such a system could not exist if its integral parts at any time could withdraw at will.

The question of regulations to be enacted on the matter of admission of State banks has already given rise to many differences of opinion. Some of the national banks contend that the State banks should divest themselves of all powers not given to national banks as a condition of entering into the system. On the other hand, many of the State banks claim that they have the right to enter the system with all their powers except those which are expressly cut down by the Federal Reserve Act itself.

The Federal Reserve Board is fully conscious of the importance of the task assigned to it and it is giving careful attention to all the problems which have arisen with a view to carry out the system loyally, not only in form but in spirit.

I believe that the system will be of the greatest advantage to the people of the United States, and will establish the United States on a solid foundation, which will in the near future make it the centre of the world's financial exchanges.