FEDERAL RESERVE BOARD

WASHINGTON

Dear Sir:-

The Federal Reserve Board has had under consideration the payment of dividends by Federal Reserve banks. In the future when it is the intention to submit to the Board of Directors of your bank the question of the payment of a dividend, the Federal Reserve Board desires to have you furnish it, a sufficient length of time prior to such submission, with the following information:-

1. Earnings.

2. Current expenses, including cost of Federal reserve notes used;
   Depreciation in vault and equipment;
   Net earnings;
   Per cent and amount of dividend suggested;
   Balance of the surplus and profit and loss accounts at the time of rendering statement, and estimated surplus after allowing for payment of dividend.

3. Unpaid indebtedness' of closed banks to Federal Reserve bank:
   (a) How secured,
   (b) Estimated losses.

4. Indebtedness' to Federal Reserve bank of member banks considered to be in over-extended or unsafe condition, giving names of banks, indebtedness of each, and security, if any.

For your information it may be stated that the Board holds that a Federal Reserve bank should, prior to the declaration of a dividend, make provision for the following:-

1. Provide for its entire organization expense;
2. Provide for the cost of Federal Reserve notes used;
3. Provide for depreciation in furniture, vaults and equipment, and where real estate is owned, provide a substantial amount to reduce the book value;
4. Provide an amount equal to its estimated losses on obligations of closed institutions;
5. Provide an amount equal to notes or obligations bearing the endorsement of failed banks where such notes have been past due for three months or more;
6. Set aside an amount equal to at least 10% of its net earnings during the first few years to provide for unexpected expenses and losses.

Attention is directed to the fact that dividends are cumulative and constitute a first claim upon the earnings of the banks. Deferred dividends should be paid when the earnings of the bank permit. It is regarded as better policy to show a gradually increasing dividend than to establish a high rate with the possibility that it may be reduced. The policy of declaring full dividends to a specified date is more highly regarded than that of declaring dividends at a lower rate for a longer period.

Very respectfully,

Governor.

FEDERAL RESERVE BOARD
WASHINGTON.

January 13, 1916.

Hon. Paul M. Warburg,
Federal Reserve Board.

Dear Mr. Warburg :

A considerable volume of trade acceptances is coming forward from the Orient to the New York market, drawn by sellers of goods in the Orient upon well known importing and manufacturing concerns in the United States. These are purchased in the Orient by the branches of the Hong Kong and Shanghai Banking Corporation, the Yokohoma Specie Bank, the Chartered Bank of India, Australia and China, and other similar banks and bankers. The branches of these banks in New York City receive the bills from the Orient, have them accepted and then sell them in the open market with their endorsement. Such bills sell at a rate equal to or approximating closely the rate for bankers' acceptances.

Regulation T provides that "Before purchasing domestic bills of exchange, the Federal Reserve Bank must secure statements concerning the condition and standing of the drawer of the paper, and, if possible, also of the acceptor of the bill, sufficient to satisfy the bank as to the nature and quality of the paper to be purchased."

In the case of bills of the kind I have described it would be manifestly impossible for us to secure statements of the drawer and Governor Strong and I feel that it would be impracticable for the present, at least, to obtain statements from the acceptors, since they have no interest in what becomes of the bill. Yet it seems to us of importance that we should be able to buy such drafts when endorsed by responsible banks or bankers (from whom we could obtain satisfactory statements of conditions). The establishment of a steady market at low rates for such bills will greatly facilitate the making of dollar exchange in the Orient, will tend to create competition for dollar bills among the bill buyers there, and will tend to an appreciation of the great differentiation in favor of dollar exchange now existing.

Possibly in the forthcoming regulation in cases where such bills are endorsed by banks or bankers and are sold on their credit, the statement required might be that of the bank or banker. We are anxious, however, to make progress in the matter promptly and I am writing to inquire whether it would not be possible for the Board to advise Federal Reserve Banks, as a temporary modification of Regulation T, that the statement required under paragraph V, in regard to bills endorsed by banks or bankers, might be considered as applying to the banks or bankers, rather than to the drawers and acceptors of bills.

Requesting that this may have the favorable attention of the Board.

Respectfully yours,

(Signed) PIERRE JAY

FEDERAL RESERVE BOARD

WASHINGTON

-509-

January 22,1916.

S I R :

Enclosed please find 50 copies of revised forms Nos. 286b and 287b for reporting the monthly earnings and expenses of your bank. No change has been made in the form of the report for the earnings except that the reading of the first two captions has been modified to agree with the reading of the corresponding items on Form 34. Under the second head should be included, therefore, the earnings from all open market purchases of trade acceptances, bankers' domestic acceptances and bankers' foreign trade acceptances. No provision has been made for reporting separately "Commissions paid". Such commissions, in accordance with informal ruling of the Board under date of September 22, 1915. (See page 309 of the October Bulletin), should be treated as part of the purchase price or cost of the investment.

Under the head of Current Expenses the following observations would seem pertinent :

1. Assessments on account of expenses of Federal Reserve Board should be apportioned to each month (regardless of the dates when paid) and cumulative figures of amounts charged since January 1 be shown in the second column.

2. The expenses of the several advisory bodies, including the Federal Advisory Council, the Governors' and the Federal Reserve Agents' conferences, should be segregated, these expenses to include fees, per diem allowances, travelling and other incidental expenses.

3. Items to be apportioned over a period should on day of payment, be charged to account "Expenses paid in advance" (BIDE- Form 34), pro rata amounts to be transferred to Current Expenses on the last day of each month and be included, under proper headings, on monthly report of expenses (Form 287b).

4. Under the general head of Organization Expenses please report, in accordance with informal ruling of December 10, 1915, (page 12 of the January BULLETIN), in short column the cost of Federal reserve notes issued by the bank prior to January 1 not offset by current earnings, and all other organization expenses shown on Form 34 after closing of books for calendar year 1915. The total of these two items (HUNT) should equal the amount shown at the beginning of the year against item BEAM on Form 34. Attention is called to the provisions of the Board's informal ruling of December 10, 1915, regarding the methods of amortizing the cost of Federal reserve notes and other organization expenses.

5. A separate account is set up for depreciation of furniture and equipment. This account is to show amounts written off in accordance with paragraph 5 of informal ruling of December 10, 1915.

6. The amount of item HALL shown at the foot of Form 287b should equal the amount shown against item BATH on Form 34 as at close of business on the last day of each month.

Items shown in memorandum on Form 286b represent amounts expended during the month on account of Federal reserve notes printed and shipped, including expressage, insurance, etc. ; also amounts paid during the month for furniture and equipment. As indicated in the heading, the figures in the second column against items HOLT and HERD in this memorandum should equal amounts shown against items BOOT and BOLO on Form 34 as at close of business on the last day of the report month.

Copies of the monthly report of earnings and expenses should be sent to us on or before the seventh of each month.

Respectfully,

Assistant Secretary.

Enclosure

Washington, D. C., January 24, 1916.

ANALYSIS OF THE RESERVE CITY SITUATION.

First:

Under Clause (e) of Section 11, of the Federal Reserve Act, the Federal Reserve Board is authorized and empowered:

> "To add to the number of cities classified as reserve and central reserve cities under existing law in which national banking associations are subject to the reserve requirements set forth in Section twenty (should be 19) of this Act; or to reclassify existing reserve and central reserve cities or to terminate their designation as such."

Second:

The Reserve requirements at the end of thirty-six months after the Banks were organized - i. e. until November 2, 1918, - will be as follows:

At the end of 36 months from the starting of the banks, (ioe. November 2, 1918) the member banks will have the option of keeping the following percentages of their demand deposits in the manner indicated, depending upon their location:

	(a)	(b)	(c)	(d)	(e)
Member Bank Located In	Required Minimum In own Vaults	Required Minimum Federal Reserve Bank Vaults	Reserve Which at Option of Member Bank may be Kept in Federal Reserve Bank or in Own Vaults	Total of (b) and (c)	Total Reserves
Central) Reserve) Cities)	6%	7%	5%	12%	18%
Reserve) Cities)	5%	6%	4%	10%	15%
Country) Cities) &Towns)	4%	5%	3%	8%	12%

Third:

Under Section 19, of the Federal Reserve Act, which is the Section making provision for the payment of reserves into the Federal Reserve Banks, the Banks in cities already known as central reserve cities or hereafter so defined, are required to pay in their reserve deposits at once, whereas, banks in reserve cities and non-reserve cities are given three years in which to transfer their reserves.

Fourth:

There are in the United States at the present time three central reserve cities and [illegible] reserve cities. Grouping these cities according to the twelve Federal Reserve Districts, the list appears as follows:

List of Central Reserve and Reserve Cities, Grouped by Districts and According to Population.

DISTRICT No. 1:	Population
(*) Boston	670,585
DISTRICT No. 2:	
(*) New York City	4,766,883
Albany	100,253
DISTRICT No. 3:	
(*)Philadelphia	1,549,008
DISTRICT No. 4:	
(*)Cleveland	560,663
Pittsburgh	533,905
Cincinnati	364,463
Columbus	181,548

DISTRICT No. 9:	Population.
(*) Minneapolis	301,408
St. Paul	214,744
DISTRICT No. 10.	
(*) Kansas City, Mo.	248,381
Kansas City, Kans.	82,331
Denver	213,381
Omaha	124,096
S.Omaha, Nebr.	26,259
St. Joseph, Mo.	77,403
Oklahoma City	64,205
Wichita, Kans.	52,450
Pueblo, Colo.	44,395
Lincoln, Nebr.	43,973
Topeka, Kans.	43,684
Muskogee, Okla.	25,278

DISTRICT No. 5:

Baltimore	558,485
Washington	331,069
(*) Richmond	127,628
Charleston, S.C.	58,883

DISTRICT No. 6:

New Orleans	339,075
(*)Atlanta	154,389
Birmingham	132,685
Nashville	110,364
Savannah	65,064
Chattanooga	44,604

DISTRICT No. 7:

(*) Chicago	2,185,283
Detroit	465,766
Milwaukee	373,857
Indianapolis	233,650
Des Moines	86,368
Sioux City, Ia.	47,828
Dubuque	38,494
Cedar Rapids	32,811

DISTRICT No. 8:

(*) St. Louis	687,029
Louisville	223,928

DISTRICT No. 11 :

San Antonio	96,614
(*) Dallas	92,104
Houston	78,800
Ft. Worth	73,312
Galveston	36,981
Waco	26,425

DISTRICT No. 12 :

(*) San Francisco	416,912
Los Angeles	319,198
Seattle	237,194
Portland	207,214
Spokane	104,402
Salt Lake City	92,777
Tacoma	82,972

Federal Reserve Cities marked with (*)

Fifth:

In order to study the reserve situation from the standpoint given under the law, a list of cities having a population of 100,000 or more, in each District, is herein shown, also, a list of cities having 50,000, but less than 100,000. It will be noticed that there are fifty cities in the United States having a population of more than 100,000, and fifty-four cities having more than 50,000, but less than 100,000. For the convenience of the student of this question these cities are grouped by Federal Reserve Districts. (See Exhibit A)

LIST OF CITIES IN UNITED STATES HAVING A POPULATION OF OVER ONE HUNDRED THOUSAND

Classified as to Federal Reserve Districts

DISTRICT NO. 1:

(*)	Boston, Mass.	670,585
	Providence, R.I.	224,326
	Worcester, Mass.	145,986
	New Haven, Conn.	133,605
	Fall River, Mass.	119,295
	Lowell, Mass.	106,294
	Cambridge, Mass.	104,839
	Bridgeport, Conn.	102,054

DISTRICT NO. 2:

(*)	New York City	4,766,883
	Buffalo, N.Y.	423,715
	Newark, N.J.	347,469
	Jersey City, N.J.	267,779
	Rochester, N.Y.	218,149
	Syracuse, N.Y.	137,249
	Paterson, N.J.	125,600
	Albany, N.Y.	100,253

DISTRICT NO. 3:

(*)	Philadelphia, Pa.	1,549,008
	Scranton, Pa.	129,687

DISTRICT NO. 4:

(*)	Cleveland, Ohio	560,663
	Pittsburgh, Pa.	533,705
	Cincinnati, Ohio	364,463
	Columbus, Ohio	181,548
	Toledo, Ohio	168,497
	Dayton, Ohio	116,577

DISTRICT NO. 5:

	Baltimore, Md.	558,485
	Washington, D.C.	331,069
(*)	Richmond, Va.	127,628

DISTRICT NO. 6:

	New Orleans, La.	339,075
(*)	Atlanta, Ga.	154,879
	Birmingham, Ala.	132,685
	Nashville, Tenn.	110,364

DISTRICT NO. 7:

(*)	Chicago, Ill	2,185,283
	Detroit, Mich.	465,776
	Milwaukee, Wis.	373,857
	Indianapolis, Ind.	233,650
	Grand Rapids, Mich.	112,571

DISTRICT NO. 8:

(*)	St. Louis, Mo.	687,029
	Louisville, Ky.	223,928
	Memphis, Tenn.	131,105

DISTRICT NO. 9:

(*)	Minneapolis, Minn.	301,408
	St. Paul, Minn.	214,744

DISTRICT NO. 10:

(*)	Kansas City, Mo.	248,381
	Denver, Colo.	213,381
	Omaha, Nebr.	124,096

DISTRICT NO. 11:

DISTRICT NO. 12:

(*)	San Francisco, Cal.	416,912
	Los Angeles, Cal.	319,198
	Seattle, Wash.	237,194
	Portland, Ore.	207,214
	Oakland, Cal.	150,174
	Spokane, Wash.	104,402

This list totals 50 Cities.

Note: Federal Reserve Cities are marked with (*).

LIST OF CITIES IN UNITED STATES HAVING A POPULATION OF OVER FIFTY THOUSAND BUT LESS THAN ONE HUNDRED THOUSAND

Classified as to Federal Reserve Districts.

DISTRICT NO. 1:

Hartford, Conn.	98,915
New Bedford, Mass.	96,652
Lynn, Mass.	89,336
Springfield, Mass.	88,926
Lawrence, Mass.	85,892
Manchester, N.H.	70,063
Portland, Me.	58,571
Holyoke, Mass.	57,730
Brockton, Mass.	56,878
Pawtucket, R.I.	51,622

DISTRICT NO. 2:

Yonkers, N.Y.	79,803
Troy, N.Y.	76,813
Utica, N.Y.	74,419
Elizabeth, N.J.	73,409
Hoboken, N.J.	70,324
Bayonne, N.J.	55,545
Passiac, N.J.	54,773

DISTRICT NO. 3:

Trenton,N.J.	96,815
Reading, Pa.	96,071
Camden, N.J.	94,538
Wilkes Barre,Pa.	67,105
Harrisburg, Pa.	64,186
Johnstown, Pa.	55,484
Altcona, Pa.	52,127
Allentown, Pa.	51,913

DISTRICT NO. 4:

Youngstown, O.	79,066
Akron, O.	69,067
Erie, Pa.	66,525
Covington, Ky.	53,270
Canton, O.	50,217

DISTRICT NO. 5:

Norfolk, Va.	67,452
Charleston, S.C.	58,833

DISTRICT NO. 6:

Savannah,Ga.	65,064
Jacksonville, Fla.	57,699
Mobile, Ala.	51,521

DISTRICT NO. 7:

Des Moines, Ia.	86,368
Peoria, Ill.	66,950
Ft. Wayne, Ind.	63,933
Terre Haute, Ind.	58,157
South Bend, Ind.	53,684
Springfield, Ill.	51,677
Saginaw, Mich.	50,510

DISTRICT NO. 8:

Evansville, Ind.	69,647

DISTRICT NO. 9:

Duluth, Minn.	78,466

DISTRICT NO. 10:

Kansas City, Kas.	82,331
St. Joseph, Mo.	77,403
Oklahoma City, Okla.	64,205
Wichita, Kas.	52,450

DISTRICT NO. 11:

San Antonio, Tex.	96,614
(*) Dallas, Tex.	92,104
Houston, Tex.	78,810
Ft. Worth, Tex.	73,312

DISTRICT NO. 12:

Salt Lake City, Utah	92,777
Tacoma, Wash.	83,743

This list totals 54 Cities

Note: Federal Reserve City marked (*)

The question naturally arises, whether this problem of greater reserves in certain banks than in others should be approached,

(a) From the standpoint of the population of the city, on the theory that the banks in cities of considerable population are more vulnerable, e. g. liable to a run, than banks in country districts;

(b) Based on the theory of the size of the bank, banks with large deposits being more vulnerable than banks of smaller deposits; or

(c) Based on the theory that different reserves should be kept against different classes of deposits. For instance, one basis of reserves against individual deposits, and a higher percentage against bank deposits.

If we proceed on the population theory, we can go ahead under the Act as it is ; ; or we can even combine the population theory with that of geographical location, with that of distance and relations of the Federal Reserve Bank as a convenient agency. If, however, we proceed under proposals (b) or (c), we must ask for an amendment to the Federal Reserve Act. It may be said with a good deal of justice that it is unfair to apply a different rule of reserves to a small bank in the suburbs of a large city, which is, to all intents and purposes, a country bank , than applies to a country bank a few miles further away. However, this is an injustice which might be remedied by giving the large city banks the right to operate branches in the same city.

If some intelligent solution of this problem is not found, complaint will certainly be made by banks in central reserve cities that they are required to maintain reserves on a basis of say 18% while given no privileges under the Act (after the three year

period) which do not apply to banks in smaller cities. The result is certain to be that pressure will undoubtedly come to reduce reserve requirements down to the fifteen per cent or even to the twelve per cent level. Already banks in non-reserve cities are asking to have their reserves reduced to nine per cent.

Seventh:

In order to show the effect on Federal Reserve Banks of giving Federal Reserve Cities the designation of Central Reserve Cities as provided in Section 11 of the Act, a table has been prepared showing the ratio to capital and available reserve deposits. This table shows that in New York this ratio is 9 per cent whereas in the three Southern Districts, excluding special Government deposits of $5,000,000 each, it varies from 31.9 to 34.4 per cent. In order to show what the effect would be of requiring banks in these Federal Reserve Cities to carry 18 per cent reserves instead of 15 per cent reserves, all of which should be paid in at once, another table has been prepared to show the results of this designation. (See Exhibit B & C)

In the case of the Minneapolis District, on account of the close proximity and great competition existing between St. Paul and Minneapolis banks, both of these cities have been treated as Central Reserve Cities.

EXHIBIT B.

STATEMENT OF
CAPITAL and RESERVE DEPOSITS
-also-
PERCENTAGE OF CAPITAL TO THE COMBINED AMOUNTS OF
CAPITAL AND 65% OF RESERVE DEPOSITS
(Figures as of December 1,1915)
(In thousands of dollars)

Federal Reserve Bank of	Paid-in Capital	Reserve Deposits	65 Percent Reserve Deposits	Paid-in capital plus 65% of Reserve Deposits	Percentage of capital to sum of Capital and 65% of Reserve Deposits.
BOSTON	5,171	27,252	17,714	22,885	22.2
NEW YORK	11,061	171,144	111,244	122,305	9.0
PHILADELPHIA	5,270	23,728	15,423	20,693	25.5
CLEVELAND	5,931	24,436	15,883	21,814	27.2
RICHMOND	3,354	(a)15,149	9,847	13,201	25.4
		(b)10,149	6,597	9,951	33.7
ATLANTA	2,421	(a)12,100	7,865	10,286	23.5
		(b) 7,100	4,615	7,036	34.4
CHICAGO	6,641	52,545	34,154	40,795	16.3
ST.LOUIS	2,780	12,502	8,126	10,906	25.5
MINNEAPOLIS	2,497	13,557	8,812	11,309	22.1
KANSAS CITY	3,030	13,692	8,900	11,930	25.4
DALLAS	2,756	(a)14,053	9,135	11,891	23.2
		(b) 9,053	5,885	8,641	31.9
SAN FRANCISCO	3,942	17,331	11,265	15,207	25.9
TOTAL	54,854	(a)397,489	258,368	313,222	17.5
		(b)382,439	248,618	303,472	18.1

Note: (a) Inclusive of $5,000,000 of Government Funds.
(b) Exclusive of $5,000,000 of Government Funds.

Division, Reports & Statistics,

1/25/16.

EXHIBIT C.

FEDERAL RESERVE DEPOSITS OF NATIONAL BANKS LOCATED IN THE NINE FEDERAL RESERVE CITIES NAMED, AND ST. PAUL; ALSO ADDITIONAL RESERVE DEPOSITS REQUIRED IN CASE THESE CITIES ARE MADE CENTPAL RESERVE CITIES.

(Figures in thousands of dollars taken from Comptroller's report for November 10, 1915)

	Net Amount on which reserve is computed.	Due from Federal Reserve Bank Nov. 10, 1915(a)		Reserve required after Nov. 16, 1915		Reserve required if the cities named were made Central Reserve Cities		Excess over amount held on Nov. 10,1915(a)		Excess over amount required after Nov. 16, 1915.	
		Per ct.	Amount	Per ct.	Amount	Per ct.	Amount	Per ct.	Amount	Per ct.	Amount
BOSTON	313,195	2.95	99,253	4	12,528	7	21,924	4.05	12,671	3	9,396
PHILADELPHIA	363,144	3.50	12,713	4	14,526	7	25,420	3.50	12,707	3	10,894
CLEVELAND	88,778	3.16	2,801	4	3,551	7	6,214	3.84	3,413	3	2,663
RICHMOND	31,348	3.23	1,027	4	1,274	7	2,229	3.77	1,201	3	955
ATLANTA	23,659	4.58	1,084	4	946	7	1,656	2.42	572	3	710
ST. PAUL	68,749	2.52	1,733	4	2,750	7	4,812	4.48	3,079	3	2,062
MINNEAPOLIS	82,175	2.66	2,188	4	3,287	7	5,752	4.34	3,564	3	2,465
KANSAS CITY	84,377	3.55	2,994	4	3,375	7	5,906	3.45	2,912	3	2,531
DALLAS	24,152	3.34	806	4	966	7	1,691	3.66	835	3	725
SAN FRANCISCO	142,084	2.69	3,827	4	5,683	7	9,946	4.31	6,119	3	4,263
TOTAL For nine F. R. Cities and St. Paul.	1,222,161	3.14	38,426	4	48,886	7	85,550	3.86	47,124	3	36,664

(a) As shown by Comptroller's report.

1/25/16.

FEDERAL RESERVE BOARD

WASHINGTON

January 25, 1916.

S I R :

In a letter dated January 18, 1916, transmitting a memorandum outlining a plan for handling unfit Federal reserve notes, the Board stated that the purpose of the plan was to afford Federal reserve banks facilities for returning their own unfit Federal reserve notes "to the nearest subtreasuries and through them to Washington."

This statement was not intended to alter the procedure outlined in the memorandum which that letter enclosed and which contemplates that shipments of unfit Federal reserve notes by Federal reserve banks shall be direct to the Treasurer at Washington. The Treasury Department, however, has informed the Board that it will interpose no objection to the assistant treasurers extending to Federal reserve banks the use of their mechanical facilities in cutting and preparing notes for shipment. Federal reserve banks which are located in subtreasury cities may, therefore, arrange with assistant treasurers for permission to use the mechanical equipment of the subtreasuries for this purpose.

It is suggested that lower halves be shipped first and uppers on a succeeding day, both shipments being given the same lot number in order that they may be easily identified. When both sets of halves have been received and verified by the Treasurer in Washington he will notify both the Federal Reserve Agent and the Federal reserve bank, and the Federal Reserve Agent should immediately direct the Federal Reserve Board to transfer from his account with the Board to the account of the Federal reserve bank in the Gold Settlement Fund an amount equivalent to the value of the Federal reserve notes received by the Treasurer for redemption; or, if a Federal Reserve Agent has no such account with the Federal Reserve Board, he should make the transfer direct to his bank in order that it may be reimbursed for the notes shipped for redemption.

Because of the fact that the Federal Reserve Board has no account with the Treasurer of the United States whereby book transfers could be made, this procedure will obviate the necessity of requiring innumerable transfers of actual funds from the Agent, or his account with the Board, to the Treasurer and a retransfer from the Treasurer to the Board for the account of the bank in the Gold Settlement Fund.

Nothing herein contained, however, should be construed to do away with the necessity of each Agent's keeping on deposit with the Treasurer five per cent of the amount of outstanding Federal reserve notes covered by a deposit with him of gold or lawful money. This amount will be held like the five per cent redemption fund of the Bank, primarily for the redemption of notes presented to the Treasurer by holders other than the Federal reserve banks.

Enclosed are blanks of the forms referred to in paragraphs IV and V of the procedure for disposing of unfit Federal reserve notes.

Respectfully,

Governor.

Secretary.

FORM OF POWER OF ATTORNEY CONFERRING AUTHORITY INDICATED IN PARAGRAPH V OF THE PROCEDURE INVOLVING THE DISPOSITION OF UNFIT FEDERAL RESERVE NOTES. 516.

KNOW ALL MEN BY THESE PRESENTS,

That I,..... ..,.Federal Reserve Agent of the Federal Reserve Bank of ...., have constituted and appointed, and by these presents do constitute and appoint, the Treasurer of the United States my true and lawful Attorney in fact, for me and in my name and stead, to transfer and deliver to the Comptroller of the Currency for dedestruction all unfit Federal reserve notes of the Federal Reserve Bank of ....., which the said Treasurer of the United States now holds, or may hold in the future, for my account or subject to my order, and generally to do and perform any and every lawful act and thing necessary to effect such transfer and delivery.

Witness my hand and seal this.....day of ....., A. D. 1916.

Signed, sealed and delivered in

presence of - .....(SEAL)

.....)
)
.....)

FEDERAL RESERVE BOARD

WASHINGTON

January 25, 1916.

S i r :

One of the Federal Reserve Agents has called attention to, and sent in for inspection, a number of Federal Reserve notes which have been seriously mutilated and marked up with blue pencil, or other disfiguring marks. While there is no law specifically covering this matter, it is generally understood that the mutilating, disfiguring or counterfeiting of Federal Reserve notes, because Federal Reserve notes are obligations of the Government, must be regarded just the same as the mutilating, disfiguring or counterfeiting of other United States Government obligations; "greenbacks" for example.

The practice of blue penciling notes in counting them or at other times, is very specifically forbidden in the case of National bank notes, and it is perhaps a fair inference that it should not be permitted in the case of Federal Reserve notes, because the loss through the mutilation or disfigurment of Federal Reserve notes falls upon Federal Reserve banks and ultimately upon the National banks. It seems proper therefore, to call the attention of the Federal Reserve Banks to the matter and suggest that they take it up with their member banks.

Yours very truly,

Governor.

FORM OF RESOLUTION CONFERRING AUTHORITY INDICATED IN PARAGRAPH IV OF THE PROCEDURE INVOLVING THE DISPOSITION OF UNFI FEDERAL RESERVE NOTES.

At a meeting of the Board of Directors of the Federal Reserve Bank of _____, called pursuant to the provisions of the by-laws of said bank and held on the _____day of _____, 191_, the following Resolution was offered, seconded and duly adopted:

"BE IT RESOLVED, That the Treasurer of the United States be and he hereby is authorized, empowered and directed to transfer to the account and hold subject to the order of _____, Federal Reserve Agent of the Federal Reserve Bank of _____, all unfit Federal reserve notes of this bank which the said Treasurer of the United States now holds or may hold in the future for the account of this bank or subject to its order and to do and perform any and every lawful act and thing necessary to effect such transfer."

I hereby certify that the foregoing is a true and correct copy of a resolution adopted and spread upon the minutes of the Board of Directors of this bank, held on the date specified.

_____
Cashier or Secretary
Federal Reserve Bank of _____

1/25/16

An Analysis
of the Condition of
National and Other Member Banks
of the
Cleveland District

ooo O ooo

The Grouping of the Banks is as Follows:

1.	Banks with Total Resources of up to $100,000.						
2.	"	"	"	"	"	$100,000 to	$200,000
3.	"	"	"	"	"	200,000 "	300,000
4.	"	"	"	"	"	300,000 "	500,000
5.	"	"	"	"	"	500,000 "	1,000,000
6.	"	"	"	"	"	1,000,000 "	10,000,000
7.	"	"	"	"	"	10,000,000 and Over	

2/2/16.

Data taken from
Reports of Condition of Member Banks
District No. 4 - Nov. 10, 1915.

	Group 1.	Group 2.	Group 3.	Group 4.
Average Loans and Discounts per bank	33,207.64	82,195.56	135,198,46	221,407.29
Officers and Directors Liability.				
Direct	12.28	7.40	7.40	6.12
Indirect	20.81	7.11	4.75	5.30
Per cent of Eligible Paper	28.30	26.80	20.14	16.17
Losses to Borrowers other than Banks 1912 - 1913 - 1914.	.95	1.75	1.50	1.75
Average Total Deposits per Bank	30,542.04	96,501.45	173,548.12	272,478.13
Per cent of Demand Deposits to Total Deposits	89.93	80.05	70.77	67.55
Per cent of Time Deposits to Total Deposits	10.07	19.95	29.23	32.45
Average Capital, Surplus and Undivided Profits per Bank	31,137.57	34,357.37	48,811.13	75,468.05
Per cent of Demand Deposits	88.24	325.81	251.65	243.89
Per cent of Time Deposits	9.83	56.25	103.90	117.16
Average Total Resources per Bank	80,302.94	153,943.53	239,637.68	390,010.26
Per cent of Loans and Discounts	41.35	52.39	56.41	56.74
Per cent of Bonds, Securities, etc.	3.44	11.73	14.67	12.27
Per cent of Eligible Paper	11.95	14.31	11.36	9.15

Data taken from
Reports of Condition of Member Banks
District No. 4 - Nov. 10, 1915.
(Continued)

	Group 5.	Group 6.	Group 7
Average Loans and Discounts per bank	553,9[illegible].38	2,956,792.50	16,579,547.64
Officers and Directors Liability			
Direct	5.26	5.66	3.93
Indirect	3.84	3.56	2.44
Per cent of Eligible Paper	14.81	22.14	23.67
Losses to Borrowers other than Banks 1912 - 1913 - 1914	1.83	2.34	.91
Average Total Deposits per Bank	680,721.64	4,009,916.89	27,738,738.85
Per cent of Demand Deposits to Total Deposits	66.40	80.18	96.44
Per cent of Time Deposits to Total Deposits	33.60	19.82	3.26
Average Capital, Surplus, and Undivided Profits per Bank	194,200.39	1,082,744.37	5,741,892.93
Per cent of Demand Deposits	232.76	296.95	465.89
Per cent of Time Deposits	117.76	73.39	17.19
Average Total Resources per Bank	976,841.33	5,583,969.11	35,817,345.37
Per cent of Loans and Discounts	56.71	52.95	46.25
Per cent of Bonds, Securities, etc.	14.80	14.25	17.15
Per cent of Eligible Paper	8.40	11.72	10.96

Comparative Market Values of the
Stock of the National Banks in Cleveland, Ohio.

Bank.	1913	1914	Increase.	Decrease
Bank of Commerce, N. A.	219	209	- -	10
Central National Bank	163	160	- -	3
Cleveland National Bank	106½	90	- -	16½
First National Bank	240	266	26	--
National Commercial Bank	164	160	- -	4
National City Bank	220	208½	- -	11½
Union National Bank	165	160	- -	5

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	Capital	Nov.1914.	Jan.1916.	Increase	Decrease
Bank of Commerce N.A.	2,000,000.	209	190	- -	19
Central National Bank	1,000,000.	160	185	25	- -
Cleveland National Bank	500,000.	90	105	15	- -
First National Bank	3,500,000.	266	300	34	- -
National Commercial Bank	1,500,000.	160	160¼	¼	- -
National City Bank	500,000.	208½	205	- -	3½
Union National Bank	1,600,000.	160	188	28	- -
Average.	1,368,586.	179.08	190.46	11.38 Net increase.	

Stockholders' Advantage

	1913 - 1914.	1914 - 1915.
Bank of Commerce, N. A.	200,000.*	380,000.*
Central National Bank	30,000.*	250,000.
Cleveland National Bank	82,500.*	75,000.
First National Bank	650,000.	850,000.
National Commercial Bank	60,000.*	3,7500
National City Bank	57,500.*	17,500.*
Union National Bank	80,000.*	448,000.
(*) Depreciation.		
Net Increase.	240,000.	1,229,250.

Total percentage of

Eligible Paper to Loans & Discounts	19.97
Real Estate Loans to Loans & Discounts	1.87
Officers & Directors Direct Liability to Loans & Dis.	5.13
Losses to borrowers, other than banks. 1912, 1913, 1914, to Loans & Discounts.	1.62
Average per year.	.607
Time Deposits to Total Deposits	19.25
Demand Deposits to Total Deposits	30.75
Overdrafts to Total Deposits	.046
Overdrafts to Demand Deposits	..0595

MEMORANDUM.

"If Bank "A" and Bank "B" have dealings with each other, and Bank "A" "receives on deposit" from one of its own depositors a check or draft drawn on Bank "B" and immediately credits the depositor's account with the amount, is there any recognized usage or custom of banking which would authorize Bank "A" to simultaneously debit the amount to the account of Bank "B"?"

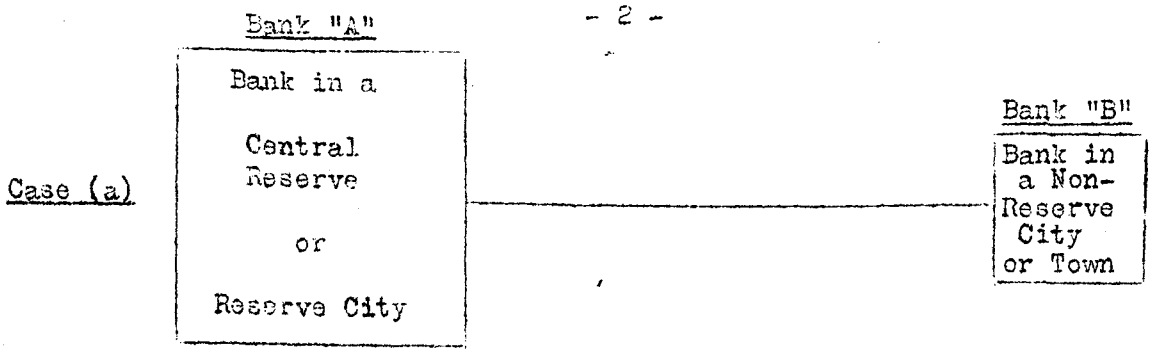
Answer: "Yes" in some cases and "No" in others, depending on the relation of the banks to each other.

In considering this question the relations of one bank to another must be taken into account, for the answer will depend upon the exact arrangement which is a matter of contract or agreement between the banks and may be broadly differentiated under three heads, to wit:

(a) Where Bank "A" is a large bank in a Reserve or Central Reserve City and Bank "B" a small bank which uses Bank "A" as its reserve depositary,

(b) Where Bank "A" is the little bank in the country and Bank "B" the large bank in the city, sending checks drawn against it for collection,

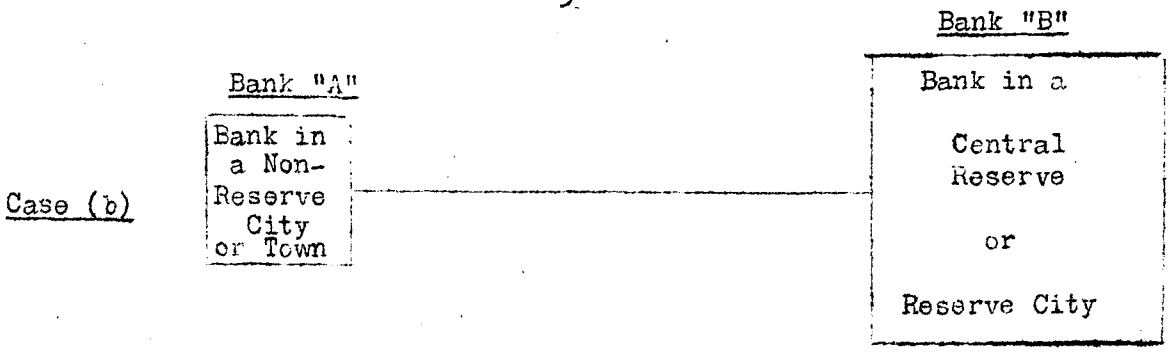
(c) Where Banks "A" and "B" are on terms of equality, they may be banks in different cities, receiving each other's checks either on the basis of reciprocal balances, or on the collection basis, carrying no balances.



CASE (a)

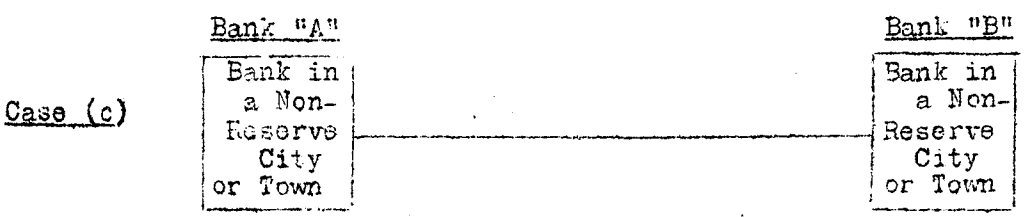
Under the usual custom, which is of course subject to exceptions by agreement in particular cases, Bank "A" receives from its depositors, whether banks or individuals, checks drawn on Bank "B" which has a reserve account with it, and gives their depositors immediate credit. Bank "A" may receive such checks from some depositors, either bank or individuals as the case may be, at par, in consideration of a satisfactory balance carried with it by such depositor, and in other cases it may deduct a charge sufficient to compensate it for cost of collection and time involved in transit. If the depositor be a bank, the credit is usually a bookkeeping entry which does not draw interest or entitle the depositor bank to draw against it until the checks have actually been collected. As every credit must have a simultaneous corresponding debit, Bank "A" debits daily the sum total of the checks that it is sending to Bank "B" against an auxiliary account known as the "transit account", which debit in turn receives a corresponding credit after Bank "B" has received the checks and has made remittance to Bank "A" for them. If this remittance is in the form of a check on some other bank no debit is of course made against the account of Bank "B" with Bank "A", but where Bank "B" advises Bank "A" that it has credited Bank "A's" account with the amount of the checks, Bank "A" credits the transit account and charges the amount against Bank "B's" reserve account. In effect this is a system of immediate credit and deferred debit, but as between banks at least really tantamount to deferred credit and deferred debit since the immediate credit is not available. The principle governing this arrangement is that Bank "B" is carrying with Bank "A" a reserve account against which it has occasion to draw checks. Bank "B" desires to know at all times the exact amount that it has with Bank "A" subject to check, which would be impossible if it permitted Bank "A" to charge on receipt items against the account.

While, however, this is doubtless the predominating custom today, it is also true (1) that Bank "A" may have a general agreement with Bank "B" providing for immediate debit of items drawn on the latter, without getting any specific permission in any given case, such checks in some large banks amounting to a considerable percentage of t... tal, and (2) that Bank "A" may in some cases where it doubts the solvency or promptness of Bank "B" make immediate debit without getting permission to do so.



CASE (b)

Under the usual rules, subject to exceptions, Bank "A" when it receives from its depositors checks drawn on Bank "B" or other banks, which by special arrangement it collects through Bank "B" gives the depositor immediate credit and at the same time makes an immediate debit on its own books against Bank "B". This operation enables Bank "A" to include the sum total of these items charged against Bank "B" as part of its lawful reserves. Bank "B" of course does not credit these items on the account of Bank "A" with it until these items have actually been received, and would not make such a credit against telegraphic advice from Bank "A" that it was mailing the items.



CASE (c)

In this case Banks "A" and "B" collect each others checks and checks on such other banks as may have been mutually agreed upon, on a reciprocal basis. Each bank charges the other with the sum total of the daily remittance letters and credits the other subject to final payment, with the sum total of items received from the other, making the entry upon receipt. Each account therefore, shows offsetting debits and credits and it frequently happens that balances are not large either way. As balances accumulate one way or the other, they are usually settled by check of the debtor bank upon its correspondent in a reserve city.

2/3/16

"Assuming that it were the statutory duty of each Federal Reserve Bank immediately to credit the accounts of its member banks with the face value of all checks and drafts drawn upon depositors of the Federal Reserve Bank which may be deposited with it by its member banks, could that duty be performed at all or could it be performed consistently with sound banking practice unless the Federal Reserve Bank could simultaneously debit the amounts of such checks and drafts to the accounts of the banks drawn upon?"

Answer: "No".

At the present time the common, but not universal rule of immediate credit and deferred debit results in the case of large banks with many correspondents carrying what is known as a "float" amounting, in at least one case which had come to our attention, to the large total of $19,000,000. That is to say there are at any one time book credits aggregating that amount on the books of one bank in excess of the debits which have been charged by that bank against the individual bank corresponding with it. In other words, the banks in reserve or central reserve cities, to a considerable extent, carry these book credits in excess of the debits actually charged as an asset, under the title "Due from other banks." However, this is not quite so dangerous a procedure from the standpoint of the bank giving these credits as it would appear in the telling, for the reason that these credits are simply book credits, which banks are not permitted to draw against until collections have been made and the offsetting debits charged; and by the same token, interest is not allowed on these accounts until returns from collections have been completed.

The real effect of immediate credit and deferred debit is to make for the depositing banks a fictitious showing in reserve deposits in the hands of the correspondent bank in the reserve or central reserve city, for while the credits are not available to be drawn against, they are counted as book credits and hence as reserves.

2/3/16.

868

A GENERAL SCHEME OF CHECK COLLECTION AND CLEARING

UNDER THE FEDERAL RESERVE ACT.

Washington, February 24, 1916.

1. The Federal Reserve Board may designate every Federal Reserve Bank to act as a Clearing House for the checks of its District.

2. A member bank may send to its own Federal Reserve Bank for deposit checks drawn on or collectible through other member banks of the same District, but not checks drawn on banks of other Districts.

3. Every member bank may send to the Federal Reserve Bank of any District for collection and for the credit of its own Federal Reserve Bank checks drawn on or through member banks of that District. This means that a member bank receiving on deposit checks drawn on banks all over the country, will send to its own Federal Reserve Bank the checks drawn on banks of that District, claiming immediate credit therefor and it will send to other Federal Reserve Banks, for collection and credit to the account of the Federal Reserve Bank of its own District, checks drawn on banks of the District of which such Reserve Bank is the head. In other words every Member Bank will make up its checks into twelve envelopes or packages, one for its own, and one for each of the other eleven Reserve Banks. It will send to its own Reserve Bank carbon duplicates of letters transmitting remittances of checks sent for collection and to the credit of its Reserve Bank. It can claim immediate credit for items sent to its own Reserve Bank, but only deferred credit for items sent for collection to other Reserve Banks.

4. Under the above arrangement every Federal Reserve Bank will thus be receiving direct from, say 7600 banks - bundles of checks drawn against its members. Those deposited by its own members are credited at once to the acccunt of the depositing banks and debited against the payer bank, while those sent from banks in other Districts are credited to the exchange account of the Federal Reserve Bank of the District represented by the sending bank and debited simultaneously against the payer bank.

5. A Federal Reserve Bank each night will have on its books amounts representing the aggregate of the above credited items; all of which have been charged against its own member banks; it will wire the amounts of these credits to the various Federal Reserve Banks and receive from these same eleven banks advice of the credits they have to its account. If it is assumed that each Federal Reserve Bank keeps with every other Federal Reserve Bank an account for exchange purposes which may run a reasonable credit or debit either way, it may be assumed that in most cases the resulting debits and credits by these daily balances will only have to be settled once or twice a week through the Gold Settlement Fund.

6. It is suggested that while a Federal Reserve Bank might properly charge nothing to its own member banks for items sent to it and drawn against its own members, it should charge member banks of other Districts a service charge for the expenses of collection and remitting balances to the Federal Reserve Bank of the District to which the sending bank belongs, and this service charge on a reasonable cost basis may be charged by the member bank against its customer.

7. The above plan gives immediate credit to the bank for all checks upon banks of its own District, but deferred credit with a service charge for all checks drawn against banks of other Districts. The time of transit however is greatly shortened for the reason that the forwarding bank sends checks for collection direct to each Federal Reserve Bank and should get credit as soon as the Federal Reserve Bank has received the items, charged them against the payer bank and credited them to the Reserve Bank of the District represented by the sending bank. Thus, the First National Bank of Columbus, Ohio, sends Cleveland District checks to Cleveland for deposit and claims immediate credit, at the same time it sends Chicago District checks to Chicago, St. Louis District checks to St. Louis, etc. These checks reaching these Federal Reserve Banks the next day are charged against the accounts of payer banks and credited to the exchange account of the Federal Reserve Bank of Cleveland. Thus the First of Columbus should be able to claim immediate credit for Cleveland items and, say one day deferred credit for items drawn on the Chicago and St. Louis District Banks; the same for items on Atlanta and Richmond Districts, and proportionately later dating for more distant Districts.

8. The greatest advantage of this method is the direct and simple routing of all items and the consequent reduction of float. Large city banks are now required to send checks for collection to some 500 points whereas, under this plan, they would be enabled to send checks to twelve centers (except of course, local Clearing House items) and the clearing and collecting would be focussed and concentrated at those points with a minimum of delay.

FEDERAL RESERVE BOARD

WASHINGTON

554

February 25, 1916.

S i r :

On January 25, 1916, the Federal Reserve Board, at the request of the Secretary of the Treasury and in accordance with the provisions of Section 16 of the Federal Reserve Act, requested each Federal Reserve Agent to transmit to the Treasurer of the United States an amount in gold equal to five per cent of all outstanding Federal reserve notes which are covered by a deposit of gold or lawful money.

The establishment of a redemption fund by the various Federal Reserve Agents became necessary because of the fact that only four of the twelve Federal reserve banks at that time had outstanding notes covered by commercial paper and only those four were required to maintain any credit balance in the gold redemption fund.

In those cases when both the agent and the bank have funds to their credit in the redemption fund, the Treasurer legally has the right to redeem notes either out of the account of the Agent or of the bank, but upon request of the Federal Reserve Board he made all redemptions, whether of fit or unfit notes, out of the Agent's account, delivering the unfit notes to the Comptroller of the Currency for destruction and returning the fit ones direct to the Agent. This request of the Board was made partly to insure similar treatment of all fit notes presented to the Treasurer for redemption, and partly to aid in retiring Federal reserve notes by returning them to the Agent rather than to the bank for further circulation.

In view of the fact, however, that various Federal Reserve Agents have formally asked the Board that fit notes be returned to the Bank instead of to the Agent, on the ground that such Agent has not the facilities for handling periodic shipments of small amounts of notes, the Board has now formally requested the Treasurer to redeem all fit notes out of the redemption fund of the bank, provided such bank has a credit balance in that fund. If it has no such balance, fit notes will be redeemed out of the Agent's account and will be returned to the Agent. Fit notes redeemed out of the Bank's account will, of course, be returned to the bank. All unfit notes, as contemplated by the plan dated January 18, 1916,

will be redeemed out of the Agent's account and, acting under the power of attorney given to him by such Agent, the Treasurer will deliver such notes to the Comptroller of the Currency for destruction.

Any bank which has no money on deposit with the Treasurer and which desires its fit notes returned to it rather than to the Agent may make a voluntary deposit for the purpose of meeting the redemption of those fit notes which are received by the Treasurer for that purpose.

Respectfully,

Secretary.

February 22, 1916.

My dear Governor:

The accompanying letter from Mr. Myron Campbell, Cashier of The South Bend National Bank, South Bend, Indiana, has been referred to this office for an opinion.

Mr. Campbell asks whether in the opinion of this office Section 5211 of the Revised Statutes gives the Comptroller of the Currency power to require National banks to furnish any information other than that which is to be published in the newspaper, and whether the Comptroller may impose the penalty prescribed by Section 5213 of the Revised Statutes for failure to furnish such information.

The question of what information may be called for by the Comptroller under the authority of Section 5211 was considered by the Attorney General in an opinion dated November 9, 1912. In this opinion the Attorney General says -

> "By section 5211, Revised Statutes, the Comptroller is expressly given - -
> 'power to call for special reports from any particular association whenever in his judgment the same are necessary in order to have a complete knowledge of its condition'.
>
> One view of this section is that it limits the power of the Comptroller to call for reports concerning the financial condition of a particular association only, and that it is not broad enough to empower him to ask reports regarding general conditions which may have a bearing merely upon the expediency of amendments to the existing law. I think that too narrow a construction of the section, because section 333, Revised Statutes (above quoted) requires the Comptroller to make an annual report to Congress at the commencement of its session, showing among other things, 'any amendment to the laws relating to banking by which the system may be improved and the security of the holders of its notes and other creditors may be increased', and the power given in section 5211 to call for special reports is, in my opinion, broad enough to authorize him to call for any reports which may be necessary to enable him to determine how, in his opinion, the banking system may

"be improved by new legislation and what legislation he should recommend to Congress for that purpose".

It seems clear, therefore, that the Comptroller is not limited to the statement showing the financial condition of the bank which is published in the newspaper, but may call for any information which is necessary to enable him to determine the true condition of the bank.

Section 5213 refers specifically to failure to furnish information called for in Section 5211.

In the opinion of this office, therefore, the Comptroller could impose the penalty prescribed for failure to furnish the information called for.

Respectfully,

M. C. ELLIOTT,

Counsel.

Honorable Charles S. Hamlin,
Governor.

March 1, 1916.

My dear Sir:

On February 29 the Federal Reserve Board gave final consideration to the appeal of certain Connecticut banks for transfer from District No. 1 to District No. 2, and it was agreed to transfer Fairfield County, Connecticut, to District No. 2, (New York), the remainder of the territory covered by your petition and appeal to be left for possible consideration at some future time, when more experience with the clearing system shall have been had. I enclose a copy of a press notice which was approved by the Board, and states the situation.

Action has been taken with reference to effecting the transfer of the banks in Fairfield County, and the Federal Reserve Banks of Boston and New York will take the matter up direct with the institutions which are affected by the transfer.

Respectfully,

Secretary.

562.

STATEMENT FOR THE PRESS.

February 29, 1916.

The Federal Reserve Board today voted to grant the appeal of certain Connecticut bankers for the transfer of territory west of the Connecticut River from District No. 1 to District No. 2, in so far as relates to the banks situated in Fairfield County, adjoining New York State. Action as affecting the balance of the territory covered by the petition was suspended, a majority of the Board not being as yet ready to dispose definitely of the appeal, pending more complete development of the clearing system.

3/2/16

567.

A BILL TO LIMIT THE USE OF THE WORD "FEDERAL".

BE IT ENACTED BY THE SENATE AND HOUSE OF REPRESENTATIVES OF THE UNITED STATES OF AMERICA IN CONGRESS ASSEMBLED.

That all banks, other than Federal reserve banks, created and organized under an Act of Congress approved on December 23, 1913, and known as the Federal Reserve Act, and all firms, partnerships or corporations doing the business of bankers, brokers, or savings institutions, and all insurance, indemnity and trust companies, are prohibited from using the word "Federal" as a portion of the name or title of such bank, corporation, firm or partnership, and any violation of this prohibition committed after the first day of January, 1916, shall subject the party charged therewith to a penalty of [illegible]y dollars for each day it is permitted or repeated, PROVIDED, however, that this prohibition shall not apply to corporations organized prior to December 23, 1913, under titles which include the word "Federal" or to firms or partnerships doing business prior to that date under such titles.

3/8/16.

AMENDMENT TO SECTION 22.

BE IT ENACTED BY THE SENATE AND HOUSE OF REPRESENTATIVES OF THE UNITED STATES OF AMERICA IN CONGRESS ASSEMBLED.

That that part of Section 22 of the Act approved December 23, 1913, and known as "The Federal Reserve Act", which reads as follows:

> "Other than the usual salary or director's fees paid to any officer, director, or employee of a member bank and other than a reasonable fee paid by said bank to such officer, director, or employee for services rendered to such bank, no officer, director, employee, or attorney of a member bank shall be a beneficiary of or receive, directly or indirectly, any fee, commission, gift, or other consideration for or in connection with any transaction or business of the bank",

be amended and re-enacted so as to read as follows:

> "Other than the usual salary or director's fee paid to any officer, director, or employee of a member bank and other than a reasonable fee paid by said bank to such officer, director, or employee for services rendered to such bank, no officer, director employee, or attorney of a member bank shall be a beneficiary of or receive, directly or indirectly, any fee, commission, gift, or other consideration for or in connection with any transaction or business of the bank, PROVIDED, HOWEVER, that nothing in this Act contained shall be construed to prohibit the payment of reasonable fees for services rendered by an attorney to a member bank who is a director of said bank, or prohibit a director, officer, or employee from receiving the same rate of interest paid to other depositors for deposits made with such bank, and, PROVIDED, FURTHER, that notes, drafts, bills of exchange or other evidences of debt executed or endorsed by directors of a member bank may be discounted with such member bank on the same terms and conditions as other notes, drafts, bills of exchange or evidences of debt upon the affirmative vote of three-fourths the members of the board of directors of such member bank".

3/8/16.

BE IT ENACTED BY THE SENATE AND HOUSE OF REPRESENTATIVES OF THE UNITED STATES IN CONGRESS ASSEMBLED, That Paragraph 31 of Section 4, of the Act approved December 23, 1913, and known as the Federal Reserve Act be amended and reenacted so as to read as follows:

"Class C directors shall be appointed by the Federal Reserve Board. They shall have been for at least two years residents of the district for which they are appointed, one of whom shall be designated by said board as chairman of the board of directors of the Federal reserve bank and as 'Federal reserve agent.' He shall be a person of tested banking experience; and in addition to his duties as chairman of the board of directors of the Federal reserve bank he shall be required to maintain under regulations to be established by the Federal Reserve Board a local office of said board on the premises of the Federal reserve bank. He shall make regular reports to the Federal Reserve Board, and shall act as its official representative for the performance of the functions conferred upon it by this Act. He shall receive an annual compensation to be fixed by the Federal Reserve Board and paid monthly by the Federal reserve bank to which he is designated. ~~One of the directors of Class C, who shall be a person of tested banking experience, shall be appointed by the Federal Reserve Board as deputy chairman and deputy Federal reserve agent to exercise the powers of the chairman of the board and Federal reserve agent in case of absence or disability of his principal~~".

3/8/16.

M E M O R A N D U M

-of-

Various Plans

for the

Clearing and Collection

of Checks.

Submitted to the

Federal Reserve Board.

oOo

Washington, D.C.
March 21,1916.

PLAN NO. 1.

Plan of check collection and clearing recommended by a Committee of Federal Reserve Agents (Messrs. Martin, Curtiss and Jay) under date of October 13, 1915, and embodied in a report of the Committee, printed in full in the Federal Reserve Bulletin for November 1915, Pages 369-372.

1. That as soon as practicable, and under arrangements which will make clear and restrict its use to the purposes for which it was established, settlements through the gold settlement fund should be made daily.

2 That the Federal Reserve Banks should soon arrange to undertake the collection of notes and drafts, and of items drawn on non-member banks upon the most favorable terms which can be arranged in the respective districts.

3 That the Comptroller should be asked to endeavor to arrive at an agreement with all State bank supervisors that on and after a given date checks in the mail shall not be counted as reserve

4. That through mutual agreements, each Federal Reserve Bank should receive checks drawn on members of the collection system of every other Federal Reserve Bank, deferring credit for them a sufficient number of days to allow them to reach the Federal Reserve Bank of the district of origin, plus the number of days, if any, allowed by such Federal Reserve Bank to reach

the paying bank; and further

5. That through mutual agreement, any Federal Reserve Bank may receive for immediate credit checks drawn on members of the collection system of any other Federal Reserve Bank; and that whenever it is both practicable and more direct, member banks in such collection systems may send direct to the Federal Reserve Bank of the district of origin instead of to their own Federal Reserve Bank.

6. That the development of inter-district collecting need not await the completion of the intra-district collection systems.

7. That in extending the collection system both within and across district lines uniformity need not prevail but instead there should be freedom and flexibility of rules and requirements in order that each reserve bank may best meet the conditions and needs of its member banks.

8. That each Federal Reserve Bank should retain the right to change immediate credit points to deferred credit points, to assess upon members the cost of its collection service, to make charges against its member banks for using their balances to create exchange on other districts, and generally to make such rules and regulations as will enable it promptly to safeguard its position and protect itself against unsound development.

PLAN NO 2

Plan for Check Collection Adopted by the Executive Committee of Governors at a meeting on October 23, 1915, submitting, with slight alterations a plan previously adopted by the Transit Managers of the Reserve Banks.

The Fifth Conference of Governors at the morning session, Saturday, October 23rd, 1915, considering the further development of the collection system, "adopted as its recommendation the substance of Vote 12, of the Transit Managers' Conference of October 6th and 7th, 1915, as representing substantially its views on this subject, and left to the Governors' Executive Committee the development of the details of the plan and its submission to the Federal Reserve Board with power to invite the attendance at any meetings of such of the transit men of the different banks as the committee may select."

In order that you may be advised of the principles adopted as the basis upon which the plan outlined in Vote 12, mentioned above was drafted, I enclose copies of the minutes of the Transit Managers' Conference with notations in ink showing such changes as were made by the Conference of Governors, except that a typewritten slip is attached giving the vote of the Governors Conference adopted in lieu of Vote 8 of the Transit Managers' Conference.

RECOMMENDATIONS TO EXECUTIVE COMMITTEE BY THE TRANSIT MANAGERS

Morning, afternoon and night sessions were held on October 6th and 7th.

The deliberation of the Conference resulted in the passage of the votes recorded below, every representative being

present when each vote was taken, except that in one or two cases representatives absent for a few minutes authorized the Secretary to record their votes:

1. Voted - That we heartily favor every extension of the operation of a check collection system consistent with sound principles and permissible under the Federal Reserve Act.

Concurred in by Governors

2. Voted - The deliberations of this body are based on the assumption that every member bank is required by law to cover at par all checks and drafts drawn upon it received from the Federal Reserve Bank of which said bank is a member. Immediate debit and credit not required.

Mr. Pike of Atlanta asked to be reported as voting "No."

Concurred in by Governors

3. Voted - That the Federal Reserve Bank should have the privilege at its discretion of accepting checks on any bank, banker or trust company.

Unanimously carried.

Concurred in by Governors.

4. Voted - We recommend that the actual expense of handling items on non-member banks shall be assessed by the Federal Reserve Bank against the member depositing such items with the Federal Reserve Bank.

Unanimously carried.

Concurred in by Governors.

5. Voted - That consideration of a service charge by the Federal Reserve Banks for collection of checks on member banks deposited with the Federal Reserve Banks be deferred at this time.

Carried without a dissenting voice

Concurred in by Governors

6. Voted - WHEREAS, Section 16 of the Federal Reserve Act stipulates that Federal Reserve Banks shall accept at par from their member banks checks and drafts on their members, this Conference recommends to the Governors' Conference that this provision of the Act be developed by the several Federal Reserve Banks on a deferred credit and deferred debit basis, but we believe that the privilege to handle items on an immediate debit and credit basis, so far as expedient to do so, should be granted.

Concurred in by Governors.

Carried.
Mr. Pike voting "No", explaining that the Atlanta directors are on record as being opposed to putting into effect any system of clearing on a par basis.

7. Voted - That items sent to Federal Reserve Banks should not be counted as reserve until credited by the Federal Reserve Bank, but in computing reserves the total amount of such items may be deducted from the member banks' gross demand deposits.

Concurred in by Governors.

Unanimously carried.

8. Voted - That any plan for the interchange of checks between districts should apply only to those banks which do not impose restrictions as to endorsements.

Substituted by Governors

Unanimously carried.

9. Voted - We recommend that the matter of transfers of funds for member banks between the several Federal Reserve Banks be handled on the basis outlined by the Governors of the Federal Reserve Banks at their recent Conference until such time as the intra-district

Concurred in by Governors.

clearing facilities are developed to an extent which will justify a reconsideration of this question.

Unanimously carried.

10. Voted - It is the sense of this meeting that transfers of funds between any two banks in any Federal Reserve District should be made by means of direct order rather than by checks and drafts.

Concurred in by Governors.

Unanimously carried.

11. Voted - That the direct interchange of items between members by settlements through the Federal Reserve Banks be encouraged.

Concurred in by Governors.

Unanimously carried.

12. Voted - We recommend to the Executive Committee of the Governors' Conference that a system of Inter-District Collection be inaugurated at once as follows:

Each Federal Reserve Bank will accept from any of its member banks for deferred credit and deferred debit at par, in accordance with the provisions of Section 16 of the Federal Reserve Act, checks and drafts on member banks in any of the other Federal Reserve Districts.

Each Federal Reserve Bank will agree to accept at par from other Federal Reserve Banks checks and drafts on its own members for credit a certain number of business days after the receipt of such checks and drafts, said number of days to be based upon the average length of time necessary to obtain returns from its members. Upon

receipt of advice from the other Federal Reserve Banks as to the number of days determined as aforesaid each Federal Reserve Bank will prepare a schedule of deferred credits applicable to checks on other Federal Reserve Districts deposited by its members.

Every Federal Reserve Bank operating on a deferred debit and deferred credit basis within the district will include in said schedule of deferred credits indication of the number of days for which it will defer credit to its members of checks and drafts on other members in its district.

Each Federal Reserve Bank will, if possible, avoid having more than three classes of deferred credit, and will request its member banks to sort items in accordance with the number of days for which credit is deferred, and to list in one letter all the items for which credit will be deferred the same number of days, furnishing the Federal Reserve Bank a separate letter for each class of deferred credit, as well as another letter in which will be listed all items to be accepted for immediate credit. Debit against a member bank's account of checks and drafts drawn upon it will be deferred for the same number of days for which credit is deferred in accepting such items from other members of the district.

Letters of transmittal to member banks will show plainly the date on which the items listed therein will be

charged to the member bank's account. Each letter of transmittal to a Federal Reserve Bank will show plainly the date on which credit is expected in accordance with the schedule of deferred credits, and will be charged to the Federal Reserve Bank on said date.

In order to guard against the great congestion incident to taking on at once a large increase in the volume of items, the plan should be developed in progressive stages by beginning with checks, each one of which amounts to $1,000 or more, and gradually reducing the limit as to the amount of each check until the limit can be safely removed. Changes in said limits should be identical in all districts both as to the amount and the date on which the change is made effective.

Nothing in the foregoing shall be construed as prohibiting any Federal Reserve Bank from continuing to handle such items as it is now receiving.

In order to show how schedules of deferred credit may be made up in each district, there is herewith submitted a tentative schedule applicable to checks deposited in the Federal Reserve Bank of Chicago by its members. (See Exhibit "A")

In accepting checks from other Federal Reserve Banks, Chicago will give immediate credit for checks on members of the Chicago Clearing House Association, and

will defer for two days credit of checks and drafts on other banks in its district.

This plan contemplates that Federal Reserve Banks particularly may adopt short-cut methods for eliminating time in receiving credit.

For instance, if Chicago accumulated a large volume of items on Seattle, it would expect to send such items to Seattle for account of the Federal Reserve Bank of San Francisco, after agreeing with San Francisco as to a basis of deferred credit for our Seattle letter.

3/20/16.

586 - a.

E X H I B I T "A"

SCHEDULE OF DEFERRED CREDITS FOR DISTRICT NO. 7.

TWO DAYS.

Illinois (Except Chicago Clearing House Banks - immediate credit)

Indiana

Iowa and all Federal Reserve Cities except San Francisco.

Michigan

Wisconsin

FOUR DAYS.

Alabama	Maine	North Dakota	West Virginia
Arkansas	Maryland	Ohio	
Colorado	Massachusetts	Oklahoma	
Connecticut	Minnesota	Pennsylvania	
Delaware	Mississippi	Rhode Island	
District of Columbia	Missouri	South Carolina	and San Francisco, California.
Florida	Nebraska	South Dakota	
Georgia	New Hampshire	Tennessee	
Kansas	New Jersey	Texas	
Kentucky	New York	Vermont	
Louisiana	North Carolina	Virginia	

EIGHT DAYS.

Arizona	Nevada	Washington
California (except San Francisco)	New Mexico	Wyoming
Idaho	Oregon	
Montana	Utah	

PLAN 3.

A PLAN FOR CLEARING AND COLLECTING CHECKS
BY FEDERAL RESERVE BANKS.
(Suggested by Mr.W. S. Rowe of Cincinnati,Ohio)

Every Federal Reserve Bank would send a circular to its members stating that it proposed establishing a Clearing House Department (as required to do by the Federal Reserve Board, acting in accordance with the terms of the Act) for its members, accepting from its members and from any member bank in any other district, any item on member banks in its own district, and to charge for that service, a rate based both upon the volume in thousands and the actual number of items handled to cover its expenses, such rate to be determined by experience and then fixed by rule of the Federal Reserve Board.

On the other hand, the Federal Reserve Banks would state in the circular that they proposed paying each member bank for the service rendered by the member bank whose items sent to the Reserve Bank Clearing House had been offset against items on the member bank. This charge also would be determined by experience, to be based upon the volume in thousands, and would then be fixed by rule by the Federal Reserve Bank. These rulings as to charges would undoubtedly vary from time to time, depending upon conditions and seasons.

The circular would then recite that if any member bank proposed sending items on member banks, bearing the endorsement of a non-member bank, the service charge would be at a higher rate, as non-member banks either directly or indirectly, should not reap benefits at the same cost as the member banks. And further, any member bank, desiring the privilege of having checks of a neighboring non-member bank treated as though such checks were drawn upon it, might apply to, and this application might be granted by its Federal Reserve Bank. The rate of compensation to the member bank for clearing these items and the rate to be charged for collecting items on such non-member banks for whom arrangements as above had been made, would also be fixed by rule, but these rates would be higher than member bank check rates, thus operating as an additional reason why non-member banks should join the system, as ultimately it would cost a merchant more to collect items on non-member banks, than to collect items on member banks, and more to deposit items in a non-member bank than in a member bank, if this plan becomes operative in its fullest extent.

Under this plan, we for example, the First National Bank of Cincinnati, Ohio, would arrange to have checks drawn on a given list of non-member banks treated as though they were checks on ourselves, and after the Cleveland Bank had completed making such arrangements covering every non-member bank in the district, it would mail an announcement saying that it was prepared to accept through its clearing house department, any items on non-member banks, as well as any items on any of its own member banks, the

charges and payment to member banks to be determined later, as outlined above, and that it would credit or charge each member bank's account at the day's clearings, with the difference between the items sent through the clearing house, and the items received at the clearing house.

It is manifest that these operations of the clearing house department would not affect in any way, the total deposits of the Bank, as credits and debits would equal. In the banking department ,however, a credit from the clearing house department might be immediately withdrawn, while a debit might even overdraw another account. To provide for this, rules in regard to maintaining a deposit in the Clearing House Department, to cover items to and from the Reserve Bank, should be promulgated,based upon fairness to the member banks and safety to the Reserve Banks. The proportionate relation between volume of items on and collected for a bank, to its required reserve, should affect the size of the clearing balance.

Inasmuch as similar notices would have now been sent out by the other 11 Banks, we would receive one from each of the other 11 Banks, stating that each Federal Reserve Bank would receive items in its Clearing House Department from any member bank or any bank in the district, and stating that each Federal Reserve Bank would take from any member bank outside of its district, any items on member banks or non-member banks, and that it would remit, after deducting a fair charge, to the send-

ing Bank's Reserve Bank for its credit. This remittance would then be credited to the account of the member bank by each Reserve Bank when received, subject to a slight charge, and as the settlement between the twelve Reserve Banks at the close of each day would be large, they might even be cleared as between themselves by telegraph each afternoon, and adjustments made through the main Clearing House of the twelve banks, at the office of the Federal Reserve Board, through the gold fund already created.

From a practical point of view, we would then write a letter to each of the twelve Reserve Banks, instead of writing as we do now, more than 500 letters, and would list items very much the way we do when sending items to Chicago, drawn on many different places. Chicago does not demand now that we sort our items based upon the places of payment, and we can see no reason why the Reserve Banks should, as they should be able to sort an immensely larger volume of items than the ones we would send, at a lower cost, and we would be paying our proportion of such cost.

Our endorsement on such items should read :

"Cleared through Federal Reserve Bank of _____"

followed by our name and the date sent, as well as the date it should be cleared unless letters are delayed in transit, and accordingly the actual date of clearing changed. No additional endorsement would be necessary. Our entry on our books would be

to charge each Reserve Bank with the total of our letter, and in figuring reserve, our balance at Cleveland would be counted, while the amount of the total letter sent to the other Banks would not be reserve. This other total,however, would undoubtedly not equal the total of our present balances in St.Louis, Chicago,New Orleans, New York, Albany, Boston, Baltimore, etc., even after allowing for such balances as we would wish to continue to keep in larger cities for exchange and other purposes.

If telegraphic remittance was arranged for with each of the other eleven banks, we could make the entry on our books covering letters sent today as follows: we could charge Cleveland with the total of the letters to Richmond, St. Louis and Chicago after one day; New York, Philadelphia, Boston, Kansas City, etc. on the second day, and finally San Francisco, etc., on the fifth day. Obviously the accumulation of such letters in transit before they reached their destination would not be very large.

Return items might be handled in two ways, either through the Reserve Bank which had previously cleared them, or direct to the member bank.

Experience would show which banks would be more usually creditors at the daily clearing, and which banks would more usually be debtors, and the rules suggested heretofore in regard to maintaining of balances on the books of each Reserve Bank could only be promulgated so as to be fair, after experience reached through a trial. Banks having customers apt to check unusually heavily should prepare themselves, and might well watch their larger ac-

counts; and such action would be in the interests of good banking.

This plan then contemplates, although many details are omitted or only inferred, the establishing in each Reserve Bank of the following departments:

(I) Clearing House Department, in which all items on the district are cleared and in which department suitable and fair excess balances must be maintained.

(II) Exchange Department, in which department the twelve Reserve Banks would clear as between themselves, and also clear the credit turned over from the resultant credit of a member of another district, whose checks on that district had been cleared in Department I.

(III) Banking Department, in which only currency and drafts on itself would be accepted at par, and the resultant credit or debit after the days clearing in Department I would only be credited or charged to the member banks reserve account in this department, after deciding that the clearing balance in Department I was satisfactory. The Banking Department would also include the other functions of discount, examination, etc.

Thus the charges in Department I would be fairly large, based upon total in dollars and total number of items, and would also be reciprocal to cover expense incurred in restoring balances.

Charges in Department II would be smaller and charges in Department III would be nil, in so far as " cash items" are concerned. Of course, "collections" as distinguished from "cash items" could easily be handled upon a cost basis in either Department I or Department III.

3/20/16

PLAN NO. 4.

A COMPOSITE OF VARIOUS SUGGESTIONS FOR CHECK COLLECTION AND CLEARING UNDER THE FEDERAL RESERVE ACT.

Predicated on the theory that the practical and perhaps the legal requirements demand that a check, being an order to pay cash at the counter of the Payee Bank, must be sent to the Payee Bank and be in the hands of that bank before it can be charged against it and credited to the Depositor.

1. Under Section 16 of the Federal Reserve Act, the Federal Reserve Board may require each Federal Reserve Bank to act as a Clearing House for checks drawn on banks of its District. In view of the further transfer of reserves on May 16th, the Board has set June 1, 1916, as the date when these functions shall be undertaken in a complete manner.

2. Every member bank handling many checks shall send in twelve separate envelopes, one to each Federal Reserve Bank, checks against banks of its respective district; provided, however, that a bank having less than, say fifty items for any given district may if it prefers send those items to its own Federal Reserve Bank for sorting and transmission.

3. Checks on banks in the same city clearing house district shall be given one day deferred credit and debit but all other checks in same district shall be given two days deferred credit and debit, unless the one-way time shall exceed that amount, in which case deferred credit and debit, equal to the one-way time, shall be fixed.

4. Checks on banks in other districts must be given a minimum deferred credit and debit of two days and an increment over this if, and by as much as the one-way time from the sending bank to the Federal Reserve Bank of the district on which check is drawn, plus the time from that Federal Reserve Bank to the payee bank, exceeds this two days.

5. Banks sending checks to Federal Reserve Banks of other districts shall claim credit for their own Federal Reserve Bank Exchange Account, sending duplicate of letter of transmittal to their own Federal Reserve Bank.

6. Nothing in the above shall prevent banks in neighboring cities sending checks direct to other banks provided that time is saved by so doing; thus Rochester, N. Y. and Buffalo, N. Y.; New Haven, Conn. and Hartford, Conn. might interchange checks on any mutually satisfactory basis if by doing so time is saved and float diminished.

7. The Federal Reserve Board will authorize Federal Reserve Banks to charge their own members as follows: ¾¢ per item plus 10¢ per thousand on all collections made for sending banks; at the same time, the Federal Reserve Board will authorize member banks to charge Federal Reserve Banks or other member banks, sending checks for collection, 10¢ per thousand upon all items sent. Settlements to be made monthly. These charges, subject to modification on sixty days notice, are intended to cover approximate average cost of remitting cash or exchange to meet balances or reserve requirements.

8. Member banks will be authorized to make collections of State bank items in their own town or within a convenient radius of operation and will be authorized to charge for this service the amounts above quoted or as much as the actual cost of the service should it exceed this amount - all such rates to be approved by the Federal Reserve Board.

9. Under the above arrangement every Federal Reserve Bank may be expected to receive direct from perhaps 3,000 banks bundles of checks drawn against its members. Those deposited by its own members are credited to the exchange account of the District represented by the depositing banks and debited against the drawee bank, according to the time schedule above referred to, while those sent from banks in other districts are credited to the exchange account of the Federal Reserve Bank of the district represented by the sending bank and debited simultaneously against the drawee bank.

10. A Federal Reserve Bank each night will have on its books amounts representing the aggregate of the above credited items, all of which have been charged against its own member banks, it will wire the amounts of these credits to the various Federal Reserve Banks and receive from these eleven Reserve Banks advice of the credits they have to its account. If as is assumed each Federal Reserve Bank keeps with every other Federal Reserve Bank an account for exchange purposes which may run a reasonable credit or debit either way, it is safe to say that in most cases the resulting debitsand credits by these daily balances will only need to be settled once or twice a week through the Gold Settlement Fund.

11 The above plan gives deferred credit and debit to the bank for all checks outside the home city starting with two days, but not beyond that in excess of the one-way time between districts, plus the one-way time from the Federal Reserve Bank of the drawee bank to that drawee bank. The time of transit is greatly shortened as compared with the methods commonly in vogue by reason of the direct routing and of using the twelve Federal Reserve Banks as clearing houses, each a focussing point for the checks of the district. Thus, the First National Bank of Columbus, Ohio, will send its Cleveland District checks to the Cleveland Reserve Bank for deposit, claiming immediate credit two days later, at the same time it sends Chicago District checks to the Chicago Reserve Bank, St. Louis District checks to the St. Louis Reserve Bank, etc. These checks reaching these Federal Reserve Banks the next day sent to the drawee banks and in most cases are charged the following day against the accounts of the drawee bank and credited to the exchange account of the Federal Reserve Bank of Cleveland Thus the First National Bank of Columbus will claim two days deferred credit for Cleveland items and, in most cases, two days deferred credit for items drawn on banks in the Chicago, St Louis, Atlanta and Richmond Districts, and proportionately later datings for more distant Districts It is safe to say that a very large proportion of the business of the country in check clearing would be done on a two days deferred basis.

12 The obvious advantage of this method is the direct and simple routing of all items and the consequent reduction of float. Whereas large city banks are now required to send checks for collection to some 500 points, under this plan, they would

be enabled to send checks to twelve centers, and perhaps five or six other points with which the interchange of checks is considerable. Generally speaking, the clearing and collecting of checks is by this plan focussed and concentrated at twelve Federal Reserve Banks with a minimum of delay. At the same time small country banks would be given the privilege of sending all their checks regardless of the district on which drawn to their Federal Reserve Banks, or to some correspondent bank for collection and credit.

13. The reason it is not necessary to defer debit and credit beyond the one-way time may be thus illustrated: Let us suppose, for the sake of an argument, that the Federal Reserve Bank of Chicago sends to its Agent at Des Moines all the items drawn against Des Moines Banks. That agent presents the checks next morning at the various banks and draws out cash or takes a credit on the local bank's books. Having thus accumulated in the five local banks, say $250,000 in cash or credits, he wires or telephones the Federal Reserve Bank of Chicago of the fact. The Federal Reserve Bank of Chicago replies that it has itself received in checks sent by Des Moines banks against Chicago banks items aggregating $260,000 and that it is, therefore, not necessary for the Des Moines agent to remit any cash or exchange, because the drawings on Des Moines are more than offset by the drawings on Chicago; in fact that Chicago must send Des Moines $10,000 as a balance. However, as the amount is small and the balance may

may be reversed the next day, it is agreed between the agent and principal that the balance in favor of Des Moines shall be allowed to stand. It will thus be seen that this plan of credit and debit deferred to equal the one-way tube admits the principle that the payee bank shall see items drawn against it before having these items charged against its reserves and enables it, if any of these items are unusually large, to make a special arrangement by wire or telephone to meet them.

3/20/16

PLAN NO. 5.

Memorandum and Plan submitted by the Governor of the Federal Reserve Bank of Dallas, Texas, under date of March 15, 1916, for the Clearing of Checks under what may be designated as the Talley System of Offsets.

After careful consideration of all suggested or proposed plans for a clearing or collection system which have come to our notice, the officers of the Federal Reserve Bank of Dallas are firmly convinced that none can ever be adopted which will be acceptable to the member banks or satisfactory to the Federal Reserve Banks unless it be based upon a system of offsets, or what is known as the clearing principle in use by all of the local clearing houses of this country.

The Cashier of the Federal Reserve Bank of Dallas, Mr. Lynn P. Talley, has made a thorough study of the details of such a plan and an outline of the fundamental details of the result of his study is presented below. This plan is not to be confused with the plan of operation in use by the Boston Country Clearing House and other similar Country Clearing Houses which are nothing more nor less than Joint Collection Agencies.

Some of its advantages are as follows:

(1) An immediate debit and credit system would of necessity, frequently impair and destroy reserves and place upon the Federal Reserve Banks such a burden of "float" that their usefulness would be seriously impaired. On the other hand a deferred debit and credit system would place upon the member banks the entire burden

of "float", without offset, on which account it would be used only to a very limited extent. The plan proposed is, in effect, an immediate debit and credit system to the extent of the amount of offsets, with a minimized deferred debit and credit of only the amount of the resultant balances, which deferred debit and credit is equitably distributed.

(2) This plan provides for the payment of items by the drawee bank only at its counter and after it has inspected the items.

(3) The reserve balances of a member bank with the Federal Reserve Bank are debited only at the direction of said member bank, which therefore has knowledge at all times of the condition of its reserve.

(4) The cost is minimized and is equitably distributed among the banks receiving the benefit of the transfers of funds necessary to complete the settlement.

(5) The plan of apportioning returns to the creditor banks in the order of their size (Section 2 (e)) is based upon the axiomatic principle that one day's interest on $10,000. is equal to five days' interest on $2,000., and is the most equitable manner of facilitating settlements.

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We were so sure of the practicability of this plan that on Monday, December 27, 1915, we inaugurated, in the Federal Reserve Bank of Dallas, a "Reserve City Clearing House", made up of the thirty-three member banks in the six reserve cities of this district, which has proved the success of the plan and has been so satisfactory to the participating banks that it is still in operation and will be

continued until superseded by some plan promulgated by the Federal Reserve Board.

The total amount of items cleared through this Reserve City Clearing House from December 27, 1915, to March 15, 1916, was $85,637,602.94, with resultant balances amounting to $20,974-418.42. Of this amount of balances $6,874,900. of the debits were settled through deposits of Eastern Exchange; $3,108,000. by deposits of currency; $7,088,518.42, by instructed debits against reserve balances in this bank; while $1,903,000. was settled by arrangements between debtor and creditor banks in the same city.

We believe that a careful study of the following outline will convince any one of the practicability and simplicity of the plan.

OUTLINE OF FUNDAMENTAL PRINCIPLES OF THE TALLEY PLAN OF CLEARINGS

The plan proposed contemplates a Federal Reserve District Clearing House, and each Federal Reserve Bank, in handling clearing items for its members through its Clearing House Department shall act as agent only and shall not become responsible in any manner whatever for delinquency or default of any member.

It is proposed that each Federal Reserve Bank shall inaugurate a Clearing House Department along the following lines:

(1) The Clearing House Department shall clear for the member banks of its district checks and drafts drawn upon any other member bank of the same district except such

as are drawn by or endorsed by banks which are not members of the Federal Reserve System.

(2) The total of items received from a member bank shall be credited to such member on the credit side of the Clearing House balance sheet.

The total of items received against a member shall be debited to such member on the debit side of the Clearing House balance sheet.

Resultant balances between "Items received" and "Items sent" from and to a member bank will be settled from each day's settlement sheet in the following manner:

(a) All items received through the Clearing House on a given member will be forwarded immediately to said member, properly listed and totaled, which list shall be made in duplicate and shall show from whom received. The duplicate list shall be a part of the Clearing House records.

(b) The Clearing House shall forward to each member interested in the day's clearings a slip showing total of items received from that member, total of items sent to that member, and the resultant credit or debit balance due to or from that member.

(c) The Clearing House shall prepare and send to each member receiving a debit balance in the day's clearings a settlement check for the amount of such debit balance, which check shall be drawn against the reserve balance of such member in the Federal Reserve Bank and shall be payable to the District Clearing House.

(d) This check shall be immediately signed by the

proper officer of the member bank and returned to the Clearing House to be apportioned among the creditor banks. If the payment of this settlement check would reduce the reserve account of the member bank below the required amount, it shall be the bounden duty of such member bank to accompany said settlement check with a deposit of acceptable funds sufficient in amount to make good the required reserve.

(e) The amount of the first settlement checks received from debtor banks shall be apportioned to the bank receiving the largest credit balance in the clearings of that day, then to the second largest, and so on down, each creditor bank receiving credit in its reserve account for its credit balance as soon as settlement checks sufficient in amount have been received and paid by the Federal Reserve Bank.

(f) Clearings shall be made on each business day, and neither debit nor credit balances may become cumulative, but each day's clearings must be settled separately.

(g) Advices of all debit balances amounting to twenty-five thousand dollars ($25,000) and over will be telegraphed to the owing bank.

(h) When, in order to meet its settlement check only, it becomes necessary for a debtor bank to ship currency to the Clearing House, said debtor bank shall be entitled to and receive the actual minimum cost of transportation from its office to the Federal Reserve Bank of such currency actually shipped, providing advice of such cost accompanies the settlement check. Such cost

shall be credited to the reserve account of the shipping member and shall be proportionately charged to the reserve accounts of all members clearing items on the shipping member on that day.

(i) Debtor banks, in order to prepare their reserve accounts to meet their settlement checks, may make remittances in New York, Chicago or St. Louis exchange at the rate promulgated by the Federal Reserve Bank for such exchange.

(j) Settlement checks must be signed and returned to the District Clearing House on the same day they are received by the debtor bank.

(k) In the event a member bank receiving a debit balance in the District Clearing House fails to pay such debit balance promptly, or fails to provide funds in its reserve account with the Federal Reserve Bank to meet its Clearing House settlement checks, or suspends payment and is placed in the hands of a receiver, or otherwise becomes unable to meet its obligations on demand, or is otherwise insolvent, then the Federal Reserve Bank shall proceed as follows:

The amount of all items on such defaulting bank, which are in the process of collection or have been sent to such drawee or defaulting bank and for which payment has not been received by the District Clearing House, shall be credited to the District Clearing House, and the amount of each item included in such credit shall be charged to the reserve account of the member bank endorsing said item to the District Clearing House Department.

(3) Member banks may, if preferred, send their items to any other member bank situated in the prevailing direction such items

would take in their natural course of collection, and items so sent may then, in turn, be sent to the District Clearing House Department of the Federal Reserve Bank, but in no case will the Federal Reserve Bank receive in its Clearing House Department items bearing the endorsement of more than two member banks.

(4) Unpaid items received from the Clearing House shall be returned direct by the drawee bank to the bank endorsing same to the District Clearing House, and a debit ticket for the amount shall be cleared on such endorser through the Clearing House, carbon duplicate of such debit ticket being attached to the returned unpaid items. These tickets will be in certificate form and may become a part or all of the remittance to the Federal Reserve Bank to cover a Clearing House debit

(5) A slip giving the name of the sending bank and directing wire advice of non-payment must be attached to each item of $1,000 or over at the time it is sent to the Clearing House Department, which instructions must be followed by the drawee bank.

(6) All items of over ten dollars ($10) must be sent subject to protest if not paid.

(7) The expense of maintenance and operation of the District Clearing House Department shall be borne by the member banks by paying, on the first of each month, two cents for each item cleared during the preceding month until it is determined by experience what is the actual cost per item. When this has been determined such actual cost shall be paid

(8) The plan shall be promulgated by the Federal Reserve

Board and shall be mandatory under the provisions of Section 16 of the Federal Reserve Act.

(9) Such general rules and modifications of rules as may be necessary in the operation of the plan may be promulgated by the Federal Reserve Board from time to time

3/20/16.

SUPPLEMENTAL TO PLAN NO. 5 SUBMITTED BY MR. LYNN P. TALLEY, CASHIER OF FEDERAL RESERVE BANK OF DALLAS.

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The fundamental principles upon which any clearing plan which might be adopted must be based :

First. That the face of a check and the back of a check are entirely different propositions. Granting that a check is payable at the counter of the drawee bank and that it is not incumbent upon the drawee bank to transport the funds to the point where the holder resides at an expense to the payer. The holder of a check at a point different from the place of payment receives the check for value and determines its value at the time the check is received and it is then incumbent upon him, either with or without previous knowledge of conditions, to convert the check into funds that he can use.

Second. That the interchange of items between banks under present methods perhaps increases the float two or three fold. Briefly, because a bank concentrates its items with various other banks of its own selection and the receiving bank must, of course, stand the burden of float in conversion. A large proportion of these checks received must be collected by sending them to banks which will send the last endorser a remittance drawn on still another bank, perhaps in another city, with which it concentrates its items for balances through its own choice. There is then a float created in collecting returns which have been sent in for original items.

Third. That this choice of correspondents is largely a matter of individual right and need not be necessarily disturbed by breaking off relations of years standing by being compelled to collect miscellaneous items through the Federal Reserve Bank.

Therefore, the plan provides that a member bank may send its items to another member bank which may, in turn, deposit them with the Federal Reserve Bank for credit in the District Clearing House, provided such items bear no more than two member banks' endorsements, including its own, and the prevailing direction of collection which the item would naturally take is not violated.

You can readily see that this would permit the country banks to continue to send their items to city banks which would have facilities available for collecting them through the Federal Reserve Bank.

Fourth. To minimize the float referred to in (1st) by the system of offset under the clearing principles; that is to say, the float would be reduced to collecting the difference between items sent and received at the District Clearing House, which I venture to say would be somewhere in the neighborhood of 20 to 25% of the total volume cleared. In addition there would be a float equal to the transit time between the location of the member bank and the Federal Reserve Bank, which would be equitably distributed between the member banks and involve only their own items. This float, however, could be appreciably reduced by member banks sending items received in volume on any one point direct to the drawee member banks at that point and sending us a copy of the letter.

Fifth. Exchange charges have not been taken into consideration in the revised plan submitted in view of the clear intent of the Act to abolish exchange charges to the point of only actual expense involved in the transportation of funds. Since, technically, exchange charges are based on shipments of the actual amount of currency representing the difference in the balance of trade, the cost, under the plan proposed, would be reduced to a final minimum as remittance would involve the settlement of only the difference between items sent and received.

You can see, therefore, that I have sought to reconcile conditions existing heretofore with the new order of things to the extent that I believe the plan fairly overcomes the objection of the member banks in giving up their exchange charges by providing them with the most economical facilities at the Federal Reserve Bank for the collection of items rather than issuing a mandate that member banks must clear their items through Federal Reserve Banks.

Sixth. It is very natural that any plan suggested would emanate from some large Reserve or Central Reserve city institutions by reason of its wide experience in receiving and collecting miscellaneous items or by suggestion of one who had had broad experience along this line in these larger institutions.

3/21/16

PLAN NO. 6.

A PLAN FOR CHECK COLLECTIONS BY FEDERAL RESERVE BANKS.

(Submitted by Mr. Ray M. Gidney of the Staff of the Federal Reserve Board)

Preliminary Statement

In the consideration by those connected with the Federal Reserve Banks of the problems connected with the establishment of check collection service by Federal Reserve Banks, there has been substantial agreement that the greatest difficulty to be met is that involved in carrying "float" represented by checks in process of collection, which might have to be assumed by the Federal Reserve Banks. "Float" in this sense may be defined as the extention of credit which takes place when credit is given for a check in advance of its actual payment by the bank upon which it is drawn. Its magnitude is measured by the amount of checks in transit at any one time, and the "float" for a single item is its amount multiplied by the number of days which must elapse before it is collected.

The question of who should carry the "float" must be considered and dealt with before any plan of check collection can safely be put in operation. Three parties may be recognized in this transaction; the payer of the check, the payee, and the agency through which the payee attempts to collect the item. The payer is represented by the bank upon which the check is drawn, the payee by the bank which receives the check on deposit in first instance, and the collecting agency by the bank which is used as an intermediary in the collection of the check, in the present situation the Federal Reserve Bank. One of these parties must carry the float. The

general practice now is that parties receiving the check in first instance carry the float. A firm or individual receiving a check and depositing it in a bank is required to keep a balance which will justify the bank in handling and collecting the check , and as a rule is not allowed to withdraw the funds in advance of collection by the bank. The bank which thus receives an out of town check must in turn carry the "float" whether it sends the check direct to the paying bank or sends it through a collecting bank. In the first case it is not permitted to charge the bank upon which the check is drawn until the latter has received the check and given authority for the charge. Even if the check is collected through such an institution as the Boston Country Clearing House, the bank does not get its money until two days have elapsed. If the bank attempts to collect the check through another bank it does not receive real credit until the check is collected, although it gets an immediate credit in appearance, but must keep a "reasonable" minimum balance on deposit with the correspondent and must not draw against items until they are collected.

The Executive Committee of the Conference of Governors has recommended that a Federal Reserve Bank, if it is to act as a collecting agent for its member banks, shall not carry the float. The reasons urged are that to the extent that a Reserve Bank does so, it impairs its power to meet the requirements of its members for rediscount facilities, and that the amount of the aggregate float of the country is so large as to absorb almost the entire loaning power of the Federal Reserve Banks. The Governors also point out

the difficulties to be encountered if it is sought to have the paying banks carry the burden. Member banks upon which checks are handled are required to maintain excess reserves equal to the amount of checks in transit to them from the Federal Reserve Bank during two or more days' business; they have no very exact means of estimating the amount of checks which are thus in transit and overdrafts are likely to occur with possibility of loss to the Federal Reserve Bank. The Governors do not, however, except in connection with their proposed plan for deferred debit and deferred credit, appear to consider the possibility of leaving the burden of carrying the float where it is; namely with the bank which has received a check on deposit in first instance and therefore has it to collect as best it can.

If a method can be found whereby the Federal Reserve Banks can successfully perform the check collection functions clearly contemplated by the Federal Reserve Act, without carrying the float involved, it is obvious that they should not carry the said float. There is doubt as to whether they are able to assume the burden of the float without seriously impairing their loaning power and even if they are able to do so they should not grant the credit extension involved without proper remuneration. They are corporations dealing in credit and should not give away in any form the goods which it is their business to sell. At the same time it should not be the problem of the Federal Reserve Banks to determine whether the float shall be borne by the banks upon which checks are drawn or by the banks which have received the checks upon deposit. This is

a matter of general business arrangement with which the Federal Reserve Banks are not directly concerned. The purposes of the Act will be carried out and the usefulness of the Federal Reserve Banks greatly increased if they are able to provide prompt collection at par of checks drawn on member banks and prompt collection, with a moderate exchange charge of checks drawn on non-member banks in cities where there are also member banks. To this end the following plan, combining features of both the immediate credit and debit and the deferred credit and debit plans, and based upon the assumption that member banks can be required to remit promptly at par for checks on themselves sent to them by the Federal Reserve Banks, is submitted:

Details of Proposed Plan.

Each member bank will carry 'clearings account' on the books of its Federal Reserve Bank, in addition to its reserve account. All deposits of checks drawn on member banks will be credited to the depositing banks in their clearings accounts and charged to the member banks upon which the checks are drawn, in their clearings accounts. The depositing banks will be permitted to draw against the balances resulting from deposits of checks on other member banks only after a suitable time has elapsed to permit collection or offset of the items. The length of time which it will be necessary to delay such withdrawals will vary in the different districts, reaching a maximum in the San Francisco District, and can be finally determined only after some months of experience in the operation of the plan. To start with sufficient time should be allowed for the checks to reach the paying banks and a remittance in payment to be received in

return. The immediate result of this operation will be that the depositing banks will have credit balances and the paying banks overdraft balances, and as the overdraft balances will just offset the credit balances, it will not be necessary to maintain a reserve against the latter. In the case of a district in which practically all banking points can be reached by mail in one day the banks which acquire credit balances will be permitted to withdraw any portion of such balances representing deposits made two days or more previously. In this way, even assuming that the paying banks have not themselves made deposits of checks on other member banks and thus become creditors as well as debtors, they will remit funds in time to meet the withdrawals permitted so that overdraft accounts will not exceed the credit balance accounts.

If, however, the banks which we have been considering as the paying banks are constantly mailing checks to the Federal Reserve Bank for deposit, their remittances will arrive in such manner as to offset the checks against them and thus reduce the time of float by one-half. To what extent this will occur can of course only be determined from the actual operations of the clearings system, but it is certain that the offset principle will be operative to a very large extent as operations become general. Through this reduction in the time of float the average time which must elapse before a member bank can draw on a deposit will be proportionately shortened. This matter of offset is of greatest importance and in it lies the superiority of the plan which is given here over the plan under which the Boston Country Clearing House is now operating and over the plan

of deferred credit and deferred debit proposed by the Governors of the Federal Reserve Banks. It is much as though the New England Country Banks instead of awaiting receipt of their checks from the Boston Country Clearing House and then drawing a draft on a Boston correspondent bank in favor of the Clearing House for the amount of the remittance, were to send daily to the clearing house all checks on Boston which they might receive in the course of business instead of sending them to Boston correspondents against whom they later issue a draft in payment for the checks received through the clearing house. It is clear that if this were done the effect would be to shorten by one-half time required for the collection of checks sent out by the Boston Country Clearing House.

The following example will illustrate the operation of offset, the first column showing a case in which offset is effective and the second column a case where it does not operate and in which, as with the Boston Country Clearing House and the Governors' plan of deferred credit and debit, a return remittance must be awaited.

A member bank in Philadelphia deposits with the Federal Reserve Bank of Philadelphia on a certain day for credit in its clearings account, checks aggregating $25,000 on a member bank in Harrisburg, Pa. The following will be the course of the transaction:

With offset.	Without offset.
On the same day the Harrisburg member bank mails to the Federal Reserve Bank of Philadelphia for deposit in its clearings account, checks on the Philadelphia member bank amounting to $25,000.00. Entries will be as follows:	On the following day and upon receipt of the remittance the Harrisburg member bank issues and forwards to the Federal Reserve Bank of Philadelphia, its draft on the Philadelphia member bank, for $25,000.00. Entries will be as follows:
Day of remittance:	Day of remittance:
Philadelphia member bank charges Federal Reserve Bank of Philadelphia, $25,000.	Philadelphia member bank charges Federal Reserve Bank of Philadelphia $25,000.
Federal Reserve Bank of Philadelphia credits Philadelphia member bank, $25,000.	Federal Reserve Bank, Philadelphia credits Philadelphia member bank, $25,000.
Federal Reserve Bank of Philadelphia charges Harrisburg member bank $25,000	Federal Reserve Bank of Phila. charges Harrisburg member bank $25,000.
Harrisburg member bank charges Federal Reserve Bank of Philadelphia $25,000.	
First day following:	First day following:
Harrisburg member bank receives remittance from Federal Reserve Bank and credits account of the latter $25,000.	Harrisburg member bank receives remittance from Federal Reserve Bank and sends in return draft on Philadelphia member bank $25,000.
Federal Reserve Bank receives remittance from the Harrisburg member bank and credits account of the latter, $25,000.	
Federal Reserve Bank charges Philadelphia member bank $25,000 and delivers by messenger the drafts, etc., received from the Harrisburg member bank.	
Philadelphia member bank credits Federal Reserve Bank $25,000 for items thus received.	
Transaction closed.	

Collection example, continued. Without offset.

Second day following:

Federal Reserve Bank of Philadelphia receives remittance from Harrisburg member bank and credits account of the latter, $25,000.

Federal Reserve Bank charges Phila. member bank $25,000 and delivers by messenger the draft received from the Harrisburg member bank.

Philadelphia member bank credits Federal Reserve Bank $25,000 for draft thus received.

Transaction closed.

Reserve status of clearings accounts.

Such portion of the balance of each member bank in its clearings account as is available for withdrawal may be counted as reserve, for it can at any time be withdrawn or transferred to the regular reserve account, but such portion as is not available for withdrawal should not be so counted as it represents uncollected items. Neither should the Federal Reserve Bank be required to hold reserve against the portion of the clearings accounts representing uncollected items, but it should be required to hold reserve against that portion which represents items which have been collected and are therefore subject to withdrawal at any time.

It will be objected by some that the credit given to member banks which deposit items in the clearings account will not be "immediate credit". This is true, but the credit given is certain to be more nearly immediate than would be given under the deferred debit and credit plan proposed by the Governors, which does not contemplate offset of

of items but apparently treats each remittance as a unit to be settled for separately. It will also be more nearly "immediate credit" than is given to banks which collect through the Boston Country Clearing House and than that given by check collecting banks which do not permit withdrawals until the item is collected and which do not utilize the practice of offsetting items. It would be well to provide that the credit may be made immediate in fact as well as in name by permitting a member bank which wishes to withdraw a balance created by deposit of items on other member banks or to count such balance as reserve, before the items have been collected or offset, to do so by paying interest thereon at the rate in force for discount of short-term paper. In such case the Federal Reserve Bank would assume float to the amount involved but would be properly reimbursed for so doing.

Prompt remittances at par are essential to the successful operation of this plan. Where a bank does not remit promptly an interest charge at the rate current for short-term paper should be assessed against it for the time of such withholding on the amount of items upon which prompt remittance is withheld.

Checks on non-member banks.

It is quite generally agreed that checks on non-member banks must be handled by the Federal Reserve Banks in order to make the check collection system completely successful. This step should be taken at once in connection with the plan here submitted and with the cooperation

of member banks. Arrangements can doubtless be entered into with most member banks under which they will handle checks on non-member banks in their respective cities and towns at a charge of five or ten cents per hundred dollars, such charge to be computed on the total amount of such checks sent in a remittance letter. Checks on non-member banks in cities where there are also member banks, may then be received by the Federal Reserve Banks just as checks on member banks will be, but subject to a collection charge of five or ten cents per hundred dollars. This plan will doubtless prove sufficiently remunerative to the member banks handling the checks and will result in many State banks entering the system. The facilities which the Federal Reserve Banks will thus be able to offer will greatly exceed those offered by any country clearing house.

Inter-district clearings.

Inter-district clearings should be undertaken very soon after the inauguration of the plan herein outlined. Checks and drafts on member banks in other Federal Reserve Districts should be taken on the basis of the transit time between the Federal Reserve Cities plus the average transit time between the Federal Reserve Bank of the paying district and the member banks upon whom the checks are drawn. Drafts on Federal Reserve Banks should be credited immediately at par. This may appear to be a disregard of the problem of float, but when it is considered that each Federal Reserve Bank has a heavy deposit in the Gold Settlement Fund and that the acquisition by one Federal Reserve Bank of a draft on another Federal Reserve Bank gives control of a

corresponding portion of the Gold Settlement Fund, it is apparent that drafts should be regarded as cash by all Federal Reserve Banks. In order to make this as apparent as possible daily settlements should be at once adopted on the basis suggested in the report of the Preliminary Organization Committee and more lately by Mr. W. E. Cadwallader. The effect of making such drafts acceptable for immediate credit at par by all Federal Reserve Banks will be to give them currency and make them the preferred form of remittance within the United States. This will of course be of advantage to the Federal Reserve Banks in many ways, one of which will be that there will at all times be a large credit float in the form of drafts outstanding on Federal Reserve Banks, which will be more than sufficient to offset any possible burden of float which might fall upon the Federal Reserve Banks by reason of cashing or crediting immediately drafts drawn on each other. The amount of such drafts in transit from the drawing banks and not yet presented to a Federal Reserve Bank would be always greater than the amount in transit between the Federal Reserve Banks for the reason that the time of such float would be at most the mailing time between the Federal Reserve Cities concerned and would be further shortened by offset, while the time required for drafts to reach Federal Reserve Banks other than that upon which drawn would be at least the mailing time between the districts involved and usually longer.

3/21/16.

PLAN NO. I

MEMORANDUM AND SUGGESTIONS ON THE SUBJECT OF BANK RESERVES AND THEIR RELATION TO THE SUBJECT OF THE CLEARING AND COLLECTION OF CHECKS

(Submitted by Mr. Frederic H. Curtiss, of Boston)
Under date of March 28, 1916.

The reserve of a bank is that percentage of its deposits that it should carry uninvested to meet the demands of its depositors. There are two kinds of reserve; norman reserve, and excess or insurance reserve. The normal reserve of a bank should be based on the maximum demand of its depositors in normal times. An excess or insurance reserve is the reserve set aside to meet abnormal or unusual demands; that is a sort of insurance fund.

Reserves should be real; that is, cash in a bank's own vaults or a deposit in a Federal Reserve Bank. The character of the deposits of a bank varies the percentage of reserve needed. The character of a bank's deposits are as follows:

Savings accounts; - require small reserve,
Individual or personal accounts; - require a higher reserve than the preceding,
Commercial accounts; - require a higher reserve than the preceding
Bank accounts; - " " " " " " "

There are two kinds of normal reserve:

1. To meet ordinary counter demands,
2. Reserves to be carried at an exchange center to furnish exchange to its depositors, either in the form of checks drawn by the bank on that center, or by exchange created by customers sending their own checks afar.

As for the reserve for counter purposes, a bank can gauge its own counter demands and can be trusted to keep cash on hand to meet them.

The reserve to be kept elsewhere must be proportionate to its exchange transactions; that is, either the demand of its customers for checks on an exchange center (e.g. Federal Reserve city) to be used in paying bills elsewhere, or exchange created by its customers through paying bills elsewhere with their own checks. This outside reserve, therefore, pertains chiefly to two kinds of bank deposits; viz., commercial and bank. The excess reserve, that is, the reserve for insurance purposes should be held in a Federal Reserve Bank and should be based on all the demand deposits of a bank and the percentage, therefore, should be based somewhat upon the character of the city or town in which the bank is located.

In connection with the composite plan of clearing (i.e. Plan 4) the following problems arise.

1. The figuring of reserves,
2. Those arising from deferred credit and debit,
3. Charges for service and exchange,
4. The handling of checks on non-member banks.

1. The figuring of reserve.

Although this plan by direct routing of checks originating outside of the district, will materially reduce the float on those the country bank will never be satisfied to maintain its reserve on a deferred basis plan, and besides, the bookkeeping called for is too intricate for the country bank; hence we must make up our

our minds to allow country banks to figure their reserve as they do now, from their own books. By so doing, the reserve bank will receive additional balances from the outstanding checks drawn by the country bank on it, and by time items which it has collected and credited, and which the country bank will not debit on its books until advice is received. It will be the duty of the Comptroller of the Currency to see that every member bank maintains its reserves by its own books up to the requirements of the legal minimum.

On the other hand, the member bank, both in the Federal Reserve city and elsewhere in the district, must carry its "excess" legal reserve with the Federal Reserve Bank of its district, this reserve account being figured from the books of the Federal Reserve Bank, the member banks being obliged each week to send in a statement of their net liabilities so that each Federal Reserve Bank can see that the proportion of reserve is maintained. In other words, this is, as we have said, in the nature of an insurance fund and this reserve the Federal Reserve Bank must see is maintained.

2. Those arising from deferred credit and debit.

In the case of immediate credit and immediate debit: we are troubled with:

a. The question of overdrafts,
b. The question of float.

In this connection it is to be noted that the overdraft and float are analogous when taken as a whole and not as they pertain to the individual bank. On the other hand deferred debits and credits involve complications distasteful to small banks.

It has been customary, under the note circulating system to require a redemption fund at some central point to take care of notes circulating throughout the country, as, for instance, under the National Bank Act the 5% redemption fund in Washington. The circulating of bank notes is similar to that of bank checks except the latter circulate faster, and, therefore, require a larger redemption fund.

If we can cause each bank outside of a reserve city to maintain a redemption fund proportionate to what is ascertained to be its normal clearings, we shall have solved the problem. The total of these funds will readily take care of the float. We can accomplish our purpose if we allow member banks 1½% interest on excess balances, a rate lower than the going rate allowed on bank balances, and which would, therefore, induce the country banks to transfer their surplus balances to the city banks, at the same time charging 2% interest on current overdrafts, current overdrafts being for the day's business, and charging one-half of one per cent above the current bank rate on overdrafts that a bank has had time to cover. This excess reserve which serves as a redemption fund, will only pertain to banks outside the Federal Reserve cities, and would be for clear-

ing purposes, the banks in the Federal Reserve cities would be enabled to make good their clearings by cash in their own vaults or by buying and selling exchange, or by rediscounts with the Federal Reserve Bank.

3. Charges for service and exchange.

It is proposed that Federal Reserve Banks shall handle all member checks at par, each member bank being charged a rate per item based on the cost of the collection department of each Federal Reserve Bank, but on some general rule to be promulgated by the Federal Reserve Board. Under the Federal Reserve System the cost of exchange is reduced to a minimum; members of a Federal Reserve Bank are able to create exchange by rediscounts with its own Federal Reserve Bank and such exchange will be current throughout the United States. In this connection it may be necessary to differentiate between drafts on a Federal Reserve Bank and exchange transactions. That certain small country banks are living off the exchange charged on their own checks does not appear fair. An exchange charge, if one is made should be assessed against the drawer or maker of the check and not the receiver and depositor of a check. Furthermore, it should be against public policy to allow a collection charge to be made by a member bank against its own checks.

4. The handling of checks drawn on non-member banks.

There is no reason why the Federal Reserve Banks should not

agree at the outset to accept non-member checks on all Federal Reserve cities on terms similar to checks on member banks in Federal Reserve cities, for those checks can be presented at the counter. Checks within the district on non-member banks remitting at par to the Federal Reserve Bank should be handled on a deferred basis similarly to member checks on other districts and here again a member bank might send those checks to the Federal Reserve Bank of its own district, giving immediate credit on its own books and count them as reserve, the Federal Reserve Bank handling this item similarly to items on other districts.

Checks on non-member banks in other districts, outside of Federal Reserve cities should be forwarded through the Federal Reserve Bank of the District of origin only as collection items for deferred credit.

In connection with the handling of non-member checks within the district on certain specified points, arrangements might be made, where the trend of exchange warrants it, that non-member checks might be cleared through specified member banks; that is, charged to the account of a member bank and forwarded for presentation and collection by the member bank.

BOOKKEEPING UNDER THE COMPOSITE PLAN.
(Plan 4)

1. Record books of member banks,
2. Record books of Federal Reserve Banks.

It is proposed that each member bank shall keep only one

account on its books with the Federal Reserve Bank, as it does now with its city correspondent, debiting at once to that account all cash items that it sends for collection whether to its own or to other Federal Reserve Banks, and debiting time items only when advised of their payment by its Federal Reserve Bank. The member bank will figure its reserves, therefore, from its own books on the basis of this account.

On the other hand, the Federal Reserve Bank shall maintain two accounts with each member bank, the reserve account and the exchange redemption account. The reserve account will be comparatively inactive and will be adjusted either weekly or monthly as a member bank's net deposits increase or decrease, the account to be based on the average for the preceding period.

The exchange or redemption account will be maintained only by banks outside of Federal Reserve cities, (banks in the Federal Reserve cities being able to redeem or settle for their checks by cash from their own vaults or through the sale of exchange or the making of rediscounts.) This exchange or redemption account will be the active account which the member bank outside of the reserve city will draw against; to which cash items within the district will be credited upon receipt; and cash items drawn on other districts and time items will be credited when paid. This account will be credited with interest on balances and charged interest on overdrafts irrespective of the reserve account. A statement of this account will be sent daily to the member bank.

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S U P P L E M E N T A R Y

An arrangement might be made with non-member banks along the following lines:

1. Non-member banks might be permitted to have their checks redeemed or settled for by a member bank in a Federal Reserve city, on a plan similar to that of member banks in Federal Reserve cities.

2. We might allow such non-member banks to print some statement or announcement that their checks were handled with Federal Reserve Banks without charge for exchange.

3. We might restrict member banks in the Federal Reserve cities handling of non-member bank checks through the Federal Reserve Banks only to the check of banks which have agreed to this redemption plan, endorsing or stamping on the checks some device stating that fact.

P L A N N O . 8

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SUGGESTIONS SUBMITTED BY THE GOVERNOR OF THE FEDERAL RESERVE BANK OF ATLANTA, UNDER DATE OF MARCH 24, 1916, FOR THE CLEARING AND COLLECTION OF CHECKS.

FIRST:

I would suggest that the officers of the Federal Reserve Banks be authorized to inaugurate a clearing house, which I believe they have a right to do on the approval of your Board, as set forth in Section 16 of the Federal Reserve Act. I also note that the cost of operating a clearing house under these conditions, can be charged into expenses against the banks using the clearing house.

SECOND:

I suggest that credits be deferred for two days within each of the Federal Reserve districts for checks collectible in the district and deposited by the member banks; and that from four to six days be allowed as deferred payment for checks payable in the other Federal Reserve Bank districts, according to distance.

THIRD:

That an Inter-District system be created between the Federal Reserve Banks similar to the clearings now taking place in the gold fund.

FOURTH:

That the Federal Reserve Bank be permitted to receive on the endorsement of the member banks, checks on State banks, private banks, savings banks and trust companies, as well as on their member banks, which I think is covered by open market transactions, as set forth in Section 14.

FIFTH:

That the Federal Reserve Board establish a zone system as to the allowance for exchanges, and for the experimental stage, would suggest the following:

On checks drawn on banks in towns or cities up to 3,000 inhabitants, according to the last census of the United States, and to be changed at each census period, that the bank to whom these checks are sent for collection be permitted to charge 1/8 of 1% for the remittance of such items. (My conclusions for this arbitrary stand, is that the National Bank Act permits banks to be organized in places of this size with a capital of $25,000, and this size bank is dependent largely upon collection charges on checks to sustain their expense account.)

On all towns or cities, subject to the same rule of the census, of 3,000 up to 10,000 inhabitants, the banks be permitted to charge 1/10 of 1% for remittances and collections.

That banks in all towns or cities of 10,000 up to 25,000 inhabitants be permitted to charge 50¢ per $1,000 on all collections and remittances.

That all towns or cities above 25,000 inhabitants collect checks at par.

That the Reserve Bank be authorized to charge the depositing bank the cost of exchange as above referred.

That in the event no member bank is located in a town or city, then the Reserve Bank may choose a State bank, trust company, savings bank or private bank, located in that town, to whom it may send the items

drawn on that town, provided said bank will agree to collect at the said rate. In the event no bank not a member, be willing to collect at these rates, then the postmaster in that town be authorized to collect these checks, deducting as remuneration the same fee as would be allowed to the member bank thus located.

SIXTH:

That the overhead cost of collecting these items be determined by two units; one unit to be the aggregation of the total face value of the items handled, and the other unit to be for the number of items handled. An equalization between these two should determine the charges to be made for this service.

SEVENTH:

That the Federal Reserve Bank should determine when the item had reached its maturity of deferred payment, and immediately credit the same into the reserve account of the member bank thus producing the credit, and correspondingly charge transit account with the same.

EIGHTH:

That the Federal Reserve Bank shall not be responsible for the loss arising from any item, and shall not be held responsible until it has received ultimate final payment for said item.

4/6/16

PLAN NO. 9

PLAN SUBMITTED BY MR. GEORGE O. BORDWELL, CASHIER OF THE FEDERAL RESERVE BANK OF SAN FRANCISCO, UNDER DATE OF MARCH 24, 1916, for the CLEARING AND COLLECTION OF CHECKS, WITH IMMEDIATE CREDIT AND DEFERRED DEBIT PROTECTED BY INTEREST CHARGE ON FLOAT.

Federal Reserve Bank to receive, for immediate credit and deferred debit checks and drafts upon any member bank or non-member bank

(Federal Reserve Bank carries member banks' Transit Account but is protected by deposit of optional reserves)

Interest charge at higher than 90-day discount rate to be made to depositing banks on amount of outstanding items minus excess of reserve deposits over required reserve deposits

(Member bank carrying with Federal Reserve Bank excess deposits equal to full amount of float pays no interest)

Time schedule for interest charge to cover average time by States, "San Francisco, immediate, California three days, Oregon five days, ... etc. . . . .".

(Great advantage to San Francisco Banks)

Exchange paid by Federal Reserve Bank to be debited back to depositing banks.

Transportation charges to be paid by Federal Reserve Bank on shipments to cover excess collections forwarded by Federal Reserve Bank to banks which remit at par.

Service charge

on interdistrict cash items say 20¢ per $1,000

on intradistrict cash items rate based on actual cost in-

cluding transportation charges, not retroactive.

on collections - - - - say 10¢ per item

(Reduction of cost to member banks in operation of their Transit departments should largely offset total service charges)

Transfer drafts and special items received for deferred credit.

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The plan suggested will:

make it advantageous for member banks now collecting own out-of-town items to deposit them with Federal Reserve Bank (see illustration)

make it practicable for all member banks to route items through Federal Reserve Bank

permit banks to control their balances

give incentive to carry excess balances with Federal Reserve Bank, at least to the extent of optional reserves which in amount approximate estimated float

protect Federal Reserve Bank from extensive involuntary loans through check collections.

I L L U S T R A T I O N :

(applicable November 1917 to member banks now collecting own items)

A member bank now handles $4,050,000 out-of-town items in one month;

California $3,000,000; Oregon $600,000; Washington $450,000;

outstanding 3, 5 and 7 days respectively

Average items outstanding - - - - - - - - - - - - $505,000

Reserve requirements now reduced by deducting float from bank deposits - - - - $75,000

Required reserve deposits - - - - - - - - - - - - - 600,000

Optional reserve deposits - - - - - - - - -		400,000
Reserve requirements to cover $400,000 increase in net bank deposits would be increased - - -	60,000	
Total unproductive funds, member bank collecting own items - - - - - - - - - - - - - - - - - - -		1,505,000
90-day discount rate - - - - - - - - - - - -	-4½%	
Rate of interest charge on collections - - -	-6½%	

WITH FEDERAL RESERVE BANK COLLECTING ALL ITEMS:

Unproductive funds reduced to - - - - - - - - - -		1,060,000
If only minimum balance maintained, interest charge - - - - - - - - - - - - - - -	2,735	
If balance increased by deposit of optional reserves interest charge - - - - - - - - - - -	569	
If additional deposit maintained of $105,000 interest charge - - - - - - - - - - - - - - -	none	
unproductive funds - - - - - - - - - - - -		1,165,000
Gain in loanable funds through Federal Reserve Bank collecting items - - - - - - - - - - - - - - -		340,000

RESULTS:

Member bank, by routing items through Federal Reserve Bank,

increases loanable funds $340,000

at same time, avoids interest charge of $2,166 by depositing with Federal Reserve Bank optional reserves otherwise unproductive,

at same time, avoids interest charge of $569 through excess deposit of $105,000 to cover remaining items,
(this deposit only necessary when float exceeds optional reserve)

is encouraged by lower discount rate to borrow by rediscounting rather than through failure to maintain latter deposit.

DEFINITION:

Plan 1	Proposed by Federal Reserve Agents	Optional	Deferred credit and deferred debit with option of immediate credit and immediate debit.
" 2	Proposed by Governors	Mandatory	Deferred credit and deferred debit
" 2a	Now partially operated in District 12	Optional	Deferred credit and deferred debit
" 3	Proposed by Messrs. Rowe & Davis	Mandatory	Immediate credit and immediate debit
" 3a	Now partially operated in District 10	Mandatory	Immediate credit and immediate debit
" 3b	Now partially operated in 9 Districts	Optional	Immediate credit and immediate debit
" 4	Composite of suggestions	Mandatory	Deferred credit and deferred debit limited to one-way time for points more than one day distant
" 5	Now partially operated in District 11		Immediate offset for each bank's incoming and outgoing items with deferred credit and deferred debit for resultant balances
" 6	Proposed by Ray M. Gidney	Mandatory	Deferred credit and deferred debit with float pro-rated and loans authorized at current discount rate
" 7	Proposed by Geo. O. Bordwell		Immediate credit and deferred debit protected by interest charge.

4/7/16

ITEMS HANDLED:

1 proposes to handle a portion of items on member banks and all on State banks;

2, 3a, 4 & 5 provide for handling items on all member banks;

2a & 3b provide for handling a portion of the member bank items;

3 proposes to handle all member bank and some State bank items; but to make discriminatory charges against State bank checks;

6 proposes to handle all member bank and some State bank items;

7 proposes to handle all items.

THE FLOAT:

1 leaves burden with depositing banks, except when immediate credit and debit availed of;

2 & 2a leave burden with depositing banks;

3, 3a & 3b attempt to pass burden to drawee banks;
actual results: Overdrafts and depleted balances at Federal Reserve Banks;

4 leaves burden with depositing banks for one day items and with Federal Reserve Bank or drawee banks for return trip on more distant items;

5 distributes burden in uncertain and constantly varying proportions between endorser banks, drawee banks and other banks which are neither endorsers nor drawees;

6 attempts to pro-rate to depositing and drawee banks with permit to withdraw pro-rated average outstanding funds at current discount rates;

7 places responsibility direct upon Federal Reserve Bank but offers depositing banks effective inducement to carry excess deposits to cover.

CONTROL OF BALANCES:

1, 2, 2a & 7 permit member banks to control their balances;

3, 3a & 3b do not give member banks control of their balances;

4, 5 & 6 give member banks only partial control of their balances;

EXCHANGE CHARGES:

On member bank checks: Unless to discuss pending legal decision or legislation either requiring drawees to cover at par or authorizing exchange debited back to depositing banks' accounts;

On State bank checks: plans 3 and 6 propose flat rate to be paid all drawee banks to debit of depositing banks' accounts

plan 7 leaves open question of paying exchange but provides for debit to depositing banks' accounts for such exchange as may be paid.

A M E M O R A N D U M

TO THE GOVERNORS OF THE FEDERAL RESERVE BANKS

by F. A. Delano.

Washington, April 7, 1916.

A general statement of the reasons why the time has come for the Federal Reserve Board to put into effect a check clearing system which, even if not complete to start with shall be the foundation of a structure which may be completed with reasonable dispatch and which, while not requiring member banks to avail themselves of the new facilities, will give the privilege to every member bank that wishes to make use of them.

FIRST:

It is very evident that the Federal Reserve Law, while not absolutely mandatory, or entirely specific in its requirements about clearing, certainly contemplates that the Board shall establish a check clearing and collection system, which shall include in its adherents all member banks, and furnish an effective collection agency for checks drawn on member banks in all districts.

SECOND:

The shifting of reserves from banks in reserve and central reserve cities to Federal Reserve Banks would, in effect, deprive many banks in the country of opportunities for check clearing and collection which they have heretofore enjoyed. The framers of the Federal Reserve Act, having this in mind, saw that they must create a machinery to perform the functions which correspondent banks had previously performed in return for bank balances.

THIRD:

The criticism is made that, whereas, banks in central reserve and reserve cities have in the past carried the reserve balances of their client banks, have paid interest on those balances, and rendered important services in the matter of check collection and clearing, and in other ways as well, it is strange that the Federal Reserve Banks, which pay no interest on reserve deposits, hesitate to perform this service on the score of expense. Hesitation to assume clearing and check collection functions is the more strange because of the fact that the strategic position of the Federal Reserve Banks is such as to make it possible for them to handle this business at a much lower cost than it can be handled under present conditions and with present methods. The additional expense which such operations will entail to the Federal Reserve Banks has doubtless been overestimated and it may well be pointed out that as the overhead expense is already largely provided, the additional expense will be mainly mechanical and clerical, and therefore moderate and proportional to the volume of the checks handled.

FOURTH:

With each successive transfer of reserves (the complete transfer having already been made in central reserve cities and the final payments as to reserve cities being due in May, 1917, and in non-reserve cities in November, 1917), there is increased necessity and demand for a complete and satisfactory clearing system.

FIFTH:

In discussing the clearing system, reference has been made frequently to various evils in banking practice which have grown up in the past fifty or more years; for example, the common practice by banks in central reserve and reserve cities allowing immediate credit and deferred debit on country bank items; or the practice whereby exchange charges are assessed against the depositor or indorser of the check, rather than the drawer or maker. These and other practices which might be mentioned, all more or less vicious in character, should be corrected, and doubtless will be corrected or modified in future years; but it certainly would be unwise to undertake too many reforms simultaneously or impose upon any proposed check clearing plan the burden of all the desirable reforms. Doubtless we can check some of these evil practices now, can reduce "float" by more direct routing of items, and build up a machine which will be able gradually to effect other reforms, but we must not attempt to do it all at once.

SIXTH:

An important feature in the development of American banking in the last two generations has been the development of book credits in the form of deposits, rather than note issues. European banks, and especially those of continental Europe, give credit to a borrower in the form of bank notes. In the United States the extension of credits has taken the form chiefly of book credits. The immense system of

State banks and trust companies which has developed so phenominally in late years has long been denied note issuing powers, and even the national banks use the note issuing power to only a relatively small extent.

Hence, it is a mistake to assume that the chief function of the Federal Reserve Banks is to be that of note issuing. On the contrary, it is but fair to expect that as the years roll by their more important functions will be the extension of book credits to their members and currency only in crop moving seasons or in times of stress. But member banks will not go to the Federal Reserve Banks for book credits or balances in excess of legal minimums unless these balances can be of some service to them. If there is no check clearing system - if there is no system by which they can issue drafts drawn on Federal Reserve Banks, or send them to their correspondents, they will not care to avail themselves of these credits. This character of service will bring the member banks and the Reserve Banks in daily contact, whereas, the note issuing feature will only bring that contact at rare intervals.

Hence, it may be fairly said that the success and development of the Federal Reserve System depends quite as much on a good system of check clearing as on any other single feature.

4/7/16.

PLAN NO. 10.

A CLEARING AND COLLECTION PLAN

Being an Evolution of the plan submitted by Mr. Lyman H. Talley (Proposed by Mr. M. J. Fleming, Assistant Cashier, Federal Reserve Bank of Cleveland, under date of April 7, 1916)

- - - - - - - - - - - -

For the utmost possible development of the check as a medium of exchange, it is obviously essential to cure the serious evils which have grown into the present methods of check collection. Four purposes must be sought:

1: Minimize the life of the check;

2: Minimize the volume of "float" carried by the banks, especially that large part which is now fallaciously and dangerously counted as reserves;

3: Minimize the cost of collection, and eliminate exchange charges;

4: Place the cost of the service where it belongs.

The plan of deferring debits and credits by schedules will shorten the life of the average check, and will greatly reduce the float, but will leave a considerable volume of float to be carried by the Federal Reserve Banks. Its principal objection, however, is that it would be a radical reform, strange and novel, necessarily compulsory, and therefore unwelcome, and so it might drive member banks out of the system.

It will be acknowledged that the application of the clearing house principle would be the ideal solution of the problem if it is practicable and that clearing house operations could accomplish all

the purposes above named. The Act recognizes the clearing house principle in terms; and a country-wide clearing house being obviously impracticable provides that the Federal Reserve Board "may require each Federal reserve bank to exercise the functions of a Clearing House for its member banks."

The plan herein proposed is an evolution of the "Reserve City Clearing House" as now operated in the Dallas district. Practically all of the "Outline of Fundamental Principles" submitted by Governor Van Zandt is applicable to this plan which therefore has the merits so well urged therein for Mr. Talley's plan; so it is unnecessary to repeat herein the fundamental principles of that plan, which are (without leave) "hereby made a part of this report." The features now proposed to supplement or modify the Talley Plan are as follows:

1. All Clearing House membership being essentially voluntary, member banks should be given the option of joining the Federal Reserve Bank Clearing Houses or accepting deferred credit and debit.

2. The Clearing House Departments of Federal Reserve Banks should be entirely independent of the Reserve Banks themselves; that is, the reserve accounts of member banks should be kept entirely distinct from the Clearing House accounts. Credit balances in the Clearing House when collected from debtor banks should however be deposited to the credit of the member bank's reserve account in the Federal Reserve Bank. Debtor banks should settle for debit balances by drafts on the Federal Reserve Bank to the order of the Clearing House department or manager, as provided in the Talley Plan.

A debtor bank obliged to ship currency to meet its settlement draft should be credited with the actual minimum cost of such shipment, as in the Dallas system; but it is believed that such cost should be charged to the general operating expense, rather than to attempt to charge it against the banks clearing items on the shipping bank, which would involve much clerical work.

3: Each Federal Reserve District should be divided into a suitable number of sub-districts for clearing house purposes only; each such sub-district to contain a Clearing House Agency of the Federal Reserve Bank. Each such Clearing House Agency should be a member of each other Clearing House Agency in the same Federal Reserve District. Each member bank should send all items on other member banks located within its sub-district to the Clearing House Agency thereof, and should send all items on member banks of other sub-districts within the same Federal Reserve District, direct to the Clearing House Agency of the sub-district in which the payer bank is located, with a duplicate letter to its own Clearing House Agency. This Agency being a member of all other Clearing House Agencies in the Federal Reserve District, receives credit on the clearing sheet of the payer bank's Clearing House Agency, and its balances will be offset in the same manner as balances between other members of that Clearing House Agency. All balances, however, should be settled on the books of the Central Clearing House at the Federal Reserve Bank; and there the offsets will probably be such as to obviate the necessity of apportioning credits as in the Talley Plan. Resultant balances between

the several agencies would also be settled through the Central Clearing House Department at the Federal Reserve Bank.

4: Items of non-member banks may be cleared through member banks, as is now the custom in some local Clearing Houses. For the service of clearing or collecting items presented by member banks, but bearing the indorsement of non-member banks, an additional discriminatory charge should be made.

INTER-DISTRICT OPERATIONS

5: The handling of checks payable outside of the Federal Reserve District of the depositing bank, although involving deferred settlements, can be conducted in a similar manner. Member banks having items payable outside of their own Federal Reserve District could send all such items direct to the Clearing House Department of the Federal Reserve Bank of the district in which the payer bank is located, or to its sub-district Clearing House Agency; or to the payer bank direct if located in a center, but in each case for credit of the Clearing House Department of their own Federal Reserve Bank; at the same time sending duplicates of such letters to the Clearing House Department of their own Federal Reserve Bank. The payer bank's Federal Reserve Bank will then advise the depositing bank's Federal Reserve Bank. A bank having a small number of items payable in other Federal Reserve Districts might be permitted to send all such items to its own Federal Reserve Bank for sorting and transmission, although each member bank should be urged to send items

direct to the district where payable whenever possible to avoid delay in transit. Resultant debit or credit balances in the Inter-district system should be settled in the same manner as those in the Intra-district Clearing House with the exception that they would be cleared through the Gold Settlement Fund.

EXPENSE OF OPERATION.

6: The expense of maintenance and operation may be provided for as suggested in the Talley Plan as far as Intra-district clearings are concerned. In Inter-district operations a Federal Reserve Bank Clearing House receiving items from banks in other Federal Reserve districts direct should not enter any item charges upon its books, but the Federal Reserve Bank of the District where such items originate should make an item charge from the duplicate letter of advice received by it from its member bank which has sent the items to the other Federal Reserve District.

The item charge for both Intra and Inter-district items should, of course, be sufficient to cover all incidental expenses, including any necessary remittances of funds.

4/7/16

PLAN NO. 11.

FEDERAL RESERVE BANK OF ST. LOUIS.

THE FOLLOWING PLAN FOR THE COLLECTION OF CHECKS IS INTENDED TO SHOW:

WHAT WE BELIEVE SHOULD BE DONE;
THE REASONS WHY WE BELIEVE SO;
AND THE METHODS PROPOSED TO ACCOMPLISH IT.

FUNDAMENTALS:	REASONS:	METHODS:
1 - All member banks should receive at par checks drawn on them, which have been deposited in the Federal Reserve Banks. This should be mandatory.	This is based upon the last two paragraphs in Sec. 16 of the Federal Reserve Act.	It should be put into effect by orders issued by the Federal Reserve Board.
2 - The Inter-District exchange of checks should be put into effect simultaneously with the mandatory collection of checks on members.	Any practical method of collecting checks must include means for the passing of a check from the District where it is negotiated to the District where it is payable.	Federal Reserve Banks shall receive for credit from other Federal Reserve Banks checks drawn on points in the former Banks' Districts. Further details are given under Sec. 6.
3 - Federal Reserve Banks should receive from Member Banks, and other Federal Reserve Banks checks drawn on Non-member banks, on the basis of the exchange cost on such checks.	Recognition must be given to conditions actually existing. The National Banks are now handling 75% to 80% of the country checks in circulation, consisting of checks on Members and on Non-member banks. The checks on Members will be turned into the Federal Reserve Banks, who will therefore accumulate 75 to 80% of the checks drawn on their members; and the members will have to provide payment for them to the Federal Reserve Banks. Some assistance should be given to the Country Member to restore its reserve balances thus depleted by the Federal Reserve Bank.	A start can be made by collecting checks on non-members located in the same place as a member - at par if possible, at a slight service cost if necessary. The Federal Reserve Bank will then begin negotiations with non-members located in places where there are no members for the collection of checks on such

FUNDAMENTALS:	REASONS:	METHODS:
3 - (Continued)	Owing to the greater number of State Banks, the outside checks received by a country member are mostly drawn on State Banks in the vicinity. Some are drawn on National Banks, which can of course be sent to the Federal Reserve Bank, but these do not by any means provide a fair offset to the payments the country member has to make to the Federal Reserve Bank. To say to the country member bank that it can restore its depleted balance by sending a check on its City correspondent is to say: "We leave you where we found you, and you must find the means to offset a situation created by the Federal Reserve Bank." The equitable way is for the Federal Reserve Bank to provide the member bank with the means to convert all of its outside checks into a credit balance in the Federal Reserve Bank, at a minimum expense to all concerned. The collection of country checks will not in practice prove to be such a tremendous country-wide affair as first appears. The outside checks received by a country bank are largely drawn on banks in its vicinity and by far the larger part of them would not go outside of the Reserve District in which the Member is located if the Federal Reserve Bank undertakes their collection, and declines to receive from another Federal Reserve Bank checks already endorsed by a bank located in the district of the receiving Federal Reserve Bank. The collection of country checks will resolve itself into a local proposition.	banks, on as favorable terms as possible, in exchange which is convenient to the remitting bank and convertible by the Federal Reserve Bank. Since the twelve Federal Reserve Banks will become the largest collectors of country checks, they will secure the lowest rates from the banks who charge exchange. They will be in position to offer certain advantages to non-members who remit at par, as will be explained in Section 4. The manner of giving credit to the sending member bank for checks on Non-members will be explained further on.
4 - The Federal Reserve Banks should differentiate between Non-member banks who remit at par for checks sent them by Federal Reserve Banks and those who charge.	Under any comprehensive plan of collecting country checks a Non-member can receive by virtue of a connection with its City correspondent all of the advantages of the collection facilities of the twelve Federal Reserve Banks. Unless some distinction is drawn between the Non-member	The differential charge shall be the same rate of exchange which is charged by the endorsing bank on items sent it by the Federal Reserve Bank. The rate will be as-

FUNDAMENTALS:

4 - (Continued)
This should be a charge made on account of the endorsement of a Non-member bank which does not remit at par for the Federal Reserve Bank. The enforcement of the differential charge will be voluntary on the part of the drawee bank, as explained in the reason for levying the charge.

REASONS:

who remits at par for the Federal Reserve Bank, and the one which will not, the latter bank receives an undue advantage over the former and also over Member Banks. A way should be found to equalize this discrimination and offset the undue advantage given the Non-member who seeks to enjoy the facilities of the Federal Reserve Banks and make a profit from them at one and the same time. It is proposed that the Federal Reserve Bank charge exchange on any check, which reaches it, that is endorsed, by a Non-member who charges for remitting to the Federal Reserve Bank. This differential charge shall be at the same rate of exchange as the Non-member charges the Federal Reserve Bank. The exact amount of this charge is to be paid to the Bank on which the check is drawn, if the drawee bank remits at par for checks sent it by the Federal Reserve Bank. It is apparent that the Federal Reserve Banks can by this means have a definite advantage to hold out to the bank who will remit to it at par.
It is true Member banks have been urged to join the clearing system, now in use on the ground that they can have their customers' checks collected at par through the Federal Reserve Bank. This differential charge will effect this to a certain extent; but it will return the Member Bank the exact amount of the charge levied on its customers' checks, putting it in position to return it to the customer; OR, IF DESIRED BY THE MEMBER BANK, no differential will be imposed on its customers' checks on account of endorsement, if it prefers this to being paid exchange on them.

METHODS:

certained from the negotiations to be carried on as explained under Sec.3. The charge is to be levied against the depositing member bank. The charge is to be levied by the Federal Reserve Bank in which the item is first deposited. The Federal Reserve Bank of the District will know what banks in its District are charging exchange. It is apparent that the bulk of the outside items endorsed by these charge-banks will be offered to the Federal Reserve Bank located in its District. (See last paragraph in "Reasons" Sec. 3). The amount of the charge will be noted on the letter of transmittal carrying the item from the Federal Reserve Bank to the Member Bank or another Federal Reserve Bank. The check charged on will be indicated by a symbol opposite the check. A coupon at the foot of the letter will name the amount of the check on which the differential has been levied, amount of the charge and contain a request to deduct

FUNDAMENTALS:	REASONS:	METHODS:
4 - (Continued)	The bulk of the exchange charges on checks is levied by country banks in the smaller towns and cities. It is no secret that the evil of exorbitant exchange charges is rooted in the competition of reserve city banks for accounts of country banks. Experience of the past twelve months has demonstrated that little assistance can be expected from interests outside of the banks in the solution of this exchange problem. The first step towards a solution must be reached in the relations between a country bank and its reserve city correspondent. By imposing a differential charge on the checks, which can be deposited in a Federal Reserve Bank, the Reserve City bank will soon have two plans which it can extend to the country bank for the handling of its items. One plan to the bank which remits at par for the Federal Reserve Bank (Whose items can be deposited through a Member at par in the Federal Reserve Bank) and a second plan for the bank which charges the Federal Reserve Bank and whose items are therefore subject to a charge if deposited in the Federal Reserve Bank. The profits to the reserve city bank will be quite different on the first class from the profits on the second class of accounts. This wide difference in profits will soon effect the basis upon which the reserve city bank can receive the country account. Country banks will, by their own volition, divide themselves into two classes. Those banks, having a large volume of outside checks to collect, will manifestly find it to their interest to par for the Federal Reserve Bank, while those having only a small volume of out-	the amount of it from next remittance, if the check is drawn on a non-member who pars; or if drawn on a member the coupon will be an advice of credit. If the letter of transmittal is to another Federal Reserve Bank, the notation will be an advice of credit for the amount of the differential. If the check is drawn on a Non-member who charges the Federal Reserve Bank, the amount of the differential will be retained by the Federal Reserve Bank, and used to reduce the cost of check collection. Member banks will be furnished with a list of the banks who charge the Federal Reserve Bank, so that they can arrange accordingly for handling items with charge bank endorsements. Federal Reserve Banks will not receive from other Federal Reserve Banks items bearing the endorsement of member or non-member banks, located in the second Federal Reserve Banks' District. All Federal Reserve Banks

FUNDAMENTALS:	REASONS:	METHODS:
4 - (Continued)	side checks may prefer to charge the Federal Reserve Bank and pay the same rate on the outside items it may receive from its customers. Eventually the number of banks charging exchange will be reduced to a minimum .	will exchange with each other lists showing rates of exchange paid to the various non-member banks.
5 - The twelve Federal Reserve Districts should be sub-divided and Sub-Agencies established for the collection of checks in the immediate vicinity of the Sub-Agency. The distribution of Sub-Agencies should be so arranged that the majority of banking points in the Reserve District are within one day's time from a Sub-Agency.	This is following long established lines of practice in the collection of country checks. The commercial banks of the country have found it necessary to distribute country checks through 50 to 60 centers. Experience has developed the necessity for this. The Sub-Agencies should be so located that a majority of the banking towns in the sub-district are within one day's time from the Sub-Agency. This will enable a remittance containing checks on members to be credited the next business day after receipt at the Sub-Agency, and enable remittances of checks on Non-members to be credited two days after receipt at the Sub-Agency. The principal argument advanced against the parring of checks has been the cost to the paying banks to make the exchange in which it is required to remit. If Sub-Agencies are properly located, banks remitting to them will remit in exchange which they make readily and which costs nothing.	Location of Sub-Agencies shall be designated by the Federal Reserve Bank. The Sub-Agencies may be Member Banks, but the men handling the items should be employes of the Federal Reserve Bank, under proper bond. A list of Sub-Agencies shall be furnished member banks in the district with instructions to send items in the Sub-District to the Sub-Agency. Receipts at each Sub-Agency may be telegraphed if necessary to the Federal Reserve Bank, and confirmed by mail. The manner of entry on the books of the Member Bank of remittances sent to the Sub-Agency is taken up further on.
6 - Checks on Member Banks or Federal Reserve Banks should be credited to the sending bank on the day the checks should reach the drawee bank. Checks on Non-Member banks should be credited on the day returns for same should reach the Fed-	It is the purpose of this method to enable X Bank to realize on a check drawn on Y Bank within the same period that Y Bank can realize on a check drawn on X Bank. It is intended that a check drawn on a Member Bank shall become reserve for the sending bank on the day the check reaches the drawee bank. The sending bank will accordingly charge the Federal Reserve Bank with remittances sent it on the day such	Member Banks will be furnished with forms of remittance letters which will show that the letter is addressed to a Sub-Agency, the Federal Reserve Bank of its district, or a Federal Reserve Bank or Sub-Agency outside of its District.

FUNDAMENTALS:	REASONS:	METHODS:
6 - (Continued) eral Reserve Bank collecting same.	remittances should reach the drawee banks. Its books will therefore correspond with the books of the Federal Reserve Bank . What is usually termed in transit matters "the float" is the volume of checks which have been credited to depositors' accounts and are in process of collection. It grows out of the long established practice of giving credit on receipt to a depositor of checks on outside points. Manifestly the crediting bank receives some advantage in this manner of handling outside items. It is also plain that the drawee bank receives some advantage from the circulation of its customers checks drawn on it. The above plan divides the burden of this "float" equally between the receiving bank and the drawee bank. It is proposed as being an equitable division. It is based on the belief that a Federal Reserve Bank can define when a Member Bank may count as reserve any checks deposited in the Federal Reserve Bank.	The form will show when the Member Bank is to charge the remittance to the Federal Reserve Bank. It may charge checks on the same city in which a Sub-Agency of Federal Reserve Bank is located to its reserve account one day after transmittal. Checks on other members in the District shall be charged two days after transmittal: Checks on Non-Members in the District may be charged three days after transmittal. This will take care of the bulk of the outside checks received by the average country member. There will remain a small volume of checks on points outside of the District, which may be sent to the Federal Reserve Bank of the member's district or by arrangement to a Federal Reserve Bank located in the district where the checks are payable. It will not be difficult to arrange with the large collecting banks a practical convenient method for the handling of checks on points outside of their Federal Reserve

FUNDAMENTALS:	REASONS:	METHODS:
6 - (Continued)		a matter which must be left to the discretion of the Federal Reserve Bank concerned. Remittances containing checks on non-members shall be separated from those containing only checks on Members. The exchange charges if any on checks on Non-Members will be assessed the depositing bank on receipt of the check, if within the District. If the check is drawn on a point outside of the district, the exchange will be assessed on receipt of advice of the collecting Federal Reserve Bank. Exchange charges on non-member checks received from other Federal Reserve Banks will be assessed on receipt of the check, from the known schedules of charges which the Federal Reserve Bank will have on file from non-members in its District. Lists showing time in transit will be furnished Members and Federal Reserve Banks. It is recommended that the question be taken up later for adjustment, as to when drafts drawn by a member bank on its Federal Reserve Bank shall be deducted from the drawers balance on its books.

FUNDAMENTALS:	REASONS:	METHODS:
7 - Currency or coin shipments made by a Member to a Federal Reserve Bank shall be at the expense of the shipping bank, but shall be counted as reserve on the date the shipment is made by the Member Bank.	The establishment of Sub-Agencies will largely offset the need for currency shipments for purposes of making exchange. They will therefore be made principally as a matter of convenience to the shipping bank. They should be counted as reserve while in transit, since the currency would probably be reserve had it remained in the member's vault.	No details are needed. The shipments will simply be counted and credited on receipt.
8 - Checks representing transfers of funds shall be received on a basis to be fixed by the Federal Reserve Bank concerned.	This is to permit Federal Reserve Banks to engage in the purchase or sale of domestic exchange in accordance with conditions existing at the time of the transaction.	The manner of entry of such transfer checks is to be left to the discretion of the Federal Reserve Bank concerned.
9 - Reserves of Member Banks shall be computed from the books of the Federal Reserve Bank.	The carrying out of Section 6 will enable the Member Banks to have their books agree with the Federal Reserve Bank. The equitable division of the burden of uncollected checks is explained in the same Section; as is also set out the jurisdiction of the Bank in the calculation of reserves carried with it.	By direction of the Federal Reserve Board Member Banks shall make a periodical report of their reserve requirements. A comparison will then be available with the reserves actually carried. If any penalty be necessary on account of deficiency maintained over a given period it can then be fined as may be directed by the Federal Reserve Board as provided in Section 19 of the Act. The present method to continue until experience develops the necessity for change.
10 - Settlements between the Federal Reserve Banks in the Gold Fund should continue as heretofore until experience develops the necessity for more frequent	This recommendation carries its own reason.	The present method to continue until experience develops the necessity for change.

FUNDAMENTALS:	REASONS:	METHODS:
11 - That uniform methods should be followed by Federal Reserve Banks in the handling of Inter-District remittances.	Federal Reserve Banks should be enabled to have their books agree with every other Federal Reserve Bank at the close of business each day.	Uniform types of remittance letters should be adopted, showing when each remittance will be charged by the sending bank. Advices of credit by the receiving bank should show when the outside checks will be available for the sending bank. They should be held in a Transit account until the date the funds become available.
12 - The expense of operation should be left as a matter to be taken up later after experience has developed the approximate cost peritem.	After a few months' operation, some definite figures will be obtained and from then on an equitable assessment of expense can be levied.	

4/10/16.

FEDERAL RESERVE BOARD

WASHINGTON

ADDRESS REPLY 387.
FEDERAL RESERVE BOARD

March 1916.

Dear Sir:

The following message was authorized by the Federal Reserve Board at its meeting of March 21, and was sent to all those banks, which have filed applications for the sale of bonds, which could not be reached in sufficient time by mail.

> "Applications for the sale of bonds through the Treasurer of the United States on March thirty-first have been received from member banks up to the close of business today. Indications are that bonds offered for sale will very considerably exceed amount to be allotted to Federal reserve banks because many of these banks have already purchased more than their allotment. Hence in answer to an inquiry the Board has ruled that applications may be withdrawn if request for withdrawal is received by the Board before March twenty-eighth."

The notice is mailed to you as an applicant bank and reply may be sent by mail or telegraph in the event that you desire to withdraw all or any of the bonds you have tendered. The notice must, however, be received by the Board before the close of business on March 28th.

Respectfully,

Secretary.

FEDERAL RESERVE BOARD

WASHINGTON

March 24, 1916.

S i r :

In answer to several inquiries regarding proper entries to be made on Forms 34 and FRA-5, in case of redemption of Federal reserve notes, either "fit" or "unfit", received from a Federal reserve bank, a Federal reserve agent, or in the ordinary course of business, the following entries are suggested as satisfactorily representing the transactions in question:

1. When cancelled Federal reserve notes are forwarded by the bank to the Treasurer of the United States for redemption, the bank should increase on Form 34, "Mutilated currency forwarded for redemption" (Item BONE) and decrease "Federal reserve notes on hand" (Item BEET), no entries, however to be made on FRA-5.

(a) When advice is had from the Treasurer of the United States to the effect that such notes have been received (notices being sent simultaneously to the bank and the Agent), the bank should increase either "Gold settlement fund" (BABE) or "Gold redemption fund" (BELT), depending on what arrangement is made between the Agent and the bank and with the Treasurer of the United States,

and should decrease at the same time "Mutilated currency forwarded for redemption" (BONE).

(b) In case gold or lawful money is returned to the bank by the Agent on account of Federal reserve notes redeemed, the bank's cash reserve (gold or lawful money) should be increased instead of the items specified in paragraph (a).

In the memorandum account on the liability side of Form 34, the following changes should also be made: Decrease "Federal reserve notes outstanding" (Item DEER); also "Gold and lawful money" (Item DOPE).

This will result in reducing the amount of Federal reserve notes outstanding as well as the amount of gold or lawful money deposited with the Federal reserve agent, but will leave the bank's net liability on Federal reserve notes outstanding unchanged.

Upon receipt of notice from the Treasurer of the United States, the Agent should increase on Form FRA-5, "Federal reserve notes returned to Comptroller of Currency for destruction" and should decrease "Federal reserve notes outstanding", "Provision for redemption of Federal reserve notes", and "Credit balance in gold redemption fund", except when gold or lawful money is returned by the Agent to the bank, in which case "Gold on hand" or "Lawful money on hand" should be decreased instead of "Credit balance in gold re-

demption fund". Whenever a transfer of credits is made from the Agent's credit balance with the Federal Reserve Board to the bank's account in the gold settlement fund in connection with the redemption of Federal reserve notes, appropriate entries should be made on Form FRA-5.

II. When notice is had by the Federal reserve agent from the Treasurer of the United States that "unfit" Federal reserve notes, received from some source other than the bank, have been redeemed by him and charged to the Agent's gold redemption fund, the following changes should be made on Forms 34 and FRA-5:

In the memorandum account on the liability side of Form 34, the bank should decrease "Federal reserve notes outstanding"(Item DEER) and"Gold and lawful money with Federal reserve agent for the retirement of outstanding Federal reserve notes" (Item DOPE). This will result in reducing the amount of each of these two items, but will leave the bank's net liability on Federal reserve notes outstanding unchanged.

The Federal reserve agent should increase on Form FRA-5 "Federal reserve notes returned to Comptroller of Currency for destruction" and should decrease "Federal reserve notes outstanding", "Credit balance in gold redemption fund", and "Provision for redemption of Federal reserve notes".

III. In case "fit" Federal reserve notes are redeemed by the Treasurer of the United States, they will be charged to the bank's gold redemption fund and returned to the bank of issue, in which case the Federal reserve bank should increase "Federal reserve notes on hand" (Item BEET) and decrease "Due from Treasurer of United States, gold redemption fund" (Item BELT). No entries should be made by the Agent on Form FRA-5.

IV. When cancelled Federal reserve notes are returned by the Agent to the Comptroller of the Currency for destruction, the Agent should increase "Federal reserve notes returned to Comptroller of Currency for destruction" and decrease "Federal reserve notes on hand". No entries should be made by the bank on Form 34.

Where reference is made to changes on Form 34, it is understood, of course, that appropriate entries shall be made in general ledger accounts, balances of which only are shown on Form 34.

It is thought that the above suggestions, while by no means exhaustive of the subject, will be found sufficiently detailed to insure uniformity of treatment by all Federal reserve banks of all the various transactions connected with the redemption and destruction of Federal reserve notes.

The appended chart, prepared by Mr. H. M. Jefferson of the Federal Reserve Bank of New York, may be found useful in this connection.

Respectfully,

Governor.

FEDERAL RESERVE BOARD

WASHINGTON

March 27, 1916.

Dear Sirs:

One of the banks in your section of the Federal Reserve District of Dallas has written to the Federal Reserve Board stating its desire to be transferred to the Federal Reserve District of Kansas City, urging as the reasons for such transfer; geographical location, better mail facilities, and the necessity for carrying balances in Kansas City.

Will you please advise me whether you are satisfied to remain attached to the Federal Reserve Bank of Dallas or if you would prefer to be transferred, if this can be done?

Very truly yours,

FEDERAL RESERVE BOARD

WASHINGTON

594.

March 28, 1916.

Dear Sirs:

There is enclosed for your information copy of a resolution, adopted by the Federal Reserve Board at its meeting today, in connection with the sale of United States bonds offered by member banks of the Federal reserve system through the Treasurer of the United States under Section 18 of the Federal Reserve Act.

You will note from the resolution that the Board has determined under the circumstances to make no allotment of bonds for purchase at this time.

Very respectfully,

C S Hamlin.

Governor.

RESOLUTION ADOPTED BY THE FEDERAL RESERVE BOARD,
Tuesday, March 28, 1916.

W H E R E A S , It appears from statement furnished the Board by the office of the Secretary that eleven out of the twelve Federal reserve banks have purchased in the open market bonds in excess of the amount which might be allotted to such banks at the end of this quarterly period on a basis of one-fourth of twenty-five million dollars which the Board had considered alloting at this time, and

W H E R E A S , The bonds offered for sale through the Treasurer under Section 18 of the Federal Reserve Act aggregate more than twenty times the amount which might be allotted on the basis indicated, and it will, therefore, be possible on this basis to sell for each member bank less than five per cent of the amount offered for sale, and

W H E R E A S , It appears that the only Federal reserve bank which has not purchased in the open market bonds in excess of the amount which might be allotted to it is under contract to purchase a sum very largely in excess of its allotment and has been prevented from consummating such purchase by reason of the fact that more than nine million dollars in lawful money has been deposited with the Treasurer during the current month to retire circulation by national banks and the banks under contract to sell are thereby prevented from making delivery.

NOW, THEREFORE, BE IT RESOLVED, That it is the sense of the Board that no necessity exists for enforcing the requirement provided for under Section 18 of the Federal Reserve Act at the end of this quarterly period ending March 31, 1916, and that it will not at this time require the Federal reserve banks to purchase any of those bonds which are offered for sale by member banks through the Treasurer of the United States under the provisions of Section 18.

BE IT FURTHER RESOLVED, That the Secretary be instructed to send a copy of this resolution to the various Federal reserve banks and to the member banks which have offered bonds for sale in order that they may be notified of the action of the Board in the premises.

580

THE PRESENT COTTON SITUATION.

SPEECH OF W. P. G. HARDING, MEMBER FEDERAL RESERVE BOARD, UNDER THE AUSPICES OF THE BIRMINGHAM CHAMBER OF COMMERCE, AT BIRMINGHAM, ALABAMA, FRIDAY EVENING, MARCH TENTH, 1916.

(For release Saturday morning, March 11)

During the next six weeks, assuming normal weather conditions, the cotton crop of 1916 will be planted. While the acreage put in cotton will bear a direct relation to the size of the new crop, other factors must be considered in reaching conclusions as to the final outcome. The quality and amount of fertilizer used, the character of the season, methods of cultivation, the ravages of the boll weevil and other insect damage will all have an important bearing, so that under some conditions it is conceivable that thirty million acres planted in cotton will produce a larger yield than thirty-five million acres under other conditions. The new crop acreage however, which will probably be known definitely within the next sixty days, will play an important part in fixing the market value of that portion of the crop of 1915 which remains unsold, for it is likely that not until July will reports of condition of the growing crop become a factor in price control. It will be remembered

that during last July there was a decided slump in the cotton market which brought about an extremely nervous feeling throughout the South. Despite the very vigorous and diligent campaign that had been made in the spring of 1915 for a sharp reduction in cotton acreage, reinforced as it was by the severe object lesson of the dangers of over-production that had been impressed upon cotton growers during the preceding Fall and Winter, it was found that the area planted in cotton had been reduced by only about 15%. The season up to July had been propitious and there was much talk of a new crop of at least fourteen million bales. It was known also that Great Britain intended to declare cotton an absolute contraband, which was regarded as meaning the loss of a market for about two and one-half million bales which had usually gone to Germany and Austria, and which had, to a considerable extent during the season of 1914-1915, reached those countries through neutral ports. Farmers and business men throughout the South were aroused, and, without any definite organization, but through the force of public sentiment, a policy of gradual marketing was decided upon. Warehouse facilities had been found to be adequate and the banking situation was such as to render ample funds available to carry out such a policy. At the same time it became evident

that the yield would not be as large as had been anticipated, so that consumers, finding that there be no rush of cotton to the market, for sale at forced prices, began to contract for their wants, and prices advanced rapidly. The new crop, instead of bringing seven to eight cents per pound, as had been predicted by many pessimistic persons, found a ready market up to 12½¢ per pound, and cotton seed advanced in a corresponding degree so as to give producers the equivalent of $20.00 to $22.50 per bale from sales of seed. The advance attracted speculative interest and by December some enthusiasts had visions of 15 to 18 cents per pound. Many farmers and merchants who, a few weeks before would have sold most gladly at 12 cents, caught the infection and decided to hold for the much higher prices which they felt were coming. About this time however, the export movement began to compare unfavorably with the previous season. Except as to coastwise trade, our ocean freights are carried almost entirely in foreign bottoms. Of these, German vessels are idle, being interned in neutral ports throughout the world, or else blockaded in the waters of the North Sea. This scarcity of shipping has caused a great advance in ocean freight rates, which are from six to ten times the normal, so that rates on cotton from American ports to Liverpool have been ruling as high as three dollars per hundred pounds, or fifteen dollars per bale, being three

cents per pound. Even at these abnormal rates, exports of cotton have been restricted, as ship owners, acting probably under instructions from their Governments, have given preference to cargoes of grain and munitions. Under these conditions stocks abroad have been greatly reduced, and during the month of January there was a time when the stock at Liverpool was sufficient to supply British spindles for less than six weeks, with prices ruling at 18¢, against 12¢ in New York. There is reason to believe however, that during the past month arrangements have been made to increase the ship room available for cotton, and there has been some increase in the supply at Liverpool, London and Manchester. The total stocks in Great Britain on March 3rd have been estimated to be 1,000,000 bales, against 1,452,000, 1,289,000 and 1,498,000 bales for the same date in 1915, 1914 and 1913, respectively. The depletion of stocks on the Continent is still more marked. The Financial Chronicle estimates the supply of stock at Hamburg, Bremen and Trieste to be about 1,000 bales at each point, against a total of 384,000 bales on March 1st, 1915, 570,000 bales in 1914, and 578,000 bales in 1913; and, including stocks at Havre, Marseilles, Barcelona and Genoa, it estimates Continental stocks on March 3rd at 479,000 bales, against 1,083,000 bales in March 1915, 1,065,000 in 1914 and 1,089,000 in 1913. The Chronicle places the total visible

supply for the world on March 3rd at 5,777,448 bales, against 7,607,227, 6,107,140, and 5,491,952 bales in 1915, 1914 and 1913, respectively. In Egypt figures relating to cotton receipts are expressed in cantars, approximating 100 pounds, and exports in bales which weigh about 750 pounds. Reducing the figures to the equivalent of 500 pounds to the bale, receipts of cotton at Alexandria from August 1st to February 9th have been, according to the same authority, 790,300 bales against 942,500 bales last year, and 1,350,000 bales for the same date in 1914. The Financial Chronicle's report dated Friday night, March 3rd, gives the following statement as to the movement of the crop for the week: Total receipts, 107,849 bales, against 156,956 and 142,403 bales for the two weeks immediately preceding. Total receipts since August 1, 1915, 5,402,039, against 8,093,162 for the same period of 1914-15. Decrease since August 1, 1915, 2,691,123 bales. Exports for the week, 142,143 bales, of which 73,972 were to Great Britain, 24,125 to France, and 44,046 to the rest of the Continent. Total exports August 1, 1915 to March 3, 1916, to Great Britain, 1,755,493 bales, against 2,487,993 bales for the same period last year; to France, 510,883, against 376,892; to Continent, 1,295,565, against 2,672,188, making a grand total of 3,561,941, against 5,537,073 last year, and 7,296,085 for 1913-14. The export movement therefore, is approximately 2,000,000 bales

behind last year and nearly 3,750,000 bales under 1914. There seems to be no material difference of opinion on the part of various authorities as to stocks of cotton held abroad or as to the exports, but there is some divergence in the views as to the domestic situation. A well known cotton authority, who prefers not to be quoted, gives me the following estimate of the supply of cotton in America on July 31, 1916, at the close of the current cotton year:

Visible supply in U. S., July 31, 1915		1,300,000
Unmarketed on plantations, July 31, 1915		1,800,000
Crop 1915-1916 (including linters)		12,250,000
Total supply this season		15,350,000
American consumption	7,000,000	
Total exports	6,500,000	13,500,000
Leaving on hand visible and invisible		1,850,000

and checks his figures as follows:

Unmarketed July 31st, 1915		1,800,000
Crop, 1915-16		12,250,000
Total supply from plantations		14,050,000
In sight to February 26th, 1916		9,554,795
Unmarketed supply February 26th		4,495,205
Stock U. S. ports, Feb. 26th		1,410,285
Stock Interior towns Feb. 26th		1,102,047
Total supply in U. S. Feb. 26th		7,007,537
U. S. Consumption, season	7,000,000	
Total takings to Feb. 26th	4,684,000	
Still to be taken	2,316,000	-2316000
Exports, season	6,500,000	
Exports to Feb.26th	3,561,922	
Still to be exported	2,938,078	-2938078
		5,254,078
		1,753,459

I quote as follows from a letter received from him:

> "It is reasonably plain that if we export 6,500,000 bales of cotton this year, we shall not have more than about 1,800,000 bales left over in the United States. This includes the cotton at the ports and interior towns as well as the unmarketed supply on the plantations. I do not think it can be considered burdensome with the financial facilities that the Federal Reserve Banks provide, and if the war ends during the present summer, I believe that all the cotton that is left over and all that America can possibly produce next year will be required to fill up the vacuum created by the blockades and the war."

Another view is given in the weekly cotton letter dated March 4th of a well known brokerage house which adopts the figures and estimates of the Watkins Bureau. From this statement I quote:

> "The world's visible supply of American cotton is now 1,604,000 bales less than at this date last year and 64,000 less than in 1914. The stocks of American cotton in Liverpool with one exception, are the smallest in the past ten years, and practically the same is true of Continental stocks of American cotton. Our cotton markets are absolutely closed to Germany and Austria, which was not the case at this date last year and yet in spite of the extraordinary advance in ocean freight and insurance (the rate to Liverpool is now $15.00 a bale as compared with about $1.00 August 1, 1914) we exported the first six months of the season 2,961,000 bales and to date 3,680,000, clearly indicating an export movement for the season of fully 6,000,000 bales. The domestic consumption for the first six months of the season amounted to 3,528,000 bales and it is increasing as the season advances, foreshadowing a total of fully 7,250,000 bales for the year. With a supply of about 14,675,000

> bales (made up from the carry-over from last year of 2,765,000 bales, the crop estimated by the Government at 11,161,000 and an estimated linter crop of 750,000) and allowing 6,000,000 bales for export and 7,250,000 for domestic consumption, we would close the season with an apparent surplus of 1,425,000 bales."

There is a difference in the estimates of these two authorities of 425,000 bales. The first mentioned estimate places the carry-over from last year at 3,100,000 bales, while the second puts the amount carried over at 2,765,000 bales. The first places the present crop, including linters, at 12,250,000 bales, while the second, accepting the Government estimate, figures the crop, including linters, at 11,911,000 bales. The first estimate puts American consumption at 7,000,000 bales and exports at 6,500,000 bales, or a total of 13,500,000 bales; while the figures given by the second are 6,000,000 bales for export and 7,250,000 bales American consumption, or a total of 13,250,000 bales. Mr. Watkins however, says further that from the apparent surplus of 1,425,000 which is shown according to his figures, "there must be deducted 1,179,000 bales of linters, 429,000 carried over from last year and the linter crop of this year, 750,000, every bale of which will go into the manufacture of explosives. This cuts the spinner's supply down to about 13,500,000 bales, leaving an apparent surplus at the close of the season

of about 250,000 bales." I am informed that the Census Bureau in its statistics relating to the uses to which cotton is put, is confined to the consumption of raw cotton, including linters, and that additional legislation will be necessary to enable the Census Bureau to report on the consumption of cotton which has been specially prepared or treated. At a recent hearing before one of the House committees it was brought out that the Census Bureau regards an estimate of 1,000,000 bales of cotton used in America during 1915 for the manufacture of explosives as conservative, and the statement was made at the time by the representative of the Bureau that it is possible that as much as 1,500,000 bales had been used in this way during the year in the United States. It has been estimated unofficially that 2,000,000 bales were used in Europe last year in the manufacture of explosives, but I am told that the Census Bureau has no figures which throw any light upon the consumption abroad of cotton for this purpose. It is evident that much of the cotton now being exported to France is being used for explosives, as most of the cotton mills of France and all of those of Belgium are now within the German lines and are presumably not running for lack of cotton, although it is impossible to obtain definite information on this point.

Swiss mills are said to be very busy, but their supplies of cotton have been cut off recently because they were supposed to be selling to Germany and Austria. Consumption by mills in Norway and Sweden, Holland and Spain, would be abnormally large if they could get the cotton, but high freights and naval operations in the North Sea have rendered their supply precarious. Japanese mills will undoubtedly consume a great deal of cotton, but on account of proximity and lower freights they will probably take all they can from East India. The Russian mills are reported to be busy, but their supplies of American cotton must, for the present, come by way of Vladivostok, which means a long and expensive overland haul on a railroad congested with war material. The Port of Archangel however, which is ice-bound at present, will be open in May, and it is probable that Russia will add to its stock of American cotton after that time.

It is interesting to contrast the export movement during the present season with that of the last. The outbreak of the war in Europe on the first of August 1914 resulted in a practical stoppage of cotton exports until November. During December and January 1915, the movement abroad was heavy. While this movement was stimulated in February and March by the announcement of the forthcoming blockade of British waters

by German submarines, the volume of exports continued satisfactory until early in May, or until the sinking of the Lusitania. From this time on the export movement diminished appreciably and the advancing tendency in cotton prices was checked, followed by the slump in July, to which reference has already been made. During the present season, exports from August to November ran considerably ahead of the very light movement of the preceding year, but since November, owing to the reasons already outlined, the export movement compares unfavorably with that of the previous season, although the movement for February compares well with that of February 1914. The decline in cotton prices seems to have been definitely checked about the first of March. It is said that several British merchant ships hitherto used as transports, are to be restored to commercial uses in the trade between New York and Liverpool. Italy and Portugal together have seized over 60 German steamers which have been interned in their ports, the presumption being that these steamers will be put into commission for mercantile purposes. At any rate, there has been an easing in ocean freight rates, which now show a decline of 50¢ per hundred, or $2.50 per bale from quotations current the latter part of February. Announcement was made a few days ago that 12 steamships are

due to arrive at an early date at Galveston, which will load with cotton from that port. The latest issue of the Economic World, which is a recognized authority on the textile trade, has this to say regarding the demand for cotton:

> "The margin of profit between the cost of raw cotton and the market values of goods in the United States is now unusually wide, and it is the part of commercial wisdom for the manufacturer to secure for himself this margin of profit, no matter what his inclination or judgment may be with respect to a possible wider margin of profits in the future. This consideration has induced a fair amount of buying for the account of American spinners during the past week. Were it not that much the larger part of the requirements of our mills for the season has already been secured, this buying might be counted upon as a sustaining and perhaps even as an advancing influence in the markets for the immediate future. In addition to this buying for American account, some buying for foreign account has been in evidence."

The ability and disposition of the banks of this country to take care of the legitimate wants of their customers, as well as to carry well secured loans for those who are not customers has never been greater than at present. At the close of business on March 6th the total of all paper under discount with Federal Reserve banks, including rediscounts for member banks, open market purchases of bankers' acceptances, trade acceptances and commodity loans carried for member banks, was slightly over $51,000,000 against total deposits held by these

institutions of $454,761,000; while on January 2nd the amount of paper under discount was over $54,000,000 against deposits of $431,085,000. Except in the Richmond and Atlanta districts the loans secured by cotton receipts are of a negligible amount, and in these two districts they have been considerably reduced since the first of the year. The total bills discounted with the Federal Reserve Bank of Atlanta, including the New Orleans Branch, was, on January 2nd, $8,200,000. On March 6th this amount had been reduced to $4,420,000. The amount of loans held by the Federal Reserve Bank of Richmond on January 2nd was $7,612,000, and on March 6th the amount of its loans was $6,433,000. The amount of discounted paper held by the Federal Reserve Bank of St. Louis on January 2nd was $1,915,000, while on March 6th the amount was $1,429,000. The loans of the Federal Reserve Bank of Dallas on January 2nd amounted to $4,911,000, and on March 6th to $4,550,000. The same conditions are reflected in the statements of member banks. In all sections of the country first class commercial paper is sought for at abnormally low rates, and I may say that for several months past the chief concern of the Federal Reserve Board over the monetary situation in this country for the immediate future has been that the unusually low rates prevailing in financial centers might lead to an unwise inflation of credits. There is every

reason to believe that exports of cotton will continue on approximately the present scale during the spring and summer months, up to the close of the present cotton year, and there seems to be little danger of there being an unwieldy surplus carried over into the next season. There is undoubtedly a considerable amount of unsold cotton in the South which is being held by farmers and country merchants, but the amount is probably no greater than in some previous years, as the stocks reported at interior towns on March 3rd amounted to 1,080,000 bales, against 1,063,000 bales at the same towns on March 5th 1915. During the week ended March 3rd the interior stocks decreased 35,761 bales, and receipts at all towns were 84,838 bales less than for the same week last year. Attention is invited to the Financial Chronicle's comparative statement of amount brought into sight and spinners' takings for the weeks ended March 3rd, 1916 and March 4th, 1915:

In sight and spinners' Takings.	1915-16 Week	1915-16 Since Aug. 1	1914-15 Week	1914-15 Since Aug. 1
Receipts at ports to March 3.....	107,849	5,402,039	284,634	8,093,162
Net overland to 3/3.	35,173	1,011,489	31,314	921,677
Southern consumption to March 3.....	82,000	2,190,000	60,000	1,830,000
Total marketed...	225,022	8,603,528	375,948	10,844,839
Interior stocks in excess.....	*35,761	634,711	*64,959	943,420
Came into sight during week.....	189,261	---------	310,989	---------
Total in sight 3/4..	-----	9,238,239	-------	11,788,259
North spinners' takings to March 3....	34,396	2,135,026	88,743	2,047,309

*Decrease during week.

Movement into sight in previous years:

Week-	Bales	Since Sept.1.	Bales.
1914 March 6	198,304	1913-14 March 6	12,673,042
1913 March 7	154,692	1912-13 March 7	11,856,556
1912 March 8	281,157	1911-12 March 8	13,421,418

Some private letters that I have received state that there were perhaps two million bales of cotton held on March 1st by Southern farmers and local merchants. If all of this cotton, or any large part of it should be thrown upon the market at once, there would undoubtedly be a break in prices. But five months, or about 21 weeks will elapse before any new cotton can come on the market. With the demand for export and from American spinners which seems assured, there is no reason to

doubt the ability of the market to absorb much more than 100,000 bales per week. I refrain however, as I have always done, from giving advice in particular cases. I believe that the policy of gradual and orderly marketing of the crop has been proved to be the correct one by the course of the market this season, and, while there are no doubt many holders of cotton who will regret that they did not sell when prices were higher, it is no doubt true that the higher prices last fall were obtainable by reason of the fact that there was no unseemly rush of cotton to the market; and, without regard to ownership, it is safe to assume that the cotton held back has contributed its part to the prices realized for cotton that has been sold. I wish that each individual farmer would remember, when the time comes for him to determine how much of his land he will put in cotton this spring, that we are living in unusual times and that it is impossible for any man or any group of men to forecast with certainty what the consumption of a staple like cotton will be. I believe in the gradual and orderly marketing of crops, but I believe just as firmly in the diversification of crops. Farmers of the Northwest who produce the bulk of the great food crops of this country, have learned that it is dangerous to place reliance in one crop, even though it be a food crop, and, while they cannot raise cotton, they diversify by planting different kinds of grain, and by producing more than

one kind of food. I quote a statement that was made recently by a prominent bank in the Northwest:

> "The investment market does not seem to be as active as the large amount of money in banks and the heavy savings balances would ordinarily indicate. General interest rates are so low that many people are content with savings bank interest. The demand for farm mortgages is very strong, but our farmers are in such excellent condition financially that the supply of mortgages continues to be less than the demand. This, of course, has resulted in a decrease of rates to the farmers. Mortgages from the best farming communities of Minnesota and the Dakotas are especially hard to obtain. In former years, when there were plenty of these securities, it was not necessary for capital to go into the newer parts of the Northwest unless attracted by high rates. It is probable that present conditions will turn large amounts of money to investment in the less populous portions of the Northwestern States and will result in increased settlement and greater value for land. Whether this condition will result in an extended movement 'back to the farm,' cannot, of course, now be predicted, but tendencies in that direction have already been reported from two or three sources."

I am sorry that I cannot yet quote similar statements from Southern sources, but I think within a few years, after the South has learned the lesson of diversification, that like conditions will prevail, at least in favored sections. I wish to subscribe to the doctrine that is being and has been for years so effectively preached by one of the best known, and perhaps the most useful citizen of Alabama, Mrs. G. H. Mathis, who has a message of cheer and hope wherever she goes and who inspires thedispirited with new hopes and aspirations. She believes in diversified farming. She says that farming is a good business

but she warns the farmer that "the ground is sick of one crop. It is sick of cotton and by running the land down you are having to mortgage your property to death, and are making the crop self-consuming. Build it up. There are certain robber crops and certain builder crops that everyone ought to know. The robber crops are cotton, corn, wheat and oats. The builder crops are peas, beans, clovers and vetches, and you can build the land in winter when it is not in use."

I am told that there are farmers in Alabama, and perhaps in all Southern states who have never grown a stalk of corn. Let the farmersrealize, and I urge upon merchants and bankers the importance of persuading them, that an increased acreage in cotton will be looked upon as an argument in favor of lower prices for the remainder of the crop now being held, although it is by no means certain that a large acreage would yield a larger crop than a smaller and better cultivated area. Let us suppose things turn out this year as some optimists predict. Suppose peace should be restored and there springs up a greatly increased demand for cotton. Under such conditions a large crop would of course sell for a great deal of money, but with the experience of 1910 and 1911 before us, is there any reason to doubt that a moderate crop would sell for still more? On the other hand, suppose the war continues; suppose, unhappily, this

country should become involved, -- and remember that in times of stress, when it comes to a choice between something to eat and something to wear, food must be provided at any cost, while new clothes can wait. Then I ask, would we not be far better off with a moderate supply of cotton and an abundance of food supplies? Why plant a larger area than can be cultivated thoroughly? Why scatter high priced fertilizer over a large field when it would be more effective concentrated on a smaller? These matters must be determined now! A month hence will be too late! Let the farmers, the merchants and the bankers of the South take counsel together, and let the newspapers, and those published at the county seats particularly, advocate in every issue for the next six weeks, and with all their force and power, the doctrine of diversification, and let them point out the dangers of the one crop system!

Remember, my friends, that if the war continues for six months longer, in all probability the purchasing power of Europe will be seriously impaired. The cost of munitions and supplies is enormous, and food prices in the warring countries are soaring. According to the Bureau of Labor Statistics of the Department of Labor, food, taken as a whole in the United States costs 3% more today than it did a year ago. Prices in Great Britain have increased about 44% and in France about 23%. In

other belligerent countries the advance has been 100%. Remember that the cotton exchanges are not eleemosynary institutions, and that operators on cotton exchanges have no sentiment except a desire for gain. Market opinions vary as conditions change, and operators are not consistent bulls or bears, but shift their position without notice as new conditions arise. The fact is realized in all the cotton markets of the world that the course of prices depends primarily upon the supply, and for the next three months at least, estimates of supply will be based upon the new crop acreage. What this acreage will be in America depends upon the farmers of the South. Should they decide during the next few weeks to produce their food stuffs at home and to plant cotton as a money crop, their position will be secure, but if, disregarding all the warnings and portents of the times, they decide upon a policy of all cotton, they will be taking a tremendous risk which no prudent business man would care to assume.

The Southern farmer is most powerful as a factor in the cotton market at planting time.

"Every man at times is master of his fate,
The fault, dear Brutus, is not in our stars,
but in ourselves,
That we are underlings."

MEMORANDUM IN RE PAYMENT OF DIVIDENDS BY FEDERAL RESERVE BANKS, PAYMENTS UPON NEW STOCK SUBSCRIPTIONS, AND PAYMENTS UPON STOCK SURRENDERED:

1. Dividend Payments.

(a) The Federal Reserve Board should be advised by the officers of the Federal reserve banks when it is the intention to submit the question of the payment of dividends to the directors at the next meeting. At the same time the bank should submit to the Board the information as called for in the attached memorandum marked "A".

(b) Dividends to be paid annually, if earned. Books to be closed at the close of business December 31st. The suggested form of dividend resolution, which has been prepared by Judge Elliott, is attached to this memorandum and marked "B". Undistributed earnings are to be carried in the profit and loss account. No transfers should be made to surplus account until such time as accrued dividends have been paid to date. Accrued dividends, or interest on capital stock payments, are to be figured at the rate of 1/2% per month. The dividend distribution should be based upon the earnings for the year. Accrued dividends for previous year to be first paid, balance to be applied on dividend for current year.

2. Payments on additional stock subscriptions of member banks.

(a) Additional stock: Until such time as dividends have been paid in full to the last regular dividend date, new stock is to be paid for at par. When accrued dividends have been paid to date,

stock subscriptions during the following year are to be paid for at par, plus 1/2 per cent per month since the last regular dividend date, if earned.

(b) Stock subscriptions of new member banks: Rule outlined in preceding paragraph should govern.

3. Capital stock surrendered for payment and cancellation.

Until such time as a reserve bank has retired its organization expenses, surrendered stock should be paid for at par, unless a material actual impairment is shown, or unless undistributed earnings are sufficient to pay all accrued, current and organization expenses.

If a profit and loss surplus has been accumulated, after allowing for expense items referred to in previous paragraph, surrendered stock is entitled to share in such undistributed earnings as are shown by the books of the reserve bank on the last day of the preceding month, to be figured as follows:

Profit and loss account		
Current earnings (including all accruals)		
Less:		
Current expenses, including cost of Federal reserve notes used to date, allowance for depreciation in furniture and vaults, and depreciation in real estate, and accrued expenses not paid but chargeable to period.		
Estimated losses		
Estimated net undistributed earnings		

Under the circumstances outlined, the surrender value of stock will

be par, plus a share of the net undistributed earnings in the propertion which the accrued dividend or unpaid interest on the stock surrendered bears to the total accrued dividends on the stock of member banks, up to the close of business on the last day of the preceding month, i. e.,

$$\text{Par} + \text{Net undistributed earnings after making allowances for accruals, depreciation and estimated losses.} \times \frac{\text{Accrued dividend on stock surrendered}}{\text{Total accrued dividends all member banks within district.}}$$

Payments for additional stock and re-payments to member banks for stock surrendered, should be made at regular periods, say, quarterly.

"A" 601

Statement of Earnings
to be filed with
Federal Reserve Board
prior to a declaration of dividend.

Earnings since Jan. 1, 191 .

Rediscounts	_____	
Warrants	_____	
Acceptances	_____	
Commissions	_____	
Other sources	_____	
Accrued earnings (not credited)	_____	_____

Current expenses

Expenses paid, chargeable to period since Jan 1st	_____	
Accrued expenses to last day previous month	_____	
Cost of Federal reserve notes used	_____	
Allowance for depreciation in vaults and equipment	_____	
Depreciation in real estate	_____	_____
Net earnings		_____
Jan 1, 191_ Profit and Loss Account	_____	
Less interest payments made on stock surrendered since Jan. 1, 191__	_____	_____
Profit and loss balance after allowing for net earnings since Jan. 1, 191__.		_____
Estimated losses		_____
Available for distribution		_____

Supplemental Information

1. Unpaid indebtedness of closed banks to reserve banks. Give list, show if notes are secured, notes which have been past d.e six months or longer, estimated losses.

2. Member banks considered to be in over-extended or unsafe condition. Give names of banks, indebtedness to Federal reserve bank, and a memorandum of security, if any.

Dividends.

Available for dividend payments _____

Dividend payment to be recommended to the Board of Directors:
Per cent _____
Amount _____

Profit and loss account after allowing for proposed dividend payment _____

NOTE:

In the opinion of the Federal Reserve Board, there should be retained in the profit and loss account an amount equal to -

(a) Total of notes or other obligations bearing the endorsement of failed banks when such obligations have been past due six months or longer.

(b) 10% of net earnings to provide for unexpected expenses or losses. (During the first few years).

Accrued Dividends.

Interest on capital stock payments to Dec. 31, 1915 at 6% _____

Dividends paid to date _____

Accrued and unpaid dividends to Dec. 31, 1915 _____

Accrued dividends - current year (estimated) _____

Total accrued dividends to date _____

Estimated dividend payment to be recommended to Board of Directors

Estimated balance unpaid dividends after allowing for payment to be recommended to the Board of Directors _____

"B"

PESOLUTION FOR DIVIDEND.

WHEREAS, The officers of this association have submitted to the Federal Reserve Board a statement of condition in form approved by the Board, which statement has been duly certified by a committee appointed by this Board, and has been ordered spread upon the minutes of this meeting, and

WHEREAS, It appears from this statement that the estimated accrued dividends due the stockholders on _____day of _____ will amount to $_____, and that after charging to profit and loss account all expenses, whether paid or accrued which are properly chargeable as current expenses, and after making provision for any depreciation that may have occurred in the value of the assets owned by the bank and for probable losses, there will remain in said profit and loss account the sum of $_____.

NOW, THEREFORE, BE IT RESOLVED, that a dividend to stockholders of _____ per cent, payable on _____day of _____ be, and is hereby declared on all stock of this bank as shown by the books of the bank on that date.

BE IT FURTHER RESOLVED, that a copy of this resolution be transmitted to the Federal Reserve Board and upon its approval that the officers of this bank be, and they are hereby, authorized and directed to pay and distribute to said stockholders the dividend so declared. *That after the payment of all accrued dividends, and after provision has been made for all expenses, losses and depreciation in assets, said officers are authorized, empowered and directed to charge to profit and loss account and to credit to the surplus account of this bank the sum of $_____, and pay the balance remaining to the United States as a franchise tax as provided by law.

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* This part of the paragraph to be used after full dividends have been paid to date.

4/3/16

TREASURY DEPARTMENT

WASHINGTON.

April 3, 1916.

Charles S. Hamlin, Esq.,
Governor, Federal Reserve Board,
Washington, D. C.

Sir:

In response to your communication of the 27th ultimo, enclosing copy of a letter from the Carter White Lead Company, West Pullman Station, Chicago, Illinois, you are advised that drafts, acceptances, overdrafts and post-dated checks, are not taxable under the Act of October 22, 1914, as promissory notes.

Your attention is invited to paragraph I of T. D. 2170, as follows:

> (1) In view of the decision made by the Supreme Court of the United States in the case of the United States v. Isham (17 Wall, 496), that "the liability of an instrument to a stamp duty, as well the amount of such duty, is determined by the form and face of the instrument, and can not be affected by proof of facts outside of the instrument itself," this office is of the opinion that drafts, acceptances, overdrafts, and post-dated checks are not taxable under the above act as promissory notes, even though they are used in such a way as to perform some of the functions of a promissory note.

Respectfully,

DAVID A. GATES,

Acting Commissioner.

FEDERAL RESERVE BOARD

WASHINGTON

April 7, 1916.

My dear Mr.

On behalf of the Committee of the Federal Reserve Board on the subject of check clearing and collection, and on behalf of the Board, I am sending you herewith a memorandum prepared by myself, giving the reasons, as I see them, why it is important for the Board to make progress in this matter at this time. I am also enclosing herewith copies of four plans which have been submitted to the Board since the six plans which were sent to you recently. These four plans have been mimeographed and bound together.

At this writing the Board has also just received a plan prepared in parallel columns by the officers of the Federal Reserve Bank of St. Louis and submitted by them, but this plan, having been prepared on a wide carriage machine in parallel columns, has not yet been mimeographed. However, we will endeavor to have this plan copied and sent to you within a few days.

Yours very truly,

FEDERAL RESERVE BOARD

WASHINGTON

April 11, 1916.

Dear Sir:

The Federal Reserve Board has had under discussion with the Treasury Department, particularly with Assistant Secretary Malburn, suggestions which have come to it at various times that National banks be permitted to make deposits to the credit of the Five Per cent Fund in the hands of the Treasurer of the United States at Washington through their own Federal Reserve Banks, and that, if this can be arranged, it will enable Federal Reserve Banks to render an important and desirable service to their members. The rule heretofore has required National banks to get drafts on New York, but it is now suggested that that instead of requiring this, the banks may properly be permitted to request their own Federal Reserve Banks to remit to the Treasurer of the United States for their credit in the Five Per cent Redemption Fund. This would then be handled (in denominations of $10,000) and at the convenience of the Federal Reserve Bank of the District, through the Gold Redemption Fund at Washington.

In carrying out this plan it is proposed that the Federal Reserve Bank of New York shall have the privilege of

paying for its member banks directly to the Assistant Treasurer of the United States in that city, and, furthermore, it is the idea that nothing in this plan shall prevent National banks from making remittances direct to the Treasurer of the United States or to the Assistant Treasurer at New York in the old way if they do not choose to avail themselves of the method herein proposed.

As this is a matter in connection with the operation of the Banks which may well be considered by the Governors at their forthcoming conference in Washington, it is now submitted to you with the request that you take it up at that time and offer such suggestions or conclusions as you may have arrived at.

Yours very truly,

Vice Governor.

April 12, 1916.

S i r :

Some months ago the Federal Reserve Board decided that hereafter a copy of the report of examination of each Federal Reserve Bank should be given to the respective bank. It has now been suggested by one of the Governors that, in order to insure dissemination of these reports, the Federal Reserve Bank should in each case request each of its Directors to read the report, initial it, and that the Chairman of the Board of Directors shall notify the Federal Reserve Board that the report has been read by these Directors, and, therefore, had their full consideration.

The Federal Reserve Board would be very glad to have this course adopted in the future.

Yours very truly,

Governor.

COLLECTION OF OUT OF TOWN CHECKS BY FEDERAL RESERVE BANKS.

(By W. P. G. Harding)

This is a matter that has engrossed the attention of the members of the Federal Reserve Board and of the officials of the various Federal Reserve Banks, for more than twelve months. It has been the subject of many conferences and several plans have been suggested. The problem involves the handling of checks by a Federal Reserve Bank for its own member banks and also inter-bank transactions. The Gold Settlement Fund which was established by the Board about a year ago, may be regarded as a satisfactory method of adjusting balances between Federal Reserve Banks. In seeking a solution of the problems involved in the intra-district transactions, it would be well for the Federal Reserve Banks to approach the subject from the same angle that a newly established member bank would in its efforts to build up a profitable business. It should be borne in mind that the Federal Reserve Banks are not required or permitted to receive checks on deposit from the general public, but their contact with checks is limited to such as they may receive from their own depositors (their member banks) or from other Federal Reserve Banks. There has been no pressing need for radical changes in the present methods of collecting country checks,--

an evolution after years of experience,--but, as has been pointed out frequently, it is the relation between the country check and the reserves which must be considered. After November 1917 no balances in any bank other than a Federal Reserve Bank will be permitted to count as reserve and it is probable that balances hitherto carried by country banks with their national bank reserve agents, will either be curtailed appreciably or withdrawn entirely. There is, always has been, and always will be, an actual expense attached to the collection of country checks. Possibly this expense may be reduced under the clearing methods of the future just as it has been reduced in the past, but there is no doubt that many banks have been deceiving themselves into thinking that they are put to no expense in the collection of their country checks, while an analysis would show in many cases that banks pay this expense indirectly by carrying balances with collecting banks that might be more profitably employed otherwise, and that they are really paying more for a collection service than other banks who meet the expense face to face and settle it as it accrues. A Federal Reserve Bank is a purely mutual organization. Its depositors are its stockholders and its borrowers are all stockholders. Each Federal Reserve Bank should hold itself ready to serve each one of its limited number of depositors as far as it can

with safety to itself and with justice to its other depositor stockholders. Should any member bank desire to discontinue national bank reserve accounts that it has been carrying and ask a Federal Reserve Bank for the same collection facilities that had been extended by the National Bank reserve agent, such service should, without hesitation, be extended by the Federal Reserve Bank; not, however, at a loss to itself, which would be unfair to its other stockholding banks, but at cost or as near to cost as practicable. If the member bank which has been in the habit of counting as reserve, items in transit to its national bank reserve agent, desires the same privilege as to items sent to Federal Reserve Banks, it should be granted. But the Federal Reserve Bank should analyze each account in order to determine the average amount of outstanding items or float that it has permitted the member bank to count as reserve, and it should charge interest upon whatever amount of the apparent reserve carried is found to be made up of checks in transit. The actual cost of collection should also be ascertained and the proper allowance made for overhead charges. A statement of all this should be rendered the member bank once a month and the resulting charge made against its account. The Federal Reserve Bank should give full service to the member bank, including checks on state banks and trust companies and

checks drawn on other banks in other districts, but it should require as a condition precedent, that each member bank sending checks for credit should agree that checks upon it may be charged against its account with the Federal Reserve Bank, immediately upon receipt by the Federal Reserve Bank, as a matter of convenience;--but on the books of the member bank as a matter of course, not until the member bank had received the items. In the analysis of the account to be made daily and rendered monthly by the Federal Reserve Bank, allowance should be made in computing the float against a member bank of the time in transit to it of items charged against its account on the books of the Federal Reserve Bank.

By following these principles, which are based merely upon the idea of adequate service with a compensating charge, the Federal Reserve Banks will gradually assume for their members the burden of collecting out of town checks. But it is not anticipated that the change will take place so rapidly as to embarrass the Federal Reserve Banks physically or otherwise. The actual cost which must be met frankly and which cannot be disguised or diluted, will no doubt appear high at first, and will cause many member banks to be slow to use Federal Reserve Banks as collecting agencies; but the fact that balances with Federal Reserve Banks count as reserve while those with other

banks will not, will be a powerful leverage in the long run, and assuming that each member bank that uses its Federal Reserve Bank as a collecting agent will be required to permit the charge of checks on it against its account at par, it follows that the cost of handling items by a Federal Reserve Bank will be reduced from time to time as one member bank after another uses the Federal Reserve Bank as a reserve correspondent and collection agent. Those who deposit checks with the member banks, -- the public -- are already in many instances, owing to close competition between banks, getting free service, others may be paying by carrying free balances, while still others may be subjected to direct and sometimes excessive charges. But it is evident that as member banks are enabled to collect out of town checks at a reduced cost, this benefit will inure, in the last analysis, to their customers. Do not get away from the fact however, that the problem of collecting country checks with which the Federal Reserve Banks are confronted, is not one which has to do directly with the public, but concerns primarily the member banks. It is purely a matter of banking practice; it should be worked out on the basis of adequate service and proper compensation for service rendered.

Washington, D. C.
April 13, 1916.

TREASURY DEPARTMENT

WASHINGTON

April 12, 1916.

Hon. C. S. Hamlin, Governor,
Federal Reserve Board.

Sir:

Your letter of the 10th instant is received in which you say,

> "There is some apprehension on the part of the Federal Reaseve Bank of Philadelphia because of the fact that instructions were at some time given to the Assistant Treasurer at Philadelphia to pay withdrawals of funds held by the Federal Reserve Bank of Philadelphia in the Gold Settlement Fund in 'any available funds'."

You are advised that such instructions were recently wired for the purpose of facilitating the payment, and not of changing the kind of funds payable on such transactions.

It is the understanding of this office that all deposits to the credit of the Gold Settlement Fund are to be made in gold, gold certificates or gold order certificates, and that all payments under the said fund shall, where gold is available at subtreasuries, be paid in gold or its equivalent, and that in case such funds are not available, shipments thereof will be made at the expense of the Gold Settlement Fund for such payments.

Respectfully,

JOHN BURKE,

Treasurer.

J.O.M.

DEPARTMENT OF JUSTICE,

Washington.

April 14, 1916.

Sir:

At the request of the Federal Reserve Board, you have submitted the following questions for my opinion:

1. Can the Federal Reserve Board legally change the present location of any Federal reserve bank:

   (a) In the case where there has been no alteration in the district lines, and

   (b) In the case where there has been such readjustment of district lines as in the opinion of the Board necessitates the designation of a new Federal reserve city in order that due regard may be given to the convenience and customary course of business as required by Section 2 of the Federal Reserve Act?

11. Must the Federal Reserve Board, in exercising its admitted power to readjust, preserve the $4,000,000 minimum capitalization required of each Federal Reserve bank as a condition precedent to the commencement of business?

1.

In my opinion of November 22, 1915, I expressed the view that the "Federal Reserve Act" does not confer on the Federal Reserve Board the power to abolish any of the existing Federal reserve banks or Federal reserve districts. I believe that the reasoning of that opinion is equally applicable to both branches of the first question now submitted.

Section 2 of the Federal Reserve Act provides:

> As soon as practicable, The Federal Reserve Bank Organization Committee shall designate not less than eight nor more than twelve cities to be known as Federal reserve cities, and shall divide the continental United States * * * into districts, each district to contain only one of such Federal reserve cities. The determination of said organization committee shall not be subject to review except by the Federal Reserve Board when organized: Provided, That the districts shall be apportioned with due regard to the convenience and customary course of business and shall not necessarily be coterminous with any State or States. The districts thus created may be readjusted and new districts may from time to time be created by the Federal Reserve Board, not to exceed twelve in all. Such districts shall be known as Federal reserve districts and may be designated by number. * * *
>
> Said organization committee shall be authorized * * * to make such investigation as may be deemed necessary by the said committee in determining the reserve districts and in designating the cities within such districts where such Federal reserve banks shall be severally located.

The same section further provides:

> The said committee shall supervise the organization in each of the cities designated of a Federal reserve bank, which shall include in its title the name of the city in which it is situated, as "Federal Reserve Bank of Chicago."

Since the Act thus provides that each city designated as a Federal reserve city is to be the location of a Federal reserve bank, it follows that a change in the location of a Federal reserve bank would in effect be the designation of a new Federal reserve city and the abandonment of one previously designated. I find no more warrant in the Act for the abandonment of one Federal reserve city and the designation of a new one than I do for the abolition of a Federal reserve district when once established.

The power to designate a new Federal reserve city (twelve cities having been named by the Organization Com-

mittee), or to change the location of a Federal reserve bank, is not expressly conferred by the Act on the Federal Reserve Board. If the Board possesses such power it is only by implication from the provision that--

> The determination of said organization committee shall not be subject to review except by the Federal Reserve Board when organized: Provided, That the districts shall be apportioned with due regard to the convenience and customary course of business and shall not necessarily be coterminous with any State or States. The districts thus created may be readjusted and new districts may from time to time be created by the Federal Reserve Board, not to exceed twelve in all.

In my opinion there is no clear indication, either in the provision just quoted or elsewhere in the Act, of an intent to confer on the Federal Reserve Board the power to change the location of Federal reserve banks by the designation of new Federal reserve cities. On the contrary, there are indications of an opposite intent. As stated in my opinion of November 22, 1915, above referred to,--

> The merely negative statement that the determination of the Organization Committee "shall not be subject to review except by the Federal Reserve Board when organized" clearly cannot be enlarged into an affirmative grant of power to the Board to review and set aside everything done by the Organization Committee. The reasonable view is that by that language Congress meant that the determination of the Organization Committee should not be subject to review at all, except in so far as the subsequent provisions specifically authorize a review by the Federal Reserve Board. The only subsequent provision authorizing a review of the determination of the Organization Committee by the Federal Reserve Board is contained in the sentence--
>
> "The districts thus created may be readjusted and new districts may from time to time be created by the Federal Reserve Board, not to exceed twelve in all."

Again, as stated in that opinion,--

> "A reading of the Act shows at once that the Organization Committee was created not merely for the purpose of attending to the formalities of organization or to serve as a stop-gap until the Federal

> Reserve Board should come into existence, but that it had an independent function to perform and to that end was invested with wide powers. That is to say, its function was to organize the system as contradistinguished from the function of the Federal Reserve Board, which was primarily to administer the system.

The duty of designating Federal Reserve cities belonged to the Reserve Bank Organization Committee as a part of the organization of the system, and the Committee was required by the Act to designate not less than eight nor more than twelve cities. This duty is named first among those imposed upon the Organization Committee, and it is imposed by the same provision of section 2 which required the Committee to divide the United States into Federal Reserve districts. The same considerations that indicate an intention that the several districts should be permanent would also indicate that the designation of the cities was not to be made for temporary purposes, but was intended to be permanent, subject, of course, to change by Congress. The designation was to be made only after thorough investigation, and the same machinery was provided to facilitate both the determination of the districts and the designation of the cities. Thus, Section 2 provides:

> Said Organization Committee shall be authorized to employ counsel and expert aid, to take testimony, * * * and to make such investigation as may be deemed necessary * * * in determining the reserve districts and in designating the cities within such districts where such Federal reserve banks shall be severally located.

In my opinion, this coupling of the duty of determining the districts with the duty of designating the Federal reserve cities within the several districts shows an intention on the part of Congress that the cities so designated are to constitute the fixed centers in the scheme or system of division,

the duty of designating the cities being coordinate with the duty of forming districts around them. It was left to the discretion of the Organization Committee whether it should designate the full number of Federal reserve cities and establish the full number of Federal reserve districts permitted by the Act. The committee elected to designate and establish the full number authorized, thereby practically suspending the operation of the provision of the Act that "new districts may from time to time be created by the Federal Reserve Board not to exceed twelve in all." The primary if not the only purpose of that provision must have been to take care of the situation in the event that the Organization Committee had designated less than twelve Federal reserve cities.

The fact that the Federal Reserve Board, aside from the provision relating to the creation of new districts from time to time, was merely given the power to "readjust" districts suggests that there was to be some permanent characteristic or element in the districts created by the Organization Committee. If, however, in addition to the power which the Federal Reserve Board has of readjusting districts by changing their boundary lines, it also possessed the power to change the location of the respective Federal reserve cities within such districts, then the Board could, by successive changes

of cities and boundaries, entirely obliterate existing districts and substitute in their place new districts totally different from those created by the Organization Committee. I do not think that Congress intended to confer such a power.

The Act provides that each Federal reserve bank is to include the name of the city in which the bank is located. By Section 4 it is provided that the organization certificate of each bank shall state specifically - -

> The name of such Federal reserve bank, the territorial extent of the district over which the operations of such Federal reserve bank are to be carried on, the city and State in which said bank is to be located, the amount of capital stock and the number of shares into which the same is divided * * *.

Upon the filing of such certificate with the Comptroller of the Currency in the manner prescribed, such Federal reserve bank - -

> shall become a body corporate and as such, and in the name designated in such organization certificate, shall have power - -
> * * * * * * To have succession for a period of twenty years from its organization unless it is sooner dissolved by an Act of Congress, or unless its franchise becomes forfeited by some violation of law. (Sec. 4.)

It is to be noted that there is no provision in the Act by which the Federal Reserve Board may change the name of a Federal reserve bank or amend its certificate in this respect. The whole tenor suggests permanency.

The omission of Congress to grant, by express language, the power to change Federal reserve cities is significant, especially in view of the language of Section 11 (e) of the Act, which confers the power - -

> To add to the number of cities classified as reserve and central reserve cities * * *; or to reclassify existing reserve and central reserve cities, or to terminate their designation as such.

It would have been equally easy, had Congress desired to grant the authority to designate new Federal reserve cities, to have said so in express terms. (Tillson v. United States, 100 U. S., 43, 46, quoted in my opinion of November 22, 1915, supra.)

It may be suggested that changes in the "customary course of business" or other changes not foreseen by the Organization Committee may result in inconveniences which the Federal Reserve Board cannot remedy if its power to change the location of Federal reserve cities is denied. The answer is that the remedy is with Congress, in so far as it may not already be supplied by Section 3, which authorizes the establishment of as many branch banks in any district as may be found expedient.

To sum up my conclusion on the question of whether the Federal Reserve Board can legally change the present location of any Federal reserve bank, I am of opinion that the Board has no such power, and that such power is lacking whether there has been an alteration or readjustment in the district lines or not.

I I .

Coming now to the consideration of the second question submitted, namely, whether the Federal Reserve Board, in exercising its admitted power to readjust, must preserve the $4,000,000 minimum capitalization required of each Federal reserve bank as a condition precedent to the commencement of business, I am of opinion that this question is to be answered in the negative.

The Federal Reserve Act provides in Section 2:

> No Federal reserve bank shall commence business with a subscribed capital less than $4,000,000.

The same section also contains a provision requiring subscriptions to the capital stock to be paid - -

> One-sixth * * * * on call of the Organization Committee or of the Federal Reserve Board, one-sixth within three months and one-sixth within six months thereafter, and the remainder of the subscription, or any part thereof, shall be subject to call when deemed necessary by the Federal Reserve Board * * * .

Section 4 contains the following provision:

> When the minimum amount of capital stock prescribed by this Act for the organization of any Federal reserve bank shall have been subscribed and allotted, the organization committee shall designate any five banks * * * * to execute a certificate of organization * * * * .
>
> Upon the filing of such certificate with the Comptroller of the Currency the said Federal reserve bank shall become a body corporate.

The decrease of capital stock is authorized by the following provision of Section 5:

> The outstanding capital stock shall be increased from time to time as member banks increase their capital stock and surplus or as additional banks become members, and may be decreased as member banks reduce their capital stock or surplus or cease to be members.

Additional provisions relating to the decrease of capital stock are found in Section 5 and 6, as follows:

> Sec. 5. * * * * When a member bank reduces its capital stock it shall surrender a proportionate amount of its holdings in the capital of said Federal reserve bank, and when a member bank voluntarily liquidates it shall surrender all of its holdings of the capital stock of said Federal reserve bank and be released from its stock subscription not previously called. In either case the shares surrendered shall be canceled and the member bank shall receive in payment therefor * * * a sum equal to its cash-paid subscriptions on the shares surrendered * * * less any liability of such member bank to the Federal reserve bank.
>
> Sec. 6. If any member bank shall be declared insolvent * * * the stock held by it in said Federal reserve bank shall be canecled * * * and all cash-paid subscriptions on said stock, with one-half of one per centum per month from the period of last dividend, not to exceed the book value thereof shall be first applied to all debts of the insolvent member bank to the Federal reserve bank, and the balance, if any, shall be paid to the receiver of the insolvent bank. Whenever the capital stock of a Federal reserve bank is reduced, either on account of a reduction in capital stock of any member bank or of the liquidation or insolvency of such bank, the board of directors shall cause to be executed a certificate to the Comptroller of the Currency showing such reduction of capital stock and the amount repaid to such bank.

In Section 9 it is provided:

> If at any time * * * a member bank has failed to comply with * * * the regulations of the Federal Reserve Board, it shall be within the power of the said board, after hearing, to require such bank to surrender its stock in the Federal reserve bank; * * * * and said Federal reserve bank shall, upon notice from the Federal Reserve Board, be required to suspend said bank from further privileges of membership, and shall within thirty days of such notice cancel and retire its stock and make payment therefor in the manner herein provided.

It will be observed from the foregoing quotations that the Federal Reserve Act expressly provides that no Federal reserve bank shall commence business with a sub-

scribed capital of less than $4,000,000. (Sec. 2.) They were each to be organized when the minimum amount of capital stockhad been subscribed. (Sec. 4). Only three-sixths of the capital subscribed is required to be paid in, the remainder being left " subject to call when deemed necessary by the Federal Reserve Board. " (Sec. 2.)

The Act specifically provides for the decrease of capital stock (1) as member banks reduce their capital stock; and (2) as they cease to be members. (Sec. 5.)

Member banks may cease to be members for any of four causes - -

(a) Voluntary liquidation (Sec. 5);
(b) Insolvency (Sec. 6);
(c) Violation of regulations of Federal Reserve Board (Sec. 9);
(d) Transfer from one Federal district to another through readjustment of districts (Sec. 2).

The Act specifically requires the cancellation of capital stock where membership ceases under (a), (b) or (c). Secs. 5, 6 and 9 .)

No specific provision is made for cancellation of capital stock where membership ceases under (d).

While the minimum capital had to be subscribed in order to commence business, the maintenance of that minimum is nowhere prescribed by the Act. The fact that the Board is to determine whether more than half the subscription is to be paid in seems to indicate that the minimum to be subscribed was fixed as a precaution to make sure that ample credit should be pledged to insure the success of the system.

Not only is the maintenance of the minimum not prescribed, but express provision is made for reducing the capital stock as, or whenever, member banks "cease to be members." This language is general and includes in its terms all cases in which member banks cease to be members. It is coupled with no expressed condition that the minimum capitalization be preserved; and since the Federal Reserve Act required the orgainzation of the Federal reserve banks upon the subscription of the minimum, it is obvious that any reduction whatever made after commencing business might reduce the capital below the minimum.

It is plain that a member bank can be a member only of the Federal reserve bank of the district in which both are located. This is obvious from the nature of the Federal reserve districts and is assumed in Sections2, 4 and 9. Of necessity, therefore, when the Federal Reserve Board, in the exercise of its power to readjust, transfers a member bank from one district to another, such transferred bank must cease to be a member of the Federal reserve bank of the district from which it is transferred. When it thus ceases to be a member, the capital of the Federal reserve bank may be reduced; and there is nothing in the Act requiring the reduction to be made subject to the maintenance of a minimum capital.

It is to be noted that Section 5 provides that the capital stock shall be increased and may be decreased under the conditions therein mentionad. Succeeding provisions of Sections5, 6 and 9, however, make it clear that may is here used in the sense of shall, as applied to cases aris-

ing under (a), (b) and (c). It seems reasonable to infer that it is used in the same sense as applied to (d). But whether so used or used in its more literal sense is here immaterial, for so far as the answer to the question submitted is concerned, the result is the same whether the Board is <u>required</u> or merely <u>authorized</u> to reduce the capital when member banks cease to be members.

Nor can any significance be attached to the fact that specific provision is made for reducing the capital stock of a Federal reserve bank in cases arising under (a), (b) and (c), while the Act is silent as to cases arising under (d). The cases specifically provided for include cases where the member banks cease to be members as the direct result of their own acts or conduct. Cases under (d) arise where banks cease to be members as an incident of the exercise of the power of the Federal Reserve Board to readjust districts. The grant of the specific power to readjust carries with it, as fully as if expressed in the Act, the power to do what is necessarily incidental. (Broom's Maxims, 7th ed., 505; 199 U. S. 12.)

My conclusion as to the second question submitted is that the Federal Reserve Act, in prescribing a minimum capitalization of $4,000,000 for Federal reserve banks as a condition precedent to commencing business, does not require that such minimum capitalization shall be preserved under the circumstances.

Very respectfully,

T. W. GREGORY.

Attorney General.

The President,
The White House.

4/15/16

FEDERAL RESERVE BOARD

WASHINGTON

-617-

April 15, 1916.

S I R :

About a year ago the Federal Reserve Board forwarded to each Federal Reserve Bank a form of stock certificate with the suggestion that though each bank could properly have its own certificates prepared in any form it desired nevertheless it might be advisable for the various reserve banks to issue uniform stock certificates to their member banks. The whole question was subsequently postponed when the Bureau of Internal Revenue ruled that stock certificates of Federal reserve banks would be subject to the War Revenue stamp tax.

In view of the fact that the Attorney General has since filed an opinion to the effect that Federal reserve bank stock certificates are exempt from the stamp tax, the Board has caused the Bureau of Engraving and Printing to prepare a design of stock certificate, the body of which is substantially similar to that submitted a year ago. Slight changes in wording and arrangement have been made in accordance with various suggestions.

The Bureau of Engraving and Printing has made an estimate of $1,017.50 for the engraving of 24,000 of these certificates bound in book form, of 500 each, with stubs attached. On the basis of an order aggregating 24,000 certificates each Federal Reserve Bank can obtain 2,000 certificates for $84.50. The plate once engraved, future orders will undoubtedly be at even a less figure.

The enclosed copy has been prepared by Counsel after a careful consideration of the various suggestions made to the Board and in substance represents the concensus of views expressed by the several Federal Reserve Banks and members of the Board. Because of the desirability of having all certificates alike it is hoped that you may see fit to adopt this form for your bank though there is, of course, no obligation upon you to do so.

If satisfactory, please advise the Board as soon as possible of the number of certificates desired so that the plate may be engraved at once.

Respectfully,

Assistant Secretary.

M E M O R A N D U M

OF THE GENERAL PRINCIPLES TO BE FOLLOWED IN THE PREPARATION OF A CHECK CLEARING AND COLLECTION PLAN.

Washington, D. C. April 17, 1916.

Introductory

The Federal Reserve Board has no plan and has no wish to suggest to the Governors of the Banks any specific "Plan". It considers that this is a problem for the Executive Officers of the Federal Reserve Banks to work out. However, in working out their plan, the Governors should bear in mind and adhere to the following general propositions:

First:

It is to be noted that by May 16, 1917, a large part of the National bank reserves will have been transferred, and that by November, 1917, the final transfers will have been made. By that date, at the latest, each Federal Reserve Bank must be in readiness to render for its member banks the service of check clearing and collection. This, however, does not mean that any Federal Reserve Bank is expected or required to render this service without charge or for less than cost.

Second:

While the opinion of the Attorney General has not yet been rendered, informal talks with members of his Staff seem to indicate that that office regards the language of Section 16 of the Act, in which the following phrase is used:

"Every Federal Reserve Bank shall receive on deposit at par from member banks or from Federal Reserve Banks, checks and drafts drawn upon any of its depositors, "

as meaning that these checks must be credited upon receipt, at full face value. It does not necessarily follow, however, that Federal Reserve Banks would permit items thus credited to be drawn against until collections had been made, and if they did permit their being drawn against in anticipation of collection, that they would not be fully entitled to charge the cost of collection, interest on the funds advanced, etc.

Third:

It is expected that every Federal Reserve Bank will approach this subject from a purely practical, rather than a theoretical standpoint and will, so far as practicable, adhere strictly to the banking practices which the last fifty years have developed. The Federal Reserve Board has no desire to compel member banks to do their check clearing and collection through the Federal Reserve Banks, but it does expect the Federal Reserve Banks to offer this service to their member banks on substantially as favorable terms as the larger banks of the big cities, heretofore acting as reserve agents for their country bank clients. A system of check clearing which might be perfectly satisfactory in theory, but under which no business could be done, could hardly be considered as a satisfactory solution of the problem.

Fourth:

It follows from the foregoing that the Board does not contemplate the adoption of a plan which shall be mandatory or compulsory upon the member banks of the Federal Reserve System. The Board will, however, require each Federal Reserve Bank to establish, within the near future, for such of its member banks as desire to avail themselves of it, a system of check clearing and collection at least comparable with that in general use in the country; that is shall analyze carefully the cost of its service and charge these members the actual cost of the service rendered.

Washington, D. C.,
March 15, 1916.

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I must apologize for not sooner having answered your letter containing the clipping from the Boston Transcript by Mr. Arthur Stanwood Pier, entitled "Wilson's Muzzle for Americans," and in this tardy reply I shall endeavor to eliminate all personal feelings and devote myself to the national aspects of the matter.

Mr. Pier is evidently deeply offended because the United States will not give up its time honored position of neutrality and intervene in the war now going on between the great powers of Europe. He seems to think that it was the duty of the United States to protest when Belgium was entered by Germany, and that if we were fulfilling our duty we would now be at war with Germany, joining the Allies.

So far as the violation of Belgium neutrality goes, it would be sufficient to say that Germany did not violate the Hague Convention when it entered Belgium, for prior to entry it delivered an ultimatum to Belgium equivalent to a declaration of war. This fulfilled, absolutely, all requirements laid down by the Hague Convention. Germany, however, did violate the treaty of 1839 which Prussia signed with Austria, Russia, England and France, and which provided for the neutralization of Belgium. The United States, however, was not a party to this treaty, and, therefore, it could not, consistent with neutrality, protest against its violation. To have protested would have been equivalent to giving up neutrality and siding with the Allies.

I am aware that Senator Root, in his recent speech in New York, and Ex-President Roosevelt, have both recently contended that the United States should have protested because of the alleged violation of the Hague Convention. In answer to this, however, it is sufficient to point out that Senator Root was in the Senate when Germany entered Belgium, and, so far as I know, never protested or never introduced any resolution of protest, nor did any other member of the Senate or the House. Furthermore, shortly after this entry, Ex-President Roosevelt, in public interviews and in a magazine article, made it perfectly clear that he did not believe that the

United States should protest against this action of Germany. For example, four days after the invasion of Belgium, in a speech in New York, he stated that "we should be thankful beyond measure because we are Americans and not at war." He further urged support of the Administration in securing peace and justice. He said nothing of any duty to Belgium.

Again, at Hartford, Conn., on August 15, 1914, he discussed the Bryan peace treaties, but said nothing about any obligation under the Hague treaties.

Again, seven weeks after the Belgium invasion, he printed, in the Outlook, on September 23, 1914, an elaborate article on the war, with long discussions of this Belgium phase. In this article he states that there is even a possible question whether we are not, ourselves, like other neutral powers, violating obligations which we have explicitly or implicitly assumed in the Hague treaties, but adds that, under actual conditions this Hague guarantee would excite laughter were not the tragedy such as to move us to tears instead.

In another part of the article, however, he deals directly with the question of our duty to intervene because of the German invasion of Belgium. Here is what he says:

> "A deputation of Belgians has arrived in this country to invoke our assistance in the time of their direful need. What action our Government can or will take, I know not.
>
> It has been announced that no action can be taken that will interfere with our entire neutrality. It is certainly eminently desirable that we should remain entirely neutral, and nothing but urgent need would warrant breaking our neutrality and taking sides one way or the other.* * *
>
> Of course, it would be folly to jump into the gulf ourselves to no good purpose, and very probably nothing we could have done would have helped Belgium. We have not the smallest responsibility for what has befallen her, and I am sure that the sympathy of this country for the suffering of the men, women and children of Belgium is very real.
>
> Nevertheless this sympathy is compatible with full acknowledgment of the unwisdom of uttering a single word of official protest unless we are prepared to make that protest effective; and only the clearest and most urgent national duty would ever justify us in deviating from our rule of neutrality and non-interference."

Furthermore, Ex-President Taft, in a speech at Morristown, N. J., publicly expressed his full concurrence in the attitude of President Wilson.

Even, however, if the Hague Convention had been violated, it would have imposed no duty on any nation which had signed the treaty to protest unless its interests were injured by the act. For example, none of the signers of the Hague Convention protested when Austria-Hungary assumed sovereignty over Bosnia and Herzogovina in 1908, nor did any of them protest when Italy siezed Tripoli in 1911. Nor did the British Government protest because of any violation of the Hague Convention of 1907, for it had never ratified it; its protest and action were based upon the violation of the treaty of 1839, to which, as I have said, the United States was not a party. I may add, also, that if the United States was bound to protest at the Belgium invasion, it was equally bound to protest at the invasion of Luxemburg by Germany, for Luxemburg also was neutralized by the treaty of London in 1867, to which Prussia, and the other nations now at war were parties.

I think, on reflection, you will see what a position the President of the United States would have been in if, as the official head of one hundred million people, without any action on the part of Congress, he had protested to Germany. Supposing Germany replied that we were not affected and that, in short, it was none of our business. The President then would have had to back up that protest with force, which he could not do without the authority of Congress, and which we could not possibly do because of our unpreparedness, even if Congress had advocated such a course. Can you not see what a humiliating position this would have placed the United States in?

President Wilson, however, soon after the outbreak of the war, offered his services as a mediator, - the Hague Convention providing that such an offer should not be considered an unfriendly act, - but neither party availed itself of this offer.

Our country has always proceeded on the theory of keeping out of the quarrels of Europe. We have said in the Monroe Doctrine and now say to Europe, you must keep your hands off the New World, and then follows the necessary corollary - we must keep our hands off of Europe unless we are directly injured by the act of some belligerent. This is well brought

out in the declaration attached by the United States Senate to one of the most important Hague Convention treaties. This declaration read as follows:

> "Nothing contained in this convention shall be so construed as to require the United States of America to depart from its traditional policy of not intruding upon, interfering with or entangling itself in the political questions of policy of any foreign State; nor shall anything contained in the said convention be construed to imply a relinquishment by the United States of its traditional attitude toward purely American questions."

This would seem to be a clear and explicit statement of the policy of the United States. It has bound us in the past and I trust it will always be our rule of action in the future.

If by protesting we were drawn into the war on the side of the Allies, against Germany, it would not only violate the established policy of the United States, but it would lay the foundation for a repudiation by foreign nations of the Monroe Doctrine.

A nation can observe neutrality only when its Government treats all belligerents alike. That has been President Wilson's endeavor throughout, and that attitude naturally prevented the Government of the United States, as it has prevented that of Spain, Switzerland, Holland, Denmark, Norway, Sweden, and the Latin-American Republics, from making any official protest or interfering in any way in this unfortunate war.

Whenever Germany has injured the United States, or its people, by a violation of International Law, President Wilson has been quick to demand redress. How far he has been helped by Congress in this attitude you can gather from recent events in that body. In any event, I think you will agree with me that the President has no right, by any official act, to put the United States in any other position than that of a strict neutral, without the direct authority of Congress, in which body is vested the right to declare war, and a violation of neutrality under these circumstances would be equivalent to a declaration of war.

Mr. Pier also claims, in his article, that President Wilson should have protested against the atrocities in Belgium. It would seem, however, to be clear that no President, or country, should ever protest

against actions in any foreign country without first making an independent investigation for itself by sending a commission, or otherwise; for however clear the atrocities may seem, it should never be forgotten that evidence should be taken on both sides of the controversy before any action is taken. For example, President Cleveland notified the British Government that its acts in Venezuela were in violation of the Monroe Doctrine, but he was careful to state that he should appoint an independent commission to investigate the whole matter and report, and that then he should sustain the report of said commission with all the authority of the United States.

There seems to be a feeling that President Wilson has, by failing to protest against the atrocities in Belgium, in some way changed the traditional policy of the United States. It would seem to be a sufficient answer to this to point out that between 1901 and 1909 when Mr. Roosevelt was President, and, during the greater part of which time, Mr. Root was in the cabinet, there occurred various atrocities abroad. For example, in 1903 occurred the terrible massacre at Kishineff. At the same time Macedonia was running red with blood; in 1905 the horrors of the Congo were revealed.

In the same year Korea was absorbed by Japan, although the United States had entered into a treaty with Korea promising to use its best efforts in case Korea was unjustly treated by any power. Ex-President Roosevelt, in the Outlook for September 23, 1914, among other things, writes the following with regard to Korea:

> "Korea is absolutely Japan's. To be sure, by treaty it was solemnly covenanted that Korea should remain independent. But Korea was itself helpless to enforce the treaty, and it was out of the question to suppose that any other nation with no interest of its own at stake would attempt to do for the Koreans what they were utterly unable to do for themselves. Moreover, the treaty rested on the false assumption that Korea could govern herself well. It had already been shown that she could not in any real sense govern herself at all. Japan could not afford to see Korea in the hands of a great foreign power. She regarded her duty to her children and her children's children as overriding her treaty obligations. Therefore, when Japan thought the right time had come, it calmly tore up the treaty and took Korea, with the polite and businesslike efficiency it had already shown in dealing with Russia, and was afterwards to show in dealing with Germany. The treaty,

when tested, proved as utterly worthless as our own recent all-inclusive arbitration treaties - and worthlessness can go no further."

In 1906 Morocco was parceled out, and in the same year occurred the terrible Russian massacre. In 1909 we had the Armenian horrors.

All of these terrible events occurred during Republican Administrations, yet, to my knowledge, no official protest was ever made, either by the President or by Congress.

May I also point out to those claiming that the unwarranted death of a single American demands an immediate declaration of war, that President Grant, in the Virginius case, accepted an indemnity from Spain for the brutal murder, without trial, of a large number of Americans in Cuba.

Mr. Pier, in his article, makes the surprising statement that chivalrous feeling caused the United States to take sides with the Cuban revolutionists. Even a limited knowledge of history would be sufficient to satisfy anyone that the United States interfered in Cuba primarily for the reason that its own interests were deeply affected by the terrible conditions in that island. Cuba is within the sphere of influence of the United States, and, furthermore, our citizens were deeply affected by the incidents there.

In this connection let me say that I have recently read a pamphlet prepared by Dr. Morton Prince, who severely criticises President Wilson for not protesting against the German entry into Belgium, and citing the fact that President Monroe, in a message in 1821, expressed the hope that the Greeks, who were then struggling with the Turks for independence, might be successful. Dr. Prince also cites the fact that Daniel Webster, at that time in the House of Representatives, made a strong speech in behalf of Greek independence.

It is a fact that President Monroe, in one of his annual messages, expressed the personal hope that the Greeks would succeed, but no resolution was passed in Congress or the slightest assistance given to the Greeks in their valient fight. It is true that Daniel Webster introduced a resolution providing for sending a commission to Greece to

investigate conditions, and that he, in a strong speech upon this resolution, expressed the deepest sympathy with the Greeks. It is a fact, however, that Mr. Webster never asked for a vote on this resolution; on the contrary, he expressly asked that it be laid on the table. He introduced it merely as a basis for a speech, and, as a fact, as I have stated, no expression of sympathy or aid to Greece was given by Congress.

Mr. Webster's feeling as to the duty of the United States to maintain neutrality can be well illustrated in another case; that of the Hungarian rebellion in 1850. You will remember that Kossuth had fled to Turkey, and that he was brought to America on a United States warship. He was received everywhere with acclamation, and every attention was paid to him personally, but Congress passed no resolution of sympathy, nor did it aid him in the slightest degree in his efforts. On the contrary, the President told Kossuth that he could do nothing for him. Webster and Clay told him the same, which made him deeply indignant.

Mr. Webster, in writing about this, said to a friend that if Kossuth should speak to him of the policy of intervention "I shall have ears more deaf than adders".

In conclusion, let me say that, so far as I can find, our Government has never protested at the conduct of nations abroad engaged in war when that conduct did not directly injure us. Our policy has been that of neutrality. We demand that foreign nations shall keep their hands off of our continent, and, as I have said, the necessary corollary of this is that we must keep out of interference with their affairs. This has been the policy laid down by Washington, Jefferson, Adams, Monroe, and by every other President of the United States, including President Wilson, and I must express the firm conviction that it will prove an unhappy day for the United States if ever we shall reverse that policy.

Very sincerely yours,

THE BANKER AND THE PUBLIC

Address of MILTON C. ELLIOTT
To be delivered at meeting of Texas Bankers Association
at Houston, Texas - May the 2d.

-oOo-

MR. PRESIDENT AND MEMBERS OF THE TEXAS BANKERS ASSOCIATION:

One of the incidental benefits that may be said to have resulted from the passage of the Federal Reserve Act is that it has awakened both the banker and the public to a realization of the true relations that exist between them. The banker in studying the whys and wherefores of this legislation has necessarily viewed the subject of banking from a broader and more comprehensive standpoint and has appreciated more fully than ever the public responsibility that he assumes when he undertakes the management of a bank. The public has been awakened to a realization of the vitally important part that banking plays in the commercial life of the nation.

In recent years there has been a tendency to look upon banks as purely private corporations organized for individual profit, and under what we have called our banking system the right to start a bank has been regarded as an inherent right of every citizen. To challenge the right of any set of men to charter a bank if they can provide or procure the necessary capital would probably be regarded as unreasonable as to challenge the right of the same individuals to charter a corporation to manufacture shoes.

When we turn back the pages of history, however, we find that in their inception the incorporation of banking institutions

was looked upon with fear and suspicion. The States were reluctant to grant charters and those that were granted contained exacting restrictions. The right of the Federal Government to incorporate a bank was the subject of litigation and bitter controversy for a number of years.

The great State of Texas, as you will no doubt recall, came into the Union with a provision in its Constitution -

> "That no corporate body shall hereafter be created, renewed, or extended with banking or discounting privileges * * * . The legislature shall prohibit by law individuals from issuing bills, checks, promissory notes, or other paper to circulate as money."

As you know, it was not until 1903 that the legislature of Texas provided for the submission to popular vote of an amendment to the Constitution authorizing the incorporation of banks. This amendment was adopted in November, 1904, and in 1905 a general banking law was enacted under which banks might be incorporated. It seems that as late as 1852 there were no banks in Florida, Texas, Arkansas, Illinois, Wisconsin, Iowa, Minnesota, Oregon, California, and the District of Columbia.

One conception of banking advocated in the early days appears to have been that it should be conducted solely for the benefit of the public; that the profits from this business, like the revenue derived from taxation or from the collection of duties on imports, should be paid into the public treasury for the benefit of the people.

In the History of Banking in the United States by the late professor Sumner of Yale, he says, in speaking of the early banking

institutions -

> "We observe that a bank was conceived of primarily as a means of creating wealth. Every one wanted to share in its beneficent operation. If the legislature created it, all the people ought to participate in its blessings."

Later in discussing the debates in Congress on the subject of renewal of the charter of the first Bank of the United States which expired in 1811, he says that -

> "Nicholas of Virginia moved that 'provision be made by law for a general national establishment of banks throughout the United States, and that the profits arising from the same, together with such surpluses of revenue as may accrue, be appropriated for the general welfare, in the construction of public roads and canals, and the establishment of seminaries for education throughout the United States'."

When we contrast the attitude of the public in these early days with that of the present time, it is obvious that the pendulum has swung to the other extreme, and that the private interest of the stockholder or owner often overshadows the public responsibility that is involved in the management of a bank.

While the incorporators may take into consideration the needs of a community before undertaking to open a new bank, this is frequently a matter of business judgment from the standpoint of the prospective owner or stockholder. The State or Federal authorities may likewise make an investigation of the local banking facilities before granting a charter to a new bank, but here again the question to be determined is primarily whether the community can support another bank. When the charter has been obtained and a bank is opened for business other considerations than that of the service

to be rendered to the public are at times regarded as of first importance.

Competition with other banking associations naturally becomes an important factor. While this competition is no doubt desirable in so far as it encourages the officers and directors to build up and strengthen a bank, it becomes a dangerous element when these officers and directors lose sight of their public responsibility and view the success or failure of the bank solely from the standpoint of the amount of dividends that may be earned, or when they fall into the popular falacy of judging the strength of a bank solely from its size as indicated by its balance sheet. It is, of course, true that a bank's earnings and the volume of its resources are both important elements in determining its success, whether we view the subject from the standpoint of the public or from that of the shareholder. It is, however, the source of its earnings in which the public is interested and the causes of the increase of its deposits. A bank may increase its earnings by speculative investments or by charging excessive rates of interest on doubtful risks. It may purchase deposits by paying a greater rate of interest than its business justifies. It may exceed its corporate powers but by the transaction may net a profit. In any of these cases its statement of condition may indicate success if we are to judge by the apparent results obtained. It is obvious, however, that a bank with good luck may increase both its earnings and its resources but may be operated without consideration of its public responsibility.

It is true that such instances are rare and yet we not infrequently hear bankers say that the administrative officers of the Government should limit their inquiries to the financial condition of the bank, and if it is solvent and its capital is unimpaired, it constitutes an illegal assumption of authority for an administrative officer to inquire into those operations which brought about improvement in its financial condition. When we analyze the business of banking, however, is it not true that the public has a very vital interest in each and every operation? And is not the assumption that banks are purely private corporations organized for the individual profit of the shareholder just as extreme a view as the early conception that the profits arising from this business should be paid into the public treasury? And is it not true that all administrative officers must take into consideration the public responsibility of banks and bankers when they are called upon to make rulings as to the operations of the banks?

I, of course, do not mean to suggest that bankers, as a general rule, look upon their institutions as organized solely for the profit of the shareholders. On the contrary, there is an increasing tendency on the part of the officers and directors of banks to consider general and not merely local conditions in the conduct of the banking business. Bankers are brought into such close and intimate contact with all commercial and industrial activities they are naturally alive to the interest of their communities. They must constantly study general conditions in

order to anticipate the needs of the public. There are perhaps no set of men who have occasion to consider and do consider the public welfare as extensively as the officers and directors of our banking institutions. The public, however, has an interest in each individual operation of a bank as well as in the net result of these operations, and it is this fact that is sometimes lost sight of.

The comparatively few adverse criticisms of the Federal Reserve Act appear to be based primarily upon objections which indicate that those indulging in criticism have considered the private and not the public character of the banking business. For example, among the important provisions of the Act are those which relate to the collection and clearance of checks, and which authorize Federal reserve banks and the Federal Reserve Board to perform the functions of clearing houses. There is perhaps no operation of the banking business which better illustrates the public responsibilities assumed than that which the banker undertakes when he performs the service of collecting checks and other items payable elsewhere than at the counters of the bank.

Viewing the matter from the standpoint of public service it would seem that if the efficiency of this service can be increased by the adoption of a more direct and scientific method of handling these items, such a method should be welcomed, by the banker; and yet it appears that one of the principle objections urged against the system provided by the Federal Reserve Act is that the bankers are afraid the operations of this system will curtail their earnings from collection and exchange charges. Assuming this to be true,

is not the objection based upon the assumption that the shareholders are entitled to receive these charges for the service performed, whether or not this service can be rendered by more direct methods on a basis which would benefit the public ? Is it not true that this objection is based upon the fact, that a clear conflict results between the interest of the shareholder and the interest of the general public.

It is not my purpose to undertake to discuss in detail the intricate operations that are involved in our present system of check collections and clearances, but as bearing upon the question of the bank's responsibility in these matters and of its duty to the public there are certain elementary principles involved, a discussion of which may serve to illustrate the necessity for the perfection of a more scientific system. Various experts are at work on plans designed to precipitate what they call the "float"; that is to say, to reduce the number and volume of items that are constantly in transit. These experts may not be agreed as to the details of operation which will best accomplish this purpose, but they apparently are agreed as to the necessity for improving this service by the adoption of more scientific methods. They are also more or less agreed that any system must have the cooperation of the banker in order to reach its greatest efficiency, and from the layman's standpoint it seems obvious that defects which are known to exist should be corrected, and that the correction of such defects should be brought about by the cooperation of the bankers rather than by corrective legislation.

In discussing the principles involved, my excuse for referring to certain elementary factors before an audience of this kind is that all banking operations are so closely inter-related it is difficult to discuss any one operation without considering the fundamental though well-known principles that are involved in that particular operation.

Under the Act of March 14, 1900, which amended Section 5211 Revised Statutes of the United States the gold dollar is established as the standard unit of value and all forms of money issued or coined by the United States must be maintained at a parity of value with this standard. The silver dollar, fractional and minor coins are made legal tender by statute within certain limitations and certain notes of the United States are likewise made legal tender. The volume of this form of currency or money, however, is, of course, inadequate to carry on the enormous commercial business of the United States, and bank credit as a medium of exchange takes the place of money in a very large proportion of our commercial business.

As the test writers express it -

> "A bank has been aptly defined as a manufactory of credit and a machine for facilitating exchanges. It manufactures credit by accepting the business prospects of its customers as security in exchange for its own bank credit in the form of a deposit account. Business credit cannot be conveniently used for current business transactions, but bank credit in the form of checks and drafts is widely acceptable and is the actual medium of exchange for a large part of the community."

While a great many obligations are discharged by the use of checks and by an exchange of credits this is due to the fact that the public voluntarily and not by reason of any legal requirement

accepts these checks, and through an exchange of credits many obligations are canceled without the actual use of money. The public is willing to utilize bank credit in this way, because it furnishes a convenient method of handling commercial transactions and because it has confidence in the ability of the banks to pay these checks in legal tender whenever they are called upon to do so.

It would seem to follow that any system of check clearances and check collections which strengthens the ability of the banks to respond to a larger percentage of demands for legal tender results in a benefit to the bank by adding to the practical value of this medium of exchange.

Under our present system the 25,000 or more banks in the United States act more or less independently; each bank selects its own correspondents and makes its collections primarily through these correspondents. For example a customer in Dallas presents a check for $1,000 drawn on a San Francisco bank. The Dallas bank, not having a correspondent in San Francisco, indorses and forwards this check to its correspondent in New York. The New York bank credits Dallas and forwards the check to Chicago. The Chicago bank, in turn, forwards it to Denver and the Denver bank to San Francisco. Until this check is actually paid in San Francisco the Dallas bank remains liable upon it as indorser. It is true that it has obtained a credit in New York, but if the check is returned this credit will be canceled. In the meantime, it has paid out

funds representing the face value of the check to the payee, and if it is returned unpaid, the bank must look to the payee or drawer for indemnity.

When we multiply this transaction by the number of items received by the 25,000 or more banks in the United States, and when we consider that each bank receiving an item for collection is likely to select one of its correspondents through which to send it, it is manifest that bank collections are not made through defined channels and that the time consumed in making a collection varies according to the route by which the several items happen to be sent. As a consequence, a very large number of items representing a very large volume of money are constantly in transit. In the meantime the bank which receives these items on deposit and forwards them for collection is under obligation to pay the amount they represent in legal tender if it is called upon to do so. If, by a more scientific handling of these collections, the amount in transit can be reduced and the time consumed in collection can be cut down, the banks to this extent are given a greater ability to respond to the demands that are made and this increased ability is a matter of interest to the public.

While the check performs a vitally important function in our commercial development and while it is estimated by some authorities that approximately 90% of our commercial transactions are carried on by its use, we must not overlook the fact, that this use is made possible by the voluntary act of the public and not by statute.

I do not mean to question the soundness of the practice. The experience of nearly all nations has demonstrated the fact that real commercial development is made possible only through the scientific use and exchange of credits. Some economists go so far as to claim that if a proper system of credit exchange can be worked out there is no need for a metallic currency. Whether this view is extreme or not every factor which contributes to the ability of the bank which is used as a medium of exchange, to respond immediately to demands made upon it, strengthens the system and makes more valuable the credit used.

Bank clearances may be said to constitute the most direct method of exchange of credits as between banks. It is through this method that reciprocal balances are offset or canceled. Heretofore clearing house operations have been confined to the larger cities. If the banks in one city find that time can be saved by meeting at one place and exchanging reciprocal items rather than by having each bank send out by runner the checks drawn against every other bank in that city, is it not reasonable to assume that the same result may be obtained as between banks in the same general locality? And is not the plan provided for in the Federal Reserve Act merely the application of a plan which has been tried and used successfully in the larger cities? There can be no doubt of the fact that, as we increase the number of banks that clear through any clearing house, we will decrease the number of items that are in transit and will reduce the time consumed in making the exchange of credits.

When Congressman Glass, chairman of the Banking and Currency Committee, made his report to the House, he voiced the hopes of the framers of the Federal Reserve Act when he said, in speaking of bank clearances and collections -

> "The provision as it stands will result in an immense saving to the trades people of the United States. It will eliminate the amazing wastefulness incident to the many independent collection organizations by substituting one compact collection system."

It cannot be denied that the Act provides for a more scientific handling of this important function of the banking business. By clearing the various items received for collection through the agency of the twelve Federal reserve banks, the element of time will be materially reduced. For example, an item on San Francisco will not have to go through four or five intermediary banks, but may go direct from the Federal Reserve Bank of Dallas to the Federal Reserve Bank of San Francisco, and through an adjustment of accounts in Washington the transaction will be completed in a very much shorter time than is possible through the many independent collection organizations now in use.

The advantages of one compact system are obvious. The objections that are raised are founded primarily on local interests. A bank may prefer to send an item for collection to its reserve correspondent, since it shows immediately a credit with its correspondent, and not only counts this as part of the reserve which it is required by law to maintain but in many instances receives interest on this deposit. In counting as reserve an item which

is drawn against some other bank than its reserve agent, it is treating a conditional credit as funds actually deposited with its reserve agent.

In other words, let us suppose that a Dallas bank sends a check on San Francisco to its New York correspondent, which is its reserve agent and receives credit on the books of its reserve agent. If the check is returned unpaid, it is charged back to the account of the Dallas bank, and until actually collected the Dallas bank remains liable on this check. It does not show this liability on its books, but takes credit for the amount of the check. This is one of the legal inconsistencies of this practice. When the Dallas bank receives this check and gives credit to the depositor it has a claim only against the drawer and indorsers of this check. The San Francisco bank, not having certified the check, has assumed no liability.

If, instead of receiving a check from its depositor, it accepted his promissory note and indorsed and rediscounted this note with its reserve agent, while it might show the credit thus established as part of its reserve, it would show on the other side of its ledger a liability to its reserve agent for money borrowed in addition to the liability shown on the individual ledger to the depositor.

The practice, therefore, of building up reserves by conditional credits presents an anomalous situation, and if banks should be required to discontinue this practice and should not be permitted to count collection items as reserve, until they have been actually collected, they would manifestly take into consideration the

element of time and would undertake to reduce this to a minimum by the adoption of any scientific method of clearances.

It is, of course, realized that a change of this sort must be brought about gradually and the Federal Reserve Act provides a medium by which this can be done without disturbance to existing conditions. It would seem to be to the interest of the banks to adjust their operations so as to accomplish this purpose.

In the same manner it is to their interest to bring about by thorough cooperation the perfection in every detail of a scientific system of banking.

This is of especial importance at this time in view of the general disturbance of international trade conditions that results from the great European war.

No bank could be expected to liquidate its own assets in time to discharge any large proportion of its obligations in case of unusual demands if it had to rely solely upon its own debtors. The very nature of the banking business makes this impossible. The larger proportion of its loans and investments are made for fixed periods of time, while the larger proportion of its obligations are payable on demand. When these demands are in excess of normal and when the bank is under the necessity of converting its loans or investments into cash in order to meet these demands, it must rely primarily on other banking institutions.

When unusual demands are made upon a great number of banks, it necessarily becomes more difficult for the banks to convert their

investments into cash.

The panic of 1907 is still sufficiently fresh in the memory of the banker for this situation to be fully understood and appreciated. The experience of that year demonstrated the fact that when the strain becomes general liquidation of assets becomes correspondingly difficult. You will recall that at that time the banks were forced to resort to various expedients in order to meet the demands made upon them. United States bonds were borrowed in order to increase circulation. In many localities banks found it necessary to refuse to pay out money except in small amounts. Clearing house certificates were used as a temporary substitute. Banks which had money on deposit with their reserve agents found it difficult to obtain this money for their needs since their reserve agents were likewise in need of additional funds. Banks in reserve cities which had been competing for country bank accounts began to question the advisability of soliciting and paying interest on those deposits.

The Federal Reserve Act provides a scientific remedy for the difficulties that were experienced during that year. One of its purposes is to make the reserve carried with a Federal reserve bank actual reserve which will be available when needed and not merely reserve in name. By a concentration of a part of the cash resources in the twelve Federal reserve banks funds are made available for use wherever they are needed. If the demands of one section are greater than the demands of another, the Federal reserve bank may obtain rediscounts with other Federal reserve banks, and

may thus acquire the benefit of the surplus funds in other districts. In addition to making the money in circulation available wherever it is needed provision is made for an increase of circulation by the issuance of the Federal reserve notes.

The machinery has, therefore, been provided for a compact and scientific system of banking which gives additional strength to every member bank. The critics of the system do not deny that it is scientific and sound, but complain that it is composed of only 7,500 out of 25,000 or more banks; that it does not represent the full force of our banking power. The advantages of the System, however, are fortunately open to the State banks and trust companies as well as to national banks, and it is possible for the State institutions to share in its benefits.

Bankers and economists are not agreed as to the effect that the European war is destined to have on the commercial business of this country. There are those who feel that during the readjustment of commercial interests following the close of the war this country must look for a reaction and can not expect an indefinite continuance of the present prosperous conditions; that the markets of the belligerent nations will be reopened, and that competition for the world's trade will make it difficult for this country to market to advantage its great resources; that securities held by citizens of other countries will be sold and will have to be absorbed by our markets; that following a period of commercial prosperity it will be difficult for those who have shared in and enjoyed this prosperity to readjust them-

selves to new conditions; that plants and factories which are now making munitions of war and which are supplying the belligerent nations with necessities will have their output reduced and will have to find other field for their activities.

There are others who are inclined to the view that there will be no substantial reaction until sometime after the close of the war; that competitive markets will have to be reorganized; and that during the period of readjustment of the commercial affairs of those unfortunate nations which are now engaged in this great conflict, there will continue to be a great demand for our products; that many of our factories and institutions which are furnishing supplies to the belligerent nations are already operating on profits earned and are accumulating a surplus which will enable them to convert these factories to other uses.

The economists, however, are agreed that sooner or later we must face commercial conditions which are unprecedented in the history of the world; that, as one of the great commercial nations of the world, we must bear our proportionate part of whatever strain there may be. It can hardly be denied that any situation that may arise can best be met by a compact, effective banking system better than by an unorganized system of unrelated banks. The enormous banking power of the nation should be used to advantage.

I do not mean to question the strength of our banking institutions. It is manifest that our banks are stronger today than at any time in the history of the nation, and that we have the resources and the potential power to insure continued prosperity is

no doubt true, but the responsibility is very largely with the bankers to determine the degree of that prosperity. By cooperation and proper organization and by a scientific use of these resources a greater degree of prosperity will follow than will be possible if the individual interest of the banker is to overshadow his public responsibility.

Those who believe in preparedness might well apply the principles involved to our banking situation. Whatever potential powers the banks may have acting independently, their efficiency will be increased by systematic organization. It is encouraging to note that the State authorities are acting in harmony; that the State laws are being remodeled along scientific lines; that the legislatures of most of the States have taken the necessary action to make it possible to perfect our banking system, and we have every reason to believe that we will ultimately have a banking system that will make it possible to utilize the banking resources of this country to far greater advantage than is possible at present. We have reason to hope and believe that whatever the outcome of this world struggle this country will be enabled not merely to insure its own prosperity, but to lend the assistance that its size and importance demands in the readjustment of the world's trade and the rehabilitation of the world's prosperity.

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THE BANKER AND THE LAW.

Address of MILTON C. ELLIOTT to be delivered at meeting of Alabama Bankers' Association - held at Pensacola, Florida, on April 29, 1916.

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Mr. President and members of the Alabama Bankers' Association:

The Federal Reserve System has been in operation for a period of about eighteen months. The Act which created this System has been in force since December 23, 1913. It is natural that legislation of this importance should be the subject of both favorable and adverse criticism.

From these criticisms we are enabled to determine to some extent the attitude of the banker as well as that of the public.

From its operation during a period of abnormal prosperity it is difficult if not impossible to judge of the efficiency of any banking system. It is in times of stress rather than in times of prosperity that the real test must come.

An analysis of the adverse criticisms of the Act, however, will at least indicate what are supposed to be the defects in this legislation which must be corrected or which must be proven not to exist by experience or by a better understanding of the principles involved.

On the one hand it is claimed by a very large majority of those who have followed closely the operation of the System during its first year that it has inspired confidence; that it is developing sounder and more scientific banking practices and that in principle it is the most important constructive legislation that has ever been enacted by Congress.

On the other hand, there are those who say that it is a banker's law passed in the interest of the banker; that it may increase the lending power and the earning capacity of the banks, but that it does not make it easier for the borrower to obtain loans; that interest rates are still as high as ever, and that the farmer, the merchant, and the general public have not been benefited.

There are officers of member banks who claim that the Act imposes unnecessary restrictions and hardships on the banking business; that the transfer of reserve balances to the Federal reserve banks deprives them of earnings they have heretofore enjoyed; and that, while their lending power may be increased, other features of the Act offset any advantage that might be derived from this source.

There are officers of non-member banks who are inherently opposed to the System on general principles and others who are pursuing a policy of watchful waiting and who desire a practical demonstration in dollars and cents of the advantages to be derived from membership before becoming stockholders in any Federal reserve bank.

There are still others who, while admitting that confidence has been inspired and possible panics have been avoided) claim that the same results might have been attained by other less complicated methods.

One of the prominent New York publications recently contained an article claiming that the Aldrich-Vreeland Act providing for emergency currency would have accomplished all of the benefits that have been accomplished by the Federal Reserve Act.

The Wall Street Journal in a recent issue published an

article in which the following statement appears:

"The head of one of the largest banks in the country privately declared when the Federal Reserve Act was going through:

> 'We are not much concerned; we are gradually slipping our bonds; the state laws are being remodeled upon safe, conservative lines, and my own impression is that it is only a question of time when the national banking system is a thing of the past and the Federal Reserve System will be on the hands of the Government and not on the hands of the banks. We can get along without any national banking system in the United States if we only have strong central reserve banks under state laws.' "

I do not mean to suggest that bankers generally have made objections of this sort or that these criticisms represent the views of the majority. On the contrary the Federal Reserve Board and the officers of the several Federal reserve banks have had the cooperation and assistance of the bankers in placing the System in operation, and one of the most significant indications that the principles of the Act are both sound and scientific is the absence of any general complaint on the part of those who are most familiar with banking from a practical standpoint.

The criticisms which have been made may be said to represent four viewpoints:

(1) That of the borrower who assumes that to increase the bank's lending power correspondingly decreases the difficulty of obtaining loans. This is, of course, true in the sense that an increase of lending power makes available additional funds for conservative investment. It was not intended, however, to make it easier to borrow

money without the same security or financial responsibility that was required before the Act. The bank is naturally as anxious to lend as the borrower is to obtain loans where the security or financial responsibility offered is adequate. Interest rates, as a matter of fact, have been appreciably lowered in most sections during the past year. Whether this is due to the operations of the Federal reserve system or in part at least to an unusual period of prosperity, this criticism does not appear to have been justified. In any event a charge of this kind can not be properly considered without the facts upon which it is based.

(2) Another viewpoint to be considered is that of the officer of a member bank who feels that his bank is placed at a disadvantage in competition with non-member banks because of the requirements of the Act. To consider this and other like objections it is necessary to analyze some of the purposes and to consider some of the effects of the Act.

(3) The third viewpoint may be said to be that of those who are inherently opposed to any Federal banking laws and who feel that the States should have exclusive jurisdiction over and control of the banking business. This opposition has been mainfested from time to time ever since the adoption of the Federal constitution. A brief review of State and Federal legislation will best illustrate the difficulties involved in establishing a compact banking system where the banks composing the system conduct their operation under the laws of forty-eight States. These difficulties are manifest since a State has jurisdiction over transactions carried on within its

borders, while each bank is required as an incident of its business to engage in transactions outside of the borders of the State in which it is domiciled.

(4) The fourth viewpoint may be said to be that of the banker who recognizes the fact that the business of the country can be conducted to a greater advantage under a scientific banking system than it can be by several thousand unrelated banks, but who desires to be assured by a practical demonstration that the Federal Reserve System is scientific and will accomplish its desired purposes before he becomes a member of the System.

Before undertaking to discuss the merits or demerits of the Federal Reserve Act, it seems appropriate to consider the attitude of the banker towards banking legislation generally.

In addition to the Federal Reserve Act which was enacted by Congress, the various State legislatures in recent years have probably enacted more general banking laws than at any time during the previous history of this country. The trend of nearly all of this legislation has been to more clearly define and to provide for the regulation and supervision of the banking business.

Has this legislation been enacted at the instance of the banker in order to safeguard and promote the banking business or has it been passed as a result of a popular demand for greater protection to depositors and customers of the banks?

When we consider the fact, that there has been no popular outcry against abuses of banking powers; that there has been no concerted effort on the part of the public to correct supposed banking evils, is it not a significant fact, that the trend of

State as well as Federal legislation has been to provide for a more effective supervision and regulation of the banking business? May we not infer from this fact that the banker feels that his interest as well as that of the public will be best served by the enforcement of laws which will require all banks to conduct their operations along conservative lines?

It is unquestionably true that the officers of a bank rarely complain because of a too rigid examination of the affairs of the bank, but are much more apt to criticise a cursory and incomplete examination by a bank examiner. It was my experience as an examiner that the officers of banks were uniformly anxious to learn whether by inadvertence any provision of law had been violated, and to adjust their affairs so as to conform to all requirements of the National Bank Act.

The success with which the great banking business of this country has been conducted under an admittedly defective system is a sufficient proof of the conservatism and integrity of the banker. It is probably because he is lawabiding that he wants to digest any new or proposed legislation and to fully understand its purposes and probable effects. This being true, is it not reasonable to infer that recent legislation providing for a more careful supervision and regulation of the banking business is attributable to the fact that such legislation strengthens the banks and promotes the development of the banking business along legitimate lines? Conceding this, it is necessary to consider what necessity exists

for legislation of the character which has been enacted by the States as well as by the Federal Government in recent years. This necessity can be best understood by reviewing briefly the history of legislation on the subject of banking in the United States.

For many years banks were chartered by special acts of the legislature. It was not until 1838 that the free banking system was adopted by some of the States. In defining the corporate powers of the earlier State banks, various restrictions were imposed upon their operations. These restrictions related primarily to the amount of indebtedness that might be contracted and to the character of investments to be made. Some of these restrictions were the outgrowth of the prejudice that existed against banking during the early period of our national history and furnish an interesting illustration of the extreme to which the legislature may go.

The historians tell us that after the revolution the banking business was looked upon with fear and suspicion. The granting of a bank charter was almost invariably made a political issue which engendered the most bitter controversies. The first incorporated bank in the United States was chartered by the Continental Congress in 1781, and the validity of its charter was immediately brought into question. It was contended that the Federal Government was without any power to incorporate a bank, and in view of the doubt created a charter was obtained from the State of Pennsylvania in 1782. This bank which was known as the Bank of North America continued as a State bank until 1864 when it entered the national system.

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In 1791 the Bank of the United States was incorporated by Congress. The right of Congress to create this bank was questioned and its establishment was bitterly opposed. It was finally granted a charter for a period of twenty years. Upon its expiration Congress after a bitter fight refused to renew its charter.

In spite of repeated efforts on the part of those who were in favor of the establishment of another Bank of the United States it was not until 1816 that a charter was secured for the Second Bank of the United States. This bank which obtained a State charter before its Federal charter expired was finally forced out of existence by political influences. During this period it was almost equally difficult to obtain a State charter and those charters which were granted contained many of the same restrictions that are now embodied in the National Bank Act and in the laws of the several States.

In the "History of Banking of All Nations", by the late professor Sumner of Yale, published by the Journal of Commerce and the Commercial Bulletin in 1896, certain striking illustrations of the attitude of the public to banking are referred to.

It is said that in 1803 two bank acts in Vermont were vetoed on the ground " that banks demoralize the people by gambling and concentrate the wealth in the hands of the few and are useless to the many since they give credit only to the rich. "

In speaking of the Bank of Alexandria, Virginia, it is said that, "It required all the eloquence of Brandt of Virginia to persuade the legislature that the little Bank of Alexandria would not

sweep away their liberties."

It is said that in Massachusetts in 1799, "a law was passed making it unlawful to join any association to do banking of any kind unless authorized by law, the penalty being $1,000."

As illustrating some of the restrictions imposed upon the banking business it is of interest that in 1874, the legislature of Rhode Island passed a law, "fining any officer of a bank $50 for every check, note, or bill signed by him for less than $50 payable at any place out of the State. A fine of $5 was also imposed on any person who should pass a note for less than $5 issued by a bank out of the State."

Among the early regulations which were adopted either in the constitution of the banks or in the Acts of incorporation it is said that in the case of the Bank of Massachusetts, chartered February 7, 1784, "amongst the rules of this bank were the full names of all delinquents to be posted in the bank in order to avoid useless applications for credit; absolutely no renewals."

In a New York bank incorporated about the same time the constitution of which was supposed to have been written by Alexander Hamilton, the following rule was said to have been adopted: "No discount will be made for longer than thirty days, nor will any note or bill be discounted to pay a former one. Payments must be made in bank notes or specie."

Another interesting rule referred to which is in striking contrast with the publicity required in our banking business at

this time was that of a bank in Hartford, which was that, "what passes in the bank not to be spoke on at any other place."

In addition to these somewhat extreme and unusual regulations many of the early charters contained prohibitions against making loans or dealing in real estate, they limited the amount of money that might be borrowed by a bank and stipulated certain investments which could not be made. Nearly all required the maintenance of a proper reserve against deposits and against circulation.

A distinction was made between liabilities for deposits and liabilities incurred in other ways. It is claimed that this was due to the fact that deposits were created at that time by the delivery of actual funds to the bank and were not multiplied as they are today by the use of promissory notes, drafts, and bills of exchange. This distinction, however, has been continuously observed in the act regulating the banking business and is still recognized.

It was probably because of the political favoritism shown in granting bank charters and of the bitterness that developed whenever an attempt was made to procure such a charter that the free banking system was adopted by many of the States. Under this system banks were chartered under general banking laws adopted by the States. As a development of this practice banks were chartered in many States which had adopted no banking laws, under the general laws applicable to corporations. The charters granted under general laws lacked uniformity, were very broad in their scope, and in most instances were free from restrictions. It is only in comparatively recent years that the majority of the States have adopted laws regulating

the business engaged in by the banks, and it was not until 1863 that the Federal Government attempted to create a banking system by the passage of what is known as the National Bank Act. When we consider the restrictions placed on the operations of the earlier banks and compare these with the regulations now in force it is apparent that the tendency during the last fifty years has been to liberalize the banking business, and that only those restrictions which have been considered necessary to safeguard the interests of the depositor and customer of the bank have been retained. This is illustrated by the fact that in the fifty odd amendments to the National Bank Act nearly all have been along lines which increase the lending power of national banks.

For example, these banks were originally prohibited from lending an amount greater than ten percent of their capital stock to any one person, firm or corporation. By an amendment to the Act national banks are now authorized to lend to any one person, firm, or corporation an amount equal to ten per cent of their capital and surplus, provided this does not exceed 30% of their capital.

They were originally authorized to issue national bank notes to the extent of 90% of the bonds deposited as collateral security. This amount has been increased to one hundred per cent of the bonds so deposited.

They were originally required to maintain reserve against circulation as well as against deposits. All reserve against circulation except the 5% redemption fund was abolished by amendment, and

while the Aldrich-Vreeland Act was in force national banks were not required to maintain any reserve against Government deposits.

Liberality was also shown in the administration of the national banking laws. For example, in computing the liabilities against which reserves should be maintained banks were permitted to deduct balances due from banks from the balances due to banks, and to carry reserve only against the net balance due to banks. This practice has been confirmed by the Federal Reserve Act. In spite of efforts to liberalize and broaden national banking powers, both by legislation and by the administration of the laws, it was generally conceded that national banks were more restricted in their operations than their competitors, the State banks and trust companies. Accordingly, to place them more nearly on an equality with State banks and trust companies, the Federal Reserve Act provided for a further increase in the powers of national banks. By this Act the reserve to be maintained against demand liabilities has been reduced. National banks which were heretofore prohibited from lending on real estate have been authorized to lend a limited amount of their resources on farm lands. While they were limited in the amount of money that they might borrow from other banks they have been given the power to rediscount with Federal reserve banks their commercial paper, and have in addition been authorized to increase their liabilities by accepting bills of exchange or drafts which are based on the exportation or importation of goods; and with a view of coordinating their powers with those of trust companies many of which

do a commercial banking business they have been authorized to exercise, with the approval of the Federal Reserve Board, the powers of trustee, executor, administrator, and registrar of stocks and bonds, when the exercise of these powers does not contravene the laws of the State in which they are located.

It will be observed, therefore, that the banking powers of both State and national banks have been consistently enlarged and liberalized. It necessarily follows that as these powers are increased, the necessity for proper supervision and regulation is correspondingly increased, and it is in this view that the recent legislation providing for more careful supervision and regulation becomes significant. The danger that follows the failure to regulate the banking business is clearly illustrated by a consideration of the circumstances under which State bank notes were withdrawn from circulation.

It will be recalled that in their inception both State and national banks performed the functions of banks of issue as well as banks of deposit and discount. Before the Civil War State bank notes constituted one of the principal mediums of exchange, and their circulation and the power to issue these notes was looked upon as one of the most important functions of banking. Under existing laws, while State banks still have the legal right to issue bank notes only national banks and the recently created Federal reserve banks exercise this right. State bank notes are no longer in circulation. The fact that Congress imposed a prohibitive tax on State

bank circulation was due in part at least to the lack of uniformity in State banking laws, and to the lack of supervision and regulation of the business of State banks.

It may be said to be an elementary principle of economics that any substitute for specie currency must have a stable value if it is to be used successfully as a medium of exchange. If a credit instrument is to be used to discharge other obligations its value must be unquestioned. Accordingly, if a bank note is to be accepted in the discharge of an individual liability, the individual accepting the bank note must be assured that at his option it can be converted into specie at its face value.

Some of the States realize this and imposed the necessary restrictions on the issue of such notes. Banks were required to maintain a proper reserve of cash against them to make provision for their prompt redemption and the amount of issue was limited by the laws of the State. Others imposed few if any safeguards. Little or no provision was made for their redemption and the value of the note as a medium of exchange depended upon the reputation of the issuing bank. The inevitable result was that the notes of some banks were accepted at par through a wide section of the country. The notes of others were accepted at par in the immediate neighborhood of the issuing bank, but were discounted when offered in settlement of liabilities in other parts of the country. The notes of still other State banks had little or no value as a medium of exchange. As the States had failed to standardize their banking laws it be

came necessary for the Federal Government to pass an Act designed, among other things, to provide for a more uniform currency, and to accomplish in this way what the States had failed to accomplish by not providing for proper supervision and regulation of the banking business.

As originally passed the Act of 1863 authorized State as well as national banks to issue their notes on the security of Government bonds. In 1864, however, this provision was omitted when the original Act was amended and re-enacted , and in 1865 a tax of ten per cent was placed on State bank notes which were placed in circulation. While Congress would no doubt have created the national banking system in any event, since the Federal Government needed these agencies in the conduct of its fiscal affairs, it is at least probable that, except for the failure of the States to properly supervise and regulate the banking business, no necessity would have arisen for the tax which was imposed upon State bank circulation; and the fact that this necessity did arise demonstrates the value to the banking interests of supervision and regulation.

Since 1865 this form of bank credit has not been used by State banks but bank credit in the form of checks, drafts and bills of exchange is still used for many of the same purposes and constitutes a medium of exchange in commercial transactions in this country.

Mr. Brown, instructor in political economy in Yale University. in his work on International Trade and Exchange, says that it is estimated that more than nine-tenths of the total business

of the United States is carried on through the use of bank credit. This being true it is manifest that the same necessity for regulation of the banking business exists today that existed in 1864, and this necessity has been materially increased since the banking business has reached such enormous proportions and the powers of banks have been so consistently liberalized.

When we examine, however, the adverse criticism of the Federal Reserve Act, and analyze the indictments made against it, many of them seem to be based upon an objection to those provisions which are designed to scientifically regulate the banking business.

For example, the officer of a member bank who objects to the Act because he is required to maintain a proper reserve against demand liabilities, and who objects to losing interest on reserve balances usually carried with other national banks, fails to take into consideration that this regulation is in the final analysis a benefit rather than a burden, since it tends to strengthen the credit of the banks composing the System. He fails to appreciate the fact that the purpose of this provision is to provide for an actual reserve to take place of a reserve in form only; and to make this reserve available at all times. He overlooks the fact that experience has demonstrated that under the old system it was difficult in times of panic for a national bank to get the benefit of reserve balances carried with approved reserve agents. In estimating his loss from this source he fails to take into consideration that his lending power has been increased: (1) by a decrease in the amount of

reserve to be maintained; (2) by his ability to rediscount his commercial paper with the Federal reserve bank; (3) by the use of his credit in the form of acceptances in certain transactions; and that the potential earnings that may be derived from this increased lending power will more than offset any loss that results from interest on reserve balances.

The opposition of an officer of a non-member bank who is inherently opposed to Federal supervision is likewise based to a very great extent upon the assumption that Federal laws are too exacting and are enforced with too great severity. If this is not the basis of his contention it is somewhat difficult to understand why Federal regulation and supervision is less desirable than that of the States.

The suggestion that a compact system will be created by remodeling the laws of the several States has been more or less frequently made. The difficulties in accomplishing this purpose, are, however, at once manifest. If we assume that all of the States could be induced to adopt one standard of banking laws, thus providing for uniform regulation and supervision, this uniformity might be destroyed at any time by amendments to the State banking laws of one or more States. The laws of each State would apply to transactions engaged in within the borders of the State, whereas, each bank, as an incident of its business has transactions with banks and individuals in other States. Legislation might be uniform but the same laws might be administered with great liberality in one and with

severity in another State. It is not possible within the limits of this discussion to consider the many difficulties involved in this proposal, but it must be obvious that from a practical standpoint it would be exceedingly difficult to accomplish.

Conceding that the business of this country can be conducted to greater advantage under a compact and scientific banking system than is possible where it is handled by several thousand unrelated banks, it is manifest that objections made to the creation of such a system must be based upon local considerations. Those who claim that the same objects may be accomplished by less complicated methods apparently assume that it is only necessary to continue to liberalize banking powers in order to meet new conditions and that an extension of banking powers does not necessitate more effective supervision.

When we consider that the Federal Reserve Act deals with the various activities of banking; that it provides for a more effective supervision; that it adds to the power of national banks the ability to lend its credit in the form of acceptances; that it concentrates reserves so as to make them available when needed; that it provides a legitimate method for the rediscount of commercial paper; that it adds to the national banking powers the power to lend on real estate to a limited extent; that it permits national banks to act in certain fiduciary capacities; and that it provides a medium by which the surplus funds of one community may be utilized to supply a deficit in another; and when we recall that this important constructive legis-

lation was not undertaken until Congress had collected and analyzed more information on the subject of banking and currency than has ever been collected by any commission in the history of the world, it is difficult to understand upon what theory it can be argued that the Aldrich-Vreeland Act which merely added an additional method by which banks might borrow money to be used in an emergency can be said to afford the same advantages that are afforded by the Federal Reserve Act.

It is of particular importance at this time that a scientific and compact banking system should be perfected. The use of bank credit is constantly increasing in the conduct of the business of this country. In so far as a bank's business is local the reputation of those who have charge of its management may be a sufficient guarantee of its credit, but when a bank engages in transactions with those who have no personal knowledge of its management, reliance must be placed upon its statement of condition rather than upon the personnel of its board of directors, and the reliability of this statement must depend to a very great extent upon the character of the laws under which it operates and the manner in which these laws are administered. It is not sufficient that this statement shows an excess of assets over liabilities due to creditors, but the investment of its funds must have been made under laws which provide for proper regulation and supervision of its business.

Liberality in banking laws brought about by the single desire to increase earnings may reach the danger mark. The laws

regulating the banking business are, therefore, an asset of the bank. Every banker has an interest, not only in his own credit, but in the credit of every other bank with which he deals. Few commercial transactions can be completed that do not involve at some stage the use of credit, and bank credit is generally substituted for that of individuals in completing these transactions. It is, therefore, of interest to the banker to see that the laws provide proper safeguards and to cooperate in the enforcement of these laws. Where the public undertakes by legislation to restrict the exercise of business judgment and to substitute a rule of action prescribed by the law makers, it is necessary that careful consideration should be given to the interest of the banker. On the other hand, in reaching a conclusion as to the value of legislation, it is equally important that the banker should give consideration to the public interest as well as to the interest of the individual bank he represents. A law that places no restrictions on banking operations makes it possible for a few to endanger the business of the most conservative, since if public confidence is shaken the whole banking structure is affected.

The creation of a compact banking system is particularly important at this time. As a result of the European war this country is called upon to assist many of the neutral nations in financing their commercial transactions. This necessarily involves the use in other countries of the credit of banks in the United States, and other nations have an increasing interest in our banking laws.

The National Bank Act has served to accomplish the purpose its advocates claimed for it. Bank note circulation has been placed upon a substantital foundation, and as agencies of the Federal Government national banks have aided materially in the conduct of its fiscal affairs. Many of the disadvantages of the old independent treasury system have been overcome. With the benefit of more than fifty years experience Congress has been able to determine the defects as well as the advantages of this legislation and the new Federal Reserve System is a development of the system established in 1863. Unlike most of the previous legislation on banking and currency the Federal Reserve Act was not the outgrowth of a demand for legislation to meet a pressing emergency. Its provisions were adopted after mature deliberation and after an exhaustive study of the future as well as the present needs of the country. Those who are familiar with the intricacies of banking from a practical as well as theoretical standpoint have declared it to be based upon scientific and sound principles. The machinery for a strong and compact system has been provided. This machinery may require some slight adjustments from time to time which will be brought about by amendments proved to be necessary by experience. It is free from the objections which occasioned the alarm that was felt when the first and second Banks of the United States were organized. The public feared that then their liberties would be endangered by a concentration of power in one mammoth corporation.

The present system provides for a co-ordination of the

powers of the several thousand banks which compose it, but each bank is an independent corporation owned by independent stockholders and managed by directors selected by the stockholders. It furnishes a legitimate method of cooperation which gives additional strength to each member bank. It provides for a standard of regulation and supervision of the banking business which is more permanent than would be possible if the standard established were subject to modification by amendments passed by the forty-eight different States acting independently.

The rapidity with which this system develops must, of course, depend in the final analysis upon the cooperation of the banker. To the layman the advantages derived from membership far outweigh any possible objections which may be based upon the theory that membership of State banks in this System involves some curtailment of banking powers. The restrictions imposed are only such as experience has demonstrated to be necessary to properly safeguard the interests of those who deal with banks, and the fact that member banks are subject to these restrictions and to proper regulation will in the end prove an asset in the development of its business and not an obstacle to that development.

In times of unusual prosperity when the deposits and resources of banks are constantly increasing and there is a surplus rather than a deficit of loanable funds, it is natural perhaps that the banker should feel confident that, acting independently, he should be able to meet any emergency, and that he can obtain such assistance

as may be necessary from other banks with which he deals. It is in such times, however, that our system should be strengthened and that preparation should be made for any reaction that may occur. If this preparation is made in prosperous times it can be accomplished on more scientific lines than is possible if made only when there is an existing emergency to be met.

The economists are not agreed as to just what conditions must be faced following the close of the great European war, but they are agreed that we can not expect an indefinite continuance of the present prosperous conditions, and that sooner or later we must be prepared to meet conditions which are without precedent.

It is obvious, therefore, that, in analyzing this legislation, the banker should view the subject from a broad and comprehensive standpoint and should not let purely local considerations influence his judgment. It is equally obvious that any unusual demands that may be made on the resources of this country following the close of the European war can be met with less disturbance to our commercial prosperity by a compact, well organized system than by several thousand unrelated banks each acting independently. It is, therefore, to the interest of the bankers to co-operate in developing a system which will not only insure a continuance of prosperity in this country, but that will make it possible for the enormous banking resources of the United States to be utilized to advantage in the readjustment of the world's trade. A system that will enable the banks of the United States acting as nearly as possible as a unit to lend all possible assistance in the rehabilitation of the prosperity of those unfortunate countries which are now engaged in this great conflict.

4/21/16,

Washington, D. C. April 22, 1916.

OUTLINE OF THE PLAN OF CLEARING AND CHECK COLLECTION ADOPTED BY THE FEDERAL RESERVE BOARD .

The Plan proceeds upon the following assumptions and principles:

First:

A Federal Reserve Bank can not compel an unwilling member bank to send the checks of its patrons to it for collection or clearing;

Second:

It would be inexpedient at the present time even if legal, upon which no opinion is expressed to compel an unwilling member bank to pay at the counter of the Federal Reserve Bank, a check drawn against it (i.e., the member bank) before it has even seen it. The member bank may, of course, authorize the Federal Reserve Bank to redeem at par checks drawn against it and forward them to it for final settlement; or, it may authorize the Federal Reserve Bank to charge the checks against its account;

Third:

In view of the conditions hereinabove stated, and because your Committee believes that the best results will be secured by a complete co-operation of the member banks with the Reserve Bank, it is proposed that the plan to be followed shall be sufficiently attractive to member banks to appear to them as desirable. Hence, in carrying out this idea, it is proposed to follow the lines of development which long experience by member banks in their relations with city correspondents has established. This, in effect, means that Federal Reserve Banks shall receive from their member banks, checks, whether drawn against members or non-members, or private bankers, and give immediate credit for them;

Fourth:

Your Committee regards it important that the Federal Reserve Banks shall strictly guard their reserves and that member banks which do not maintain the reserves required by law shall be penalized for deficiencies. In this connection, the Federal Reserve Bank will not class as reserve

any checks which it has received from its members and credited to them but which have not been collected.

Fifth:

While it is proposed that every Federal Reserve Bank shall render this service of collection for all those member banks who choose to avail themselves of it, it is not contemplated that the service shall be rendered gratis, or without expense to the depositing bank, which is the beneficiary. Therefore, as explained in Mr. Harding's memorandum, every Federal Reserve Bank shall keep adequate analyses of its clearing and collection expense and charge the depositing bank for the service rendered, the actual cost of that service, as nearly as it may be determined, including interest at a rate to be determined upon and approved by the Federal Reserve Board, upon all cash advances. On the face of it, this means that a member bank might deposit checks on far distant banks and secure immediate credit at par for these items, and at the same time draw against them before the Federal Reserve Bank has been able to collect the funds, but, as a practical matter, a member bank could not afford to do this for the reason that it is proposed to charge the member bank, as a part of the expense of handling its checks, the cost of advancing funds; the rate to be charged to be slightly higher than the lowest discount rate established;

Sixth:

Every Federal Reserve Bank is authorized to receive checks from other Federal Reserve Banks, or under such rules as may be prescribed, from member banks in other Districts, where such routing will save time, but in all cases only for the credit of the Reserve District represented by the sending bank and upon terms similar to those upon which it receives checks from its own member banks.

Seventh:

It is proposed, under this plan, that every Federal Reserve Bank shall be authorized to pay its own member banks a fee for acting as its agent in the collection of checks drawn against non-member banks.

Eighth:

It is quite likely that it will be found necessary to create collection agencies at various points, especially in Districts of large area. The working out of this system of collection agencies and their establishment is a matter of detail which will follow in due course and will undoubtedly greatly reduce the so-called "float".

MEMORANDUM ON PROPOSED AMENDMENTS TO SECTION 16 OF THE FEDERAL RESERVE ACT NOW UNDER CONSIDERATION BY THE FEDERAL RESERVE BOARD.

C. S. H.
May 1, 1916.

The amendments proposed are designed to secure five principal objects which will be considered separately.

I.

Bills of exchange and bankers' acceptances purchased in the open market by Federal reserve banks, under Section 14 of the Federal Reserve Act, may serve as collateral for the issue, by the Federal Reserve Agent, of Federal reserve notes, provided that the acceptor or one of the indorsers is a member bank of any Federal Reserve District.

Under the present law the collateral for Federal reserve notes is limited to notes and acceptances discounted, under Section 13 of the Act, by the Federal reserve bank for a member bank and indorsed by the member bank.

Under Section 14, however, Federal reserve banks are authorized to buy such bills or acceptances in the open market without the indorsement of a member bank, but such purchases are limited to paper of the kind and maturity which would be eligible for discount by the Federal reserve bank under Section 13 if offered by a member bank.

Such purchased bills and acceptances, when not indorsed by a member bank, can not be accepted by the Federal Reserve Agent as collateral for the issue of Federal reserve notes, for the reason that they would not represent a rediscount operation with a member bank, and such notes can only be issued, under the present law, when growing out of such a rediscount operation, as it is only through such operations that a member bank can avail itself of the reserve deposits required to be maintained in the Federal reserve bank. If such paper were presented to the Agent by a Federal reserve bank, the lack of an indorsement by a member bank would show conclusively that the paper did not grow out of a rediscount operation with a member bank.

On the other hand, the Federal reserve bank might present paper to the Agent upon which the last indorsement was that of a member bank, but the paper may have been bought in the open market,

through the medium, for example, of a note broker.

Under such circumstances, the Federal Reserve Board has ruled that such paper could be received by the Agent as collateral, inasmuch as the indorsement of the member bank makes the paper, in effect, arise out of a rediscount operation whether directly at the request of the member bank or indirectly, as, for example, through the medium of a note broker. As a matter of fact, the Agent could not know whether the indorsement of the member bank represented a rediscount or a purchase, and in such a case the distinction would not be material as the benefit of the transaction enures to a member bank whether through rediscount or purchase.

After careful consideration the undersigned has reached the conclusion that the law should be broadened so that the Agent may accept as collateral for Federal reserve notes, any bills or acceptances, lawfully purchased under Section 14, which are either accepted by or indorsed by a member bank of any Federal Reserve District.

To illustrate: A in Buenos Aires sells merchandise to B in Boston and, by arrangement, draws a bill of exchange upon a non-member trust company, C in Boston, payable to the order of A. A then indorses the bill and discounts it with Bank D in Buenos Aires. D indorses it and sends it to its correspondent E, a National Bank in Boston. E presents it for acceptances to C in Boston and having indorsed it, later sells it to the Federal Reserve Bank of New York.

It is a matter of some doubt, under the present law whether this bill could be received by the New York Federal Reserve Agent as collateral for the issue of Federal reserve notes, for the reason that, although indorsed by a member bank, it could not have originated out of a rediscount operation with a New York member bank as E, although a member bank, is not a member bank of the Federal Reserve District of New York, and only member banks of the New York District can obtain rediscounts from the New York Federal Reserve Bank.

Under the proposed amendment, however, this bill could serve as collateral for Federal reserve notes and there is no reason why it should not be permitted so to serve, as the acceptance is guaranteed

by the indorsement of a member bank although not of the Federal Reserve District of New York.

To take another illustration: A in Buenos Aires, draws a bill, by arrangement, upon B, a National Bank in New York City, payable to A's order. A indorses the bill and discounts it with Bank C in Buenos Aires. Bank C indorses it and sends it to its correspondent D a non-member trust company of New York City. D presents it for acceptance to B and then sells it, with or without its indorsement, to the Federal Reserve Bank of New York.

Under the present law, this bill could not serve as collateral for the issue of Fedoral reserve notes, as, there being no indorsement of a member bank upon it, the bill would show on its face that it did not arise out of a rediscount operation with a member bank.

Under the proposed amendment, however, this bill could serve as collateral as it is accepted by a member bank. The real reason advanced for the objection to such a bill serving as collateral for Federal reserve notes is not from any doubt as to the due payment of the acceptance, but from the fact that permitting such bills to serve as collateral would have the effect of giving the rediscount privilege to other than member banks, which would be contrary to the spirit of the Federal Reserve Act.

It should be remembered however, that the Federal Reserve Act permits Federal reserve banks to purchase such bills and acceptances in the open market in order that they may invest their available funds at times when there is a falling off in the demand for rediscount operations by member banks, or that they may make their discount rates effective. If, therefore, such bills and acceptances can lawfully be purchased under Section 14 there would seem to be no good reason why such purchases; all representing paper which would be eligible if offered for rediscount by a member bank;should not serve as collateral for Federal reserve notes.

The fact that thereby benefits are incidentally given to a non-member bank is not a valid objection,because the transaction is entered into for the direct benefit of the Federal reserve bank, and

for no other purpose. The incidental bendfit received by a non-member bank not being a valid objection to granting to Federal reserve banks the power to purchase the paper in the open market, should not, by parity of reasonings, be allowed to serve as an objection to Federal reserve banks paying for such purchases by Federal Reserve notes taken out against the purchased paper as collateral, for the sole benefit of the Federal reserve bank.

Under the present law, when such bills or acceptances are purchased from any holder other than a member bank, the payment must necessarily be made in cash, drawing down the cash resources of the Federal reserve bank. The reason for this is that the seller not being a member bank, could not accept a book credit in payment for the sale, and, the acceptance not being eligible as collateral for Federal reserve notes, the bank could not obtain the Federal reserve notes out of this transaction with which to pay for the purchase.

Furthermore, under present conditions in the money market, even though the purchase were made for a member bank on its indorsement, the member bank would usually take the purchase money in cash, or if accepting a book credit, would at once draw against it. In the latter case, however, if the law were amended, Federal reserve notes could be issued against the pledge of the acceptance which the member bank selling the acceptance very likely would be perfectly willing to receive in payment.

There would seem therefore, to be no good reason for not amending the Act so that paper purchased, having on it the name of a member bank as acceptor or indorser, can serve as collateral for the issue of Federal reserve notes.

II.

Collateral pledged with the Federal Reserve Agent, either gold or paper, may be withdrawn by the Federal reserve bank and other collateral, either paper or gold, substituted therefor

The present law permits the withdrawal of collateral and the substitution of other like collateral, and this amendment simply strikes out the word "like", thus permitting the exchange by the Federal reserve bank with the Federal Reserve Agent, of gold for commercial paper, or of commercial paper for gold.

Under the present law only commercial paper and bills in foreign trade can be pledged as collateral for Federal Reserve notes. One of the proposed amendments, however, which will be considered in detail later, permits gold to be thus pledged as collateral as well as commercial paper, and if this latter amendment should be enacted into law it will be most desirable to permit the exchange of one kind of collateral for another, as above indicated.

III.

Federal reserve notes may be originally issued against the deposit of gold with the Federal Reserve Agent to the face value of the notes to be issued, and in such case the Federal reserve bank need not carry in its vaults a 40% gold reserve against outstanding Federal reserve notes so covered by gold.

Before considering this amendment it may be well to point out that "issue" in the amendment means issue by the Government, and, further, that notes can only be issued by the Government against the pledge of commercial paper, under the present law, and against commercial paper or gold, or both, under the amendment.

The first object aimed at in the above amendment can now be accomplished in effect under the present law, although indirectly, but none the less legally. Before discussing this proposed amendment, therefore, it may be well to consider present methods by which the first result reached by the above amendment is attainable and in fact, attained under the present law.

Under the Act, as it now stands, as above stated, Federal reserve notes can be issued by the Federal Reserve Agent only against the de-

posit of commercial paper. When once the notes have been issued, however, by the Federal Reserve Agent, the present law permits the Federal reserve bank to pay to the Federal Reserve Agent the face value of the notes in gold, receiving back from the Agent the commercial paper originally deposited.

This follows from the language of Section 16, which reads as follows:

> "Any Federal reserve bank may at any time reduce its liability for outstanding Federal reserve notes by depositing with the Federal Reserve Agent, its Federal reserve notes, gold, gold certificates or lawful money of the United States. "

When, therefore, such a payment of gold has been made by the Federal reserve bank to the Federal Reserve Agent the outstanding notes, to the amount of such gold, are in the same position, practically, as if they had been originally issued against gold by the Agent, with certain qualifications which will be explained later.

For example, the weekly statement issued by the Federal Reserve Board showing the condition of the Federal reserve banks on March 17, 1916, showed, under the head of "Liabilities", that the twelve Federal reserve banks had, on that day, outstanding Federal reserve notes on which they were liable to the amount of 11.9 millions of dollars, which was further reduced by 1.7 millions, the amount of such notes held among the assets of the banks, making the net liability only 10.2 millions of dollars. On the other hand, the daily Treasury Statement, published by the Secretary of the Treasury for the same day, showed that there were 191.1 millions of Federal reserve notes outstanding as a liability of the United States Government.

Both of these apparently inconsistent statements were correct, for the reason that on that day, while the Federal reserve banks had originally taken out 191.1 millions of Federal reserve notes against the

deposit of commercial paper, they had later deposited with the Federal Reserve Agent, in gold, the sum of 179.2 millions, and thereby, under the clause of Section 16 above quoted, had "reduced"their liability upon 179.2 millions of Federal reserve notes. Thus the outstanding Federal reserve notes were in the same position as if 179.2 millions had been originally issued against gold deposited with the Agent and 11.9 millions or 10.2 millions net, above referred to, had been originally issued against the deposit of commercial paper.

The statement, made in the last paragraph, that the banks, by the payment to the Federal Reserve Agent of 179.2 millions of gold had thereby "reduced" their liability upon 179.2 millions of Federal reserve notes requires some explanation.

What the word "reduced" really means is that the banks, by this payment, are released from the necessity of carrying any reserve against notes so paid and also that they need not henceforth include them among their liabilities.

All outstanding Federal reserve notes, however, can be presented at any one of the twelve Federal reserve banks for redemption and, therefore, could be so presented to the banks which had paid their full value to the Federal Reserve Agent, as in the example cited above.

The banks, therefore, by making the payment of said 179.2 millions to the Federal Reserve Agents, merely reduced their liability to carry a reserve against these notes and are, therefore, permitted, and in fact, required by the clause of Section 16 above quoted, henceforth to exclude them as outstanding liabilities.

The general obligation, however, imposed by the Act upon all Federal Reserve banks,- to redeem all Federal reserve notes, by whatever Federal Reserve Banks issued,- remains undiminished, but is, of course, not set down as a liability in Federal Reserve Bank statements.

From time to time criticisms have been made upon the action of Federal reserve banks in taking out Federal reserve notes against the deposit of commercial paper and almost immediately paying their face value in gold to the Agent, taking back the commercial paper, - it being claimed that this, if not a direct violation of the Act, is at least an evasion of the spirit of the requirement that notes can only be issued against commercial paper.

Before considering whether this course, thus criticized, violates the spirit of the law, it may be well to point out that there is no inflation of the circulating medium brought about by it, for every note thus issued against the deposit of gold, - whether directly issued, as under the proposed amendment, or indirectly, by the course above described under the present law is covered, dollar for dollar, by gold withdrawn from circulation and impounded with the Federal Reserve Agent. On the other hand, when the note is redeemed the contraction is overcome by the return to circulation of the gold impounded.

It should also be pointed out,- as will be shown fully later,- that if the existing National bank note circulation,- against which no reserve other than the 5% redemption fund is required,- were to be suddenly wiped out and Federal reserve notes, secured by commercial paper, substituted in its place, an immediate contraction of the outstanding circulation would result from the necessity of carrying a 40% gold reserve in place of the 5% reserve carried against National bank notes.

What then is the reason for the above outlined process by which the 191.1 millions of outstanding Federal reserve notes have dwindled as a liability of the Federal reserve banks to the comparatively small amount of 11.9 millions, or, as pointed out above, 10.2 millions net, by virtue of the impounding with the Federal Reserve Agent of 179.2 millions of gold ?

At the outset, it must be apparent that this impounding of gold with the Federal Reserve Agent must have been of some benefit to the Federal reserve banks, or it would not have been so impounded.

What this benefit is, is not difficult to understand. Under the present law the benefit is,

(a) If a bank has made an excess deposit of gold and later desires to withdraw it, but is willing to accept Federal reserve notes, every available Federal reserve note in the bank vaults will help the bank to satisfy the demand of the member bank without depleting its gold supply, and by securing such notes by the deposit of gold with the Agent, a gold fund is built up which is available, at any time, for rediscounting purposes.

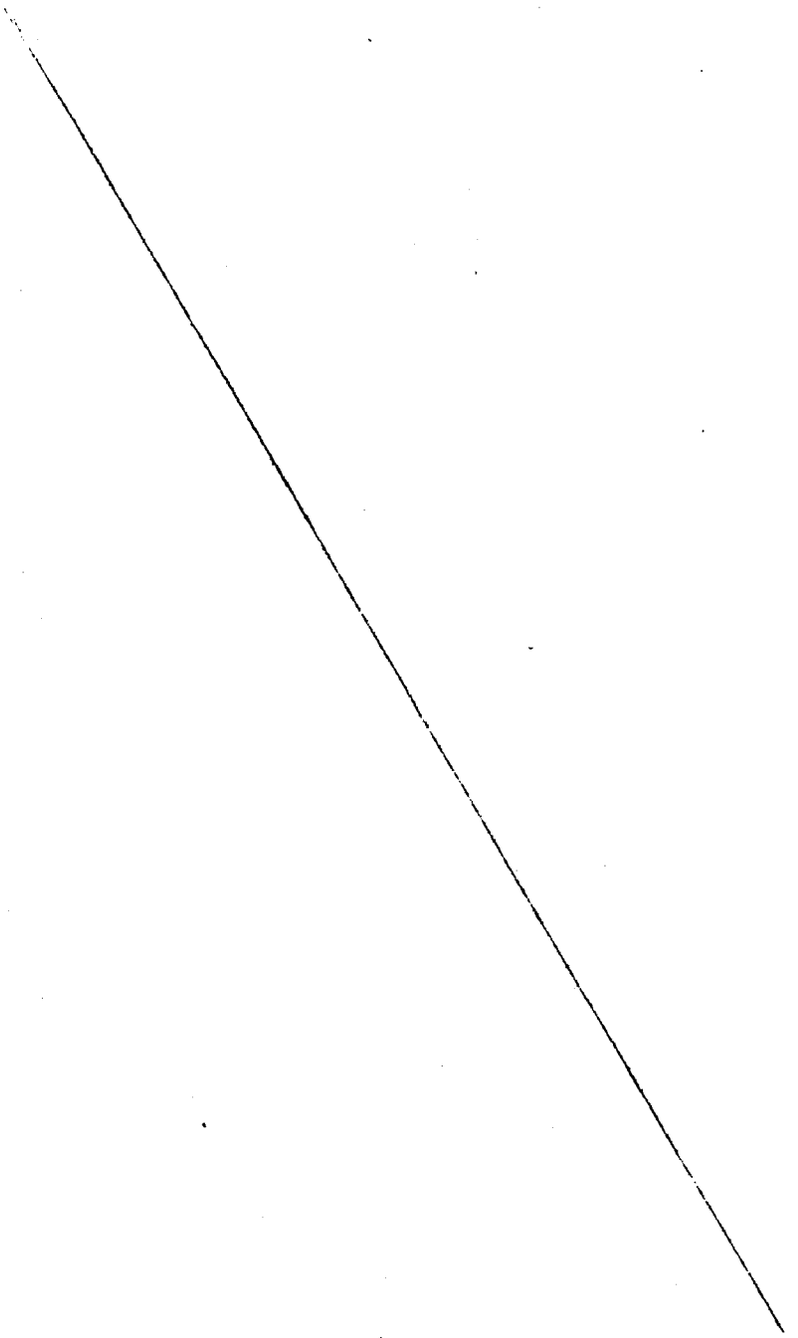
(b) If the Federal reserve bank finds that the demands for rediscounts by member banks have fallen off so that the bank needs some other source of earnings for its expense and dividend purposes, by paying out Federal reserve notes already issued to it, it can purchase in the open market eligible bills of exchange or bankers' acceptances, (not bearing the indorsement of a member bank, and hence not directly eligible as collateral for Federal reserve notes), and thus secure needed earnings, and, although not retaining the gold in its own vaults, by placing it in the hands of the Agent, it is rendered available if later needed.

It may, however, be pointed out that, leaving out of consideration excess deposits, a member bank can never draw gold from a Federal reserve bank except by offering commercial paper for rediscount and that such paper when offered for rediscount will serve as collateral for the issue of Federal reserve notes which can be given to the bank if it will take them, in return for the paper rediscounted.

This is undoubtedly true, and if there were no excess deposits of gold made by member banks, the only benefit to the Reserve banks, from the indirect method of issuing notes against commercial paper and later paying gold to the Agent, taking back the paper, would be that described under (b) above, - thus enabling the reserve banks to increase their investments by purchase, with these Federal reserve notes, of bills and bankers' acceptances which could not be directly discounted because of the lack of an indorsement by a member bank.

The underlying spirit of the Federal Reserve Act, however, is to encourage the member banks to make excess deposits. With a satisfactory system of check clearances in operation, excess deposits must

inevitably result. Furthermore, the burden of maintaining the gold standard of value, although primarily upon the Government, yet will in effect be and is placed upon the Fed-



eral reserve banks under the Federal Reserve Act, as they must pay all their disbursements, whether by way of rediscount operations, clearing balances, or withdrawals of excess deposits, in gold. If they ceased to do this, while they could, under the Act, undoubtedly discharge all their obligations in lawful meney, i. e. in greenbacks, silver certificates or silver dollars, yet such a course would inspire distrust and would throw upon the Government a very heavy burden in keeping all our money on a parity with the gold standard, that is, in exchanging for gold the disbursement of the Federal reserve banks made in lawful money.

It must also never be forgotten that the business exchanges of the country rest upon a lawful money basis and that it is the duty of the Government to maintain these exchanges upon the gold standard basis. The Federal reserve banks, through the gold clearing fund, - as between one another, - and by virtue of gold payments to the member banks, are helping the Government materially in keeping all exchanges upon the gold standard of value, and every assistance which Congress can give to the reserve banks in this work should, and it is confidently believed will, be given.

Returning now to the indirect method followed by the banks of taking out Federal reserve notes against commercial paper and immediately paying, in gold, to the Agent, the full amount of such notes, the question arises what immediate gain do the reserve banks derive from this circuitous process.

The answer is that when the reserve banks have gold which can not be used for taking out Federal reserve notes, because of the lack of commercial paper to pledge as collateral for the notes, they have found by experience that they can take notes out against this gold by the circuitous process above referred to and hereafter more particularly described.

It is scarcely necessary to add that if the banks have on hand or can secure an ample supply of commercial paper, their note issuing capacity will be greater by pledging such commercial paper than it could possibly be by paying gold to the Federal Reserve Agent under said circuitous process.

Even under such circumstances, however, the privilege afforded

by the amendment of taking out notes against gold, will enable the reserve banks to conserve their gold, as will be shown more particularly later.

To illustrate this circuitous process, above referred to, let us suppose that a Federal reserve bank desires to invest $200,000 in open market purchases of bills of exchange or non-member bank acceptances. It holds in its vaults $100,000 in Federal reserve notes taken out against the pledge of $100,000 in commercial paper, and can obtain no more commercial paper to pledge with the Federal Reserve Agent for additional Federal reserve notes. It does not want to use $100,000 in gold, which it has available for such purchases, but wishes to find some way by which it can take out $100,000 additional notes against this gold, using these notes for the purchases and thus conserving its gold.

By employing the circuitous process now to be described it can take out $100,000 in Federal reserve notes, based upon this gold paid to the Agent, without securing any more commercial paper to pledge with the Agent for such notes.

For example, it already holds $100,000 notes secured by the pledge of $100,000 commercial paper. As a first step it would pay to the Agent $100,000 in gold thus releasing its $100,000 of commercial paper. As a second step, it could redeposit the $100,000 commercial paper with the Agent and take out $100,000 additional of Federal reserve notes.

The bank would then hold $200,000 of Federal reserve notes secured by $100,000 commercial paper and $100,000 in gold, and it could use these $200,000 of Federal reserve notes in making its open market purchases and thus conserve its gold.

The above indicates the exact steps taken by the Federal reserve bank which it is claimed, constitute a violation or at least an evasion of the spirit of the law.

It is certainly clear that each step taken by the bank, in the above illustration, is in literal compliance with the law. The notes were originally issued on the pledge of commercial paper, and

and when issued became a liability of the bank. When, however, the bank paid to the Agent $100,000 in gold, the liability of the bank on these notes was from that moment "reduced" The resources of the bank were decreased by the exact amount of the payment in gold, and at the same time the liability of the bank upon the notes was extinguished

In other words, at least, in a technical sense, the bank made the payment for the purpose, - to quote the words of the statute, - of "reducing", its liability upon the notes.

The liability upon these notes, however, thus "reduced" as to the bank, remains undiminished as to the Government, but the Government, to meet its continuing liability, now holds 100% in gold, through the Federal Reserve Agent, and the Federal reserve notes, as to the Government, at least, now become in effect a gold certificate upon which the Government only is liable, but to redeem which it holds 100% in gold.

If there were no demand for Federal reserve notes for circulation purposes these notes would come back very quickly for redemption. The Government would redeem them and that would end the matter. There being a demand, however, as we assume, for such notes for circulation purposes, they may remain outstanding indefinitely. The bank, however, from the moment of its payment to the Federal Reserve Agent, has parted with its gold and has "reduced" its liability upon these notes.

The criticism, however, might be made that the Government, which originally issued the notes through the Federal Reserve Agent, is now practically in the same position as if it had originally issued these notes against the deposit of gold, rather than of commercial paper, and that the provision of the Act that notes can be issued originally only against the deposit of commercial paper has been evaded by the course thus pursued by the Federal reserve bank.

In this connection, however, it should be pointed out that this same result may be reached directly, even without the payment of gold by the bank to the Agent, in a regular normal way. For example, suppose that a Federal reserve bank takes out $100,000 in Federal reserve notes against the pledge of commercial paper, as in the above

illustration. The Federal reserve notes have no definite maturity, - they remain an obligation until finally redeemed. Let us suppose, however, that the commercial paper runs only for three months. At the end of that period the maker of the paper must pay the notes to the lawful holder, that is, to the Federal Reserve Agent. The Agent will then be in the same position, practically, as if the bank had paid him the $100,000 in gold, as in the above illustration, the day after the notes had been issued to the bank, - for the payment of this commercial paper at maturity will "reduce" the liability of the bank upon these notes in precisely the same manner, whether the payment is made by the maker of the commercial paper at maturity, or by the bank before maturity. In either case, however, the liability of the Government remains unchanged.

The above would seem to show conclusively that the course taken by the Federal reserve bank, above described, is at least, in technical compliance with the law. The question remains to be answered, however, whether, admitting such a technical compliance, the course followed is not really an evasion of the spirit of the law.

What, then, is the spirit of the law? It might be claimed to be that Federal reserve notes should be originally issued only on the pledge of commercial paper, and that a bank should only pay the face of the notes to the Federal Reserve Agent when it genuinely desires to "reduce" its liability upon the notes, or desires to secure the commercial paper pledged with the Agent, so that it may be in its possession at maturity when the maker or acceptor must pay it, and that the bank, evades the spirit of the law by taking out the notes against commercial paper, but almost immediately paying the amount in gold to the Agent, thus getting back its commercial paper and leaving the notes outstanding secured by gold as if they had been originally issued upon such security.

The question would therefore arise why, assuming, for the sake of argument, that the above course evades the spirit of the law, the law should now be changed so as to validate the above indirect process by permitting the original issue of Federal reserve notes against the deposit of gold as collateral rather than against the deposit of commercial

paper.

To answer this question we must find the reason why the banks desire this privilege and that reason has already been given, - viz: - when the supply of commercial paper is falling off, and yet there is a demand for cash the member banks must draw down their excess deposits in the reserve banks and if the reserve banks can furnish Federal reserve notes it will thereby conserve their gold; or, on the other hand when the reserve banks desire to make investments, and have Federal reserve notes on hand, they can make the investments and still conserve their gold, So also, conversely, when the member banks have an ample supply of gold they will be glad to deposit it with the reserve banks taking back Federal reserve notes which at any time they can present to the reserve bank for gold, and the issue of these notes against gold at times when there may be a scarcity of eligible commercial paper, will put the reserve bank in the position of being able to conserve its gold.

In the summer of 1914, for example, there was a profound business disturbance growing out of the European War, and an extraordinary demand for currency. Coincident with this demand for currency there was threatened a very great depression in business, which would necessarily decrease the amount of commercial paper eligible as collateral for Federal reserve notes. If some future similar emergency should arise, the member banks, not having the power to issue notes, would have to draw down their excess deposits with the reserve banks and pay out the gold thus withdrawn, which would very probably be hoarded and disappear from circulation, while they could meet every demand for cash if they could receive from the reserve banks, Federal reserve notes.

Experience may thus demonstrate that the present limitation upon the issue of Federal reserve notes to the amount of commercial paper pledged as collateral would greatly hamper the usefulness to the community of the issue of such notes, as the required collateral would tend to decrease in amount while the demand for the notes as substitutes for gold might, at the same time, increase. It would seem, therefore,

most reasonable to permit the issue of these notes either against commercial paper or against gold.

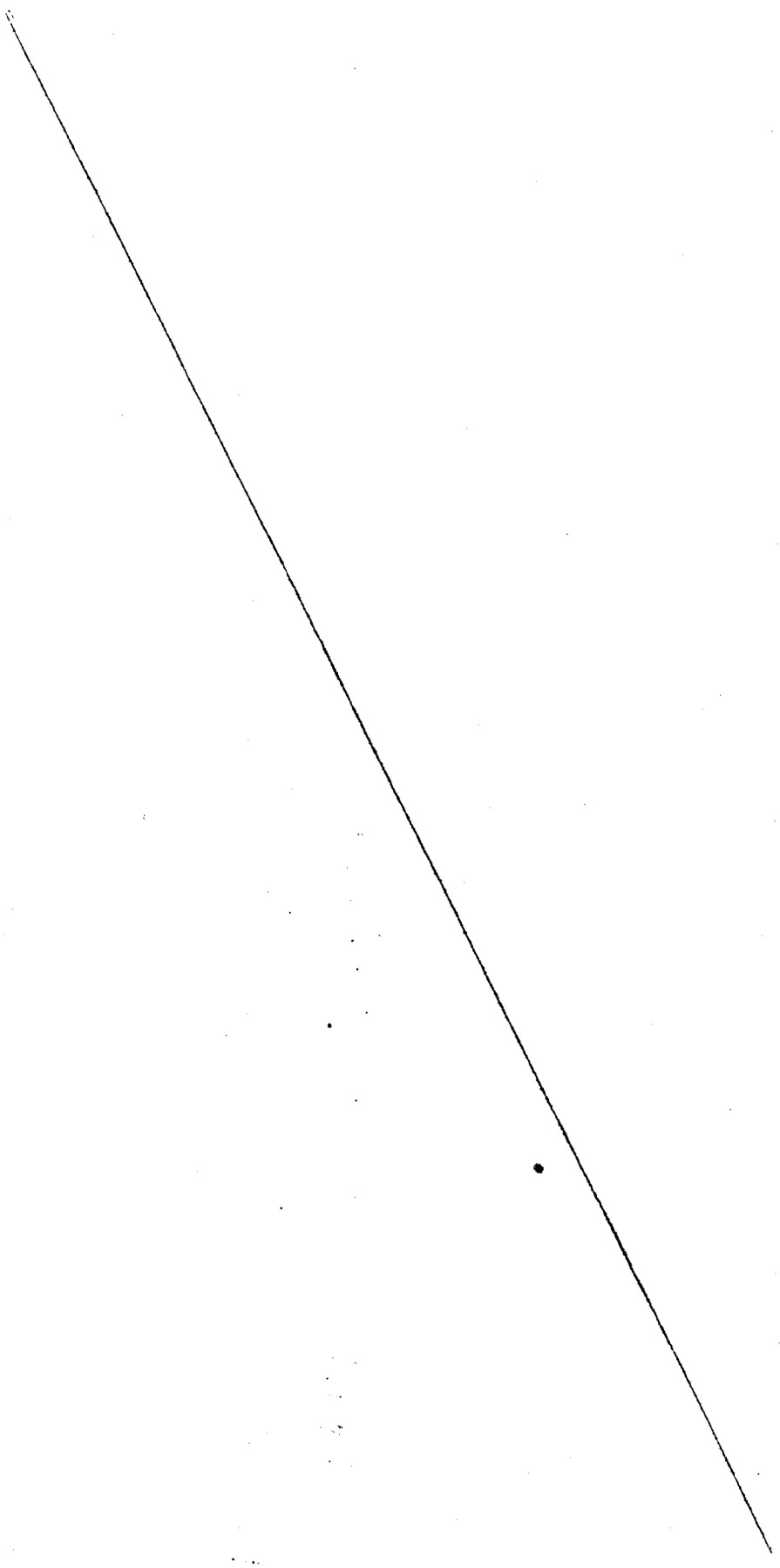
So, also, there might arise a demand for gold by some member bank for export, and in this event, if the Federal reserve bank had the necessary amount of gold deposited with the Federal Reserve Agent, whether under the circuitous method used under the present law, or pledged with the Agent, under the amendment, it could obtain this gold from the Agent by substituting the commercial paper rediscounted by the member banks to secure the gold, and thus give to the member bank the gold so withdrawn from the Agent.

An interesting table, prepared by Federal Reserve Agent Jay, (Appendix I and II), demonstrates that gold thus withdrawn from the Agent's possession does not diminish the credit power of the Federal reserve bank, but, on the contrary, protects that credit power from the inevitable decrease resulting from the payment of the gold directly from the bank's vaults. Mr. Jay shows conclusively that the gold thus deposited with the Federal Reserve Agent increases the credit power of the bank to the extent of 50% of the amount of gold deposited.

The proposed amendment would also, at the present time, at least, operate most conservatively, correcting any present tendency toward undue expansion caused by the great inflow of gold into the United States, for every dollar of this gold which could be secured by the Federal reserve banks from member banks in return for Federal reserve notes, would be taken out of the vaults of the member banks and impounded in the Federal reserve banks. Furthermore, every dollar of gold which a Federal reserve bank could deposit with the Federal Reserve Agent as a basis for Federal reserve notes would be a use of this gold by the issue of the notes simply dollar for dollar; that is to say, there would be no expansion whatsoever in the circulating medium, because for every dollar of notes issued by the Federal reserve bank a dollar in gold would be impounded with the Federal Reserve Agent.

The amendment, furthermore, would enable the Federal reserve banks to lay down and maintain, under the guidance of the Federal Reserve Board, a uniform, National policy of conservation of the gold supply of the United States.

For the above reasons, it would seem most advisable that the law should be amended,



as indicated above, so that Federal reserve notes may be issued by the Federal Reserve Agent against the deposit of gold as well as of commercial paper.

The adoption of this amendment would also correct the curious anomaly, - pointed out above, - the "reduction" of the bank's but not of the Government's liability, - which results from the payment to the Federal Reserve Agent by the bank, in gold, after the original issue of the notes against commercial paper; for under said amendment the Federal reserve notes, instead of being paid in gold after their issue by the bank, as under the present circuitous process, will be issued originally to the bank upon the deposit of gold, so that as a result the liability of the bank upon these notes will continue the same as the liability of the Government, - until their final redemption.

The apparent inconsistency between the Federal reserve bank statement and the Treasury statement, pointed out above, will also be removed by the passage of the amendment, and the total note liability, both of the banks and of the Government, will be the same, that is, they both will be liable for the total amount of Federal reserve notes outstanding, until final redemption, and the two statements will be in perfect harmony.

The above amendment also provides that where a Federal reserve bank has taken out Federal reserve notes on the deposit of gold with the Agent it need not keep the required 40% gold reserve in its vaults against such notes.

In the indirect operation described above, where the bank takes out the notes originally against the pledge of commercial paper but later pays the full amount in gold to the Agent, the bank, after the payment, need keep no gold reserve in its vaults against these notes, for the good and sufficient reason that the payment of the gold has "reduced" its liability on these notes; therefore, no reserve need be maintained.

Similarly, under the proposed amendment, the original issue of Federal reserve notes to the reserve bank against the deposit of 100% gold will leave the bank liable upon these notes as well as the Government,

but the Government having in its hands 100% in gold with which to pay them, the bank need keep no reserve, for, if presented by the holder to the bank for payment the bank would merely turn the notes over to the Agent who would redeem them from the 100% in gold in his possession for this purpose.

The exact measure of expansion under this proposed amendment, as compared with the maximum expansion under the present law will be shown in detail later.

IV.

The right of the Federal reserve bank, described above under III, to pay to the Agent in gold, etc., the full value of outstanding Federal reserve notes and thus "reduce" the liability of the bank upon such notes is repealed by the omission of the paragraph of Section 16 hereinbefore quoted, granting this privilege. It is also provided that any rate of interest which may be charged by the Federal Reserve Board upon Federal reserve notes shall not be applicable to such notes when and as long as secured by gold deposited with the Agent.

The object sought by this proposed amendment is to maintain the liability of the banks upon all notes issued until they are finally redeemed, thus making the liability precisely the same as that of the Government. This change will also bring about, harmony between the daily statement of the Treasury and the Federal reserve bank statement, and will remove the apparent inconsistencies pointed out above under III.

It would seem also desirable to provide, - as does the proposed amendment, - that in so far as the Agent holds gold pledged against outstanding notes, the bank should be released, pro tanto, from payment of any interest charge imposed by the Federal Reserve Board upon the outstanding notes, as such notes, - in so far as they are secured by pledge gold, do not constitute, an increase in the circulating medium, but are, to the extent that gold is pledged against them, - to all intents and purposes, merely gold certificates. Under such circumstances it would seem as unreasonable to impose an interest charge on such proportion of the notes, thus secured, as it would be to impose such a charge upon the gold for which the notes have become, pro tanto, to all intents and purposes, merely a warehouse receipt.

V

Federal reserve notes may also be issued not only against the deposit of 100% in gold with the Agent, but as well, against the deposit of paper and gold, and further, the gold so deposited as collateral with the Federal Reserve Agent shall be counted pro tanto and included as if in the vaults of the bank as its gold reserve against outstanding Federal reserve notes in actual circulation.

To illustrate:

1. Suppose a Federal reserve bank takes out one million dollars in Federal reserve notes pledging, under the amended law, as collateral 60%, or $600,000, in eligible paper and 40%, or $400,000, in gold.

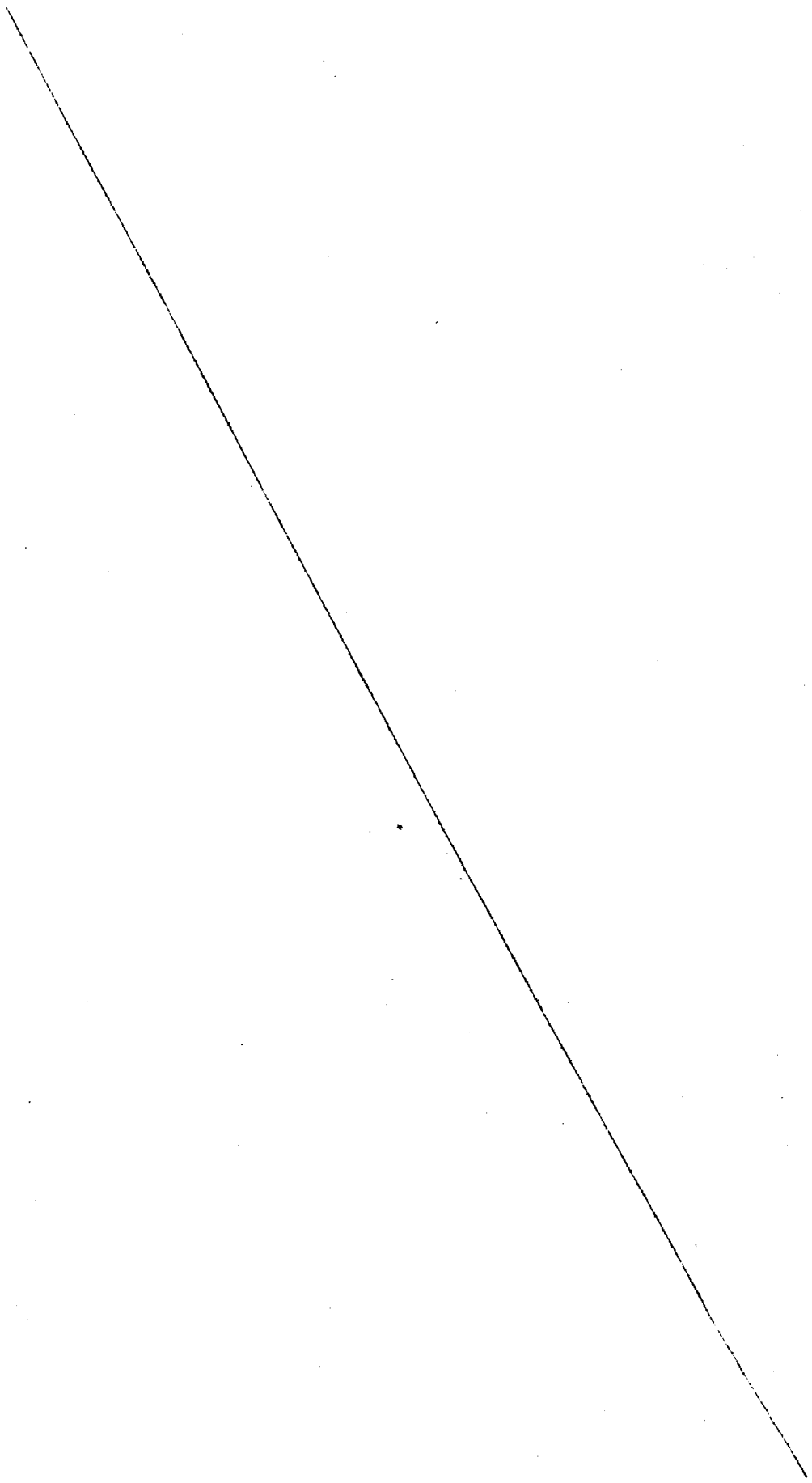
The effect of the above amendment would be that the reserve bank would count the $400,000 gold deposited with the Agent as its 40% required gold reserve just as if it were actually carried in its vaults, and need carry no reserve in its vaults against such notes.

2. Or, in the alternative, let us suppose, that the reserve bank takes out one million dollars in Federal reserve notes, pledging, - under the amendment, as collateral, 80%, or $800,000, in commercial paper and 20%, or $200,000, in gold. The $200,000 deposited with the Agent would count as one-half of the required 40% reserve, but the reserve bank would have to carry $200,000 gold as reserve in its vaults, which, together with the $200,000 deposited with the Agent, make up its required 40% gold reserve. Under such circumstances, however, the bank would probably deposit with the Agent the $200,000 free gold, and take back a similar amount of commercial paper, leaving the situation the same as in 1. supra.

3. Or, again, let us suppose that the Federal reserve bank takes out one million dollars of Federal reserve notes, pledging with the Agent, as collateral, $400,000 paper and $600,000 gold. Under the amendment, the Federal reserve bank would be in the same position as if the $600,000 gold were still in its vaults, that is, it would have $400,000 as a 40% gold reserve and would have $200,000 free gold which could serve as a reserve for further issues of Federal reserve notes, but not as a reserve against deposits.

- 17 a -

It is to be noted that illustrations 1 and 2 could be as pointed out supra, indirectly accomplished under the present law, by the payment of gold to the Agent after the notes had been issued



against 100% commercial paper, i.e. the same situation would result, - the notes outstanding would be the same - one million dollars - at least as to the Government liability, - and the Agent would hold commercial paper in part and gold in part as collateral, - 100% in all.

The reserve situation, however, would be very different, comparing the present law with the proposed amendment.

For example, under 1. supra, the $400,000 payment to the Agent would cancel the bank's liability on $400,000 Federal reserve notes but the bank would have to carry in its vaults a gold reserve of 40% upon the $600,000 Federal reserve notes covered only by commercial paper, i.e. a gold reserve of $240,000.

So also in 2. supra, under the present law, the bank must carry in its vaults in gold 40% of $800,000 or $320,000.

So also, in both 1 and 2, supra, under the present law, the payments to the Agent would be subtracted from the gold resources of the bank.

Under the proposed amendment however, in illustration 1 supra, the payment of $400,000 to the Agent would not extinguish the liability of the bank upon $400,000 of Federal reserve notes. On the contrary, these notes would remain as an outstanding liability of the bank.

So also, the bank would not have to keep any reserve against these notes in its vaults, for the $400,000 pledged with the Agent counts as if it were in the bank vaults, as, instead of being paid to the Agent to **reduce** liability it is now pledged with the Agent as security for a continuing liability, and being counted as if actually in the vaults of the bank it would count as its 40% gold reserve.

So also, in 2 supra, under the amended law the $200,000 pledged with the Agent would necessitate only $200,000 gold to be carried by the bank in its vaults, instead of $320,000, as under the present law.

So also, in 3 supra, the bank would count the $600,000 deposited with the Agent as if it were cash in the vault and it could, therefore, have, theoretically, its 40% gold reserve and also $200,000 free gold

actually in its vaults, as a basis for further Federal reserve note issues.

The first objection which may be advanced against the proposed amendment is that it permits an expansion of note issues.

As a fact, however, where the bank can secure ample commercial paper, no more notes could be issued under the amendment than under the present law, and the amendment would merely permit a substitution of gold as collateral in the place of commercial paper.

On the other hand, assuming that the bank has e. g. 400 millions of free gold and only 600 millions of commercial paper, the amendment would admit of an additional note issue limited to the exact amount of the gold deposited with the Agent as collateral.

The total note issue, however, could in no event exceed 100% of the total collateral, paper and gold, pledged with the Agent; nor could the total note issue in any event exceed 2½ times the free gold owned by the bank, - 400 millions, - whether the gold is held in the bank's vaults or pledged with the Federal Reserve Agent.

It would seem reasonably clear that expansion to this extent is not undue but is consistent with sound banking.

It should also be pointed out that, whenever Federal reserve notes are placed in circulation as a substitute for retired national bank circulation an actual contraction of the circulation takes place.

This will at once be seen from the following tables. For example, there are today about 735.7 millions of national

bank notes in circulation and about 1928 millions in gold coin or certificates, Let us, then, assume that these National bank notes are removed from circulation over night and that their place is to be filled in the circulation by an equivalent amount of Federal reserve notes, the Federal reserve banks having an ample supply of commercial paper to pledge with the Federal Reserve Agent against the issue of the Federal reserve notes.

The account would stand:

		Reserve	Gold in circulation	Notes and gold in circulation	Security held by U.S.Treasurer or F. R. Agent
1. National Bank Notes	735.7	(5%) 36,8	1928	2663.7	735.7 U. S. bonds
2. Federal Reserve Notes	735.7	(40%) 294.2	1670.6	2406.3	735.7 Commercial paper
Contraction			257.4	257.4	

This shows that, under Section 16 as now in force, if 735.7 millions of Federal reserve notes were substituted for the 735.7 millions of National bank notes now outstanding, the gold reserve requirement for Federal reserve notes would result in a contraction of gold in circulation of 257.4 millions, - the amount of the excess of said gold reserve, - 294.2 millions, - over the reserve required for National bank notes, - 5%, or 36.8 millions.

Let us now suppose that the proposed amendment has been enacted into law, and that the Federal reserve banks have only 441.5 millions of commercial paper, and that they take out 735.7 millions of Federal reserve notes by pledging 441.5 millions in commercial paper (60%) and 294.2 millions (40%) in gold.

The account will then stand:

		Reserve	Gold in circulation	Notes and gold in circulation	Security held by U.S.Treasurer or F.R.Agent
1. National Bank notes	735.7	36.8	1928	2663.7	735.7 U.S. Bonds
2. Federal reserve notes Present law	735.7	294.2 (36.8 + 257.4)	1670.6	2406.3	735.7 Commercial paper
3. Federal reserve notes Law as amended	735.7	(294.2) (36.8 + 257.4)	1670.6	2406.3	(441.5 commercial 735.7(paper (294.2 (gold
4. Federal reserve notes	1164.8	465.9 (36.8 + 429.1)	1498.9	2663.7	1164.8 Commercial paper

Line 3 above shows just what the proposed amendment would accomplish, - it permits the bank to carry its required reserve in the Federal Reserve Agents' trust fund where it is available for the issue by the Agent of 294.2 millions of Federal reserve notes, dollar for dollar.

It will be noticed that the reserve of 294.2 millions in line 3 supra, is put in brackets, for the reason that it is not in fact in the bank vaults but is carried by the bank, - as the amendment permits, with the Federal Reserve Agent.

The gold in circulation is, however, contracted by the same amount, - 257.4 millions net, - as though the notes were issued as in line 2, under the present law, the same reserve being required, but permitted to be carried, under 3, with the Federal Reserve Agent.

It is interesting to note here that, in order to prevent any contraction in the total notes and gold in circulation, - 2663.7 millions, as shown in line 1, a much larger amount of Federal reserve notes would have to be issued. This can be shown by the following algebraic formula:

Let X = the required amount of Federal reserve notes to be issued.

Then 40/100 X will be the required new reserve.

The formula will then stand: X - 735.7 = 2/5 X - 36.8.

That is to say the new amount of notes to be taken out minus the 735.7 millions now outstanding will equal the new required gold reserve minus 36.8 millions, - the amount of the 5% redemption fund for National bank notes:

Then:

X - 735.7 + 36.8 = 2/5 X

X - 698.9 = 2/5 X

X - 2/5 X = 698.9

3/5 X = 698.9

X/5 = 232.96

X = 1164.8

Transferring these figures to line 4 in the above table, we will see that to keep the total notes and gold in circulation the same as when the National bank notes were outstanding, there must be issued 1164.8 millions of Federal reserve notes, instead of 735.7 millions. The gold in circulation would then be contracted by 465.9 minus 36.8 millions (the amount of the 5% National bank redemption fund) = 429.1 millions, but the same amount, - 421.9 millions, - of Federal reserve notes would be added to the 735.7 millions of notes outstanding, and this would make the total notes and gold 2663.7 millions, - the same amount as was outstanding in line 1 of the table.

This issue could not be made, however, unless the banks had or could secure 1164.8 millions of commercial paper.

It may be asked, however, what amount of Federal reserve notes the reserve banks could issue under the present law, by using the circuitous process above described, that is, by paying to the Agent all free gold in the bank's vaults, thus releasing a similar amount of commercial paper, and then repledging the commercial paper for a similar amount of additional Federal reserve notes.

Using the process above described, assuming that the reserve banks have only 441.5 millions in commercial paper and 294.2 millions in gold, they could take out only 441.5 millions of notes against the pledge of commercial paper, but could then pay their free gold, - 117.6 millions (the balance, - 176.6 millions being held as a 40% gold reserve against the 441.5 millions of notes outstanding) to the Agent, taking back 117.6 millions of commercial paper and later repledging the commercial paper for 117.6 millions of additional Federal reserve notes.

The account would then stand:

Rediscounts	441.5	Federal Reserve Notes	441.5	Rediscounts	441.5	
Gold	176.6	Capital	294.2	Gold	117.6	
F. R. Notes	117.6				F. R. Notes	559.1
	735.7		735.7		559.1	559.1

Thus, by using the circuitous process, the Federal reserve banks, under the present law, could take out 559.1 millions of Federal reserve notes, being 117.6 millions more than they could take out without recourse to the process above described; the additional 117.6 millions of notes, however, would constitute a liability only of the Government and not of the banks.

The following table gives the results of the various methods above described:

(See following page)

		Notes	Reserve	Gold in circulation	Notes and gold in circulation	Security held by U. S. Treasurer or F. R. Agent.
1.	National Bank Notes	735.7	36.8	1928	2663.7	735.7 U. S. Bonds
2.	Federal Reserve Notes - Present Law: Notes issued vs. com. paper Direct method	735.7	(36.8 ǂ 257.4) 294.2	1670.6	2406.3	735.7 Com. Paper
3.	Federal Reserve Notes - Present Law: Notes issued vs. com. paper Direct method To make total notes plus Gold in circulation the Same as in 1	1164.8	(36.8 ǂ 429.1) 465.9	1498.9	2663.7	1164.8 Com. Paper
4.	Federal Reserve Notes - Assuming Federal Reserve Banks can secure only 441.5 com. paper and 294.2 in gold. Notes issued vs. com. paper Direct method	441.5	(36.8 ǂ 139.8) 176.6	1751.4	2192.9	441.5 Com. Paper
5.	Federal Reserve Notes - Same as 4 Circuitous method	*559.1	(36.8 ǂ 139.8) *176.6	*1670.6	*2310.5	(* 441.5 Com. Paper (* 117.6 Gold
6.	Federal Reserve Notes - Proposed amendment. Assuming reserve banks can secure only 441.5 com. paper and 294.2 in gold. Notes issued vs. com. paper and gold	735.7	(36.8 ǂ 257.4) (294.2)	1670.6	2406.3	735.7 (441.5 Com. Paper (294.2 Gold

* Note that the reserve in 5, - 176.6, - is the same as the reserve in 4, yet that 559.1 notes are outstanding in 5 and only 441.5 in 4. The reason is that the payment to the agent of 117.6 millions of gold operates to "reduce" the liability of the banks on that amount of notes, while the liability of the Government is increased by 117.6 millions. The banks being liable only on 441.5 millions of notes need keep a reserve only against 441.5 millions.

Note also that the contraction of gold is the same in 2 as in 5, for the 117.6 millions of gold is taken out of circulation equally whether held in the bank's vaults, as in 2, or held by the Agent, as in 5.

The above table clearly shows that, - when the banks have an ample supply of commercial paper, - the amendment causes no expansion of notes. It merely permits the same amount of notes to be issued, but the requirement of the present law that the Agent shall hold 100% commercial paper is contracted to 60%, and the balance is made up of gold.

The table also shows that when the banks can not secure as much commercial paper as their gold would sustain as a reserve for Federal reserve notes, i. e., 2½ times as much, there is an expansion, dollar for dollar, by the exact amount of gold pledged in lieu of commercial paper, but the total amount of notes outstanding can never exceed 2½ times the total gold held by the banks, whether in their vaults or pledged with the Agent, nor can the total amount ever exceed the total amount of collateral, whether paper or gold, pledged with the Agent.

It may be claimed, however, that in 3 supra, the 294.2 millions of gold serves two purposes, - both as reserve in the bank's vaults and as collateral with the Federal Reserve Agent, - and that this gold cannot serve two masters at the same time.

This latter proposition is undoubtedly true, but it has no application to the present case, for although this 294.2 millions of gold stands for two purposes and thus, in a sense, may be said to serve two masters, it does <u>not</u> stand for both purposes or serve two masters <u>at the same time</u>; on the contrary, it stands in the <u>alternative</u> for <u>either</u> at <u>any time</u>, but not for <u>both</u> at the <u>same time</u>, and there is nothing inconsistent or impossible in this dual but alternative relation.

A similar alternative use of the 40% gold reserve is found in another portion of Section 16 which provides that the Federal Reserve Banks must keep on deposit in the United States Treasury <u>not less than</u> 5% in gold as a redemption fund, but that such deposit of gold shall be counted and included as part of the 40% gold reserve to be maintained by the Reserve Banks in their vaults. Unquestionably, under this clause, the Federal Reserve Board, at the request of the

Secretary of the Treasury, could require the Federal Reserve Banks to deposit their whole 40% gold reserve with the Treasury, and we should then see this gold reserve serving two masters, but the service would be only an alternative service just as in the proposed amendment.

VI.

Let us now work out, step by step, just what note issuing power a Federal Reserve Bank has under the present law and what it would have under the suggested amendment, assuming only a limited supply of commercial paper.

In Appendix II, this has been worked out in detail by Federal Reserve Agent Jay and in Appendix III by Mr. Jacobson, of the Statistical Division of this Board, based upon the present resources, upon certain specified days, of the twelve combined Federal Reserve Banks.

It may, however, be easier to follow the various steps by taking a simpler illustration. We will, therefore, assume that a Federal Reserve Bank has, say, 400 millions of *capital which has been paid in in gold and that the bank has discounted 600 millions of commercial paper for member banks, pledging said commercial paper with the Federal Reserve Agent for Federal reserve notes which the member banks wish to draw out against their rediscounts.

The bank must keep in its vaults 240 millions of gold reserve against the 600 millions of Federal reserve notes outstanding, and thus has left 160 millions in gold which is free. The bank would like to impound this gold and at the same time use it in the shape of Federal reserve notes so as to derive earnings from it.

We will assume that the supply of eligible paper has fallen off and that the Bank can secure no more so that it can not utilize its 160 millions of free gold for taking out Federal reserve notes, having no eligible paper to pledge.

(*) By the term "capital", free gold is meant, in all the following tables. The term "capital" is used in order to distinguish the free gold, entered under this heading, from gold creating deposit liabilities and requiring a separate 35% reserve.

We will further assume, however, that paper eligible for purchase in the open-market (but not eligible for rediscount for lack of the indorsement of a member bank,) or U. S. bonds or Municipal warrants for any part of 400 millions, have been offered to the bank and that it is prepared to buy in the open-market as much of these as it can pay for by the issue of Federal reserve notes based upon the 160 millions of free gold in its vaults, assuming, at the same time, that those who offer these securities or paper for sale are willing to accept Federal reserve notes in payment.

The question which then arises is what amount of Federal reserve notes can the bank, under the present law, take out and issue against this 160 millions of free gold. We can then compare this with the amount of notes which can be issued under the proposed amendment.

The answer to this question will be found from an examination of the following tables :

PRESENT LAW

I.

The Federal reserve bank starts with 400 millions of capital paid in in gold. It has discounted 600 millions of commercial paper for member banks, pledging said paper with the Federal Reserve Agent against the issue of Federal reserve notes which the member banks draw out against their rediscounts.

It desires also to invest in open market purchases, United States bonds, or warrants as above assumed.

The account of the Federal reserve bank will stand as follows:

Reserve Bank.				Federal Reserve Agent.			
Rediscounts pledged	600	F.R.Notes	600	Rediscounts	600		
Rediscounts free	-	Capital	400	Gold	-		
Rediscounts total	600						
Gold paid to F.R.Agent	-						
Gold in bank vaults	400						
Gold - total	400						
F. R. Notes	-					F. R. Notes	600
Total	1,000		1,000		600		600

Reserve.
40% of 600 = 240

Free gold = 400 - 240 = 160

Credit power. F. R. notes = 2½ x 160 = 400.

The bank here has 160 millions free gold but it can not take out Federal reserve notes against it <u>directly</u> under the present law, not having rediscounts to pledge, all its rediscounts - 600 millions - having been already pledged with the Federal Reserve Agent. The bank, however, can indirectly, but none the less legally, make a further issue of Federal reserve notes, even on its present holdings of redis-

counts, by taking two steps as follows:

2.

S t e p 1.

The bank pays 160 millions of gold which it has in its vaults free, to the Federal Reserve Agent, taking back 160 millions of rediscounts from the Federal Reserve Agent, under the provisions of Sec. 16 above quoted.

The account will then stand:

Reserve Bank				Federal Reserve Agent			
Rediscounts pledged	440	F.R.Notes	440	Rediscounts	440		
Rediscounts free	160	Capital	400	Gold	160		
Rediscounts total	600						
Gold paid to F.R. Agent	(160)						
Gold in vault	240						
Gold total	240						
F. R. Notes	- -					F.R.Notes	600
Total	840		840		600		600

Reserve.

40% of 440 = 176

Free gold = 240 - 176 = 64

Credit power, F. R. Notes = 2½ x 64 = 160

This operation leaves the bank with 160 millions in free rediscounts upon which a further issue of Federal reserve notes can be taken out.

2.

S t e p 2.

Let us assume that the Bank repledges the 160 millions of free rediscounts and that it takes out 160 millions of additional Federal reserve notes.

The account would then stand:

Reserve Bank				Federal Reserve Agent.			
Rediscounts pledged	600	F.R.Notes	600	Re-discounts	600		
Rediscounts free	- -	Capital	400	Gold	160		
Rediscounts total	600						
Gold paid to F. R. Agent	(160)						
Gold in vaults	240						
Gold total	240						
F.R.Notes	160					F.R.Notes	760
Total	1,000		1,000		760		760

Reserve.

40% of 600 = 240

Free gold = 240 - 240 = 0

Credit power. F. R. Notes = 0

Thus by the two steps above described the Bank has paid 160 millions to the Agent and has thus "reduced" its liability on 160 millions of Federal reserve notes. This payment, however, has released 160 millions of rediscounts which have been repledged for 160 millions of additional notes. The bank's liability for Federal reserve notes remains as before at 600 millions, the additional 160 millions being offset by the 160 millions on which the bank's liability was "reduced" by the payment to the Agent. As the notes are all outstanding, however, the liability of the Government is increased by 160 millions and now stands at 760 millions.

The bank still has 240 millions of gold in its vaults, but this 240 millions it must keep as a 40% gold reserve against the 600 millions of Federal reserve notes outstanding.

The total note-issuing power of the bank is thus seen to be 760 millions. It could therefore issue 160 millions of additional Federal reserve notes for the purpose of making investments other than regular discount operations, for which latter, as assumed above, there is no demand, and these additional 160 millions would be a liability only of the Government.

3.

Let us now assume that the proposed amendment has become law and that henceforth Federal reserve notes may be issued by the Agent originally against the deposit of gold, commercial paper, or both.

Going back to I, we will assume the Bank pledges its 160 millions free gold with the Federal Reserve Agent instead of paying it in order to reduce its liability. The account will then stand :

Reserve Bank			Federal Reserve Agent			
Rediscounts	Pledged	600	F. R.Notes 760	Rediscounts	600	
	Free	-	Capital 400	Gold	160	
	Total	600				F.R.Notes 760
Gold *	Pledged	160				
	Free	240				
	Total	400				
F.R.Notes		160				
Total		1160	1160		760	760

Reserve
40% of 760 = 304
Free gold, 400-304 = 96
Credit power, F.R.Notes = $2\frac{1}{2}$ X 96 = 240

By this process, under the amended law, the pledge of 160 millions gold, instead of "reducing" liability on 160 millions of Federal reserve notes as was the case in II, steps 1 and 2, supra, has increased the liability of the bank by the amount of additional Federal Reserve notes taken out, - 160 millions,- and the bank, as also the Government, is liable on the total,- 760 millions. Note also that the bank has in fact only 240 millions gold in its vaults and 160 pledged with the Federal Reserve Agent. The amended law, however, provides that the 160 millions pledged with the Agent shall count as reserve against Federal reserve notes as if actually held in the bank's vaults. The total gold in the bank's vaults- 240 millions should, therefore, have added to it the amount pledged with the Agent- 160 millions, making a total of 400 millions.

We saw above under II, step 1, supra, that a payment to the Agent under the present law reduced the cash in the bank's vault to 240 millions while on the other hand the liability of the bank on Federal reserve notes was reduced to 440 millions.

Under the amendment, however, the 160 millions of gold pledged with the Agent is still counted as cash in the bank's vaults, while, on the other hand, the 160 millions of additional Federal reserve notes taken out by the bank instead of reducing its liability to 440 millions, increases its liability on Federal reserve notes from 600 to 760 millions, making it the same as the liability of the Government.

4.

We saw also under II, Step 2, supra, that the bank had 240 millions of gold in its vaults which it could not utilize for further issues of Federal reserve notes as it had to serve as a 40% gold reserve against the 600 millions of Federal reserve notes outstanding upon which the bank was liable. This 240 millions, however, is not a trust fund for the redemption of the notes but merely a gold (cash) requirement.

Inasmuch as the amendment provides that this gold reserve may be deposited with the Federal Reserve Agent and still be counted as if in the bank vaults let us suppose that the bank transfers i.e. pledges this 240 millions of gold with the Federal Reserve Agent. By this transfer or pledge, what was reserve before now becomes part of the Agent's trust fund, but being gold, it also, under the amendment, satisfies the gold (cash) reserve requirement as if it still were in the bank's vaults.

After such transfer, the account would stand:

Reserve Bank				Federal Reserve Agent			
Rediscounts: Pledged	600	F. R. Notes	1000	Rediscounts	600		
Free	-	Capital	400	Gold	400		
Total	600					F. R. Notes	1000
Gold Pledged	400						
Free	-						
Total	400						
F. R. Notes	400						
Total	1400		1400		1000		1000

Reserve:

40% of 1000 = 400

Free gold 400 - 400 = 0

Credit power, Federal Reserve Notes = $2\frac{1}{2}$ x 0 = 0

In the above statement the gold in the bank vaults is entered as 400 millions. In fact there is not a dollar in gold in the vaults, as it all has been pledged with the Federal Reserve Agent, but, under the amendment it counts as reserve in the bank vaults.

V.

Let us now consider just how great an expansion of credit power in the shape of Federal reserve notes has been made possible by the provisions of the amendment that gold deposited with the Agent shall count as reserve in the bank's vaults. We here still assume that 600 millions represents the maximum of eligible paper the bank can secure.

We saw above under I that the bank had 160 millions in free gold but could not take out Federal reserve notes directly against it because it had no free discounts.

Under the amendment, however, the Agent can issue Federal reserve notes against the deposit of this gold.

We also saw in II, Steps1 and 2, that by paying this 160 millions in gold to the Agent the bank received back 160 millions in commercial paper and that this paper was redeposited with the Agent and 160 millions additional notes taken out but that although the bank was liable on this additional 160 millions, it had also, by the payment of 160 millions "reduced" its liability on notes to an equal amount, and that therefore, the bank remained liable only on 600 millions, as before, while the Government liability had increased to 760 millions.

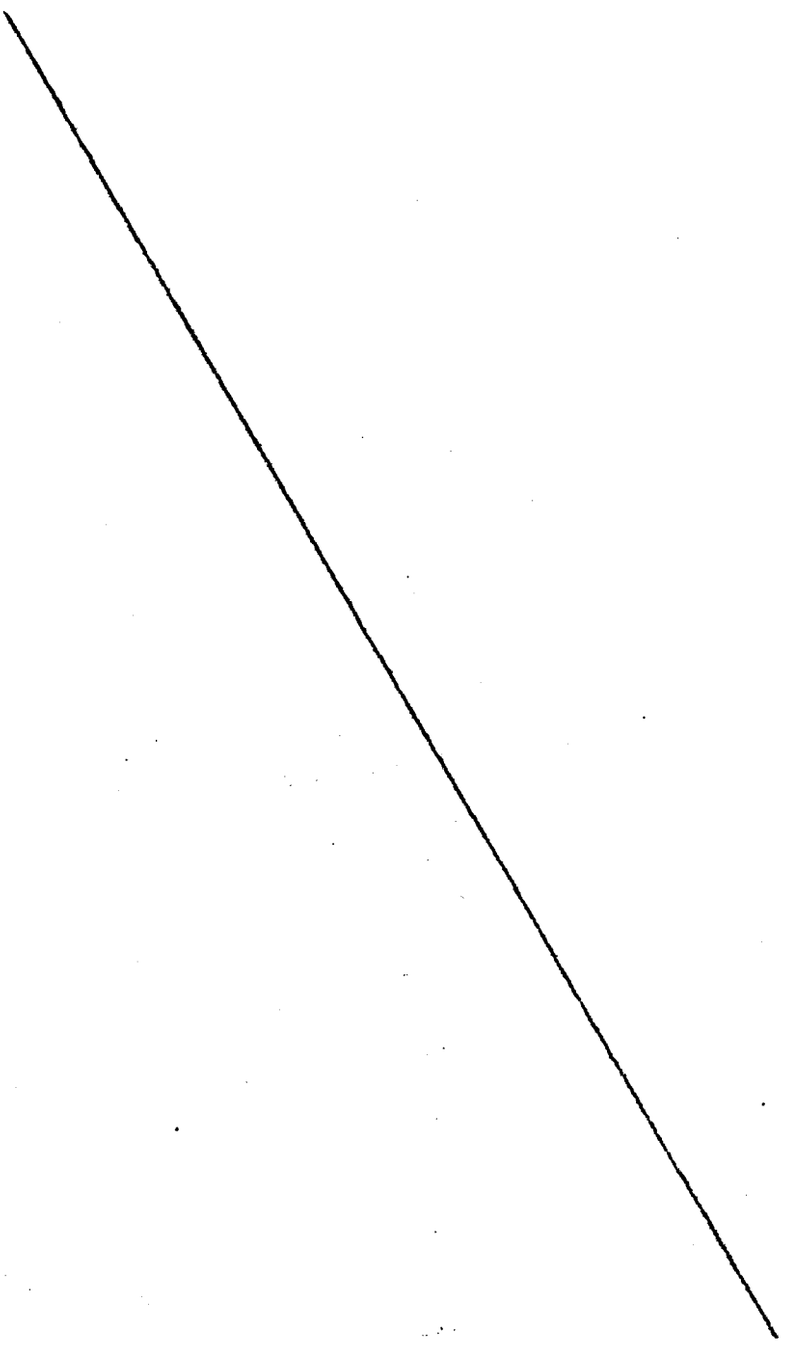
We also saw under III that under the amendment, the bank could pledge this 160 millions of gold with the Agent and thereby increase the total note issue outstanding from 600 to 760 millions upon which both the bank and the Government were liable.

We also saw that under the amendment the bank could also pledge its 240 millions of gold held as reserve against the 600 millions of out-

standing Federal reserve notes, with the Agent and take out 240 millions of additional Federal reserve notes.

To find, therefore, the true measure of expansion under the amendment we must consider; (a) the effect of the payment of 160 millions of gold to the Agent, under the present law, as compared with; (b) the effect of the pledge with the Agent of 160 millions of gold under the amendment, and (c) the effect of the further pledge of 240 millions of gold with the Agent.

We find that (a) increased the total note issue 160 millions while (b) increased the total note issued by 160 millions, and (c) by 240 millions, making a total of 400 millions in all.



That is to say, the payment to the Agent left the bank under the present law, with only 240 millions of gold which constituted its gold reserve of 40% against 600 millions of Federal reserve notes outstanding, while under the amendment, this 240 millions is actually deposited with the Agent, authorizing the issue by him of 240 millions of additional Federal reserve notes, but the 240 millions , as also the 160 millions above mentioned is counted as if still in the vaults of the bank. In the bank's vaults, this 160 + 240 = 400 millions stands as a reserve for 2½ X 400 millions of Federal reserve notes, while with the Agent it stands for the issue, dollar for dollar, of 400 millions Federal reserve notes, while the 600 millions of commercial paper pledged with the Agent serves as collateral for 600 millions of Federal reserve notes.

The Agent then holds 100% in collateral,- 600 millions in commercial paper and 400 millions in gold, while the 400 millions of gold, is counted as reserve in the bank's vaults, and serves as a gold reserve for 2½ X 400 millions = 1000 millions in Federal reserve notes,- the exact amount issued by the Federal Reserve Agent.

This shows that the real effect of the Amendment is to consolidate, for Federal reserve note purposes, the gold held by the bank with that held by the Agent, that is to say, the gold held by the Agent serves as if actually held in the vaults of the bank.

Going back to II, Step 2, we see that after issuing the maximum amount of notes possible under the present law, the account of the bank and Federal Reserve Agent stand as follows:-

Reserve Bank		Step 2.		Federal Reserve Agent	
Rediscounts Pledged	600	F. R. Notes	600	Rediscounts 600	
" Free	-	Capital	400	Gold 160	
" Total	600				
Gold Paid to F.R.Agt.	(160)				
" in vaults of Banks	240				
" Total	240				
F.R.Notes	160				F.R.Notes 760
Total	1000		1000	760	760

Reserve:

40% of 600 = 240
Free gold = 240 - 240 = 0
Credit powers, F. R. notes = $2\frac{1}{2}$ x 0 = 0

The bank here has 240 millions of gold in its vaults but has to retain it as a 40% gold reserve upon the 600 millions of Federal reserve notes outstanding. This gold, however, is not a trust fund, it is merely a cash reserve requirement.

The amendment provides that this gold reserve of 240 millions may be deposited with the Reserve Agent and still count as reserve, After depositing this 240 millions with the Agent, the account, as shown, supra, under IV, stood: -

Reserve Bank.				Federal Reserve Agent.	
Rediscounts pledged	600	F. R. Notes	1000	Rediscounts	600
" free	-	Capital	400	Gold	400
" Total	600				
Gold pledged with Agent	400				
" in vaults of Bank	*(400)				
Total	400				
Federal Reserve Notes	400				F.R.Notes 1000
Total	1400		1400	1000	1000

*Held, as per amendment, with the Federal Reserve Agent.

Reserve:

40% of 1000 = 400
Free gold = 400 - 400 = 0
Credit power - Federal Reserve Notes = $2\frac{1}{2}$ x 0 = 0.

This shows at a glance what the amendment accomplishes:

Under II, step 2, (present law) the bank paid 160 millions in gold to the Agent which authorized the Agent to issue 160 millions in Federal reserve notes in return for the unpledged discounts which the payment of said 160 millions of gold released.

Similarly, under the amendment, the bank pledges this 160 millions for an equal amount of notes.

Under the amendment, the bank also pledges the 240 millions of gold held by the bank under II, step 2, present law, as a reserve against the 600 millions of Federal reserve notes outstanding, and this pledge with the Agent authorized him to issue 240 millions additional of Federal reserve notes making a total of 1000 millions, as against 760 millions under the present law.

Under the amendment, however, the 600 millions of rediscounts is pledged as part collateral, 60% for 1000 millions of Federal reserve notes, instead of, as in II, Step 2,(present law),as 100% collateral for 600 millions of notes.

So also, the 160 millions paid to the Agent under II, Step 2, (present law) remains with the Agent as part collateral for 1000 millions of Federal reserve notes, instead of as 100% collateral for 160 millions of notes.

So also the 240 millions of gold, which was tied up in the bank's vaults as reserve under II, Step 2,(Present law), but which, under the amendment, is pledged with the Agent, stands as part collateral for 1000 millions of Federal reserve notes.

Thus we see that the amendment has not changed the law as to the requirement of 100% collateral to be pledged with the Agent, for we see that the 1000 millions of Federal reserve notes issued by the Agent are secured by 100%, i.e. by 600 millions of commercial paper, and 400 millions of gold. Nor has it changed the law that a reserve of 40% in gold must be held against outstanding Federal reserve notes, for the required reserve on 1000 millions of Federal reserve notes is 400 millions and we see that there are in the Agent's possession 400 millions in gold which serves as the 40% reserve, as if actually in the bank's vaults.

What change, then has the amendment brought about ?

It has simply provided : (a) that the 40% gold reserve, if deposited with the Agent, may also count as part of the trust fund of 100% which the Agent must hold against all Federal reserve notes issued by him. (b) that instead of issuing notes only against commercial paper, the Agent may also issue them against gold. (c) that when the gold pledged for notes amounts to 40% of the total issue, the gold may serve as the gold reserve, or pro tanto, which the bank is required to keep, as a cash requirement, in its vaults, against such total issue. (d) that the gold reserve is not thus used at the same time for two inconsistant purposes but is used in the alternative for either of two purposes, and that its use for one releases it from the other.

It may be claimed that by the amendment the bank is permitted to take out 1000 millions of Federal reserve notes without the necessity

of carrying 40% or 400 millions in gold.

This, however, is not true in fact as the gold reserve of 400 millions is just as much a cash reserve when held by the Agent as when held by the bank. What is true, however, is that if 400 millions of gold had been actually in the vaults of the bank, under the present law, the Agent would have had to hold 400 millions of commercial paper in addition.

The proposed amendment releases the Agent from the necessity of carrying this 400 millions of commercial paper, by permitting the gold reserve to be held by him in its place. It thus disponses with the necessity for using 400 millions of commercial paper but as the bank is assumed to have no commercial paper - other than the 600 millions already pledged with the Agent- no commercial paper in fact has been released to it.

On the other hand, if the bank had an ample supply of commercial paper, the amendment would leave in the bank, unpledged, 400 millions of commercial paper, but the total note issues could never exceed 2½ times the amount of gold held by the bank, plus that pledged with the Agent.

That the permission given by the amendment to count the gold reserve against Federal reserve notes, when deposited with the Agent as part of the Agent's trust fund, is just, equitable, and in consonance with sound banking will readily be seen if we consolidate the accounts of the bank and the Agent, as is really accomplished, at least for Federal reserve note purposes, by the amendment.

The account would then stand as follows:

5.

Consolidated account of Bank and Federal Reserve Agent.

Rediscounts	600	Federal Reserve Notes	1000
Gold	400	Capital	400
Federal Reserve Notes	400		
Total	1400		1400

Reserve:

40% of 1000 = 400
Free gold = 400 - 400 = 0
Credit power, Federal reserve notes = 0.

The above shows conclusively that, under the amendment, - (a) the Agent may issue notes based upon commercial paper or gold; (b) the total notes outstanding can never exceed 2½ times the gold in the trust fund, serving also as a 40% gold reserve, as if in the bank's vaults; (c) the notes

issued can never exceed 100% of the total collateral, - commercial paper and gold - held by the Agent.

VI.

Finally, it may be claimed that, assuming that the Amendment is correct in theory, yet in practice it would not work out successfully, for the reason that the bank, - as shown in the statement of account under IV, supra, - is including the gold, - amounting to 400 millions, - deposited with the Agent as part of his trust fund, also as a reserve as if in the bank vaults, whereas it is not in the bank vaults, and the bank has no control over it, and, as a result, if the outstanding 1000 millions of Federal reserve notes, or any portion of them, were presented to the bank for redemption, it would have no gold actually in its vaults as reserve for such payment.

The answer to this objection is that although the bank does not hold this 400 millions of reserve actually in its vaults, yet it has an immediate right to its possession, which is as good as if it were in its own vaults.

In this connection it must be remembered that although Federal reserve notes are an obligation both of the Government and of the banks, and must be redeemed by either, the demand for redemption must be made upon one or the other and not upon both. In other words, the holder of the note on which he desires redemption must elect whether to present it to the Government or to the bank through which it was issued.

If for example, the holder presents it to the Government, the latter must redeem it and, towards this redemption, it has the gold deposited with the Federal Reserve Agent and with the Treasurer, that is the Government has 40% in gold and must pay also the remaining 60% which, later, the bank must repay to it.

If, on the other hand, the holder elects to demand redemption from the bank, the latter by paying the note in full and surrendering it to the Federal Reserve Agent will receive back the 40% gold reserve, leaving its net payment from funds in its vaults, 60%.

Thus in either event, the 40% gold reserve is available to the Government or to the bank, - whichever is called upon to redeem the note; and in either event the bank must pay 60% of the amount of the note from its cash resources in its vaults and can obtain the 40% gold reserve for the balance.

The only distinction is that if the holder demands redemption from the bank the 60% aforesaid is paid by the bank to the holder; while if the holder demands redemption from the Government, the 60% aforesaid is paid by the bank to the Government.

To sum up :

1. The Federal Reserve Bank, in its illustration given above, by paying the 160 millions of free gold, under the present law, to the Agent, can issue 160 millions additional notes upon which the Government is liable but upon which its liability is "reduced".

2. The bank by pledging this 160 millions of free gold, under the amendment, with the Federal Reserve Agent, can take out 160 millions additional notes, upon which it, as well as the Government is liable.

3. The bank, by pledging the 240 millions of gold held, under the present law, in its vaults, as a 40% reserve against the 600 millions of Federal reserve notes outstanding, of which the collateral is commercial paper, can take out 240 millions more of notes, as this 240 millions of gold will count both as reserve and also collateral for all notes outstanding, thus displacing the necessity for 400 millions of commercial paper being held by the Agent.

4. The same amount of reserve must be held under the amendment as under the present law, but it may be kept with the Agent and count as part of the 100% collateral behind the notes.

5. All notes issued must be covered by collateral with the Agent of 100% in commercial paper, gold or in part of cash.

The real effect of the amendment, therefore is that, whereas under the present law, when the collateral is 100% commercial paper, a 40% gold reserve must be kept by the bank, under the proposed amendment if e. g. 40% of the collateral is held in gold by the Agent this will dispense with the necessity for a gold reserve in the bank's vaults.

The effect of the present law, in other words, is to impound in the shape of reserve and collateral, 140% of the value of all notes issued, whereas the proposed amendment dispenses with the extra 40% collateral in the shape of commercial paper, where at least 40% of the collateral consists of gold.

This will appear clearly if we were to assume that the law were changed so that the office of Federal Reserve Agent were abolished and the accounts of the Agent and the bank were consolidated as in the above illustration, and that the law further provided that the bank could issue Federal reserve notes, provided, it kept in its vaults, as a trust fund for the redemption of the notes, 60% in commercial paper and 40% in gold.

It is clear, in the above case, that the requirement of a 40% cash (gold) reserve against Federal reserve notes would be satisfied if the bank held 40% in gold segregated as a trust fund. This is in effect, the result reached by the proposed amendment, the office of Federal Reserve Agent being retained, but the accounts of the bank - at least for Federal reserve note purposes,- being consolidated with the accounts of the Agent.

It is submitted that, for the reasons set forth in detail above, the proposed amendment should be enacted into law. Under the law so amended, the Federal reserve banks will be able to conserve gold already in their possession, to secure gold now held by the member banks, and finally, to initiate and maintain an effective and greatly needed National policy of gold conservation.

The writer desires to acknowledge the invaluable assistance rendered in the preparation of this memorandum by Federal Reserve Agent Jay, Mr. Harrison, Mr. Foulk, Mr. Gidney and Mr. Jacobson.

STATEMENT FOR THE PRESS.

Washington, April 29, 1916.

The Federal Reserve Board mailed this morning to the Federal reserve banks for distribution to all their member banks its circular announcing a plan for country-wide check clearing and collection. The salient points of the circular are:

The Federal Reserve Board, acting under the authority of the Federal Reserve Act, has designated the Federal Reserve Banks to act as clearing houses for the clearing and collection of checks for their members. In doing this the Federal Reserve Board has laid down certain general principles but has left it for the executive officers of the Federal Reserve Banks to work out the details. The Board evidently recognizes the immense amount of detail work that must be done in order to put such a vast machinery into smooth operation, and has set the time for beginning the operation of the system as June 15th. The important features of the plan are:

(1) The Federal Reserve Banks will accept at par all checks from member banks, whether drawn against other member banks, non-member banks, or private banks. An exception is made at the outset in the case of checks drawn against non-member banks which can not be collected at par.

(2) All checks thus received from member banks will be given immediate credit entry, although amounts thus credited will not be counted as reserves, nor become available until collected.

(3) In order to enable member banks to know how soon checks sent in for collection will be available either as reserves or for payment of checks drawn against them, time schedules, giving the minimum time for collection, will be furnished by each Federal Reserve Bank to its member banks.

(4) The actual cost, without profit, of the clearing and collection of checks will be paid by the Federal Reserve Banks and assessed against the member banks in proportion to their sendings.

(5) The whole plan is based on generally accepted principles under which clearing and collection plans have long been operated. A Federal Reserve Bank will not debit a member bank's reserve account with items forwarded to it for collection until the remittance of the member bank in payment of such items shall have had time to reach the Federal Reserve Bank.

FEDERAL RESERVE BOARD

WASHINGTON

April 29, 1916.

S I R :

Referring to our conference and correspondence on the subject of check clearing and collection, I have sent you this morning telegram reading as follows :

> " Clearing circulars are being forwarded to you this forenoon in sufficient quantity to enable you to forward one to each of your member banks. The circulars bear date of May first and we trust will be forwarded with as little loss of time as possible. "

Furthermore, I am enclosing, herewith, on behalf of the Federal Reserve Board, copy of the circular sent to you and also copy of the press statement which the Board gave out today. While it may be too much to expect that the Federal Reserve Banks will be ready on June 15th, it is the hope of the Board that the banks will diligently and energetically take hold of this matter and, through conferences with their member banks and with other Federal Reserve Bank officers, prepare the necessary circulars, instructions and forms.

The Board's circular, as sent out, embodies many of the criticisms and suggestions that have come to the Board and we believe will prove satisfactory.

Respectfully,

Vice Governor.

FEDERAL RESERVE BOARD

WASHINGTON

May 1,1916

My dear Mr.

May I ask you to tell me for the information of the Board, the extent to which you have access to examiners' reports of National banks in your district ? It is assumed that you now have a complete file of all "condition reports" of banks in your district for the year and a half since your bank was opened, - say nine reports - and that you also have a list of all banks that are on schedule for special examination, and, in addition to that, at least an abstract by the examiner of his reports to the Comptroller of the Currency.

To summarize, the Board wishes to know to what extent you feel that you have complete and accurate knowledge of the condition of your member banks, and whether or not you are in a position to decide quickly if you can safely make advances to them on eligible collateral. If you have difficulties in procuring necessary information from the Chief Examiner of your district, please explain what those difficulties are.

Yours very truly,

Vice Governor.

A PROGNOSTICATION

One feature of the general question of the clearing and collection of checks is worth pointing out because it has not been referred to by writers on the subject, and that is the strengthening of the bonds uniting the Federal reserve banks and their members which this action by the Board will accomplish. Until now the only member banks having direct communication with the reserve banks were those having occasion to rediscount their paper. This represented in some districts less than ten per cent of the member banks; in none more than one-third. The great majority of member banks have regarded the Federal reserve banks as an emergency provision for which they were paying rather dear. The Board's action in designating the reserve banks to act as clearing houses for their own member banks at once establishes a new and far-reaching relationship. Not only will the Federal reserve banks put themselves in a position to render a service to their members which only the largest banks in New York, Chicago and St.Louis have been able to render heretofore, but it seems entirely probable that on a bare cost basis this service will be rendered for less than it ever was before. But in order to protect themselves against the sendings of other banks, each member bank will find it advantageous to send items to its Federal reserve bank sufficient to offset items coming against it, and if unable to meet the flow of items against it, will find it advantageous to increase its book balances in the Federal reserve bank, which may be done by remittances, but more naturally as time goes on by discounting short-time paper with the reserve bank.

By these features of the check clearing and collection plan the relations of the Federal reserve bank with its members will necessarily become more intimate, and if, as it is fair to assume, the officers of the reserve banks treat their members with the same suavity and sagacity that the officers of large reserve city banks now treat their customer banks, there can be no doubt as to the outcome. Furthermore, while this service is to be rendered to the member banks at cost, without profit, the rediscounting of paper to create excess balances will necessarily yield a profit to the Federal reserve bank and so help that bank in a normal and natural way to earn dividends for its members. It has been pointed out that the Federal reserve banks exist chiefly to extend credit to their members through the rediscounting privilege, but it is not to be supposed that this credit is to take the form solely, nor even chiefly, of note issues; the more common form will undoubtedly be, as time goes on, book credits subject to draft.

When this clearing plan shall have been put into operation we shall hear less of the Federal reserve banks acting as emergency institutions; less of their being costly instruments for insurance. Then it will be appreciated that they exist to render a valuable service to their members, every day in the week, every week in the month, every month in the year!

F. A. DELANO.

May 1, 1916.

CONDENSED SUMMARY OF THE MEMORANDUM OF

CHARLES S. HAMLIN, DATED MAY 1st,

SO FAR AS RELATES TO PROPOSED AMENDMENTS TO SECTION 16, OF THE FEDERAL RESERVE ACT.

1. It is necessary carefully to distinguish between: -

   A. The issue of Federal reserve notes by the Federal Reserve Agent to a Federal reserve bank.

   B. The paying out of such notes by the Federal reserve bank into circulation.

2. The present law requires: -

   For A, - the pledge with the Agent of 100% in commercial paper.

   For B, - the impounding in the bank vaults of 40% gold reserve.

3. The proposed amendment permits: -

   As to A, - the pledge with the Agent of gold as well as commercial paper.

   As to B, - the pledge with the Agent of the 40% reserve fund.

4. The proposed amendment also provides that the 40% gold reserve, when pledged with the Agent, shall count as part of the 100% collateral which the Agent must have as security for all outstanding Federal reserve notes, and that it shall be counted, as if it were in the bank vaults, as the gold reserve of 40% required to be impounded in the bank's vaults.

5. The effect of the amendment is: -

   A. Where the bank has an ample supply of commercial paper.

      It permits the same issue of Federal reserve notes as under the present law, but releases commercial paper as collateral by the exact amount of gold deposited with the Agent.

   B. When the bank can secure only a limited amount of commercial paper.

      It permits the bank to issue a larger amount of Federal reserve notes by the exact amount, dollar for dollar, of gold deposited in lieu of commercial paper.

In both A and B, however, the total notes outstanding can never exceed 2½ times the amount of gold held by the bank, whether deposited, as in A, in the bank vaults, or deposited, as in B, with the Federal Reserve Agent. In both A and B, also, the total notes outstanding can never exceed the amount of collateral, whether commercial paper or gold, pledged with the Agent.

6. Under the present law, if the bank has 2½ times as much commercial paper as it has free gold in its vaults it can take out as many notes as it could under the amended law, and no special benefit would be derived by the amendment, except that it would permit banks to conserve their gold by taking out Federal reserve notes, dollar for dollar, in its place.

7. If, however, the Federal reserve bank can not secure 2½ x as much commercial paper as it has gold, some of its gold can not be utilized in the shape of Federal reserve notes for lack of commercial paper to pledge with the Agent, and the amendment permits the lack of commercial paper to be made up by the pledge of gold in its place, and thus enables all of the gold owned by the bank to be utilized by the issue of Federal reserve notes.

8. The amendment thus permits an additional issue of notes, dollar for dollar, by the amount of gold deposited by the bank with the Agent, but the total issue can never be (a) more then 2½ x the gold held in the bank's vaults (excluding that held as reserve against deposits,) plus the gold pledged with the Agent; (b) more than 100% of the total collateral, paper and gold held by the Agent.

9. Thus the amendment operates to reduce the gold and paper required to be impounded from a minimum of 140% (40% reserve plus 100% commercial paper) under the present law, to a minimum of 100% (40% reserve and 60% commercial paper) under the amendment.

10. The 40% gold reserve, under the present law, when held in the bank's vaults serves as a reserve for 2½ x that amount of notes covered by 2½ x the same amount of commercial paper; when, however, this reserve, when available as a basis for further note issues, is deposited with the Agent, under the amendment, it serves as part collateral, dollar for dollar, for all outstanding Federal reserve notes, and also as the required cash (gold) reserve.

11. The amendment is, in effect, a legal recognition of the fact that the 40% cash (gold) reserve requirement when kept in the bank's vaults is not a trust fund, but merely a cash (gold) requirement; when, however, this cash (gold) reserve is pledged with the Federal Reserve Agent, it becomes a part of his collateral, that is to say, a part of his trust fund.

12. The amendment, therefore, provides that where 40% of the Agent's trust fund consists of cash (gold), that [illegible] be held to satisfy the requirement of a 40% cash (gold) reserve.

13. The amendment, while permitting an increase of notes to the extent that gold is permitted to serve as collateral, produces no inflation, for the reason that all notes issued are covered by 100%, either in commercial paper or gold, or both, as a trust fund.

14. As a matter of fact, a contraction necessarily results from the substitution of Federal reserve notes for the outstanding National bank notes, both under the present law and under the amendment, because of the 40% gold reserve required for Federal reserve notes as compared with only a 5% reserve for National Bank notes. If such substitution could immediately take place it would more than absorb the 250 millions of net imports of gold into the United States since January 1, 1914.

15. The amendment is predicated upon two principles; (a) That, if

Federal reserve notes can be safely issued by the Government against the pledge of 100% of commercial paper, it does not impair their safety if they can be issued against 60% commercial paper and 40% gold, or against 100% of gold; (b) That the cash (gold) reserve requirement is satisfied by permitting it to be deposited with the Agent and thus constitute a part of his trust fund.

16. Assuming that the Federal reserve banks must keep a 40% gold reserve, it makes no difference whether it is kept in the bank's vaults or with the Federal Reserve Agent, for, as shown in the memorandum, it is as instantly available to the reserve bank in the latter case as in the former.

17. The real effect of the amendment is, therefore, to prevent unnecessary duplication of collateral whether considered as reserve or as a trust fund, recognizing that, if in the shape of gold, it is as available for reserve as for collateral, or as available for collateral as for reserve. It can never be actually used for <u>both</u> purposes at the same time. Its service is an <u>alternative</u> one, and its use for either purpose discharges it from liability for the other.

18. Concrete results of the amendment as to note issuing power.

A

<u>Present Law</u>

Assume that the bank holds 400 millions of free gold which, for convenience, we will call capital.

Under the present law it can not directly take out Federal reserve notes against this gold unless it has 2½ times this amount in paper.

This is to say, while 400 millions of gold held as reserve in the bank's vaults would <u>sustain</u> an issue of 2½ times 400 millions in notes, i. e., 1000 millions, yet notes to that amount could not be taken out except by the pledge of 1000 millions of paper.

Only, therefore, in the event that it could rediscount 1000 millions of paper for member banks, could it use its 400 millions of gold as a reserve for 1000 millions of Federal reserve notes.

B

Present Law

If the member banks, instead of offering 1000 millions of paper for rediscount, should offer 1000 millions of gold as an excess deposit provided the Reserve banks gave them Federal reserve notes, the Reserve banks could not accept the gold for, although such deposit would give them a total of 1400 millions in gold, not a single Federal reserve note could be taken out from the Agent by depositing it, or any part of it.

C

Amended Law

Under the amendment, however, the banks in A could take out 400 millions in Federal reserve notes by depositing with the Agent 400 millions in gold; and in B they could take out 1400 millions in Federal reserve notes, paying 1000 millions to the member banks, and retaining 400 millions in their cash, thus conserving 1400 millions in all of gold.

D

Let us suppose that in A above, the Reserve banks can not secure $2\frac{1}{2}$ times as much paper as they have in free gold, but can secure, e. g., only 600 millions. In such a case, under the present law the banks could take out only 600 millions of Federal reserve notes directly against the pledge of 600 millions of paper.

This would leave the bank with its 400 millions of gold, of which 240 millions is held as reserve for the 600 millions of Federal

reserve notes already taken out, and 160 millions would remain free in its vaults, not capable of being used for further Federal reserve note issues because of lack of commercial paper to pledge for them.

E

The bank could, however, - under the circuitous process permitted by the present law, - pay this 160 millions of free gold to the Agent, taking down 160 millions of paper, and then by repledging the paper obtain 160 millions of additional notes, making the total outstanding notes 760 millions.

F

The maximum note issuing power, therefore, under the present law, assuming 400 millions of free gold and 600 millions of paper, - is 760 millions.

G

Under the amendment, however, the bank could not only pledge the 160 millions referred to above in E with the Agent, thus receiving 160 millions in notes, but it could also pledge with the Agent the 240 millions of gold held in its vaults as a reserve against the 600 millions of Federal reserve notes secured by pledged commercial paper, and by thus pledging this 240 millions of gold, could take out 240 millions additional of Federal reserve notes.

The total notes which could be taken out under the amended law, is therefore, 1000 millions. The Agent would then hold as collateral 600 millions of paper and 400 millions of gold, - i. e., 100% of all notes issued by him.

The required reserve of 1000 millions of notes is 400 millions, Inasmuch as the Agent holds 400 millions of gold this, under the amendment, satisfies the cash (gold) reserve requirement.

H

In conclusion: -

1. Under the present law, the reserve banks can only utilize their free vault gold as a reserve against 2½ times that amount in notes secured by 2½ times that amount of commercial paper.

2. Any excess of gold in their vaults over what is used as reserves, as in A, supra, must lie idle so far as Federal reserve note issues are concerned.

3. Under the circuitous method permitted under the present law, however, this excess gold can be used, dollar for dollar, for new issues of Federal reserve notes.

4. Under the amendment, the gold used as a reserve under A, supra, can also be used, by pledging it with the Agent as part collateral, thus permitting the issue of additional notes in amount equal to the gold thus pledged, that is, dollar for dollar; Provided, however, that the total notes issued by the Agent can never exceed the amount of the collateral, - whether paper, gold, or both, - pledged.

5. The 40% gold reserve requirement is satisfied provided the collateral held by the Agent consists of gold to the amount of 40% of the total notes outstanding.

5/6/16.

FEDERAL RESERVE BOARD

WASHINGTON

May 3, 1916.

Federal Reserve Bank,

Gentlemen:

In connection with the release of United States bonds securing circulation, and similar transactions, it has occasionally happened that a Federal reserve bank desiring to deposit with the Treasurer of the United States an amount not an even multiple of $10,000 has made an independent shipment of currency to the Treasurer for the odd amount, at the same time requesting the Federal Reserve Board to make deposit of the balance in the nearest multiple of $10,000.

Some banks, however, have adopted the practice of requesting the Board to make deposit of the exact amount required for the purpose of bond release, and for credit in the Gold Redemption Fund against Federal reserve notes, such additional amount as would bring the total deposit up to an even multiple of $10,000. This method has proved entirely satisfactory.

We bring this matter to your attention for such assistance as it may give in handling deposits of odd amounts, in case you are not already following this method.

Respectfully,

Assistant Secretary.

640 1130

FEDERAL RESERVE BOARD

WASHINGTON

May 3, 1916.

To State Member Banks:

The Federal Reserve Board and the Comptroller of the Currency have agreed upon and now promulgate the following rules in regard to the periodical Reports of Condition which the State member banks of the Federal Reserve System are required to render under the provisions of the Federal Reserve Act:

1. WHEN THE REPORTS OF CONDITION MADE TO THE STATE BANKING DEPARTMENTS ARE RENDERED AS OF THE SAME DATE AS REQUIRED BY THE COMPTROLLER OF THE CURRENCY FOR NATIONAL BANKS:

   (a) The Comptroller of the Currency will accept the reports so rendered by the State banks, on the same forms used in reporting to the State Banking Departments.

   (b) The publication of reports will be accepted by the Comptroller of the Currency on the publication form rendered to State Banking Departments, provided, the office of the Comptroller of the Currency is furnished with proof of publication in the manner required of National Banks.

   (c) State member banks will be furthermore required to furnish the Office of the Comptroller of the Currency, for abstracting purposes only, a statement of Resources and Liabilities on the form prescribed by the office of the Comptroller of the Currency for National Banks. This statement must be signed by the President or Cashier of the reporting bank and acknowledged before a notary public.

2. WHEN REPORTS TO STATE BANKING DEPARTMENTS ARE NOT REQUIRED TO BE RENDERED ON THE SAME DATE AS REPORTS CALLED FOR BY THE COMPTROLLER OF THE CURRENCY FROM NATIONAL BANKS:

   (a) State member banks will be required to execute their reports on the same form prescribed by the Comptroller of the Currency for National Banks, but omitting from their report blank, if they so desire, all schedules except that relating to coin and coin certificates.

   (b) They will also be required to conform to the regulations governing National Banks in the matter of publication of reports and the furnishing of proof of such publication.

These rules may be revised or revoked on 30 days' notice from the Federal Reserve Board or the Comptroller of the Currency.

CHARLES S. HAMLIN,

Governor, Federal Reserve Board.

JOHN SKELTON WILLIAMS,

Comptroller of the Currency.

SHERMAN ALLEN,

Assistant Secretary.

May 5, 1916.

STATEMENT BY MR. WARBURG:

Secretary McAdoo, the Chairman of our delegation, has made a very complete statement concerning the work done by the conference at Buenos Aires, and I do not see what I could add to the same. In an address which I made at Buenos Aires I said that the American delegates considered themselves as "exchange professors", and that, while we had come to contribute our own share in imparting knowledge and facts peculiar to our own country, we realized at the same time that we might render a greater service by employing the time spent in foreign countries in absorbing knowledge which we would take home to our own country in order to make it available to our people.

This does not apply to our own delegation only, but with equal force to those of all South and Central American nations. There is no doubt that more Argentinos have crossed the Atlantic than the Andes, and between the majority of the Latin American sister republics there is hardly any commercial or intellectual intercourse. These conferences are, therefore, productive of the greatest good in promoting mutual understanding among American nations and in developing the consciousness of our common interests and ideas.

If by my own impressions I may judge the effect that this conference must have produced on the delegates of all nations, if they learned as much about how " the other man lives " as I learned about them, I could only wish that the " Tennessee" might have carried a thousand delegates instead of seven.

Now that we have returned home it will be the duty of us seven to make our impressions available to our country. Unfortunately, however, no matter how hard we may try, a good deal of the intensity of our impressions will be lost in transmission. After so rapid a visit it will indeed be a difficult undertaking to reproduce the impressions that we have received concerning the physical and economic conditions of the various countries, but it will be quite impossible a task to attempt to reproduce the impressions made upon us by some of the eminent men we met, who won our esteem, friendship and admiration.

Some of the countries through which we passed have difficult problems to face, due to or accentuated by the European upheaval, but hard times will prove useful taskmasters, and in some countries we found that difficult problems had produced strong men whose sincerity and ability could not but inspire a confident reliance that their country's fate was in good hands and ultimately would be worked out successfully.

Almost all of these countries offer wonderful possibilities, and for us who have gained so much through Europe's losses, it is not only a tempting opportunity, but also a serious obligation placed upon us by Destiny - to lend a helping hand to our Latin American sister republics in developing their marvelous resources, and with that their own financial and political independence.

I was delighted to see strong evidence of the awakening of the American spirit of enterprise in almost all the countries through which we passed ; be it in railroading and developing of ore lands in Brazil , or packing houses in Uruguay

and Argentine - where the opening of those plants has brought about a great increase in the price secured by the cattle raisers of those countries - or be it in mining in Chile and Peru, or raising sugar or tobacco in Cuba.

It was a great satisfaction for me to notice in those countries the beneficent effect of our new banking legislation. It did my heart good to see American banks operating in these foreign cities, and to find that the American banker's acceptance at last had become an integral part of the world's banking machinery. Much remains, however, to be done in this respect. A world market for those acceptances has been provided, but too many American importers appear to be fast asleep and do not yet realize that it is poor business for them to pay a British banker an acceptance commission and a discount rate of about five per cent, when by arranging for American bankers' credit they can secure a discount rate of but two per cent.

When passing through the Panama Canal, I had the great honor of meeting General Goethals, and I said to him that shaking hands with him gave me a peculiar thrill, because I felt that the Panama Canal and the Federal Reserve Act were the two most constructive contributions made by the United States in our generation. The Panama Canal and the Federal Reserve Act have blasted the way wide open for the development of North American enterprise, but the business that is to flow through these channels must now be developed by the individual initiative of the people of the United States.

However, if we are to secure our position in the world, all legislative obstructions that still stand in the way of a free unfolding of our economic powers must be removed, and I sincerely hope that Congress will not delay the passing of such amendments to the Federal Reserve Act as are necessary in order to place our banks on a par with the important European banking institutions with which they have to compete in foreign countries. Only those who with their own eyes have seen actual conditions can realize the importance of securing these changes and of securing them promptly.

May 5, 1916.

A B I L L

To amend the Act approved December twenty-third, nineteen hundred and thirteen, known as the Federal Reserve Act.

BE IT ENACTED BY THE SENATE AND HOUSE OF REPRESENTATIVES OF THE UNITED STATES OF AMERICA IN CONGRESS ASSEMBLED, That section twenty-five of the Act approved December twenty-third, nineteen hundred and thirteen, known as the Federal Reserve Act, be amended to read as follows:

Sec. 25. Any national banking association possessing a capital and surplus of $1,000,000 or more may file application with the Federal Reserve Board, for permission to exercise upon such conditions and under such regulations as may be prescribed by the said board, either or both of the following powers:

First. To establish branches in foreign countries or dependencies or insular possessions of the United States for the furtherance of the foreign commerce of the United States, and to act if required to do so as fiscal agents of the Unites States.

Second. To invest an amount not exceeding in the aggregate ten per centum of its paid-in capital stock and surplus in the stock of one or more banks or corporations chartered or incorporated under the laws of the United States or of any State thereof, and principally engaged in international or foreign banking, or banking in a dependency or insular possession of the United States either directly or through the agency, ownership, or control

of local institutions in foreign countries, or in such dependencies or insular possessions.

Such application shall specify the name and capital of the banking association filing it, the powers applied for, and the place or places where the banking operations proposed are to be carried on. The Federal Reserve Board shall have power to approve or to reject such application in whole or in part if for any reason the granting of such application is deemed inexpedient, and shall also have power from time to time to increase or decrease the number of places where such banking operations may be carried on.

Every national banking association operating foreign branches shall be required to furnish information concerning the condition of such branches to the Comptroller of the Currency upon demand, and every member bank investing in the capital stock of banks or corporations described under sub-paragraph Second of the first paragraph of this Section shall be required to furnish information concerning the condition of such banks or corporations to the Federal Reserve Board upon demand, and the Federal Reserve Board may order special examinations of the said branches, banks, or corporations at such time or times as it may deem best.

Before any national bank shall be permitted to purchase stock in any such corporation, the said corporation shall enter

into an agreement or undertaking with the Federal Reserve Board to restrict its operations or conduct its business in such manner or under such limitations and restrictions as the said board may prescribe for the place or places wherein such business is to be conducted. If at any time the Federal Reserve Board shall ascertain that the regulations prescribed by it are not being complied with, said board shall be authorized and shall have power to institute an investigation of the matter and to send for persons and papers, subpoena witnesses and administer oaths, in order to satisfy itself as to the actual nature of the transactions referred to. Should such investigation result in establishing the failure of the corporation in question, or of the national bank or banks which may be stockholders therein, to comply with the regulations laid down by the said Federal Reserve Board, such national banks may be required to dispose of stockholdings in the said corporation upon thirty days' notice, and in the event of their noncompliance with such order the Federal Reserve Board may direct the Comptroller of the Currency to institute proceedings for forfeiture of charter.

Every such national banking association shall conduct the accounts of each foreign branch independently of the accounts of other foreign branches established by it and of its home office, and shall at the end of each fiscal period transfer to its general ledger the profit or loss accruing at each branch as a separate item.

Any director or other officer, agent or employee of any member bank, may with the approval of the Federal Reserve Board, be a director or other officer, agent, or employee of any such bank or corporation above mentioned, in the capital stock of which such member bank shall have invested as hereinbefore provided, without being subject to the provisions of Section 8 of the Act approved October 15, 1914, entitled "An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes."

5/9/16

Washington, D. C., May 10, 1916.

COMMENTS ON GOVERNOR HAMLIN'S BRIEF ON THE NOTE ISSUE AMENDMENTS.

This is a very able, thorough and painstaking document and I would not like to have anything I say appear to show any lack of appreciation of it. I believe, however, that it is based upon some misconceptions which should be pointed out.

(1) I think there is a confusion of ideas as to the relations of two things which are not similar, but totally dissimilar; that is to say, there is a confusion between the "collateral security" for a credit given, and loan made, whether that loan be in the form of a deposit or in the form of a payment of currency, or issue of bank notes, on the one hand and the reserve which a bank is required by law to retain against either deposits or note issues on the other.

(2) Governor Hamlin's brief states in a good many different ways that the only gain in the 40 - 60 proposition is in the release of 40% of paper for use as collateral. He admits that just as much gold is used for note issues under the old plan and could be under the proposed plan; hence, that with a given amount of gold we can issue no more notes under the new plan than under the old. What he points out very clearly is that a bank with a limited supply of eligible paper could issue a good many more notes with a given supply of gold under the new plan than under the old. I believe Governor Hamlin is entirely right in this contention and it leads me to make inquiries regarding two things:

(a) Considering the fact that we are proposing to enlarge the field of eligible paper by admitting acceptances bought in the open market when bearing member bank endorsements, why should we fear that there will not be enough eligible paper ?

(b) When a member bank calls on a Federal Reserve Bank for notes it presumably offers a quid pro quo of at least 100¢ on the dollar, hence , it is inconceivable that when there is a demand for currency by member banks, the member banks will not be ready to offer eligible collateral for the currency, especially, if we enlarge the field of eligibility which we may do both by an amendment of the law and by a relaxation of our Board rules in time of stress.

(3) I am thoroughly in accord with the idea of combining the assets and liabilities of the bank and of the Federal Reserve Agent. However, I am not at all sure that this can not be done under the Federal Reserve Act as it stands. If not, I think we ought to get an amendment. My theory is that the Federal Reserve Board can publish condition reports of the banks, stating that they are combined statements of the Federal Reserve Banks and the Federal Reserve Agents, treating the Federal Reserve Agent's Department as if it were simply the Issue Division of the Federal Reserve Bank. I agree entirely that

it is all wrong that if a ten millions of Federal Reserve notes are put out against commercial paper, and at the end of a three months' period is all paid off, although the notes continue to stay in circulation, the notes should no longer appear as the liability of the bank. It seems to me obvious and proper that the outstanding notes should appear as a liability of the bank and, per contra and as an offset, the cash or collateral held against these notes ought to be written up as an asset.

(4) A fundamental proposition which seems to me must never be forgotten and, therefore, should perhaps be re-stated is that the relation of the member bank to the Federal Reserve Bank is similar in general terms to the relation of an ordinary individual, or corporation, to a commercial bank, having note issuing power. The member bank comes to the Federal Reserve Bank to borrow credit. It may need that credit in the form of a bank deposit, or in the form of currency. If it takes it in the form of a bank deposit, it may later draw out the currency, or, more likely, it will use it to meet drafts upon it for transfers to other banks in other cities. A member bank coming to the Federal Reserve Bank to borrow a million dollars, in effect, gives its note to the Federal Reserve Bank, with eligible collateral attached, for the full face value of its borrowing,

and if we assume the Federal Reserve Agent's Department is part of the bank, the bank must keep this collateral against the loan. Aside and apart from this, however, the Government which charters the Federal Reserve Bank, says to that bank, and as a condition precedent to its charter rights, " In order to compel you to be cautious and conservative, we will require you to keep a reserve against all deposit liability of 35% and against all note issue liability of 40%." This is a matter between the Government and the Federal Reserve Bank. The 35% and the 40% cannot be considered in any sense as added collateral against either the deposits or the notes. It is solely Government regulation to accomplish two purposes : First, to guarantee a reasonable amount of cash in bank to quickly redeem notes that may be presented, or repay deposits, which may be called for, and, secondly, a condition which will compel a bank, which is in the fullest sense a public service corporation, to run its business on lines of extreme conservatism.

If the above statements are correct, it isn't readily conceivable that a member bank will ever find itself in a place where it has not enough collateral from member banks to meet legitimate demands for currency, and certainly, if we wish to create a good discount market in this country, we ought to do everything we can to encourage member banks to keep in their portfolios an abundant supply of eligible

paper. It is far better to liberalize the law in respect to the character of the paper which may be offered by member banks, or to let down the bars so far as our rules are concerned, than it is to weaken the fundamental provisions of the law in respect to giving the credit by Federal Reserve Banks.

(5) Governor Hamlin cites the case of the panic of 1914, and previous panics, showing that simultaneously with the rapid dimunition in business, there was an active demand for currency. He assumes, therefore, that if these conditions should arise, the Federal Reserve Banks might find themselves unable to meet demands for currency and be compelled to weaken their cash resources by issuing the stock of gold on hand. This is an important point and should be carefully studied. In the panics of 1907 and 1914, and indeed, as I understand it in previous panics, what happened was that bank deposits were very largely pyramided by reason of the reserve city and central reserve city system so that St. Louis, Chicago and most of all New York, held a large proportion of the bank deposits. Two things which brought about this evil were, first, that deposits could be counted, as reserves, in two places; second, that interest was paid upon depocits. The first of these evils has been cured by the Federal Reserve Act; the second still remains, as a more or less serious evil. If the Federal Reserve Banks paid interest

on reserve deposits, or even on excess deposits only, we might increase to this evil, but, as we do not do so, so far as deposits of the Federal Reserve Banks are concerned, the evil is non-existent. Thus it is that no member bank will keep on deposit with the Federal Reserve Bank a deposit in excess of its actual requirements. This will mean that they will keep a minimum reserve requirement, plus sufficient to meet their own needs to pay their own drafts or checks and drafts against them. Hence, in the panicky times you will not have the condition that you had in 1907 and 1914. Then country banks were calling on reserve city banks for cash, reserve city banks on central reserve city banks, and the very fact that there was a reluctance to meet these demands accentuated them and increased the alarm. Banks began calling loans, stopped making new ones, or quickly raised their interest rates. This naturally put a sharp check on business. While this same thing can happen again to a limited extent, especially if a large proportion of the state banks stay out of the System and if interest paid on bank deposits causes the pyramiding of money at the large money centers, yet because a large share of the reserves of the country are held by Federal Reserve Banks, the evil possibilities from this cause has been greatly diminished.

(6) A number of Governor Hamlin's calculations are based on the assumption of what he calls "free gold", or

as he suggests in his assumption "capital". These assumptions lead one astray because they are contrary to certain fundamental facts. The only "free gold" in the Federal Reserve Bank System that I know of is the capital paid in by the members, approximately $55,000,000, for although there is a liability against this, the law does not require any reserve to be held to protect it. The capital can therefore be used on the basis of 2½ times as a reserve for notes issued. In addition to this capital, the principal fund of the reserve banks amounts, in round figures, to $450,000,000, and will be about $500,000,000 after the 16th of May. Against this reserve deposit, however, there must be kept 35% of reserve, and only the remaining 65% can be used as a reserve against note issuing. Thus the note issuing expansion for the reserve deposit fund is upon the ratio of 1.625 to 1; not 2.5 to 1.

It may be argued that this is ultra-conservative, but I believe it is proper, and we should leave it that way. In time of stress it would be better for the Board to reduce its reserve requirements than to treat this reserve deposit, to use Governor Hamlin's expression, as "Free gold".

In conclusion, there are three amendments to Section 16 which are immediately desirable:

First: It ought to be possible to issue Federal Reserve notes directly for gold. It is conceivable, for example, that at some future date, the Government will stop the coinage of gold, or only use gold bars and issue certificates for amounts not less than fifty or one hundred dollars against them; that holders of these gold bullion certificates may frequently be glad to deposit them with the Federal Reserve Bank and get currency in more convenient denominations. This ought to be possible and when a Federal Reserve Bank holds gold against its notes it should not be required, considering the character of its collateral, to carry any reserve against it.

Second: If it is not possible under a fair interpretation of the existing law to combine the accounts of the Federal Reserve Agents and the Federal Reserve Banks, so as to show all notes in the hands of the public as a liability of the issuing bank and all assets held against them as collateral as assets of the bank, then we should recommend such an amendment of the law as would permit it.

Third: We should ask for an amendment of the law which will permit bank acceptances, or paper bought under Section 14, of the Act, when accepted or endorsed by a member bank, to be made eligible as collateral for Federal Reserve notes. This will not only very much increase the volume of paper which will be eligible for rediscount but will assist in building up our discount market.

The above three amendments, I believe, are the only amendments which it is necessary, or desirable, to make to Section 16 at the present time. Later on, I believe, at least one other amendment should be made, and that is looking toward the consolidation of the note issuing functions of the Federal Reserve Banks. It is very undesirable that there should be two kinds of notes issued by the Federal Reserve Banks. There should be only one kind and that a Federal Reserve Bank note. If that idea should meet with the approval of my colleagues and the Congress, the Federal Reserve Banks would issue notes upon any of the following plans:

(a) For gold bullion,

(b) Upon the note of a member bank, having behind it eligible commercial paper as collateral,

(c) Against the collateral of Government bonds, having the circulation privilege.

If this were done, in case (a) no reserve would be required of the Federal Reserve Bank. In case (b) a reserve of at least 40% would be required unless the Federal Reserve Board should reduce the requirement. In case (c) a reserve of 5% would be required.

If this great reform were adopted, I should perhaps go a step further and suggest that the elaborate, costly and complicated machinery of the United States Government in Washington for refunding notes should be abolished, and that,

in the place of it, the Federal Reserve Bank notes should be made redeemable only at the counter of the Federal Reserve Bank of issue under the supervision and rules of the Federal Reserve Board.

F. A. DELANO.

6/10/16

That section sixteen, paragraphs two, three, four, five, six and seven, of the Act approved December twenty-third, nineteen hundred and thirteen, known as the Federal Reserve Act, as amended by the Act of September 7, 1916, be further amended and re-enacted so as to read as follows:

"Any Federal reserve bank may make application to the local Federal reserve agent for such amount of the Federal reserve notes hereinbefore provided for as it may require. Such application shall be accompanied with a tender to the local Federal reserve agent of collateral in amount equal to the sum of the Federal reserve notes thus applied for and issued pursuant to such application. The collateral security thus offered shall be notes, drafts, bills of exchange, or acceptances rediscounted under the provisions of Section thirteen of this Act, or bills of exchange indorsed by a member bank of any Federal reserve district and purchased under the provisions of Section fourteen of this Act, or bankers' acceptances purchased under the provisions of said section fourteen; OR GOLD OR GOLD CERTIFICATES; BUT IN NO EVENT SHALL SUCH COLLATERAL SECURITY WHETHER GOLD, GOLD CERTIFICATES, OR ELIGIBLE PAPER, BE LESS THAN THE AMOUNT OF FEDERAL RESERVE NOTES APPLIED FOR. The Federal reserve agent shall each day notify the Federal Reserve Board of all issues and withdrawals of Federal reserve notes to and by the Federal reserve bank to which he is accredited. The said Federal Reserve Board may at any time call upon a Federal reserve bank for additional security to protect the Federal reserve notes issued to it.

"Every Federal reserve bank shall maintain reserves in gold or lawful money of not less than thirty-five per centum against its deposits and reserves in gold of not less than forty per centum against its Federal reserve notes in actual circulation. PROVIDED, HOWEVER THAT WHEN THE FEDERAL RESERVE AGENT HOLDS GOLD OR GOLD CERTIFICATES AS COLLATERAL FOR FEDERAL RESERVE NOTES ISSUED TO THE BANK SUCH GOLD OR GOLD CERTIFICATES SHALL BE COUNTED AS PART OF THE GOLD RESERVE WHICH SUCH BANK IS REQUIRED TO MAINTAIN AGAINST ITS FEDERAL RESERVE NOTES IN ACTUAL CIRCULATION and not offset by gold or lawful money deposited with the Federal reserve agent. Notes so paid out shall bear upon their faces a distinctive letter and serial number, which shall be assigned by the Federal Reserve Board to each Federal reserve bank. Whenever Federal reserve notes issued through one Federal reserve bank shall be received by another Federal reserve bank they shall be promptly returned for credit or redemption to the Federal reserve bank through which they were originally issued, OR, UPON DIRECTION OF SUCH FEDERAL RESERVE BANK THEY SHALL BE FORWARDED DIRECT TO THE TREASURER OF THE UNITED STATES TO BE RETIRED. No Federal reserve bank shall pay out notes issued through another under penalty of a tax of ten per centum upon the face value of notes so paid out. Notes presented for redemption at the Treasury of the United States shall be paid out of the redemption fund and returned to the Federal reserve banks through which they were originally issued, and thereupon such Federal reserve bank shall, upon demand of the Secretary of the Treasury, reimburse such redemption fund in lawful money, or, if such Federal reserve notes have

been redeemed by the Treasurer in gold or gold certificates, then such funds shall be reimbursed to the extent deemed necessary by the Secretary of the Treasury in gold or gold certificates, and such Federal reserve banks shall, so long as any of its Federal reserve notes remain outstanding, maintain with the Treasurer in gold an amount sufficient in the judgment of the Secretary to provide for all redemptions to be made by the Treasurer. Federal reserve notes received by the Treasurer, otherwise than for redemption, may be exchanged for gold out of the redemption fund hereinafter provided and returned to the reserve bank through which they were originally issued, or they may be returned to such bank for the credit of the United States. Federal reserve notes unfit for circulation shall be returned by the Federal reserve agents to the Comptroller of the Currency for cancellation and destruction.

"The Federal Reserve Board shall require each Federal reserve bank to maintain on deposit in the Treasury of the United States a sum in gold sufficient in the judgment of the Secretary of the Treasury for the redemption of the Federal reserve notes issued to such bank, but in no event less than five percentum OF THE TOTAL AMOUNT OF NOTES ISSUED LESS THE AMOUNT OF GOLD OR GOLD CERTIFICATES HELD BY THE FEDERAL RESERVE AGENT AS COLLATERAL SECURITY; but such deposit of gold shall be counted and included as part of the forty percentum reserve hereinbefore required. The Board shall have the right, acting through the Federal reserve agent, to grant in whole or in part or to reject entirely the application of any Federal reserve bank for Federal reserve notes; but to the extent that such application may be granted the Federal Reserve Board shall, through its local Federal reserve agent, supply Federal reserve notes to the bank so applying, and such bank shall be charged with the amount of notes ISSUED TO IT and shall pay such rate of interest on said amount as may be established by the Federal Reserve Board and the amount of ON ONLY THAT AMOUNT OF SUCH NOTES WHICH EQUALS THE TOTAL AMOUNT OF ITS OUTSTANDING FEDERAL RESERVE NOTES LESS THE AMOUNT OF GOLD OR GOLD CERTIFICATES HELD BY THE FEDERAL RESERVE AGENT AS COLLATERAL SECURITY. Federal reserve notes as issued to any such bank shall, upon delivery, together with such notes of such Federal reserve bank as may be issued under section eighteen of this Act upon security of United States two percentum Government bonds, become a first and paramount lien on all the assets of such bank.

Any Federal reserve bank may at any time reduce its liability for outstanding Federal reserve notes by depositing with the Federal reserve agent its Federal reserve

notes, gold, gold certificates, or lawful money of the United States, Federal reserve notes so deposited shall not be reissued, except upon compliance with the conditions of an original issue.

The Federal reserve agent shall hold such gold, gold certificates or lawful money available exclusively for exchange for the outstanding Federal reserve notes when offered by the reserve bank of which he is a director. Upon the request of the Secretary of the Treasury the Federal Reserve Board shall require the Federal reserve agent to transmit so much of the said gold to the Treasurer of the United States SO MUCH OF THE GOLD HELD BY HIM AS COLLATERAL SECURITY FOR FEDERAL RESERVE NOTES as may be required for the exclusive purpose of the redemption of of such notes FEDERAL RESERVE NOTES BUT SUCH GOLD WHEN DEPOSITED WITH THE TREASURER SHALL BE COUNTED AND CONSIDERED AS IF COLLATERAL SECURITY ON DEPOSIT WITH THE FEDERAL RESERVE AGENT.

Any Federal reserve bank may at its discretion withdraw collateral deposited with the local Federal reserve agent for the protection of its Federal reserve notes deposited with it ISSUED TO IT and shall at the same time substitute therefor other like collateral of equal amount with the approval of the Federal reserve agent under regulations to be prescribed by the Federal Reserve Board. ANY FEDERAL RESERVE BANK MAY RETIRE ANY OF ITS FEDERAL RESERVE NOTES BY DEPOSITING THEM WITH THE FEDERAL RESERVE AGENT OR WITH THE TREASURER OF THE UNITED STATES, AND SUCH FEDERAL RESERVE BANK SHALL THEREUPON BE ENTITLED TO RECEIVE BACK THE COLLATERAL DEPOSITED WITH THE FEDERAL RESERVE AGENT FOR THE SECURITY OF SUCH NOTES. FEDERAL RESERVE BANKS SHALL NOT BE REQUIRED TO MAINTAIN THE RESERVE OR THE REDEMPTION FUND HERETOFORE PROVIDED FOR AGAINST FEDERAL RESERVE NOTES WHICH HAVE BEEN RETIRED; NOR SHALL THEY BE FURTHER LIABLE TO PAY ANY INTEREST CHARGE WHICH MAY HAVE BEEN IMPOSED THEREON BY THE FEDERAL RESERVE BOARD. FEDERAL RESERVE NOTES SO DEPOSITED SHALL NOT BE REISSUED EXCEPT UPON COMPLIANCE WITH THE CONDITIONS OF AN ORIGINAL ISSUE.

FEDERAL RESERVE BOARD

WASHINGTON

May 15, 1916.

Memorandum for the Board:

As requested, I have made a brief analysis of the provisions of the Federal Farm Loan Act, as it passed the Senate.

This Act was referred to the Banking and Currency Committee of the House, and the Committee's report appears to be a substitute bill which will have to be made the subject of a separate analysis in order to show the changes made in the substance of the Senate bill.

I assume that the Board will desire this analysis after the House Bill has been passed.

In analyzing the Senate Bill I have not attempted to outline all the details of operation, but merely to show the fundamental provisions and the general plan of operation.

Respectfully,

M. C. ELLIOTT,

Counsel.

ANALYSIS OF FEDERAL FARM LOAN ACT AS
PASSED BY THE SENATE.

* * *

May 12, 1916.

THE FEDERAL FARM LOAN BOARD.

The Act provides for the creation of a bureau in the Department of the Treasury to be known as the Federal Farm Loan Board which consists of five members including the Secretary of the Treasury, who is made an ex-officio member and chairman. The four appointed members receive salaries of $10,000 each. All salaries and expenses are paid out of the general funds of the Treasury.

This board is authorized to employ attorneys, experts,etc., in the same manner as the Federal Reserve Board. The employees are not under civil service. It makes an annual report of its operations to Congress. Its general powers, as summarized in Section 20 are substantially as follows:

(a) To organize and charter Federal land banks, national farm loan associations, and joint-stock land banks.

(b) To review and alter at its discretion the rate of interest to be charged by Federal land banks.

(c) To authorize the issue of farm loan bonds.

(d) To make rules and regulations respecting charges made to borrowers on loans, for appraisal,examining titles,etc.

(e) To require reports of condition and to make examinations.

(f) To prescribe the form and terms of farm loan bonds.

(g) To require Federal land banks to pay to other Federal land banks their equitable proportion of sums advanced to pay the coupons on bonds issued by such banks.

(h) To exercise general supervision over -

(1) Federal land banks,
(2) National farm loan associations,
(3) Joint-stock land banks.

FEDERAL LAND BANKS.

The Federal Farm Loan Board is empowered to divide the continental United States into twelve districts to be known as Federal land bank districts to be designated by number, and to create and organize in each district a Federal land bank with a capital stock of not less than $500,000.

Board of Directors: A temporary board of five directors is appointed by the Federal Farm Loan Board during the preliminary organization of these banks. This board is later replaced by a board of five directors, three of which are elected by the farm loan associations and two are appointed by the Federal Farm Loan Board, one of the two so appointed being designated as chairman.

Capital Stock: If, within ninety days after the subscription books are opened, any part of the minimum capitalization of $500,000 has not been subscribed, by individuals, firms or corporations or by the States, the Secretary of the Treasury is required to subscribe for the balance on behalf of the United States. This subscription, however, is later repaid to the United States when a sufficient amount of stock is sold to other subscribers. Ten per cent of each $100,000 worth of stock subscribed is invested in bonds of the United States not later than two years after the payment of such subscription.

These banks may act as Government depositaries and fiscal

agents of the Government.

Powers: They are given the usual corporate powers and among others the following special powers:

(1) To issue farm loan bonds;

(2) To purchase first mortgages on farm lands within the district;

(3) To deposit first mortgages with a registrar as security for farm loan bonds;

(4) To receive and set apart for expenses and profits one per cent interest on endorsed mortgages;

(5) To acquire and dispose of real and personal property under certain conditions;

(6) To make deposits with Federal reserve banks or member banks and to receive interest on the same;

(7) To receive deposits from farm loan associations, but not to pay interest thereon;

(8) To borrow money;

(9) To buy and sell United States bonds.

Restrictions: Such banks are not permitted

(1) To accept ordinary demand deposits except from its stockholders;

(2) To make loans on farm mortgages except through farm loan associations;

(3) To accept other than first mortgages;

(4) To issue bonds in excess of twenty times the amount of its capital and surplus;

(5) To receive any commission or charge not authorized by the Act.

NATIONAL FARM LOAN ASSOCIATIONS.

These associations are organized by persons desiring to

borrow money on farm mortgage security. Their directors are elected in the same manner as national bank directors. Their officers, other than the Secretary-Treasurer, serve without pay, unless the Federal Farm Loan Board approves a salary. The Secretary-Treasurer acts as custodian of its funds depositing same in such banks as the board of directors may designate; pays over to borrowers sums received for their account from the Federal land banks upon first mortgages, and is the active officer of the association.

Subscribers: The incorporators of such an association must consist of ten or more natural persons who are the owners or who are about to become the owners of farm land, qualified as security for a mortgage loan. They execute an organization certificate which is submitted to the Federal land bank, and, acting upon the recommendation of the Federal land bank, the Federal Farm Loan Board issues a charter.

The loan desired by each subscriber must not exceed $10,000 nor be less than $200, and the aggregate must not be less than $20,000. The borrower must subscribe to stock in a sum equal to five per cent of the desired loan.

These associations may be organized with limited or with unlimited liability. The capital stock is issued in shares of $5 each to borrowers, and this stock is held by the associations as collateral security for the loan made, but the borrower may receive dividends accruing and payable on such stock, and when the loan is repaid the stock is canceled and the subscription is repaid or it may

be credited on the loan when the balance has been paid. The capital stock of these associations may be increased from time to time as additional loans are desired, and may be reduced to any sum not less than five per cent of the unpaid principal of mortgages held.

The special powers of these associations consist of the right -

(1) To indorse and to discount with Federal land banks first mortgages;

(2) To receive from such banks funds to be loaned to its shareholders;

(3) To acquire and dispose of real and personal property under certain conditions;

(4) To issue certificates of deposit at four per cent per annum against deposits or current funds, convertible into farm loan bonds when presented at the Federal land bank of the district in any multiple of $25.

This stock carries with it the double liability of shareholder.

In the unlimited farm loan association the subscriber enters into a contract to become individually liable for all contracts, debts, and engagements of the association in addition to his liability on the stock.

Loans Made by Federal land banks: Loans made by Federal land banks are subject to the following restrictions:

(1) They must be secured by first mortgages on farm land located in the district;

(2) Each mortgage must contain an agreement for repayment under the amortization plan;

(3) They must run for not less than five nor more than sixty years;

(4) Payment may be anticipated by the borrower on interest payment periods at any time after five years;

(5) Interest rate limited to six per cent.

(6) Loans may be made -
(a) For the purchase price,
(b) For equipment, fertilizers, live stock, etc.
(c) For buildings and improvements,
(d) For discharge of existing mortgages.

(7) Loans limited to fifty per cent of the appraised value of the land;

(8) Applicant must state his intention to become within six months engaged in the cultivation of the land mortgaged;

(9) Loans to one borrower not to exceed $10,000, nor to be less than $200;

(10) Application to be made in form approved by the Federal Farm Loan Board;

(11) Borrower to pay ten per cent simple interest on defaulted payments;

(12) The borrower must stipulate that if any portion of the loan is expended for purposes other than those specified in application, or if he fails to comply with terms of application, the loan shall at the option of the mortgagee become due and payable.

JOINT STOCK LAND BANKS.

Joint stock land banks possess substantially the same powers as Federal land banks. They may be organized by any number of natural persons not less than ten. They may begin business with a capitalization of $250,000 in states of less than two million inhabitants. The Government of the United States is not authorized to purchase or subscribe to any part of their capital stock. They are not subject to the restrictions above enumerated on loans made by Federal land banks, except that they are prohibited from receiving

any commission or charge not authorized by the Act. The board of directors may consist of more than five members. The Federal Farm Loan Board has a more limited supervision over these banks than it has over Federal land banks. Bonds issued by these banks and known as joint stock land bank bonds are limited to fifteen times the amount of the capital and surplus. They are not subject to all the restrictions of farm loan bonds, but are based upon first mortgages and are in form prescribed by the Farm Loan Board. They are known as "joint stock bonds."

MISCELLANEOUS PROVISIONS.

The Act provides for examiners who are required to make regular examinations of the banks and associations and whose salaries are paid out of the general funds of the United States Treasury. It provides for appraisal committees to determine the value of the land offered as security and for a registrar to hold the securities against which farm loan bonds are issued.

The usual penalties applicable to bank officers are incorporated in the Act. The provisions of Section 22 of the Federal Reserve Act are likewise incorporated.

Farm loan bonds may be purchased by Federal reserve banks or member banks, by trustees or fiduciaries, and by the postal savings trustees.

Acceptances or obligations of member banks secured by such bonds are made eligible for discount by Federal Reserve banks.

These banks and associations are required to carry twenty-five per cent of their earnings to a surplus or reserve account until this account is equal to twenty per cent of their capital. Where national farm loan associations have not been organized in any locality after one year from the passage of the Act and it appears to the Federal Farm Loan Board that they are not likely to be organized, the Board may authorize Federal farm banks to make loans through approved agents.

One hundred thousand dollars is appropriated for organization expenses.

Every Federal land bank and every national farm loan association, including the capital stock and reserve or surplus therein and the income derived therefrom, is exempt from Federal, State, municipal and local taxation, except taxes upon real estate held, purchased, or taken by said bank or association under the provisions of Section eleven and Section thirteen of this Act. First mortgages executed to Federal land banks, or to joint stock land banks, and farm loan bonds issued under the provisions of this Act, are deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom are exempt from Federal, State, municipal and local taxation.

R E S U M E '

The general plan of operation appears to be that, when farm owners or prospective farm owners desire to borrow money for the cultivation or improvement of farms or to pay off the purchase price of such land or to discharge existing liens, ten or more may unite to organize a farm loan association, subscribing and paying for capital stock in such association equal to five per cent of the loans desired. Through this association an application is made to the Federal land bank. This application must recite that the borrower is engaged or intends to engage in the cultivation of farm land. The Federal land bank may thereupon make loans to the farm loan association on the security of first mortgages to the extent of fifty per cent of the appraised value of the land in question. All of such mortgages must run for a period of at least five years and not exceeding sixty years, and must contain an agreement for the payment of a fixed number of semi-annual or annual installments sufficient to provide for an agreed rate of interest during the term and for the payment of the principal during and at the end of the term on the usual amortized plan.

In order to increase their loanable funds Federal land banks may deposit first mortgages with a registrar as collateral security for bonds issued by such banks. These bonds which are engraved by the Bureau of Engraving and Printing under direction of the Comptroller of the Currency are issued in denominations of $25, $50, $100, $500, and $1,000. They have interest coupons attached payable simi-annually and bear a rate of interest not to

exceed five per cent. The bonds so prepared are deposited in the Treasury and sub-treasuries to be held subject to the order of the Federal Farm Loan Board.

When loans are repaid to the Federal land banks or to the joint stock land banks the proceeds are used -

(a) To pay off farm loan bonds as they mature,

(b) To purchase such bonds,

(c) To loan on first mortgages,

(d) To purchase United States Government bonds,

(e) To be held by the registrar as security for the payment of such bonds.

5/15/16.

Remarks of
Hon. Paul M. Warburg
at the dinner of the
Economic Club of New
York, May 22nd, 1916

When, six weeks ago, I had the honor of addressing the Conference of the International High Commission at Buenos Aires, I told the delegates that I considered myself an "exchange professor" whose most important function, while in foreign countries, was not so much to teach as to learn and then, upon his return, to impart the useful information acquired to his own countrymen.

This is the first opportunity which I have had to perform this mission, and I consider it, therefore, a duty to tell you one of the first and most inspiring impressions I received during my stay in foreign lands. This was at Rio de Janeiro, when our excellent Ambassador, the Honorable Edward Morgan, gave me the startling news that, in South America, after dinner speeches were not the fashion, and that Brazilians, in this respect as indeed in many others, were a highly advanced and kindly na-

tion, permitting their guests to enjoy their dinner in peace! From that moment on I began to enjoy my trip, and I mention this incident to you because I know it will be an added stimulus to many to start out for the wonderful lands of our Southern Hemisphere.

I was much relieved to see from tonight's program that I am not listed among the "speakers", but that I am classified only as a "guest of honor". Much as I should have enjoyed the privilege of addressing you at length, the accumulation of work since I returned two weeks ago has been such that, to my great regret, I had to inform your president, when accepting your kind invitation, that it would be quite impossible for me to prepare an address befitting this occasion. I am glad of this opportunity, however, to make a few informal remarks - but not a speech.

Permit me to say, then, how much I appreciate the great honor you have done me in inviting me to-

night, how glad I am to meet again my fellow members of this club, and with what pleasure I am looking forward to listening to the addresses to be delivered by your speakers.

The topic, "New Opportunities for American Commerce and Industry" is, of course, one of the profoundest interest to me, particularly in its bearing upon our relations with our sister republics of South and Central America.

In considering this question, we might well ask ourselves: Why is it that these opportunities are new for us? Is it that these countries have changed, that we have changed or is it that the world about us has changed? The truth of the matter is that most radical upheavals have taken place in all three directions, so drastic indeed that economic relations all over the world will have to be readjusted at the end of the war.

The United States, in the beginning of 1914, was moving towards the position of an industrial

and financial world power. The advent of the war precipitated this development with unparalleled rapidity and to an unprecedented degree; so that, as a result, our evolution from a mere agricultural and borrowing community into a great agricultural, industrial and lending power has now been completed.

While our own economic status has thus been strengthened, the wealthiest countries of Europe have been destroying their saving power at the rate of approximately $85,000,000 a day; and while our own economic position as against these other nations has been consolidated by a sum which has been estimated at about two to three billion dollars, their own indebtedness has increased by more than thirty billions. And, unfortunately, this condition continues to grow and nobody can at this time foresee how long the cruel hand of destiny will continue to grind into dust what it has taken generations of human toil and endeavor to create.

When we look into the future we ponder and wonder how these countries will manage to carry the burden under which they have to struggle. While we still hope that the load will not smother them, there is no doubt but that it will absorb so much of their strength that other countries that in the past have been developed largely by the excess saving power of some of these nations will, for years to come, find this fountain run dry or at least drastically reduced. That means, generally speaking, that the economic progress of our globe will be retarded for a generation or more, and that those nations will feel it the most that were accustomed to depend upon European funds for the development of their resources and had not proceeded far enough in this development to be able, as we were, to dispense with the assistance afforded by foreign capital.

This thought was borne in on me very vividly in South America. Magnificent countries, resplend-

ent with natural wealth and wonderful opportunities are now threatened in their progress by a struggle not their own and thousands of miles away. The deep significance of the situation impressed me all the more because of its similarity to the history and the problems of our own country and because I was conscious of the fact that the United States would have been in precisely the same position had this world conflagration taken place some twenty years earlier.

We have to visit these great South American republics in order to realize the strong bond of affinity that exists between them and ourselves; in spite of differences in antecedents and language.

When I spent an afternoon at the country house of a leading cabinet minister of one of these republics - a house possessed by the family for generations - when I admired the wonderful old trees, the rooms full of books and art treasures, the walls covered with beautiful pictures of all

schools, when I glanced at the old family portraits - and the new ones by Zorn, Sargent and Boldini - I had the same feeling that an old New England or Pennsylvania or Virginia family mansion will awaken in us, or an old house in Washington Square in New York. Here, indeed, I saw the descendants of the Spanish Pilgrim Fathers! And again, when I studied the histories of these nations and saw their monuments erected to the memory of Bolivar and San Martin, I fully realized that these countries, too, had their Washingtons and their glorious wars of independence and their periods of transformation from colonial dependencies into sovereign republics. They have their race problems, their immigration problems and, like the United States, while reaping the advantages of a democratic form of government, they too have to struggle with the difficulties caused by the premature and indiscriminate granting of equal suffrage to masses at the time not sufficiently educated.

But, gentlemen, visit Uruguay, the republic

that, ten years ago, held the record for frequent revolutions, and you will now find that it is the State of Wisconsin of South America, or - perhaps - it out-Wisconsins Wisconsin. You find a most modern, highly progressive administration; government-owned banks, and lighting plants, trams and hotels owned by the municipality; beautiful universities, splendid agricultural and veterinary schools, and prisons so attractive and modern that I asked to have a cell reserved for myself - in case of need. And as the keen and intelligent men, now in charge of the administration of the country take you through their public buildings, and as you see the wealth and progress of the country, there comes to you the profound conviction that the swamps breeding the mosquito that spreads the infection of revolution are laid dry by the same influences that are the foundation of our own national growth: the influences of education, industry and political equality and liberty.

I wish that etiquette would permit me to de-

scribe to you some of the statesmen we met. I use the word statesman advisedly, for we found men of the rarest type, courageous and sincere and inspired by the highest ideals.

It would be presumptuous on my part - after so rapid a visit to these vast countries - to attempt to picture to you the indescribable charm of Rio, or the untold and untouched riches of Brazil - a country larger by 269,000 square miles than the United States proper and having a population of only about twenty-three million people - or the endless Argentine plans, teeming with grazing cattle, or Buenos Aires, the city of over a million and a half inhabitants, with New York spirit and Paris taste, or Chile, the California of South America, with its wonderful climate, its virile race, its undeveloped water powers and mineral wealth.

I can venture only to speak to you in bird's-eye-view terms. But, speaking in these terms and fully conscious of the fact that generalization can

never do justice to all the phases it appears to cover, we might say that the wealth of these countries, the lavishness with which nature has treated them, has, to a certain extent, been the cause of their weakness. It has made many of them dependent upon the marketing of a few single staples- be they coffee, rubber, cattle, wheat, nitrates or guano - it has prevented them from diversifying their industries, from producing at home many a thing that they purchase abroad, and it has made them extravagant instead of teaching them thrift. And again, gentlemen, we need not go very far to find the parallel in our own country.

The present world crisis has taught them - as it has taught us - the necessity of economizing, of importing less extravagantly, and of developing more intensively their own resources and industries. At the same time, it has brought home to them most forcibly the other necessity of never again being found dependent exclusively upon the ships, credit

or good will of Europe to reach their markets. It is not only a humiliation to the national pride of these nations to be told from whom they may buy in their own countries and to whom they may sell abroad, but their very economic life has been placed in jeopardy by the temporary withdrawal of shipping and banking facilities, and by the extortionate freight rates exacted for what little tonnage has still been left over to take care of their trade. They look to us to remedy a situation which is as unbearable to them as it is to ourselves. They feel themselves at one with us in this respect, for it is for our own protection as well as theirs that the "stars and stripes" must fly over a mercantile fleet large enough to ensure the independence of the trade of this hemisphere! They furthermore trust that our own financial emancipation will be an important factor in securing greater financial independence to them.

I returned from these Southern shores with the

feeling that North, Central and South America are one economic unit, not only because nature has made us neighbors, inhabitants of the same great continent, but because our historic traditions, our political ideals and our economic problems and interests are substantially the same. While they are following in our wake, we are headed for the same goal, and the rocks and cliffs are the same in their course as in ours.

Central and South America and the United States are not competitors; they supplement one another. The more our population grows; the more we develop into an industrial nation, the more we ourselves shall consume foodstuffs that we used to export in the past, the more shall we be called upon to import the products of the Southern Hemisphere and export in return the articles that our manufacturers will supply.

It is but a short time since we began to take

an interest in South and Central American affairs. The reason is clear; economically we had not reached the point of development of being an industrial and, from the banking point of view, a lending nation. The consequence was that we were provincial, satisfied with our business opportunities at home, and unwilling to study and adjust ourselves to the habits and thoughts of other nations.

Changed conditions have brought about a different condition of mind. A change of mind on both sides. As Ambassador Stimson put it in a speech at Buenos Aires, we were like fishermen living in adjoining cottages facing the Atlantic, having all the windows towards the ocean, and looking across the sea all the time, with no means to look at each other. We now have broken a window into the adjoining wall; for the first time we begin to know and understand each other, and I, for one, should like to prophesy that, by mutual consent, very soon we shall widen that window rapidly and make it a

very large and comfortable door. How that may best be done, others better qualified than I will discuss tonight.

Let me express only these general thoughts: Europe's saving power being crippled while our financial power has grown by her misfortune, there is no doubt that it will be both our opportunity and our duty to assist in developing the resources and industries of those of our sister republics that are still dependent upon foreign credit for the completion of their economic development.

Let us bear in mind, however, that the best business policy is not only the square deal, but the fair deal. Permanent business relations are not established by driving a hard bargain, but by transactions fair and equitable to both parties, and that applies as much to the South and Central American who desires to establish a market for his goods or securities with us as it does to the North American entering these new fields.

Furthermore, in order to perfect the establishment of intimate relations with these nations, we must understand and speak their languages. Confidence is the basis of business. If we do not understand these people, their methods or their point of view, we cannot deal with them with that consideration and discrimination to which every human race is entitled. We must be able to discriminate between the good and the bad amongst them, as they must be able to discriminate between us, but, having found the best, we must deal with them on the basis of the same full confidence and equality as we would deal with the very best amongst ourselves.

I wish that I could impress our business men with the importance of sending abroad only men of experience and high standing, such as enjoy their confidence to a sufficient degree to permit them to discriminate and not be bound by uniform and narrow restrictions. Let us remember that a country is often judged by the first business representatives

it sends abroad, and let us, therefore, do all we can to keep away all elements that might do injury to the standing and reputation of our merchants and manufacturers. The United States Chamber of Commerce agreements for the arbitration of business disputes will be important factors in protecting the good name of American business men in foreign lands. Glib talk and speeches will not avail. We shall be judged by our acts.

And, furthermore, while, for years to come, we shall have a telling advantage in all work of development leading to more or less permanent investment in South and Central America, Europe will bend every effort at the end of the war to regain her full share in the regular commerce of these countries. She will need this trade much more than we do and we shall not be able to secure a fair proportion except by a determined and persistent effort. These markets cannot be conquered by spasmodic outbursts of energy and enthusiasm, but only by unrelenting

and well organized work.

Nor can we expect to succeed unless this, our "land of liberty", gives as much freedom to American enterprise - merchant, manufacturer, shipper or banker - as is enjoyed by our European competitors. Our banks must be as free to go into foreign countries and to finance this foreign trade according to the local usages and requirements as are the European banks, which are practically free from legislative restrictions in this respect. Great headway has already been made during these last two years, and we have reasons to hope that some of the recommendations made by the Federal Reserve Board tending further to increase the scope and efficiency of American banking in foreign countries will be acted upon promptly and favorably by Congress.

A discussion of "New Opportunities for American Commerce and Industry" naturally brings to mind two of the most constructive achievements of our generation -- the Federal Reserve Act and the Panama

Canal. It is impossible, however, to discuss tonight the important effect of the Federal Reserve System upon the development of our foreign trade and the great progress already made by our banks in these fields, or to describe the thrilling impressions received by us all during our trip through the Panama Canal, this wonderful piece of engineering which, by cutting apart the North and the South, brought them so much closer together. Let me, in closing, relate to you only one little incident that deeply impressed me at Panama. An American Admiral's wife said to me: "I am sorry we have to leave Panama and go home, because it is such a splendid place for my children."! Panama and yellow fever were words almost synonymous in the past; no higher compliment was ever paid American engineering and medical skill than this mother's comment. It is this kind of work - the beginning of which we saw at Haiti and the complete, final success of which we perceived at Habana - that constitutes the

highest type of constructive work, a contribution upon which every American may look with just pride.

I hope that American business will make for itself an equally good record. Our South and Central American fellow citizens will then esteem and love us - even though we should carry into their innocent countries the bad habit of after-dinner speeches.

F i n i s.

5-18-16.

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IN AFTERNOON PAPERS MAY 24, 1916

NOT EARLIER.

HOW THE FEDERAL RESERVE SYSTEM IS MEETING THE REQUIREMENTS

Address

of

A. C. MILLER

Member of the Federal Reserve Board

Delivered May 24, 1916

at the Annual Convention of the

MISSOURI BANKERS' ASSOCIATION

at St. Louis.

RELEASED FOR PUBLICATION IN AFTERNOON PAPERS OF MAY 24,1916.

HOW THE FEDERAL RESERVE SYSTEM IS MEETING THE REQUIREMENTS.

* * * * *

The financial outlook for the United States has never been so full of interesting possibilities as at the present time, nor has it ever called for a more definite understanding of whence we have come, where we are at, and whither we are going. In the course of the past year and a half we have replaced financial dependence upon Europe by dependence upon ourselves and we have also been able to extend a very considerable measure of financial service to some of the warring nations, and to many of the neutral countries of South America. The record of our material and financial progress in the past year and a half discloses results which are stupendous and seem little short of miraculous.

Much has been said of our new opportunities; but it is important that the banker, who has a very serious part in shaping the course of business and tempering the spirit of the community to a new situation, should recognize that the situation with which we are confronted is not alone pregnant with opportunity, but is also weighted with serious responsibility. It is, indeed, doubtfullwhether any country in the history of modern commerce has ever been faced by a situation so calculated

to challenge the best of which it is capable in conceiving and carrying to fulfillment great plans. It is a situation which invites to a mastery in the world of finance and of large affairs; but to attain this mastery we must first become masters of ourselves and of our own by developing to highest efficiency instruments of direction and control which match our splendid resources. It calls, moreover, for a new type of business leadership and a capacity for co-ordinated action on a larger scale than we have been accustomed to in order that we may be able to act with wisdom, vigor and effect in this new region of affairs and responsibilities into which we have entered.

It is fortunate,- indeed it would be difficult to exaggerate the degree of our good fortune,- that the most important and considerable step toward fitting ourselves to meet the new occasion should have been taken in advance of the great changes in the sphere of international relationships, which are bound to come as one of the results of the war. I refer of course to the establishment of our new banking organization, the Federal Reserve System. That system, and what it stands for, must be, as indeed, it has already proved itself to be, our chief reliance in meeting our new responsibilities and in turning our new opportunities to profitable account for ourselves

and to benefit for the rest of the world. No agency or resource in the field of finance which the nation today possesses or has ever possessed is comparable in its potentialities to the Federal Reserve System. It is, not only the newest thing in American finance, but also the best thing. Until we definitely understand this, we are not in a position to do our best in meeting the new occasion. To recognize this is the beginning of wisdom.

It is also well that we should recognize that the atmosphere was never so propitious for the discussion of questions of finance upon the broad and high plane of national interest and policy as now. I believe I speak truly and with strict fidelity to the historical record, when I say that for the first time since we, as a nation, began to make financial history, questions of currency and finance and banking have ceased to be political and party questions. To have taken the banking question out of politics, where it long lingered to the prejudice of the nation's commercial and financial interest, is a matter of sufficient moment and promise to entitle it to rank as a real achievement. Whatever differences may have existed on questions of banking policy before the

establishment of the Federal Reserve System, they have pretty much ceased to exist since. The country, as you know, has set its approval upon the Federal Reserve Act as a piece of fundamental legislation on which to build and under which we are to develop the banking system of our expanding industry and commerce for decades to come. So well was the work of legislation done, and so completely has the result been accepted and approved by the business, banking and general public opinion, that the banking question has fortunately at last ceased to be a problem of legislation and has become one of administration. Congress has given us a superb instrumentality; it is for our bankers and those who are charged with the administration of the new law to do their part in using this new instrumentality wisely and effectively in strengthening the financial foundations of our industry and promoting its healthy, prosperous and steady growth.

The test of a banking system is the aid it gives to productive enterprise by supplying its credit needs. Banks become powerful and valuable auxiliaries in the industrial system in proportion as they give increased activity and mobility to the community's industrial and commercial capital;

and banking profits and prosperity are never so legitimate and so fair an indication of the character and quality of the service banks are rendering, as when they prosper and flourish along with the communities in which they exist. The changes which were made in our banking system under the Federal Reserve Act were designed to accomplish many different things, but the goal toward which everything pointed was that of making the nation's credit facilities more widely available in all useful and legitimate ways for industrial and commercial employment on terms of safety, and of such ease as is consistent with safety. How far the new banking system is fulfilling the promise of its sponsors and meeting the expectations of the nation, more particularly how it has met the tests which its first year and a/half have brought, are questions of the kind which suggest themselves at a time when the nation, throughout its length and breadth, is taking stock of its capabilities and when "preparedness" is its watchword. For the new system is no longer a theory, but a fact. It is in actual operation, with a record which can be examined, and which can be tested by results.

The new banking organization has already found its place in the American financial system and has already made an enviable history for itself. Its influence has not only been felt in every part of the country, but has reached across the seas. It has had to meet conditions and circumstances in many respects more unusual than could have been contemplated by its framers, and yet so well contrived and so flexible is the structure of the new banking system that it has been found capable of adjusting itself to each new condition. It has thereby given evidence of its capacity for growth and development along with the changing and expanding needs of the American credit and business system. It is just this quality which takes the Federal Reserve Act out of the class of ordinary financial legislation and makes the new banking organization a system in a very real and far-reaching sense. In breadth of conception the Reserve Act is a constitution rather than a statute; a financial constitution characterized, as an organic act should be, by that quality of adaptiveness which has always been the boast of our great political constitution, and a quality which we have long since come to regard as an essential, not to say the sovereign, element in any great and vital piece of constructive legislation.

In reviewing the working of the Federal Reserve Banks I wish to direct your attention to four or five aspects of the new

system which in my judgment are calculated to disclose the capabilities of the system and the temper and wisdom of its administration.

1. It has facilitated the growth and financing of the country's enormous foreign trade.

2. It has met the requirements of domestic trade, particularly the requirements of the crop-moving season and has shown a capacity to ease and steady discount rates.

3. It has shown capacity to absorb the redundant gold of the country and restrain inflation.

4. It has shown capacity to maintain an atmosphere of confidence.

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1. Growth and financing of foreign trade.

The financing of our foreign trade was always a sensitive point in our credit system, and foreign exchange has long been regarded as a very accurate barometer of our international position. The year 1915 witnessed the largest foreign trade ever experienced by this country, the export trade particularly attaining the colossal magnitude of $3,600,000,000, an amount $1,000,000,000 in excess of the highest amount hitherto recorded.

The large excess of exports over imports of merchandise created a balance of trade in our favor of unprecedented character and dimensions and subjected our purchasers to the necessity of resorting to the American money market in order to obtain funds with which to meet their obligations. The new banking system met every requirement of this unprecedented situation without difficulty. At no time since the opening of the Reserve banks has there ever been any doubt of the ability of our banking system, by means of the newly established system of acceptance credits or otherwise, to take care of the financing of the country's exports, however large the excess of these over imports might become. The growth in our exports has been continuous. The last month for which we have complete figures, March, 1916, shows exports over $100,000,000 in excess of March, 1915, an aggregate of $409,850,425, and which promises an estimated total for the year of between $4,000,000,000 and $5,000,000,000. When we contrast the ease with which we now finance a volume of trade which would have staggered the imagination a few years ago, with the clumsy shifts to which we were frequently reduced under our old methods of financing, we get some idea of how fundamentally and effectively our banking machinery has been improved by substituting for a precarious dependence upon foreign facilities those of our own making

and control.

You bankers will recall the situation into which our foreign exchange was plunged at the beginning of the European war before our new banking machinery had been set in operation. Our bankers, as had long been their custom, had drawn heavily during the summer on England. The estimated amount of our short time indebtedness maturing before the first of January, 1915, was from four to five hundred millions of dollars. It had been expected that this would be taken care of by the proceeds of cotton and grain bills which would be drawn with the export of crops. The sudden suspension of our foreign trade and equally sudden termination of our foreign banking credits left us in a serious position. I recall a conference of momentous import, held in the office of the Federal Reserve Board and attended by leading bankers identified with international financing, at which was discussed whether and how our accruing obligations could be met. It was decided that they could be met and therefore should be met no matter at what inconvenience to ourselves and no matter at what cost in the loss of gold. By that act was laid a foundation for the future of America as a world banker and to the faith thus inspired in the integrity and the capacity of the American banking system we owe very largely the

enviable position that we have, in the brief period of little more than a year, attained in the international money market. Such an embarrassment as we suffered in the early autumn of 1914 is all but unthinkable under our new banking system, unless there should be a breakdown of transportation facilities. This is not a theory; it is a fact which is thoroughly attested by the experience and events of the past year. We have not only received from Europe during the year 1915 over $400,000,000 in gold, but we have taken back American securities and arranged additional credits to a combined total estimated at $2,000,000,000.

A year ago dollar credits were practically unknown in foreign centers; today dollar exchange is a recognized and established medium of international commerce and one of the most prized, because the most stable, unit of international payment. The acceptance business, for many generations the peculiar domain of English banks and the source of much of England's prestige and power and profit in banking, has been successfully naturalized on American soil and is thriving. Complete and accurate figures are not available, but it is a safe statement that the volume of acceptance credits created in behalf of the foreign trade of this country has averaged for several months $100,000,000 and

now amounts to over $200,000,000, and the amount held by the Reserve banks to $48,000,000. The certain knowledge that acceptances of a sound character will find ready discount or purchase at the counters of the Federal reserve banks and at rates as low as two per cent, which is lower than has ever been enjoyed by any class of commercial paper in this country, has given a feeling of assurance to our bankers in entering this new and unfamiliar field and has thus enabled them to gain a foothold in it and to make it for all time an important and invaluable department of American banking.

2. Domestic trade, crop-moving, and discount policy.

While this important extension of American banking enterprise into the foreign field was taking place, our banking system, with the support of the Federal Reserve Banks, was assisting in the recuperation and extension of our home trade and industry. The home trade is, after all, the basis of the country's industrial activity and prosperity. However large and important the foreign trade may bulk in the popular imagination, however much attention may be given to it in the financial columns, and however important it may be in fact, it is still the truth, which

deserves to be emphasized, that ours is primarily a country of inland trade and industry. Among the nations which have reached a high degree of economic development, there is no other in which inland trade bears so large a proportion to foreign trade. According to competent estimates, it is at least twenty-fold the volume of our foreign trade and it is therefore the necessities and the interests of our home production and consumption that deserve especial consideration in any attempt to estimate how well it is being served by the banking organization. Are its needs being supplied on reasonable terms and with the assurance that accommodation can always be had on satisfactory security? To ask this question is to answer it, so universal is the knowledge of the comfortable conditions which have obtained in the money markets of the country and generally throughout the country since the Reserve banks were put into operation.

How completely the requirements of the crop-moving season have been met is also a matter of wide experience, if not of common knowledge. Never before within the recollection of this generation have the credit and currency needs incident to the gathering and the movement of the crops been met so easily and so smoothly and so quietly. The operation of the Gold Settlement Fund which has been established to facilitate the settle-

ment of exchanges among the Reserve banks and to reduce to the lowest point the shipment of currency from one part of the country to another, is in large measure to be credited with the happy result which has been attained. The autumnal pressure on leading money markets and the consequent tightening of money rates has come to be regarded by many as something that was inevitable in a country subject to such large periodic requirements of cash for the movement of its staple crops. The last crop-moving season, the first which has had the benefit of the machinery of the Federal Reserve banking system, passed without any untoward incident and without any indication of perturbation or strain in the great money centers. Indeed, if the experience of the past year may be taken, as I believe it may, as prophetic of the great change wrought in our banking mechanism by the Federal Reserve Act, the disturbances associated in the past with the autumn requirements may be regarded as an easily manageable factor in our credit and banking situation. This, in itself, is a triumph which deserves to be signalized in estimating the workings of our new banking system.

With rates ruling as high as six per cent for commercial paper when the Federal Reserve Banks were opened in the late autumn of 1914, and when the financial disorders incident to the

European war still presented a troublesome situation, and with some variation of rates between different districts, the Reserve banks, during the year 1915, greatly reduced the general level of discount rates and maintained them at a remarkably steady level. The opening quarter of the year 1916 saw rates of from two to four per cent on bankers' acceptances, the rate in actual practice, however, running very close to the lower limit. Trade acceptances at rates of from three to three-and-a-half per cent, rates on short-term paper up to ninety days at rates of from four to four-and-a-half per cent, were the noteworthy features in the discount rate situation. The fact that rates as low as three and three-and-a-half per cent were established on commodity paper, (that is, notes and bills secured by readily marketable staples), and the further fact that the Reserve banks stood ready to take and have freely taken agricultural paper at rates of four-and-a-half to six per cent, shows that the banking accommodation provided by the new system is not restricted to any class of borrowers but is available to all classes where the security is of the type approved for Reserve bank operations.

These various rates are lower than have ever been enjoyed for like classes of paper in any considerable section of the country. What is perhaps more important from the point of

view of the geographical distribution of the facilities of the new system, there has been a marked approach to uniformity of rates among the several Reserve banking districts, a nearer approach than has heretofore been experienced. Whether it will be practicable for a long time to come to maintain identical rates throughout the twelve Federal reserve districts has been questioned. Such an outcome may not be likely as long as there are marked differences in point of economic maturity in the different sections of the country, nor is the successful operation of the Federal reserve system predicated upon the assumption that discount rates must be uniform in all the reserve districts. One of the important features in which the regional system differs from the plan of the National Monetary Commission for a central bank with branches is that it does not require uniformity of discount rates but allows these rates to be adjusted to the conditions of demand and supply in the respective districts. These conditions are admittedly so divergent that any attempt to ignore them altogether in the determination of Reserve bank rates might well be regarded as undue interference with the necessary operation of natural forces and would sooner or later result in embarrassment. As long as the different sections of this vast country of ours are in differ-

ent stages of economic development with respect to the need for, and the accumulation of, capital, it is to be expected that there will be differences in the rate of interest and also, therefore, of discount rates. But the disparity which long obtained between the rates in some of the younger and less highly developed sections and the older centers, was undoubtedly in large measure due to the peculiar banking policies and practices which had grown up under our old banking system, and which were, to a certain extent, fostered by the law. But whatever the causes, the result was an artificial disturbance of the natural distribution of the country's supply of credit facilities and a condition which threatened, if left to itself, to develop into an artificial and unwholesome interference with the free flow of the nation's credits. To the extent that such was the case, differences of commercial rates were without solid justification in economic law and to that extent at least we may expect that these differences will be mitigated, if not altogether eliminated, under the operation of the forces set in action by the Reserve Act for diffusion of credit facilities and for local control of credit conditions by regional banks.

The rates which have been maintained by the Reserve

Banks throughout the past year or more are probably not to be regarded as normal, except in a temporary sense. The conditions of the past year and a half have admittedly been extraordinary and have worked toward easy conditions in the credit markets of the country. When we have digested the immense volume of potential credit set free by the new banking reform and are no longer subject to the depressing influence on rates exercised by the great influx of gold which we have had, it is certain that rates will advance. How soon the demand will catch up with the supply can only be conjectured; so too, it is a matter of conjecture what the normal rate of discount will be when the demand and supply of loanable funds are more nearly in equilibrium. Much will depend upon what is one of the most difficult of the war's effects to forecast; namely, the effect of the interruption and suspension of a large part of the customary commerce and industry of the European world and the destruction of an untold amount of industrial capital, upon the permanent interest rate. In the long run the interest rate on fixed investments is bound to influence short term money rates. In the long run, too, there will be a tendency for both investment rates and commercial rates in the leading financial centers of the world to move toward a common level. The course of the money market

in this country is, therefore, bound to be in very considerable degree influenced by the course of the leading money markets of Europe.

Speaking for myself, let me say that I am under no illusion with respect to the function of the Reserve Banks in our credit system, nor any with respect to the Federal Reserve Board's position and power as the ultimate authority in the determination of discount rates. The Federal Reserve Act has invested the Board with extensive powers, in the fixing of discount rates but it has also charged the Board with the responsibility of seeing to it that rates are so fixed as " to accommodate commerce and business", thus indicating that the fixing of discount rates is an exercise of economic and business judgment, not an arbitrary choice. No body of men in my opinion would be competent to shape the policies or guide the destinies of our new banking system, who did not realize that the determination of discount rates at their proper levels was more a matter of the wise application of economic law than of hasty or careless experimentation with statute law; a question of the conditions affecting the demand and supply of, loanable funds, present and prospective, as reflected in the market for short term commercial loans. The Reserve Banks will, therefore, show wisdom in recommending, and the

Federal Reserve Board will show wisdom in sanctioning only such rates as correctly interpret the trend of business and credit conditions and needs, so as, in a genuine sense, " to accommodate commerce and business". For the Federal Reserve System is not above or beyond economic law.

There is a magic in the Federal Reserve System but it is no venture in financial alchemy. It cannot make something out of nothing, nor for any length of time, and except at the cost of serious injury to the movement of the country's industry, maintain rates that are out of line with the natural economic trend. It would be poor policy, at any time, to favor present business at the expense of calculable future needs or requirements, nor should accommodation be withheld from present business because of undue solicitude or fear for possible future requirements. Such rates would not "accommodate". In the one case they would be too low, in the other too high; but the error committed and its mischievous effects would usually not become manifest until the results were well beyond control.

The Federal Reserve Banks as a whole might have maintained rates at a very much lower level than has been in effect during the past year or more, but it is hard for me

to see what good purpose would have been served by such abnormally low rates. As I view it, the chief results would have probably been, first, to have given an unhealthful stimulation to business enterprise of doubtful validity, possibly going so far as to work a dangerous inflation of credit and the launching of undertakings that would later on have been caught in the grip of rising rates; and, second, to have narrowed the margin of banking profit, more especially in sections of the country which are for the first time experiencing the levelling influence on rates of a fluid credit system.

I need hardly point out that lower rates would have borne hard on those of you who still follow the costly practice of paying inordinately high rates of interest on depositors' accounts. It is a familiar fact that in many parts of the country, banking competition has raised the rate of interest paid on savings accounts to a point where industrial development is retarded and bankers' profits threatened. It is well to encourage thrift by suitable inducements, but the matter is overdone when the inducement in the shape of interest goes beyond the rate war-

ranted by industrial conditions, and thereby diminishes the incentive to individual investment and enterprise. And this leads me to remark in passing that I believe that there must be a readjustment in the interest paid to depositors to conform to the reductions in the rates of interest and discount which will result under the moderating influence of the new banking conditions.

3. Absorption of redundant gold and checking of Inflationary tendencies.

I am afraid that the great influence exerted by the Federal Reserve Banks in steadying the movement and level of rates is not generally appreciated at its full value and significance. The wise policy of conservatism and self-restraint which has been pursued by the Reserve Banks as a whole has given to the movement of industrial expansion which has been under way for the past year, taking the country by and large, a quality of health and solidity that it would almost certainly not otherwise have possessed. In this, the first substantial trial of the Federal Reserve System's capacity for leadership, its success has been unquestionable. It has, so far as its situation permitted, created an atmosphere conducive to healthy expansion, and

has used such influences as it could command to temper the spirit of reckless adventure and prevent it from becoming a menace to the country's welfare. The result has been that the forward movement in industry which every part of the country has been experiencing in greater or less degree, has been one of the most substantial that the country has ever known. How easily it might have been otherwise can be conjectured by those who have not forgotten how often incipient industrial prosperity has been turned into misadventure and collapse in the olden days, because of the lack of the guiding and steadying influence of such authoritative and competent leadership as the country now enjoys.

You will recall how frequently and confidently, up to the very last moment preceding the passage of the Federal Reserve Act, the prophecy was made that the new banking system would bring about inflation, especially inflation of currency. One of the primary purposes of the Federal Reserve Act was to provide a method of elastic note issue. It is, of course, obvious that there can be no elasticity of circulation without the possibility of expansion which may, if the management of note issues is in incompetent hands, lead to inflation.

Discretion must lodge somewhere, and if it be abused, bad consequences will result. How carefully the new system has functioned in this respect, and how prudently it has used its issuing power to diminish, rather than aggravate any tendency toward inflation of credit is one of the most gratifying evidences of the wisdom of our new banking law and the ability of its managers. This deserves to be made clear, for there has been much misconception of the policy which has been pursued by the banks with respect to note issues.

The statement is sometimes made by persons who have not taken the trouble to inform themselves, that there has been a great expansion of the Federal reserve note circulation at a time and under conditions when there was no need of additional currency. What are the facts ?

If you look at the Daily Statement of the Treasury for May 13, 1916, you will find that $187,166,000 of Federal reserve notes have been issued by the Federal Reserve Agents or the Government to the Federal Reserve Banks. The Federal reserve notes are of course obligations of the Government as well as of the issuing banks and are issued by the Government to the banks and by them to the public. Before we can determine what, if any, influence has been exerted by the Federal reserve notes issued by the

Government in augmenting the money supply of the country, we need, of course, to know on what basis the banks have issued the notes to the public, and also what portion of the notes that have been issued by the Government to the banks are held in the bank's vaults.

On may 13, 1916, it appears that $27,218,000 of Federal reserve notes issued to the banks had not yet been issued to the public, and of the $159,948,000 outstanding and issued to the public, all but $9,567,000 had been issued in exchange for gold. That is to say, that except for $9,567,000 of Federal reserve notes outstanding against which the Government holds commercial paper for an equal amount and the banks hold a gold reserve of 40%, there was for every dollar of Federal reserve notes issued to the public by the Reserve Banks a dollar of gold taken from the public by the banks and deposited with the Federal Reserve Agents, representing the Government. In brief, to this extent the Federal reserve note is tantamount to a gold certificate or warehouse receipt for gold.

A dollar of reserve money is, by usual computation, estimated to be capable of supporting a volume of credit in the customary form of deposit liabilities, of four or five times itself. When, therefore, it is recalled that the Federal reserve note is not legal tender and cannot therefore be counted in the reserves of the national banks, you can readily see how the policy and method which the Federal Reserve Banks have pursued in the management of their Federal reserve issues, so far from inflating the bankable funds of the country, has actually reduced them by a large amount. In other words, of the vast amount of $419,356,000 of gold which the country received in settlement of the international balance during the year 1915, and which, if allowed to accumulate in the reserves of the banks would have threatened a serious unsettlement and disturbance in our credit situation, 36% (or $150,381,000) has been drained off and stored up in the keeping of the Federal Reserve Agents until such time as changed conditions and the interests of commerce and industry may require its use. The note-issuing policy pursued by the banks has thus had the twofold effect of actually diminishing the tendency to inflation through substituting the note in place of gold and, at the same time, has provided a definite reservoir of gold which can be tapped without producing any

shock or anxiety when the inevitable demand begins for the return to Europe of some considerable part, if not the whole, of the gold which necessity has obliged Europe to part with to us. So far from being a source or cause of inflation, the very opposite is the case, and the country owes much to the salutary action of the Federal reserve issues in mitigating the effects of the gold influx.

Whether we could or how we would have dealt with the problem of the increasing gold supply had we not fortunately had the agency of the Federal Reserve Banks, may well be questioned; but it is worthy of remark and careful consideration that although a condition so extraordinary as this was probably never contemplated by the framers of the Federal Reserve Act, and therefore no special provision made for it, nevertheless, so well conceived was the general framework and machinery of the system that it was found that it could be turned to useful account in meeting the situation created by the presence of the redundant gold supplies.

4. Commercial confidence.

I have reviewed, perhaps at what has seemed to you tedious length, three distinct, important and difficult kinds of service which the Federal reserve organization has rendered in

the first year and a half of its existence - a period characterized in its general aspects by much uncertainty and anxiety - in order to show how the new banking system is standing the test. It has met every requirement in the financing of the largest export trade the country has ever enjoyed; it has equalized and steadied discount rates at a low level throughout every district of the country and in this connection it has withstood the temptation to utilize its vast resources and power to depress discount rates to the point where both a dissipation of its resources and an unhealthful stimulus would result; and, thirdly, it has done much to check the inflationary tendency threatened by the huge influx of gold.

I come now to a fourth matter which is in some respects equal in importance to any of the others, if not of greater importance, because it has underlain each one of them and has made possible the definite and signal results which have been achieved. I refer to the atmosphere of confidence that has been induced and maintained from the very day and even before the day of the opening of the Federal Reserve Banks, and in every section of the country. It is, of course, hard, not to say impossible, to estimate the value of any element of business health and activity so intangible as confidence, and yet it is of the very essence and life of the modern business system. Business is largely a state of mind.

Business flourishes in the atmosphere of hope and the sunshine of cheer; it is chilled and choked by the poisonous vapors of fear and anxiety and is paralysed by the atmosphere of despair. The method of the Federal Reserve System, I trust you understand by this time, is the method of hope and of encouragement. It is this quality which distinguishes the Federal reserve legislation from any other important piece of legislation ever enacted by our Government touching the fortunes of business. It is this quality which entitles it to be regarded in a very genuine and critical sense as a product of constructive statesmanship. It is this quality which makes the advent of the Federal Reserve System mark an epoch in the business life of America and a step of incalculable length in the development of the new relations which the statesmanship of the future will seek to cultivate between the agencies of Government and the agencies of business.

That it has thus far succeeded in this vital function, the past year and a half bears eloquent testimony. A more striking contrast of conditions than those which confronted the country at the inception of the Federal Reserve System, when business and financial chaos was im-

pending as a result of the outbreak of the European war, and those which have obtained since the banks were set in operation, can not be found. Our international relations during the year 1915 were marked by several critical episodes any one of which under ordinary conditions would have thrown business into convulsion. Public opinion and feeling has on several occasions been in a state of extreme tension. When we recall the Lusitania incident, the Arabic, Ancona, and Sussex, to say nothing of the Mexican tangle, we can readily understand why war at times seemed to many imminent, and to some a certainty, and yet throughout it all the business pulse has been strong and steady and firm. There has been little of a dramatic or sensational character to record in our recent business annals. There have been moments when that sensitive barometer of business feeling, the stock market, has registered some nervousness and hesitation, but nothing for a moment comparable with the disturbance and shock following threatened ruptures in our foreign relations on former occasions, so unqualified has been the confidence that the business community as a whole has felt in the new banking system. When President Cleveland, twenty years ago, sent to Congress his message defining the position of this country

with respect to Great Britain's attitude on the Venezuela boundary dispute, the leading markets of the country were threatened with collapse. When President Wilson delivered his recent address to Congress with respect to the position of our country on Germany's methods of submarine warfare, though the situation was vastly more delicate and critical, our leading markets showed little weakness and less anxiety, and why? Because there was confidence that, come what might, we were possessed of a banking organization whose resources and management gave ample guaranties of financial safety. The gratifying evidence thus given of the feeling of security which our new banking system has inspired in the business community, is one of its greatest achievements and most valuable assets. For it may be laid down as axiomatic in modern finance that a financial and banking system, to meet the ultimate test, must not only be strong, but must also be generally believed to be strong - and adequate to any need. That difficult test has been successfully met.

Indeed, when we reflect upon the conditions of the past year, the establishment of the Federal Reserve System almost coincidently with the war seems almost to have been providential. Without the new system we should certainly

have been floundering like a ship at sea without rudder or compass to guide it; with it we have sailed like a well-ballasted ship, steadily and securely. And all this has been accomplished with a very moderate, not to say insignificent, amount of activity, as business activity is commonly measured in these days, on the part of the Federal Reserve Banks, thus showing that it is not the amount of business done which measures the usefulness and effectiveness of the Reserve Banks, but the character and the extent of the influence exerted by them, whatever the ways in which that influence may be exerted. With money rates unprecedentedly low, as they have been during the past year and with the banks of the country pretty generally in liberal supply with respect to loanable funds, it is hard to see what good purpose could have been served by an attempt on the part of the Reserve Banks to force the use of their funds by demoralizing reductions of rates, even if they could have succeeded, by this means, in diverting business to themselves.

I do not doubt that as the natural expansion of business grows up to the supply of credit facilities with which we are now so richly blessed, the loaning power of the Reserve Banks will be drawn upon in increasing degree, and that most,

if not all, of the Reserve Banks will have abundant opportunity to engage in activity which will be at once useful to the community and profitable to themselves. But until this point is reached, it would be shortsighted to complain because the Reserve Banks, as a whole, have not been dividend-earning institutions. Activity is the law of being of any ordinary business concern, but the Reserve Banks are not ordinary business concerns. They have a very sacred place and function in the country's credit system. Profit is not their object, and not, therefore, the test of their fitness. Not the amount of business done, but the amount of good done, is the proper standard by which to judge them. But when this is said or admitted, it should also be added by way of a warning word to those who would wish to see the operations of the Federal Reserve Banks circucumscribed within narrow limits, simply in order to avoid the effect of their competition with powerful member banks, that the limited amount of commercial operations in which the majority of the Reserve Banks have thus far engaged, is not for a moment to be taken as indicating the range of their normal activity. There will, in time, be much business that these banks will have to assist in order effectively to perform their

functions as regulating and governing banks, and while this business should not be undertaken from motives of profit, we may confidently expect that it will, in the ordinary course, yield returns that will easily pay the expenses of maintaining the Reserve Banks and meet their dividend requirements, and thus satisfy the ordinary test of business success along with the other and more difficult tests; for let us not overlook the fact that higher and more difficult tests than any which the system has thus far had to meet may await it in the uncertain and troubled future toward which the whole commercial world seems moving, as a result of the terrific disorganization of industry, commerce, and finance which the gigantic struggle now in progress in Europe will entail.

Econimic Readjustment After the War:

It has been predicted on the one hand, that the leading countries of Europe will find themselves industrially and financially so weakened as a result of the war that they will be long in repairing the damage sustained by their industrial organization, and will be, in consequence, a factor of diminished importance in the sphere of international commerce. The more destruction of large percentages of their working populations

and the disability through injuries and disease, of other large percentages, to say nothing of the destruction of vast amounts of physical capital, it is suggested will result in such shrinkage of their productive power as to keep them busy at home for a long time in repairing waste and loss. The crushing burdens of taxation that will lie heavily upon the commerce and industry of Europe are also pointed to as factors that will retard industrial recovery. Germany, which before the war occupied a most formidable position in export trade and in ocean carrying, as a result of British domination of the sea, has been practically shut out from her customary over-seas trade. To what extent and how soon, she will recover her former position is regarded as highly problematical, and weakened competition in our markets and some of the new markets in which we have recently been acquiring a foothold, is, in consequence expected.

Others, however, predict that the economic recovery of Europe will be rapid, and that competition, both commercial and industrial, among the leading nations, more intense than has ever before been experienced, is to be expected soon after the close of the war. The animosities, rivalries, and ambitions for commercial and industrial supremacy, which had

much to do with the making of the war, will, it is said, continue and give to the period after the war much of the unsettled and unsettling character of war times. Those who take this view predict that an era of protracted and bitter commercial warfare will follow the termination of the armed conflict, and that the differences and scores which were not settled on the field of battle will be fought to a finish on the field of commerce, and that neutral nations will inevitably be drawn into the struggle.

Without undertaking to pass judgment upon predictions of this character, I think it nevertheless well that we should be alive to the contingencies which may be ahead, and I do not hesitate to express my belief that Europe will give to the world an impressive exhibition of the recuperative powers of modern industry even after such a costly and exhausting war as has been in progress. Stupendous as are the examples that the past year and a half have given us of the destructive agencies of civilization when turned to war, I believe we shall get equally impressive examples at its close, of the constructive forces of modern civilzation when its energies and aspirations are turned to the healing work of peace. War destroys,

but that is not all that it does. Fortunately for a world in which war is long likely to remain a persistent and recurring fact, war brings some industrial compensations, though the offset to the losses and injuries be far from complete. War, especially war of the kind which is going on in Europe and touching to passionate intensity the vital impulses of great communities of men, stiffens and steels their fibre and makes them more capable to bear the hard and heavy burden of modern industry, and therefore will make them more formidable competitors, in time , of nations which have not had to face the discipline of war. No one can begin to approximate how much the industrial efficiency of the average man and woman in Europe will be raised as a result of the experiences and lessons which war has taught tham in unity of purpose and action, in organization and efficiency, in economy and thrift, in industry, and in devotion to duty. These things will tell, and I believe tell mightily, in the productive and competitive strength of the larger European nations after the war. Necessity has already worked some wonderful transformations in the industrial systems of the countries at war, and it is not unreasonable to expect that the nations which emerge from the trenches will, man for man and woman for woman, (for woman is clearly to play a role

in the industrial economy of Europe in the future far more important than she has in the past) come more near to realizing their full productive capacity than ever before.

This war has also taught lessons to the warring nations which will not soon be forgotten or wasted, as to the momentous effect which an efficient credit organization can exert in maintaining a country's industry in a state of health and activity and just as the European credit system has shown a capacity to finance the costs of war which has far outrun the wildest expectation, so it may be expected that it will show a new and enormous power to meet the requirements of industrial recuperation. Let us not, therefore, make the mistake of supposing that it will be an industrially feeble and unambitious Europe which will emerge from the war.

The history of modern commerce affords no parallel to the situation which exists or may exist, and we can therefore learn little from history as to what we may expect. The nearest approach is the long period of economic disturbance following the close of the Napoleonic wars. It took fully fifteen years for the world of commerce and industry to work out the needed readjustments and recover a normal equilibrium, and the process was embittered and embarrassed by policies of

commercial reprisal and tariff wars, similar to those which are now being planned by the contending groups in the European war. Neutrality was no protection then, nor will it be now. Our commerce and industry pursued a troubled course from 1815 to 1830, marked by a succession of alternating periods of fitful and feverish activity and industrial breakdowns. The process of readjustment which had to be gone through in order to determine what the relative positions of the several nations should be in the new commercial economy was a long and costly one for each and all. Uncertainty was everywhere. To recognize the possibility, not to say the probability of the recurrence of something similar would seem to be the part of prudence for us, and the first step in intelligent preparation for it. The one thing which is certain in forecasting the future is the uncertainty of the conditions with which we shall be surrounded.

Let me add however, in order to relieve unnecessary suspense, that I do not look for an immediate reaction in our industrial situation at large as a result of the close of the war. But I do expect that some of the industries which have been stimulated into frenzied activity by the forced draught of evanescent war orders, may have their troubles. Also I

think that there is much danger that their troubles, unless localized and controlled, may breed trouble, uncertainty, and anxiety for others. There is a contagion of trouble as well as of prosperity. We know this from sad experience. This much, at least, may safely be said; that our industry and commerce are to travel uncertain and uncharted ways in the years which are ahead, and uncertainty, I need not tell you, is the great bane and foe of modern business. To eliminate it where we can, or to minimize it where we can not completely control it, is our clear duty. We shall not, therefore, if we are wise, neglect to strengthen our defenses so as to make them equal to any contingency with which we may be confronted. And this leads me, in conclusion, to say some frank words to the State banks, whose cooperation should be forthcoming in order to widen the base of our banking structure, to give the country the fullest sense of safety and security.

5. How are State banks meeting their test.

Speaking to a convention made up largely of State bankers I should be remiss in my duty if I did not avail myself of this opportunity to speak plainly to you. You know that

the Federal Reserve Act was purposely planned upon a broad and generous scale in order that every bank in the country, whether State or National, doing a commercial banking business in safe and legitimate ways, might secure for itself and its customers the advantages and protection of the Federal Reserve and at the same time contribute its quota of strength to it. The State banks surpass in number the National banks and represent a substantial part of the commercial banking power of the nation. To what extent the proportion has declined since the establishment of the Federal Reserve System can not be approximated with accuracy but it is a fact that the National banking system has since the establishment of the Federal Reserve System shown an accelerated rate of growth and a greater capacity for growth than State banking during the same period, the increase in the deposits of the National banks having been estimated to be three or four times as great as those of the State Banks since the inauguration of the new System. What the relative growth of member and non-member banks will be in the future, I shall not undertake to prophesy but as long as there is a considerable portion of the banking power of the nation organized as State banks and which is eligible for membership in the Federal Reserve System and has not joined, the system will not have attained its fullest strength and its widest field of usefulness.

Why are you State banks not coming in to the new system ? The provisions of the law respecting State bank members are as liberal as could well be desired, and the regulations which the Federal Reserve Board has laid down on this subject are even more liberal. Those of you who have read the Act and the Regulations of the Board will, I believe, find no reasonable ground of complaint. You will find few restrictions upon your customary banking methods. The Board has even gone so far as to provide a way by which any State bank becoming a member bank may withdraw from the system in order that you need not be deterred by the feeling that membership means an irrevocable choice. The attitude of the Federal Reserve Board has been founded in the conviction that our new banking system should be as broad and as strong and as capable as the financial condition of the country will support and the limitations of the Reserve Act will permit.

It is almost a year now since this Board issued its regulations concerning the admission of State banks. Thirty-four banks have joined. The strong conviction which the business community in every part of the land has formed of the benefits of the new system require that it should be known why the growth of State bank membership has been so slow.

Are any of you holding back because of dissatisfaction with the provisions of the Federal Reserve Act or with its administration ? The Federal Reserve Act and the Federal Reserve System are here to stay. They have won the sanction of public opinion and are regarded as the essential bulwark of our financial safety. As to the administration of the Act and of the twelve Reserve Banks, little but good has been heard. But if the State banks are holding back because of dissatisfaction with the administration of the law or the banks, they should make it known in order that the defects may be remedied, and the country given the full advantage of a banking system carried to the highest point of strength and efficiency.

Coming to another reason, I have sometimes heard it suggested that financial conditions have so changed that there is no longer need of the kind of protection and security which the Federal Reserve System was designed to provide. It must be admitted that the financial situation during the past year has been so exceptionally easy that it might well have begotten in the minds of those who are not in the habit of looking beneath the surface of things, the idea that financial strain and convulsion is a thing of the past. They are likely

to experience some surprises. I have already given my reasons for expecting that the years which are ahead and which will reap the consequences of the financial disorganization and demoralization growing out of the great war, will be years of uncertainty and disturbance for us in common with the rest of the world; years filled with anxiety, and requiring for the good management and the protection of our national interests, the guidance and support of the Federal Reserve System. Whatever other mistakes we make, let us not deceive ourselves on this point, and be lulled into a blinding passivity; for when trouble comes, as sooner or later it will and State banks in overwhelming numbers run to cover under the shelter of the Federal Reserve Banks, they may find some difficulty in getting in as quickly as they would like.

There is also a feeling abroad in some parts of the country that in some mysterious way the Federal Reserve System, with the membership of the National banks, has produced a situation in which the beneficent effects of the new banking system, like the rains of heaven which fallalike upon the just and the unjust, will be so inevitably and widely diffused that non-member banks, no less than member banks, will reap the full advantages. Let me say very frankly that I believe there is some truth in this - yes, much truth - but not so much as is frequently assumed.

To the extent that the success and effectiveness of the new system will depend upon the feeling of security that it inspires - in other words, to the extent that the success of the system depends upon what may be entitled its psychological reserve - it is no doubt true that all the banks, irrespective of their connection with the new system, will participate in the result. But it may readily happen, and it will probably happen, that from time to time - no one can say in the face of the critical years that are ahead of us how frequently these times will occur - the needs which the community will have of the Reserve Banks will call for more than psychological reserves and will at times cut deeply into their gold reserves, and then will it become clear that the strength of the system is measured also by the cash that it holds in hand. The State bank, therefore, which conducts a banking business that qualifies it for membership in the system under the liberal conditions laid down by the Federal Reserve Board, and which sustains relations with the business community of the kind that give rise to financial difficulties and embarrassments of the sort which have called forth the establishment of the Reserve Banks as a means of protecting the community, are taking the responsibility for

themselves and, what is of far more serious consequence, for the communities of customers which they serve, of keeping the new system from becoming in the fullest sense an American system, equal to any demands that may be made upon it.

You are the bankers of a community which is served mostly by State banks. Your State has extensive agricultural, manufacturing and merchandising interests. They are precious to your people. Their condition makes or mars your prosperity and your condition may make or mar theirs. I see no good reason why the people of Missouri, or Arkansas, or Mississippi, should not enjoy in all circumstances the same sense of security as is enjoyed by the farmer, the manufacturer, and the merchant in States or sections of the country which are served preponderantly by National banks. I believe the welfare and security of the Missouri farmer, merchant, or manufacturer was just as much in the mind of Congress when it enacted the Federal Reserve Act as that of manufacturer, merchant, or farmer of Massachusetts or Connecticut. He is entitled to all the good that can be reaped from the new banking system and he is entitled to know it, if his existing banking connections do not secure him the fullest and freest access to it.

The Reserve Bank affords an ever ready means by which good commercial paper can, at a moment's notice, on presentation at the counters of the Federal Reserve Bank, be turned into either credit or currency. No such thing as a currency famine can overtake the customer of a bank that, by reason of its membership in the Federal Reserve System, has the right and ability to go to that bank and get gold, credit or currency. Non-member banks may get it as a matter of favor, but I believe that people as they come to understand these matters more fully, will see the difference between dealing with a bank that, as a matter of right and of course, can go to a Federal Reserve Bank for assistance in the certain knowledge that it will be forthcoming, and those banks which, if they get such assistance at all, will get it indirectly and as a matter of favor and of public spirited generosity on the part of the member banks and of the Reserve Banks. In matters of such vital concern to its industry and agriculture, no community can afford, or will be willing, to pin its faith to banks which are on the outside of the Federal Reserve System.

Those of you who need a more personal and cogent reason for becoming member banks will soon find it, I believe

when the plan which has been devised for the clearing and collection of checks has been put into operation by the Federal Reserve Banks. The Federal Reserve Bank of St.Louis will soon issue a circular giving complete information and I am confident that the plan will have been in operation but a short time before many non-member banks will realize the necessity of joining the Federal Reserve System in order to participate in its new collection plan.

The plan is well conceived. The Federal Reserve Banks will extend unsurpassed collection facilities to such of their members as choose to avail themselves of them, but the system is optional. No member bank will be obliged to clear through its Federal Reserve Bank. The only element of compulsion is that every bank, whether member or non-member, will be obliged to pay without deduction checks drawn upon it and presented at its counter for payment by the Federal Reserve Bank or its representative, either in acceptable exchange or in lawful money. The plan is reasonable: many letters that are coming to the Federal Reserve Board from those who have been the victims of excessive exchange charges prove this. The plan is also practicable and is going to

be effective : this is proved by the objections that are being urged against the plan by those banks that are now taking tribute from the commerce and business of the country in the shape of unreasonable exchange charges. It has been estimated that as soon as the plan has been put into operation checks upon at least fifteen thousand banks, National banks, State banks, and trust companies, throughout the United States can be handled at par through Federal Reserve Banks, subject to a small service charge. Par collections will be the rule. State banks whose checks cannot be collected at par will be a small and rapidly diminishing minority and, as they will find it difficult to retain much good business when checks drawn upon them are at a discount while checks drawn upon the majority of banks can circulate at par, the day is near at hand when checks upon practically all banks can be handled at par by Federal Reserve Banks.

If the reasons I have advanced for State bank membership in the Federal Reserve System are sound, as I believe you will, on sober reflection conclude they are, why, then, I repeat, are you State bankers hesitating and waiting ?

I asked this question the other day of one of the largest bankers in this district and his answer as ,"most of them don't know. They can't tell you. But you will get them in quickly enough when trouble comes." I have spoken to little effect if the logic of my words does not say to you, "Don't wait 'till trouble comes, but make the assurance of the new banking system for yourselves and those you serve, doubly secure by coming in now, and doing your part in giving to this country of ours a banking system worthy of its name and worthy of its future." To falter is, therefore, to fail. To fail in this vital test, at this vital time, is unbusinesslike, is ungenerous; is, therefore, un-American and unpatriotic.

A. C. M.

5/19/16

SUGGESTED FORM OF REPLY TO INQUIRIES RELATIVE TO THE NEW CLEARING AND COLLECTION PLAN

(Prepared by Mr. Harding)

The check clearing and collection plan which has been formulated by the Federal Reserve Board is not compulsory upon any bank as far as the use of facilities to be provided is concerned. Member banks, as long as they comply with the statutory requirements, may continue to carry accounts with their approved reserve agents and with other national banks to whom they may send items for collection and from whom they may receive, for similar purposes, checks drawn upon themselves or upon other banks. They will, however, be required to pay without deduction, checks drawn upon themselves and presented at their own counters for payment. Remittance of such checks by the Federal Reserve Bank of their district through the mail will be construed as presentation at their own counters and they must settle with the Federal Reserve Bank for such checks , either by checks upon other banks or by remittance of lawful

money or Federal Reserve notes at the expense of the Federal Reserve Bank. Checks drawn upon a member bank which have been received by the Federal Reserve Bank will not be charged against its reserve account until sufficient time has elapsed for the checks to have reached the member bank and for returns to have been received in due course by the Federal Reserve Bank.

The Federal Reserve Board's clearing system provides that a small service charge, based upon the number of items handled, will be made at stated intervals against such banks as send to the Federal Reserve Bank checks on other banks for collection and credit; but it follows that no portion of this charge can be assessed against any bank unless it should elect to avail itself of the facilities offered. Federal Reserve Banks will handle, besides checks drawn on member banks, checks on such state banks as can be collected at par, and national banks desiring to handle for a Federal Reserve Bank checks drawn on state banks, will be given the preference. During crop moving periods it is

thought that this will be a distinct advantage to member banks.

The Board has no disposition to deprive member banks of any income that they may have been in the habit of receiving from the collection of drafts or from the purchase or discount of bills of exchange, and so there should be no diminution in the customary profits of member banks from such sources.

The Federal Reserve Board has received many letters in regard to the plan, a great number of which are commendatory, and it appears from those of opposite tenor that the objections raised are based upon an apprehension that profits will be decreased and upon the feeling that the plan will prove to be effective. It is estimated that as soon as the new clearing system is put into operation checks upon about 15,000 national banks, state banks and trust companies throughout the United States can be handled by the Federal Reserve Banks at par, subject to the small service charge above referred to; and as a minority of the

banks will find it difficult to retain much of their good business when checks drawn upon them are at a discount while checks drawn upon the majority of banks can circulate at par, it is thought that in the near future checks upon practically all banks throughout the United States can be handled at par by Federal Reserve Banks. Many banks have found it advisable hitherto to concentrate their available funds by maintaining balances with a number of correspondents for exchange purposes, or in order to control checks drawn upon themselves. After November 16, 1917, no bank balances will be available as reserve for national banks except balances in Federal Reserve Banks, and therefore after that time any necessity to maintain non-reserve balances with correspondents, either for exchange purposes or in order to obtain collection facilities, would be deemed in many cases a great hardship. It is thought that in numerous instances banks will find it expedient to concentrate their balances and to close many of the accounts which they now carry with other banks, and that a system which will enable them to send all of their checks on other banks

to Federal Reserve Banks for exchange purposes or as an offset against checks on themselves forwarded by the Federal Reserve Bank, will, in course of time, come to be appreciated as a convenience and the release of funds heretofore tied up in accounts carried with other banks and their employment at higher rates of interest in commercial loans, should offset to a great degree the prospective loss of exchange profits which is at the present time looked upon with apprehension by some of the banks.

WPGH-RRB-5/19/16.

FEDERAL RESERVE BOARD

WASHINGTON

665.

May 24, 1916.

Dear Sir:

For your information I beg to enclose copy of order entered by the Board in the matter of the petition of certain banks in Wisconsin for change in the geographical limits of Districts Nos. 7 and 9.

The Board has given careful consideration to the views presented and has reached the conclusion that it would not be justified in making any alterations at this time.

If future developments should indicate any necessity for such change the Board will, at a later date, give consideration to the matter upon the application of banks desiring to be transferred. The Board, however, is very hopeful that the results under the new clearing system will make a transfer unnecessary.

Attention is particularly called to the fact that if the Board had granted the petition as filed, those banks located in that portion of the Minneapolis District embraced within the upper peninsula of Michigan would have been isolated and cut off from the rest of the District. This fact should be taken into consideration if, at a future date, an amended petition is filed for modification of the district lines.

Very truly yours,

Vice Governor.

Enclosure.

IN THE MATTER OF THE PETITION OF CERTAIN BANKS IN WISCONSIN FOR MODIFICATION OF DISTRICTS NOS. 7 AND 9.

Upon consideration of the petition of certain banks in Wisconsin that the geographical limits of Districts Nos. 7 and 9 be modified so as to include in District No. 7 a part of the territory now included in District No. 9, and

After a full investigation of the matter and in view of the fact that the petition if granted would have resulted in isolating and disconnecting the upper peninsula of Michigan though leaving it in the Minneapolis District, the Federal Reserve Board has arrived at the conclusion that there is no present necessity for any change in the geographical limits of the said Districts Nos. 7 and 9 at this time.

It is ordered that said petition be dismissed without prejudice to the rights of the signers to file an amended petition at a later date.

5/24/16.

IN THE MATTER OF THE PETITION OF CERTAIN BANKS IN WISCONSIN FOR MODIFICATION OF DISTRICTS NOS. 7 AND 9.

Upon consideration of the petition of certain banks in Wisconsin that the geographical limits of Districts Nos. 7 and 9 be modified so as to include in District No. 7 a part of the territory now included in District No. 9, and

After a full investigation of the matter the Federal Reserve Board has arrived at the conclusion that there is no present necessity for any change in the geographical limits of the said Districts Nos. 7 and 9 at this time.

It is ordered that said petition be dismissed without prejudice to the rights of the signors to file an amended petition at a later date.

5/25/16.

1241

FEDERAL RESERVE BOARD

WASHINGTON

May 24, 1916.

Mr. J. Z. Miller, jr.,
Governor, Federal Reserve Bank,
Kansas City, Mo.

My dear Mr. Miller:

In answer to your letter of May 19th it is not the thought of the Committee on Clearing of the Board to take up at this time the question of charges which member banks are to make against their patrons and, therefore, the matter has not been discussed by the Board. Our thought was that we should first get the matter of par collections working, and then we could see what further it was necessary to do.

It is conceivable, for example, that a member bank might pay only 1½¢ per item to get its checks collected and be obliged in addition to allow enough time for the collection to be effected before it could draw on the fund, and then turn around and charge its patrons an exorbitant charge, but I think this is rather unlikely. As you very well know, the high exchange charges in the past by country banks have been made by country banks against the large city banks, who sent them the items, and this system would never have been effective if there had not been an arrangement, or community of interest, between the country bank and its city bank correspondent.

In the big cities it is true that the city banks have followed the custom of charging exchange on out of town items, but we believe that competition is pretty likely to rub this out. At any rate, it seems to Mr. Harding and myself that we had better do one thing at a time and see what happens to collection charges. So far as the service charge to be made by the Federal Reserve Bank is concerned, we are perfectly willing that it should be 1½¢ per item, and we do not object to 2¢ per item to start with in Districts like San Francisco and Dallas. Perhaps after a few months' trial a different basis will be found desirable, one possibly based on gross amount as well as on items.

Yours very truly,

F. [illegible] DELAN[illegible],

Vice Governor.

FEDERAL RESERVE BOARD

WASHINGTON

May 23, 1916.

Mr. J. B. McDougal,
Governor, Federal Reserve Bank,
Chicago, Ill.

My dear Mr. McDougal:

Answering letter signed by Mr. McKay under date of May 15th, as you have already been informed, the Federal Reserve Board is in general accord with the resolutions adopted at the Transit Managers' meeting as to the matter of details. This is true, generally speaking of all the resolutions with the exception of that in respect to developing the clearing operation in three stages instead of one. After hearing from all of the Federal Reserve Banks the Board concluded, as per our telegram of May 21, to direct the starting of the clearing system generally on Saturday, July 15th; thirty days later than the date set forth in our Circular of May 1st. There are a few matters, however, to which you have specially called the attention of the Board and these, after some discussion yesterday were referred to the Board's committee on clearing.

The first subject is that of par lists of non-member banks for each District, which is touched upon in Topic No. 6. Our committee entirely approves the conclusions arrived at by the Transit Managers and will be very glad to cooperate in any way it is desired in having lists printed by the Government

Printing Office for the use of the member banks. In this connection, however, we want to call attention to the fact that it is important that the committee having this matter in charge shall send us "copy" and "form" showing us exactly the style which is to be followed, and requisition stating the number of copies desired.

With reference to your Topic No. 10, entitled, "Penalties for Encroachment upon Reserves", the Board sees no objection to the rule suggested by the Transit Managers.

Topic No. 11: Analysis of Per Item Cost: We see no objection to this basis of analysis.

There are one or two other topics not specifically mentioned in your letter to which the committee would call attention.

Topic No. 3, entitled, "Sorting of Items by Member Banks", the resolution of the Transit Managers requires all member banks to sort their items in accordance with the time schedule. It appears to us this is entirely proper with banks of considerable size, but would be burdensome with small banks. In deciding what you should do in a matter of this kind we think you should certainly not be more exacting than large city banks have heretofore been in their requirements upon country correspondents. Indeed this is a rule which might, we think, be based on the number of items sent.

Topic No. 9, entitled, "Statements of Reserve Requirements from Member Banks." The resolution asks that a statement be required from member banks at least once a month, showing the average reserve requirement for the preceding month. It is obviously impossible for a member bank to figure the average reserve requirement unless it tabulates the daily net demand and time deposits and from the sum of these calculates the average. Asking for the average will result in many cases in getting simply a shrewd guess as to what that average really is. It appears to us that the way to get this information accurately with the least labor on the part of the banks is to ask the banks to give you, either weekly or monthly, a statement showing their daily demand and time deposits, from which a clerk with an adding machine can quickly determine the average. The committee offers this simply as a suggestion which should have your consideration, especially in view of the fact that three of the Reserve Districts are now requiring such statements from their members.

Topic No. 12, "Method of Applying service charge to number of items." The Transit Managers recommended a uniform charge not exceeding 1½¢ per item. We understand, however, that in the Dallas and San Francisco Districts the Federal Reserve Banks believe that they must charge at least 2¢ as compensation. The Federal Reserve Board's committee

believes that, while it is desirable that the charges should be as nearly alike as possible, it is not essential that they should be identical. It has occurred to our committee that you might like to determine that this charge of 1½¢ might be split so as to divide the compensation in some cases. As for example, a bank in the Seventh District might send Chicago a lot of items on the Cleveland District, or it might send them direct to Cleveland. If the Cleveland Bank is paid the whole 1½¢ per item in each case, there is nothing left for the Chicago Bank for its service. If, in this case, the Chicago Bank should receive 1½¢ per item and pay the Cleveland Bank something less than 1½¢ for collecting items, it would receive some compensation for its share in the service. It may be thought cumbersome and unnecessary to do this and the Board's committee does not care to press the point.

After experience of several months it may be determined best to put the charge on some different basis or to make allowance for the gross total of items as well as their number.

Yours very truly,

F. A. DELANO)
) Committee
W. P. G. HARDING) on Clearing.

A copy sent to the Governors of each Federal Reserve Bank.

FEDERAL RESERVE BOARD

WASHINGTON

May 26, 1916.

Mr. D. C. Wills,
Federal Reserve Agent,
Cleveland, Ohio.

My dear Mr. Wills:

The point raised in your letter of May 12th, reading as follows:

> "Will the country bank keeping a single account be permitted to count the full balance in that account without deduction, as reserve, provided it carries on the books of the Federal Reserve Bank a net collected balance equal to its minimum reserve requirement?"

is a matter which we have not as yet dealt with. It is really a matter for the Comptroller of the Currency to decide and we have not wished to urge a change in the Comptroller's ruling. As far as the Federal Reserve Board is concerned, it can only deal with the minimum reserve requirements in the Reserve Bank. The optional reserve and the reserves in the member banks' own vaults is a matter between the member bank and the Comptroller. If the Comptroller continues to allow member banks to count as reserve items which have been put in the mail for collection that is his lookout. If he allows banks to more than offset items due to other banks, with items due from other banks, but not collected, that is beyond the control of the Federal Reserve Board.

My own view, furthermore, is that while we must be conservative we must take our steps one at a time, and that it would be a great mistake, simultaneously with the adoption of the clearing plan, to cause the adoption of a harsh ruling by the Comptroller as to how member banks' records of reserves are to be interpreted. This is a statement which we are not "shouting from the housetop", nor one which we would include in any circular, but I believe that it has an important bearing in the successful working out of the clearing plan.

Since dictating the above I find this matter stated rather well in the circular of the San Francisco Bank to its member banks, one paragraph of which reads as follows:

> "While the proceeds may not be counted as <u>required reserve deposits</u> (i.e., the amount required by the Federal Reserve Act to be carried unconditionally on deposit with Federal Reserve Bank), yet, because credited by Federal Reserve Bank, they may be counted as part of the <u>optional reserves</u> (i.e., the amount to be carried either in member bank's own vaults, with Federal Reserve Bank or with other approved reserve agents)."

Yours very truly,

Vice Governor.

ADDRESS OF W. P. G. HARDING,
MEMBER OF THE FEDERAL RESERVE
BOARD, BEFORE THE ALUMNI SOCIETY
OF THE UNIVERSITY OF ALABAMA,
AT TUSCALOOSA, TUESDAY MORNING,
MAY 30, 1916.

RELEASED TO AFTERNOON PAPERS, MAY 30th.

EFFICIENCY AND INDUSTRIAL PREPAREDNESS.

We are celebrating the one-hundredth anniversary of the historic city of Tuscaloosa and the eighty-fifth annual commencement of our great University. Although upon such an occasion our thoughts naturally take a retrospective turn, I shall not in my remarks dwell upon the past, rich as it is with lessons of its trials and triumphs, nor will I pose as a prophet and attempt to rent the veil of the distant future. I shall speak instead of the present and of that immediate future which lies within our horizon, and which we can make what we will.

(I.) LESSONS OF THE EUROPEAN WAR.

We are living in a most critical period of the

world's history, a stupendous era, full of opportunity and fraught with grave responsibility. The frightful holocaust on the other side of the Atlantic, with its appalling sacrifice of human life, with its enormous waste and with its pandemonium of calamity and woe, has aroused in the hearts of the people of this country mingled feelings of horror and of pity, but also it has instilled in our minds a better and higher appreciation of our duty to ourselves, to our country and the world. No longer are we lulled into a false sense of security because of our splendid isolation, no longer do we feel that we enjoy permanent immunity because of the three thousand miles of ocean waves that separate us from the shores of Europe; but we have as a nation come to realize that our surest guaranty of peace lies in preparedness for war. The first steps for military and naval preparedness have already been taken, and because of this we are confident that we shall escape any part of the tragedy now being enacted on the three continents of the old world. This confidence is intensified because of the calm judgment and consummate skill of the President of the United States, Woodrow Wilson, who has

so successfully handled a grave international crisis, maintaining friendly relations, while preserving our national honor and dignity. It is not necessary, therefore, to discuss at length at this time and place, preparedness from a military sense, but it is well that we should consider it from a commercial and industrial standpoint.

(II.) EFFECT OF WAR UPON AMERICAN COMMERCE.

Out of the misfortunes of others has come to a great extent the marvelous prosperity with which this country is blessed today. The temporary depression in the United States which followed immediately the outbreak of the war and which was due to the sudden and complete collapse of credits and to the interruption of the accustomed means of transportation and communication throughout the world, was followed by a speedy readjustment which brought with it from the warring nations and from non-combatant countries whose trade had been principally with the powers at war, millions upon millions of dollars worth of orders, not only for munitions but also for the ordinary necessities of life, which have been pouring in upon this country so that it has been

enriched, according to the estimate of some authorities, to the extent of about three billions of dollars. This golden flood has fairly deluged some of the states to the north and west of us. Alabama and her sister states of the South, while feeling to some extent the impetus of better times, have not received their fair proportion.

(III.) POSITION OF THE SOUTH.

The South, since that day, back in 1881, when we members of that Class made our final bows upon the rostrum in Woods' Hall, has made great progress in all lines of industry, in agriculture, in manufacturing, in mining, in banking and in commercial pursuits, as may be exemplified by the statement that the banking power of the Southern states is now greater than that of the entire United States at that remote day. But our section, nevertheless, has not yet become highly specialized in the arts and sciences, and in manufacturing, but is still essentially an agricultural region and still has cotton as its principal money crop. Because of the inability of the central powers to import cotton on account of the rigid blockade which is being maintained, the South has, during the past year, been deprived of a market for nearly one-fourth of its export crop, so that neither its

manufacturers nor its farmers have reaped that measure of profit which has come to the same classes in other sections. The South is, however, an important part of the United States, and is interested in common with all other sections, in the maintenance of national prosperity. Already there are some indications that a wearied Europe is beginning to turn its thoughts toward peace, and perhaps it may be the mission of our Southern born President to point out the way.

(IV.) AFTERMATH OF THE WAR.

Restoration of peace will necessarily bring about important changes in the world's trade and just what these changes will be and how they will affect business conditions in this country, are problems which are being studied carefully by publicists and business men. These are vital questions here in the South as in other parts of the country, although we may not be as directly affected as other sections for the reason that a smaller part of our business has come from foreign countries or has been connected with war material. We should, however, stand ready to support the Government in any measures that it may be necessary to adopt in order to retain the legitimate foreign trade that we have already

secured, to extend still further our business intercourse with South American countries, besides maintaining a proper balance in our trade relations with the nations now at war. American bankers are permitted under the Federal Reserve Act to establish branches in foreign countries and can thereby facilitate transactions involving the importation or exportation of goods, and it is practically certain that a law will soon be on our statute books creating a tariff commission, whose duty will be to make a close study of changing conditions and to recommend from time to time such modifications of our present tariff laws as may be advisable. I do not speak authoritatively, but I hope that as a measure of commercial preparedness, steps will be taken to encourage the manufacture of dye stuffs in this country, to protect American firms against foreign dumping and to provide heavy penalties for foreign concerns engaged in unfair competition in the United States. American merchants and manufacturers seeking to compete with those of other nations in the markets of the world should be permitted to engage in the contest on equal terms with their competitors, and we should, therefore, favor some arrangement

that will enable American exporters to secure foreign trade in competition with the cartels and combinations of Germany and other countries.

(V.) AMERICAN MERCHANT MARINE.

A serious drawback to the development of our foreign trade is the utter inadequacy of our American Merchant Marine. The South has felt this perhaps as keenly as any other section of the country. We have been handicapped very greatly in exporting cotton by lack of ship room and by abnormally high ocean freights. Rates to Liverpool on cotton have for several months past, frequently ruled as high as $15.00 per bale, or 3¢ per pound, or about 10 times the normal rate, and this excess has, to a great extent, come out of the pockets of the Southern farmer. American ship yards have been very busy for the past year or more, as private capital has been attracted to shipping by the unusual profits obtainable, but in normal times this activity cannot be expected to continue.

Our wage scales are much higher than those of foreign countries, whose shipping is also, in many cases, subsidized, and, in order to establish an American Merchant

Marine which can be used in the carrying trade in time of peace and as a naval auxiliary in time of war, Government intervention and aid seems necessary. The shipping bill passed the House of Representatives a few days ago, with the support of practically all the Southern members, and will, in all probability, pass the Senate and become a law before the adjournment of Congress.

(VI.) RURAL CREDITS.

Another measure of supreme importance to the South is now in conference, -- the rural credits bill. The South for a great many years has labored under the curse of absentee landlordism and it has suffered from the evils of the tenant farming system. Hardly more than a tithe of its productive capacity has been utilized, for lack of both capital and labor. With the exception of Texas, the Southern states have not attracted their proper share of immigration, either foreign or domestic. Too many of our rural population have found it impossible to make any substantial headway, and finding themselves year after year lacking all of the luxuries and many of the necessities of life, have lost ambition and have

settled down to breathe the sodden atmosphere of a hopeless and aimless existence. The rural credits act will open the way for the organization of national farm loan associations which, in cooperation with the twelve Federal land banks to be established, will make loans on farm lands on long time; payments being amortized so that the total annual installment, including interest and reduction of principal, will amount to not more than 8% of the principal, the interest in no case to exceed 6%. Land owners will thus be afforded an opportunity of improving their farms by ditching, fencing and by the erection of silos and buildings, diversification of crops will be encouraged, cattle raising will be promoted, and the thrifty tenant farmer will be given an opportunity of becoming his own landlord. Many who have heretofore been without hope or definite ambition, will find a new incentive to work and to accumulate with a view to ultimate independence. Southern agriculture will thus receive a wonderful stimulus, and many of the young men growing up on the farms whose ambition now is to go to a town, will find it to their advantage to make a study of scientific farming and to practice it as a

life vocation. Better living conditions in farming districts and greater prosperity for the farmer mean decreased cost of living, less concentration of population in the towns and cities, more schools, better morals, and a happier and more contented people. Prosperity on the farms means larger orders for the merchant, the coal operator, the lumberman and for the manufacturer; more business for the railroads, steadier employment of labor, increased deposits for the banks and a greater demand for loans. Consider what Europe has done for its farmers and how, up to the outbreak of the deplorable war, it had improved their condition, and how the continental powers have been able, through scientific farming methods, to support themselves during abnormal conditions. While the methods adopted in Europe may not be best adapted to the United States, surely with some modifications they can be made effective here. Nearly one hundred and fifty years ago, Oliver Goldsmith wrote his greatest poem, "The Deserted Village." It was a striking exposition of English history and a remarkable forecast of the future.

"Ill fares the land, to hastening ills a prey,
Where wealth accumulates, and men decay;
Princes and lords may flourish, or may fade;
A breath can make them, as a breath has made;
But a bold peasantry, their country's pride,
When once destroyed, can never be supplied.
A time there was, ere England's griefs began,
When every rood of land maintain'd its man:
For him light labor spread her wholesome store,
Just gave what life required, but gave no more;
His best companions, innocence and health,
And his best riches, ignorance of wealth.
But times are alter'd; trade's unfeeling train
Usurp the land, and dispossess the swain;
Along the lawn, where scatter'd hamlets rose,
Unwieldy wealth and cumbrous pomp repose,
And every want to luxury allied,
And every pang that folly pays to pride.
Those gentle hours that plenty bade to bloom,
Those calm desires that ask'd but little room,
Those healthful sports that graced the peaceful scene,
Lived in each look, and brighten'd all the green;
These, far departing, seek a kinder shore,
And rural mirth and manners are no more."

Have we not in American been drifting into the conditions so graphically described? Let us never lose sight of the fact that farming is the most important industry in the world. Without the farm all other business would stagnate and die, the railroads would cease to run, the banks and mercantile establishments could no longer operate, and grass would grow in the streets of our cities, which would no longer be thriving marts of commerce but would become, through famine, whited

sepulchers of the dead. No other business can succeed without the farmer, but the farming business can survive, if left unfettered, without the aid of any other business.

(VII.) WATER POWERS.

Let us now consider for a moment the subject of water. For some years past, we in Alabama have heard a great deal about another liquid, and I am sure that it will be refreshing to turn our thoughts to pure and unadulterated water! We need not discuss its superlative merits as a beverage or as a cleansing agent, but rather let us consider its utility as a means of transportation and as a source of power. Bountiful nature has favored our State in the matter of waterways. Through the Warrior, the Tombigbee, the Alabama and the Coosa, the waters springing from the hills in the mineral regions flow through rich agricultural sections and discharge themselves into the Gulf of Mexico. The work of nature has been supplemented by the National Government and by means of locks and dams on the Warrior and Tombigbee Rivers, perennial navigation has been provided from the coal fields to the Gulf. Already

barges laden with black diamonds pass every day down the river just below the University, bound for Mobile and New Orleans. Through a beautiful valley in northern Alabama, flows the great Tennessee River, a majestic stream which springs from the mountains of North Carolina and Virginia, and flowing through east Tennessee, enters our State near its northeastern corner, and leaving it at its northwestern extremity, turns again through Tennessee and, passing through Kentucky, unites with the Ohio and finally discharges its waters into the mighty Mississippi. Most of this wonderful stream is already open to commerce, but in its course through Alabama, its waters plunge through a series of shoals and rapids, known as Muscle Shoals, which block navigation, but which, if properly harnessed, will furnish one of the greatest water powers in the United States. Locks and dams at Muscle Shoals would render the Tennessee River navigable from Knoxville to Paducah, and would, at the same time, offer to industries electric energy of approximately 500,000 horsepower. When we speak of Muscle Shoals, there results a triangulation of ideas. On one side is transportation,

on another the fertilization of our farms, and on the third, military preparedness. We all know that nitre, or saltpetre, is an essential ingredient in the manufacture of gunpowder and of fertilizers, and that the world's great natural deposits of nitre are in northern Chile. We know furthermore, that the oxygen in the air we breathe is heavily diluted with nitrogen, and that science has found the way, through mechanical means, of accomplishing the fixation of air nitrogen into nitrates. The marvelous efficiency of Germany as a nation is admitted by her friends and enemies alike, by her sympathizers and by her critics. Some years ago German manufacturers began, under adverse conditions, the manufacture of nitrates from the air. When I refer to adverse conditions, I mean that this process of fixation requires enormous power and calls for a tremendous expenditure of energy; and in a country like Germany, having no great water powers, this energy can be supplied at high cost only by the consumption of an enormous amount of fuel. I understand that not less than 300,000 horse-power must be produced in order to manufacture air nitrates on a

commercial scale, and the only nitrate manufacturing plant on the American continent is located on the Canadian side at Niagara Falls. The bill that has recently passed both houses of Congress to increase the efficiendy of the military establishment of the United States, recognizes the necessity of an adequate nitrate supply and empowers the President of the United States to make such investigation as he may deem to be necessary to determine the best, cheapest and most available means for the production of nitrates and other products for munitions of war and useful in the manufacture of fertilizers by water power, and he is further authorized and empowered to "designate for the exclusive use of the United States, such site or sites upon any navigable or non-navigable river, as may, in his opinion be necessary to carry out the purposes of the Act, and he is further authorized to construct, maintain and operate, at any site or sites so designated, dams, locks, improvements to navigation, power houses, and other plants and equipment, or other means than water power as in his judgment is the best and cheapest,

necessary or convenient for the generation of electrical or other power and for the production of nitrates or other products needed for munitions of war and useful in the manufacture of fertilizers and other products." The bill furthermore appropriates the sum of twenty million dollars, available until expended, to enable the President of the United States to secure this nitrate supply. I do not know what recommendations the War Department will make to the President, nor can I predict what his choice of a site will be, but I do know that no site in the United States is superior to Muscle Shoals from the standpoint of strategic location, the power that can be generated and the proximity to large deposits of phosphate rock. I wish that I were a word painter, so that I could picture to you the great opportunity that is presented to the people of Alabama, and the far reaching results that would come from the location of this nitrate plant within the borders of our State. Imagine a gigantic dam across a broad and majestic river, a great power house, and beyond, a nitrate plant, on one side of which will be built a large

factory where nitric acid will be produced for use in the manufacture of explosives; on the other side works for the production of ammonium phosphate, where the phosphate rock brought from nearby fields will be combined with the nitrates and converted into that important ingredient of all commercial fertilizers, ammonium phosphate. The waters of the Tennessee in their ceaseless flow toward the Ohio and the Mississippi, can generate at a minimum cost after the initial expenditure has been made, the large amount of power necessary for the operation of these plants. This power, contrary to the fears of many, would not interfere with the consumption of Alabama coal, for it would develop an entirely new industry which cannot be established if dependent upon coal as a fuel. I wish that I could picture to you the other important industries that would follow the establishment of this plant, such as electric furnaces for the manufacture of the finest grades of steel, establishments for the production of aluminum from the vast deposits of bauxite which abound in east Alabama. I would point out to you the wonderful opportunity that would thus be

opened to the young men of Alabama, and I can see in my mind's eye a great school of technology here at the University, where future generations can be taught the principles of efficiency and of applied science, which have done so much for the development of Germany during the past forty years. Surely every man of influence in Alabama will do all in his power to induce the President to locate this plant on the banks of the Tennessee. Many other states have eligible locations to offer, though none in my opinion can at all compare with the one at Muscle Shoals. Every possible influence will be brought to bear by these states to present their own locations in the most favorable light, and it behooves the people of Alabama during the next few months to work as they have never worked before, if we wish to win this great prize, which would mean an immediate expenditure within our borders of twenty million dollars, with industries to follow which will cost at least thirty millions more.

(VIII.) DEVELOPMENT OF ALABAMA'S RESOURCES.

There has been too much talk about the great natural resources of Alabama. The time has come for

action! We must develop them! About two months before the surrender of the armies of the Confederacy, a conference was held by Abraham Lincoln with three Confederate Commissioners, at Hampton Roads. I do not know whether it is history or whether it is fiction, but the story is that at that conference Mr. Lincoln, holding a sheet of white paper in his hand, said to Alexander H. Stephens, "Let me write Union on this paper and you may write whatever else you please." If this story be founded on fact, what an opportunity for the South was lost! If we could bring the people of Alabama to a proper realization of the importance of hard work, of constant and unflagging effort and of efficiency in work; if we could be justified in taking a map of Alabama and in writing across that map in outstanding letters reaching from the Tennessee to the Gulf, and from Georgia to Mississippi, the word "Efficiency," we would have a great and prosperous State no matter what else might be written there. In the South today, our economies as a rule are neither scientific nor potentially efficient, nor do our activities contribute to stop waste and to increase efficiency. We find

.waste and more waste everywhere. We have made only a beginning in the manufacture of by-products,-- we can see in half a day's journey, thousands of coke ovens, illuminating the midnight skies with flames which contain many elements of wealth, but which are absolutely thrown away. Because of the nitrogen which it contains, a million tons of cotton seed meal is put back every year into the soil of the cotton fields of the South, although overhanging every acre there are over thirty-three thousand tons of atmospheric nitrogen which the water powers of Alabama now going to waste could take out of the air and fix ready for use as a fertilizer for increasing our production of agricultural staples.

(IX.) EFFICIENCY VERSUS WASTE.

But waste and inefficiency are not to be found alone in agriculture. They are found in the forest and in the factory, as well as on the farm; in mechanical arts and in scientific achievements we lag behind. The Secretary of the Navy, a Southern man by birth and rearing, of ardent Southern sympathies, recently selected twenty-three engineers and scientists as a civil naval advisory or efficiency board, not one of whom was taken from any activity or association of the Southern

states. We are proud of our traditions, yet we have seen other states forge ahead, even the arid states in the rainless regions of the west, which have in twenty years secured from the Federal Treasury one hundred and sixteen million dollars for the accomplishment of their irrigation projects. We are afflicted too much with traditions, resignation, indifference and inefficiency. Too many of the sons of Alabama have left their paternal roof-trees and have sought their fortunes in other states. We must do something, not only to make it to the interest of the young men of Alabama to remain at home, but something that will induce the best elements of the citizenship of other states to cast their lot amongst us. According to a poetic fancy the name "Alabama" signifies "here we rest." It is too bad that any should think this means "here we do not work; here we take our ease," and we should seek to justify the construction of the word "rest" as meaning "remain;" so that the name of Alabama henceforth shall signify, as a matter of choice, and because of the glorious opportunities offered, "hence we will not go; here we remain."

RELEASED FOR THE EVENING PAPERS OF FRIDAY, JUNE 9.

Address of Hon. Paul M. Warburg
before the Convention of the
New York State Bankers' Assn.,
Atlantic City, N. J., June 9, 1916.

THE FEDERAL RESERVE SYSTEM AND THE BANKS.

A successful solution of Federal Reserve problems is dependent equally upon a thorough understanding of the many features of detail involved in the technique of banking and upon a strong grasp of the big and fundamental objects for the accomplishment of which the system was created.

It is, therefore, a pleasure to address an audience that is certain to have a keen and sympathetic interest in both of these phases of the problem.

I am particularly anxious, however, to speak to you about the broader and more fundamental questions involved, for there is an indefinite feeling of apprehension in my mind that at this time we may be losing the big point of view of financial statesmanship, and that petty and technical questions may be claiming perhaps, too much of our consideration.

While in South America, I had an opportunity to get a bird's eye-view of the operation of the Federal Reserve System. With the keenest enjoyment and pride I saw our system hitting its mark many thousands of miles away, and became deeply impressed that we are now firmly establishing ourselves as a great financial power in the world's market. Upon my return, I felt a very chilling change of atmosphere, when I met American bankers appearing to hold the view that the future of our great monetary and banking system depends upon the question whether or not a country bank might charge exchange of one-tenth of one per cent when remitting for checks drawn on itself !

The banking system of a world power can not possibly be constructed upon so small a foundation.

I still remember that, when I had my first training in banking in Hamburg, thirty years ago

my dear old father's mind strongly rebelled against what he considered then the new-fashioned idea of being required - not by the government, indeed, but by the general law of competition - to discontinue the practice of charging a small commission when remitting for checks or maturing bills drawn on his banking firm. But he soon perceived that the establishment of a general transfer and clearing system, postal orders and postal checks, had made for new conditions and that the development of a discount system based upon modern principles of banking, while breaking down certain petty revenues, was bringing about a tremendous increase in the volume of business. As a result, he soon waived his objections and lent his hand in turning his country from provincialism into an international banking power. That, as I said, was thirty years ago.

I have no doubt that this country has decided that it is entitled to as modern a banking system as the rest of the world, and that whatever old-fashioned privilege still blocks the path will have to fall by the wayside. The sacrifice will have to be borne for the general good and will find its compensation in the freer economic development of the country.

One of the most tangible results of the operation of the Federal Reserve System is the establishment and growth of the American bankers' acceptance business. In addressing a group of bankers, it is unnecessary to dwell at length upon the fundamental importance of this development for the general safety of our banking system. We have now a substantial market for bankers' acceptances to which all member banks will look for the investment of some of their idle means and in which, at any

time, they may reconvert these holdings into liquid funds.

The more important this market grows, the stronger will be the position of the Federal Reserve Banks, for the greater or lesser volume of purchases of such acceptances will offer one of the Federal Reserve Banks' most effective means of exercising a wholesome influence upon the fluctuation of interest rates. As normal conditions are reestablished in the world, this acceptance market will become an important factor in protecting our exchange position with foreign countries and, incidentally, our gold holdings. It has taken some time to develop this market, but I am confident that, from now on, its growth will be rapid. One of the obstacles that made the start difficult was found in the fact that many acceptances, which are made for the purpose of financing importations

and exportations, have to be drawn and sold in foreign countries. In order to make them negotiable in those countries as a popular and current means of exchange, it was first necessary to find banks there, which would be willing to purchase them freely whenever offered. It is unnecessary to say that European banks operating in these foreign fields were not over-anxious to see American bankers enter a business which they themselves monopolized up to the beginning of this war. It is only since our own banks went out into foreign lands and established their own branches that the necessary foreign market for American acceptances has been developed. The establishment of foreign branches of American banks has been a most important step in advance, and without it our acceptance system could not have progressed as far as it has today. The advent of these American branches

forced the other banks to modify their resistance and to compete for our bills which, up to that time, they had tried to disregard. It is to be hoped that other American banks will soon follow in establishing themselves in foreign countries. As you know, the Federal Reserve Board has recommended an amendment to the Act to enable national banks, singly or jointly, to hold stock in banks organized "principally to do business in foreign countries." One bill has already passed the House, and another has been reported favorably by the Senate committee on banking and currency. The Board hopes that a satisfactory bill will be agreed upon by both houses in the very near future.

It is a strange fact, however, that many of our business men, who enjoy the reputation of being keen and progressive, are actually wasting their funds by still using foreign ac-

ceptance credits instead of American. At Rio, I found to my surprise that the majority of American coffee importers were still using letters of credit in sterling for which they were paying a discount rate of about 4¾% as against the American discount rate of 2%. Moreover, in doing so, they were often paying two commissions, one to the foreign banker who issues, and one to the American banker who opens the credit, instead of paying a single commission to the American banker.

It is true that the wool and hide business, done by New England with the Argentine, is today financed by dollar acceptances drawn on Boston and New York, and that the oriental trade has begun to use dollar bills, but it is surprising that so large a number of New York importers are still clinging to their old pound sterling acceptance arrangements.

Let me venture to urge most earnestly that our bankers canvass their lists of importing and exporting firms and point out to them the folly of not using American banking facilities. Since my return I have tried to see personally some of these large importing firms and explain to them the anomaly of their action. I believe, however, than an association like yours is particularly well adapted for carrying on a campaign of education of this kind.

With our increasing financial strength and with the daily diminution of Europe's saving power, it stands to reason that, for a long time to come, our discount rates will compare favorably with those of Europe. We may expect, therefore, that this acceptance business will not only hold its own, but will grow and may be used to a substantial extent even by European importers and exporters, and thus relieve Europe of some of her financial burdens.

While our foreign competitors, with few noteworthy exeeptions, are still trying to keep our dollar acceptances in obscurity, our machinery is now firmly organized. There are now local banks almost everywhere abroad willing to buy American drafts going forward for acceptance and to deal in dollar exchange on practically the same narrow margin which prevails in dealings in sterling, marks, or francs, and the Federal Reserve Banks are willing, whenever desired, to do their share by quoting favorable "forward discount rates" to assure the rate of discount pending the time of transit. This new feature of American banking, which is to be one of the roots of our strength and, at the same time, a new source of profitable and sound banking, ought to be developed energetically by both our bankers and our business men.

In this connection, it may not be amiss to give you a short account of the conference of the International High Commission at Buenos Aires.

In our deliberations, the question of banking was given particular attention, and I am happy to report that the general tendency at the conference was to do everything possible to foster trade relations between the United States and her neighbors to the South, and mutually to open the doors wide to one another's banks. Resolutions were passed making for the adoption by Central and South America of uniform laws concerning bills of exchange, bills of lading, warehouse receipts, and similar matters. A further recommendation was adopted by the conference urging the respective governments to enact legislation giving the widest possible protection to the sellers of goods.

You are all familiar with the agreements for the arbitration of business disputes made between the United States Chamber of Commerce and the Chamber of Commerce of Buenos Aires. We may expect that other countries will follow in the very near future, and the creation of these agreements will be an important factor in obviating the annoyance and delay of protracted litigation in foreign countries and in providing for both sides a safe and satisfactory basis for commerce and trade.

It would lead too far to enumerate all the topics discussed by the conference. I should not omit, however, to mention that a resolution was passed recommending that all the republics of North, Central, and South America adopt a uniform standard of money of account on the basis of a gold coin 9/10 fine and weighing 0.33437 gramme. This unit, which might be called the

Pan American Franc, though nearly the value of the European franc, is not its exact equal, but is precisely one-fifth of the United States gold dollar. Delegates to the conference had suggested making the gold dollar of the United States the unit for all American countries, but against this it was pointed out that the dollar would be too large a denomination for many of the Southern republics, where small coins circulate and where, it was feared, the larger unit of money of account would bring about an increased cost of living. Moreover, the United States gold dollar could not be divided into subsidiary coins small enough to comply with the known demands of many of these countries. It was thought, therefore, that a unit of the approximate size of the franc would be better adapted to the needs of these countries, but, by adopting as the standard unit the exact one-fifth of

the United States dollar, the foundation will have been laid for a Pan American union of coins which, sooner or later, may become of great importance. If this plan should be carried into actual effect, the Pan American 20 Franc piece could ultimately circulate with us as a $4 gold piece and our $5 gold piece could circulate as a 25 Franc piece in South or Central American countries. A unity of standards of this kind will, of course, have great advantages in facilitating trade between nations. Amongst republics having actually introduced a gold currency on this basis it might ultimately lead to an understanding for the establishment of international gold trust or clearing funds, having for their object the elimination of the costs and risks caused by our present wasteful method of shipping and remelting gold coins. A plan on these broad lines, submitted by the

Americen delegates, was recommended by the conference for closer study to all governments concerned.

The immediate practical importance of this step may not be great. As indicative of the trend of future relations between North and South American republics, however, it can not be overestimated. It shows, as one of the effects of the war and of our financial emancipation, that the North and South have recognized their common economic and political interests; that they have begun to consider this large hemisphere as one economic unit, and that they are now looking to each other for mutual help and cooperation in the future development of their respective problems. A Pan American monetary union, therefore, now appears a more natural basis for the future monetary systems of American republics than a

Latin union based upon an agreement with France, Italy, Swtizerland and Belgium.

Our friends in South American consider the creation of our Federal Reserve System as one of our greatest achievements, and their willingness to rely upon our ability to provide - to a certain extent at least - such financial aid as Europe gave them in the past is predicated upon the confidence that our new system inspires. Some of these republics are carefully studying this system with a view to establishing, at the proper time a similar banking machinery. In view of the fact that several of these countries are federations like the United States and cover tremendous areas of territory, it is evident that certain features of our system would be particularly well adapted to their needs.

While observing financial and commercial conditions in these countries, it was deeply impressed upon my mind how much the United States, by legislative action, had in the past, handicapped the development of our business in foreign lands. It would lead too far to mention to what extent our own legislation in the past has driven our merchant marine from the ocean and how far it has handicapped our industries by not permitting reasonable trade combinations enabling us to compete in foreign markets. But it is well within the bounds of this address to mention that the British, French and German banks for generations have been entirely free to go into foreign countries to open branches or acquire foreign banks and to do everything and anything to further their banking and trade. On the other hand, our na-

tional banks, until the passage of the Federal Reserve Act, were forbidden by law to enter these fields or to accept drafts for importations or exportations or to exercise many other functions necessary to develop foreign banking and foreign commerce. It is a relief to feel that at least the time has come when a clear recognition of our country's banking needs is asserting itself and when most of these old shackles have been removed. Whatever obstacle remains we may confidently hope to see gradually eliminated.

Some amendments along these lines are at present under consideration by Congress, and have already been favorably reported.

The Board has recommended that Congress permit member banks to give their acceptances not only for the financing of transactions involving importations and exportations, but also,

to a limited degree and under the supervision of the Federal Reserve Board, for bankers' clean three months' drafts, such as are required in foreign countries for remittances abroad. As most of you know, in South America, such remittances to foreign lands are generally not made by checks but by three months' drafts, and it is necessary that national banks be permitted to accept for this kind of foreign exchange transactions, if the dollar bill is to be used as freely in foreign lands as is the sterling, the franc, and the mark exchange.

Turning to amendments touching domestic operations, we have recommended that national banks be permitted to accept drafts or bills growing out of transactions involving the domestic shipment of goods, provided shipping documents are attached at the time of acceptance,

and drafts and bills which are secured by warehouse or similar receipts covering readily marketable staples, or by the pledge of goods actually sold. We feel confident that, by enlarging the powers of national banks to accept in this manner we shall open for our member banks a new and profitable field of operation, and incidentally the free development of this kind of bankers' domestic acceptance will be an important factor in equalizing interest rates in the various parts of the country and will be of great benefit in this respect alike to producer and consumer.

We have also proposed an amendment authorizing any national bank, located in a city of more than 100,000 inhabitants and possessing a capital and surplus of $1,000,000 or more, to establish branches within the corporate limits of its city, and authorizing any national bank

located in any other place, with the approval of the Federal Reserve Board, to establish branches within the limits of its county or within a radius of 25 miles of its banking house, irrespective of county lines. In recommending the county line for branches, the Board was moved by the thought that it might be found convenient for several small banks doing business in the same county to combine into one larger bank, thereby reducing the overhead charges and making the deposits of one part of the county available for the demands in another. It is the hope of the Board that in some districts, through such cooperation, it will be possible to reduce the exorbitant interest rates which, in some instances, have been charged by small country banks. The Senate committee has stipulated that, for the beginning at least, the number of branches of a national bank shall be re-

stricted to ten.

We have further recommended to Congress that any national bank, not situated in a central reserve city, be permitted, within the same limits now existing for loans on farm lands, to make advances maturing in not over one year on improved real estate located anywhere within a radius of one hundred miles of its place of business. While the Board does not favor the idea of having national banks make heavy investments in mortgages, it was felt that they should not be precluded from taking, within certain reasonable limits, first mortgages as collateral security for their loans.

These are the additional powers that we have recommended to be given to national banks. As to the Federal Reserve Banks, we have suggested that Congress permit them to make advances to their member banks on the latters' own

notes secured by eligible paper, such loans to be for periods not exceeding fifteen days. This has been done with a view to enabling Federal Reserve Banks to accommodate members who, in the check clearing or otherwise, might be short in their balances and wish to have short advances at moderate rates. We believe that this power, if granted to Federal Reserve Banks, will greatly increase their ability to take care, in a simple and effective manner, of the requirements of their members, and particularly of country banks.

We have further recommended that Congress permit Federal Reserve Banks to issue Federal Reserve notes, not only against commercial paper, but also against the deposit of gold. This amendment, if granted, would greatly strengthen the lending power and the note issuing power of Federal Reserve Banks. It is the same method

that has always been followed in Europe by the Banque de France, the Reichsbank, the Bank of the Netherlands, the Bank of Italy and many other government banks. These institutions are enabled, through their note issue, to assemble a large part of the gold of the country in a central reservoir. With us, up to the present time, this accumulation of gold has taken place to only a moderate extent and has not benefitted the Federal Reserve Banks to the fullest possible degree. If the amendment were to be passed, the gold, instead of being segregated with the Federal Reserve Agent, would remain an asset of the Federal Reserve Bank, and, on the other hand, the notes issued against it, instead of being, as at present, technically redeemed, would remain the liability of the Federal Reserve Bank.

In case the amendment should pass, it is hoped that the Federal Reserve Banks may count upon the cooperation of their members in order to facilitate this substitution of Federal Reserve notes for gold certificates at present carried in the pockets of the people in the old-fashioned and uneconomic manner. As in modern European countries, the gold should accumulate in the Federal Reserve Banks and the people should use instead the Federal Reserve notes. The amendment would be an important step in the ultimate simplification and consolidation of our circulation.

These are the principal amendments recommended by the Board at this time. You will notice, gentlemen, that they move in two directions. The one is an increase of the Reserve Bank's general strength and lending power and an enlargement of their scope of usefulness in dealing

with their members; the other is the removal of limitations heretofore placed upon the operations of national banks. The Board feels keenly that, as a matter of equity, national banks should be placed on a parity with State banks and trust companies, wherever this can be done consistently with safety and conservative banking principles. But I wish to make it clear that the Board has recommended, and will recommend, only such measures as will eliminate old-fashioned or unwise restrictions such as should be removed under any circumstances, irrespective of whether or not the State banks exercise greater or lesser powers. The Board would never recommend granting national banks any powers or privileges which are contrary to good banking principles. It is to the interest of both State institutions and national banks that banking

standards should be raised wherever practicable and not that they should be lowered. Between the national and State banking systems, there must not be any competition to secure more members by a lowering of banking standards. The whole country would suffer if this took place. It would be the height of folly if States were to lower their requirements for no other reason than to underbid the requirements of national banks. To a certain degree this has been done-where State governments lowered the reserve requirements for their banking institutions because the Federal Reserve Act lowered the reserve requirements for national banks. The lowering of the reserve requirements for national banks was predicated,however, upon their joining the Federal Reserve System subscribing to the stock and putting some part of their reserves into the joint

insurance fund, and being bound ultimately to abandon the method of pyramiding reserves and to keep them instead either entirely in metallic form or with the Federal Reserve Banks. The reserves of State institutions, on the other hand, were lowered without their being required to join the system, make any such contribution, or discontinue pyramiding reserves. Moreover, lower reserve requirements are justified for member banks because they may have direct recourse to the rediscount facilities of the reserve system, but non-member banks have no such direct access.

I wish I could adequately impress upon the minds of all our bankers that there is no such thing as doing anything <u>for</u> the Federal Reserve System. Whatever the member banks do, and whatever the State banks do, they do for themselves

and for the country. The Federal Reserve System, as such, is not a self-seeking and profit-making organization. It belongs to the entire country. It is there for the benefit of everybody; for the greater security of the banks, and, through the banks, for the security of the people. If you strengthen the Federal Reserve System, you strengthen yourselves. If you raise the standard of banking, it is for your own benefit - not for the benefit of the Federal Reserve Banks, or least of all, for that of the Federal Reserve Board.

These things appear trite, but still I can not help expressing them because it is so absolutely essential that the thought be overcome that there can be such a thing as a conflict of interests between the Federal Reserve System and the banks. The Federal Reserve System and all it means is felt as an opposing factor where it

comes into conflict with bad banking practices. It is true that the law has for one of its objects the removal of certain habits which have crept into the old banking system, but it is equally true that, by removing them, financial catastrophes such as used to befall our country with uncanny regularity, are to be avoided in the future.

Let us consider, as the strongest case in point, the pyramiding of reserves. I wish it had been possible to stamp out this evil within a short time after the opening of the Federal Reserve System. As it is, many of the smaller banks are still in the condition of a patient who knows that he must undergo an operation in order to be fully cured, but whose mind every now and then rebels at the thought, and who continually relapses into arguing with himself that, after all, he might possibly prefer to continue

to live with his disease and take his chances of the certain recurrence of acute convulsions and intense suffering rather than to have the operation performed. The country, however, has decided that the operation is necessary for our future safety and growth, and the vast majority of our bankers are in full accord that it is the wisest thing to do. The pyramiding of reserves will thus end on November 16, 1917. But, as I said, I wish the operation had already been performed.

At present our national banks apparently have excess reserves approaching one billion dollars. Of these, a substantial proportion represents items in transit between the depositing and the depository banks; the balance, excepting about $100,000,000 excess cash in vault held by all national banks outside of New York,

is kept entirely in central reserve cities, the bulk being in the City of New York. There it is on deposit - drawing interest at the rate of 2% - and loaned out on stock exchange and other collateral, or invested in commercial paper, except as to the required reserve of 18% and the small total excess reserve of about fifty million dollars. This is a reduction of excess cash reserves in New York of over $100,000,000 since January 22d.

If Farmer Jones deposits $1,000 in a bank of Elk River, Minnesota, and this bank should in turn deposit this amount in a bank at Minneapolis and the Minneapolis bank in turn deposit it in New York at 2% interest, and New York invest this money in a piece of commercial paper at 3% interest, it is a most extraordinary and unique method to permit Elk River and Minneapolis to

count these deposits as reserves, while if the bank of Elk River had itself bought the piece of paper it would have carried it as a loan and all the rest of the structure of reserve bank deposits and reserves would have been wiped out.

In other words, in the final analysis, if we consider the system as a unit, there is not an excess reserve of one billion but only about $150,000,000 in cash; the balance is invested to-day in the "float", representing uncollected items in transit, commercial paper, stock exchange loans and securities. If we study the changes in the condition of the New York Clearing House national banks which have occurred between October 31, 1914, and May 1, 1916, we find the following increases estimated at:

	Oct. 31/14		May 11/16	
Collateral loans....	547 mill.	to	954 - plus	407
Investments in securities.....	106 "	"	280 - "	174
Unsecured loans which include commercial paper.....	406 "	"	667 - "	261
A total increase of				$842
During that period, deposits increased from.....	1200 "	"	2100 - "	900

In addition, collateral loans and holdings of securities of New York non-member trust companies increased by about half a billion since the end of 1914.

These are phenomenal increases and we might well ask ourselves whether or not we may take it as a certainty that so extraordinary a growth will prove to have come to stay or whether a return of more nearly normal conditions will not bring about a contraction. We should well consider this question, because an increase of 90%

in securities and collateral loans; - that is, an increase of over $1,000,000,000 in New York City Clearing House institutions - might well suggest a policy of liquidation rather than one of further expansion. Our national bank cash reserves in central reserve cities (including balances with Federal Reserve Banks, figured at 100%) were as of March 7, 22.88%; in reserve cities, 11.53%, and in country banks 9.80% *. Notwithstanding that the aggregate cash held by all national banks increased from May, 1915, to March, 1916, by over $100,000,000; in central reserve cities we are today materially below the

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* If we figured these balances at 70%, being the present cash reserve condition, and the actual metallic reserve, and added to cash in vault the metallic cover maintained against reserve agents' balances, the present cash cover would show as follows: central reserve, 20.51%; reserve cities 13.66% and country banks 11.83%.

old cash reserve requirements, and if a situation like the present had existed during any ante-Federal Reserve System period, we should have considered it a cause for alarm. Thanks to the creation of our new banking system, we are now dealing with completely changed conditions, and the spectre of the end of the lending power of the banks would not mean a panic as in the past because of the reserve lending power of the Federal Reserve Banks and the confidence created by their existence. But, gentlemen, that must not lead us into the illusion that this billion of so-called excess reserves may be considered as a basis for a loan expansion of four billion dollars or more, as appears to be the general belief. Theoretically there is the foundation for so large an expansion as long as we adhere to the old custom of counting

bank balances with reserve agents and uncollected items in transit as reserve, yet, in the last analysis, it is the metallic cover - not the re-deposited and actually invested reserves - which must be considered in dealing with this question of expansion of loans. The excess of our metallic reserve, plus the free gold of the Federal Reserve banks, constitute the basis of the reserve lending power of our country.

We are at present in a condition of extra-ordinary strength. We have bought back our own securities and made foreign loans to an aggregate amount far in excess of $2,000,000,000. Our financial position for the future has thus been greatly fortified. But the process of absorption of our securities returning from abroad should be conducted on such basis and scope as to turn the individual depositor into an invest-

or so as to free our gold reserves rather than increase our loans on an enlarged floating supply of securities.

We must not forget for a moment that not even the most experienced can foretell what demands may be made upon us in the future. At the end of the war our opportunities will be gigantic, but ultimately they will be limited by the extent to which we are able to control our gold. There cannot be any doubt that the demand for gold at that time will be very keen and determined. Wise statesmanship, to my mind, therefore, would indicate that everything should be done by the Federal Reserve System and by all the banks that are interested in our strength to watch carefully further expansion at this time and to accumulate the floating gold supply in the hands of the Fed-

eral reserve banks so as to enable them, when the time comes, if necessary, to spare large amounts without thereby crippling their lending power. We are in a period of wide-spread prosperity at this time and it must be our serious concern not to weaken its solid foundation. The ease of this summer might well be used to strengthen and prepare ourselves for the large problems that may be in store for us.

It is impossible to try to prognosticate with any degree of certainty what will be the trend of interest rates at the end of the war, but assuming that interest rates for investments in Europe will be high, and that the demand for gold on the part of Europe will be keen, we would have to expect as a consequence that eventually our rates will have to move up so as to approach theirs more closely, and before we reach that point probably a substantial

amount of our gold will have to leave the country and return to foreign lands. To preserve the advantage of our strength and to maintain our money rates on an independent basis of our own - in spite of the close inter-relation that must exist between us and Europe - will be one of our interesting but difficult tasks.

The establishment of the Federal Reserve System has been a step of inestimable value in the direction of efficient control of our country's gold holdings; and, if we do not disregard all rules of business conservatism and prudence, it will prove an efficient means of protection in case of emergencies.

If we want more than a strong instrument of defense and protection, if we desire - as we are entitled to - that the Federal Reserve System be the foundation of a banking structure

contributing its full share in rebuilding the world and at the same time assisting our own country to meet all the new demands, whether domestic or foreign, that the future may make upon it, then we must do all we can to preserve its strength and to broaden its foundation by further perfecting methods of systematically accumulating and economically using our vast treasure of gold. Too large a proportion of this gold still remains wastefully scattered and decentralized.

The gold stock of this country is estimated at $2,320,000,000. Of this amount, only $335,000,000 is held in the vaults of the Federal Reserve Banks and about $180,000,000 is in the hands of the Federal Reserve Agents. The national banks and State institutions hold about $800,000,000, and there is estimated to be in actual

circulation about $870,000,000. If we deduct from the $335,000,000 held by all Federal Reserve Banks a minimum reserve of only 40%, that would leave as their free gold about $200,000,000. This is an invaluable item of strength as a basis for a note issue of $500,000,000 in case additional currency should be demanded by our people; and the Board, by permitting the reduction of the 40% gold reserve, could, in case of emergency, sanction the issue of even larger amounts. When, however, it comes to exportations of gold you can readily see that the $180,000,000 now accumulated with the Federal Reserve Agents would serve as a very welcome additional protection. For we have learned, gentlemen, that this is a period of economic history, where balances between nations are not dealt with in millions, but in hundreds of millions.

Think of the strength that our system might possess if we carried into effect the policies pursued by the Banque de France, the Reichsbank or other powerful central banks, and if, for a substantial part of the $870,000,000 of actual gold circulation, there were substituted our Federal Reserve notes, and if national and State banks kept in their vaults only what they needed for till money and deposited with the Federal Reserve Banks the rest of their idle gold.

We talk of preparedness as the need of the hour. If we contemplate what European nations have done, before and during the war, to strengthen their grip on their gold, and compare it with our own efforts, we find that our financial preparedness is just in its first stages. The amendment recommended by the Board should prove an important step in advance in this direction

In view of the statement made by some of our critics that this substitution of Federal Reserve notes for gold certificates means inflation, it might be timely to point out that, by a simple substitution of one note for the other, there is, of course, no increase in the volume of circulation whatsoever. It is merely a change in the form of circulation. As a matter of fact, we find that the operation of all Federal Reserve Banks for a period of one and a half years has caused a net increase in the circulating medium of the country, by the issue of Federal Reserve notes and Federal Reserve Bank notes, of less than $10,000,000. On the other hand, the national bank circulation has decreased during the period November 2, 1914, to June 1, 1916, by $53,000,000, exclusive of the redemption of the approximately $385,000,000 of emergency currency issued under the so-called

Aldrich-Vreeland Act. While it is evident, therefore, that the Federal Reserve System has not increased the volume of circulation, the process of substituting, as a means of circulation, the Federal Reserve note for the gold certificate has the most important effect of strengthening the potential lending and note issuing power of Federal Reserve Banks in case of need. To refuse this larger power of protection for fear that it might be misused would be tantamount to refusing to give a modern revolver to a policeman for fear that he might shoot at the wrong man and at the wrong time.

But, let me ask you, gentlemen, is this the proper time for country bankers to urge us to recommend to Congress the further reduction of their reserve requirements or to recommend that they be granted permission to continue to hold a certain percentage of their reserves with their central or reserve city correspondents?

Some day, no doubt, it will be proper to reduce reserve requirements, but that can only be brought about by a systematic strengthening of the central reservoirs. The stronger the Federal Reserve Banks, the easier the access to their resources by sale of liquid paper, the less will become the necessity for member banks to maintain in their own vaults, as a legal requirement, large segregated gold holdings.

Steps in this direction are: first, the substitution of Federal Reserve notes for the gold circulation in the pockets of the people; second, the maintenance with Federal Reserve Banks of larger member banks' balances, created by depositing part of the "optional" now kept in vault by member banks, and, finally, the increase of the number of depositors to be secured through the entrance of the State institutions into our system.

I want to compliment our large member trust companies and State banks upon the broad point of view which guided them when entering the system; but I might at the same time ask their powerful sister institutions how, under present conditions, they can justify themselves in staying out of the system and in throwing the entire responsibility and burden upon the shoulders of the national banks

and those few trust companies and State banks that have become members? They do not contribute their fair share of gold to the general reserve fund of the nation, nor do they provide their share of the capital of the Federal Reserve Banks. Indeed, not only do they fail to contribute their share of strength to the system, but unconsciously perhaps, they become forces that make for the direct weakening of its strength and efficiency.

Do the large trust companies and State banks claim that pyramiding of reserves is sound? Would they prefer to see our ancient system perpetuated and the reforms contemplated by the Federal Reserve Act abandoned so as to make room again for the good old conditions of 1893 and 1907? Unless they are willing to subscribe to that doc-

trine, how can these large banking institutions, some located in Central Reserve cities, justify themselves in considering as reserve, after the manner of the country banks, their interest bearing deposits with other banks?

If a call loan on the stock exchange made by a trust company is not a reserve but a loan, is it sound banking to call a reserve deposit made by a trust company in a national bank a reserve, when 82% of it is loan on call on the stock exchange? Still, it is just through these deposits that, in emergencies, the trust companies will lean on the national banks and the national banks, in turn, will fall back on the Federal Reserve System. The net result is that the trust companies, in building up their business structure, must rely today on the greater assurance provided by the Federal

Reserve System, though permitting the member banks to carry the entire burden of its support. Our small country banks will have to stop pyramiding of reserves; do the large trust companies and State banks plan to continue this practice?

What is it that powerful and prominent institutions, (some of which, in their foreign and acceptance business, derive the greatest possible advantage from the discount market and the general prestige of the Federal Reserve System,) may say in justification of such an attitude?

At first they feared that, by entering the system they might lose some of their present powers and privileges. But the Board has made regulations permitting them to continue to exercise practically all legitimate banking functions enjoyed by them in the past.

Some of the State institutions have raised the point that, by joining the Federal Reserve System, they would be called upon to make investments in the stock of the Federal Reserve Banks upon which, in the case of most of the Federal Reserve Banks, no return has as yet been paid.

But, gentlemen, while for many reasons some of us would favor an amendment permitting a Federal Reserve Bank to pay back a portion of the capital paid in (leaving the liability upon the subscribed but unpaid capital otherwise unchanged) provided the member would in turn agree to increase its required reserve balance by a certain proportion of its optional balance, this question in itself can not possibly be of sufficient importance to keep any strong State institution out of the system. These dividends are

cumulative, and anybody having a moderate degree of foresight can readily approciate that, sooner or later, the back dividends will all be paid. Even at the present low rate of return of 2.4%, secured by Federal Reserve Banks from their investments, they would have to employ only an additional sum of less than $50,000,000 for the entire system to earn the full six per cent on the stock at present paid in. When the final instalment of reserves has been transferred and with the return of more nearly normal rates of interest, there will not be the least difficulty for these banks to earn their dividends without investing a larger proportion of their resources than would be consistent with safety and conservatism.

State banks and trust companies furthermore

claimed that if they entered they could not withdraw. But the Board in the exercise of its power to prescribe regulations as a condition of membership, has provided that they may withdraw under conditions previously made known, and the subscription to the stock of a Federal Reserve Bank made by a State institution is conditioned upon this express agreement.

They have objected to being examined both by their own banking department and by the examiner of the Comptroller of the Currency. The Board, in accordance with the provisions of the Federal Reserve Act, has provided, however, that, wherever there is an efficient State examination, as in New York, it shall be accepted in place of examination by the

Comptroller and, only failing that, an examination shall be made by examiners under the supervision of the Federal Reserve Board.

Furthermore, in a circular letter sent to all State member banks in May of this year, the Board and the Comptroller of the Currency announced that State member banks in making their stated reports to the Comptroller of the Currency, might use the form of statement prescribed by their respective State banking departments, provided they are rendered as of the same date as required by the Comptroller of the Currency for national banks. If reports are not rendered on those dates, State member banks are required to use the same forms as national banks, but they may omit from their reports to the Comptroller all schedules except that relating to coin or coin certificates.

They have feared that the Clayton Act would deprive them of valuable directors. But Congress has amended that Act so as to permit a director of a member bank to be, at the same time, a director of two other banks or trust companies, provided they are not in "substantial competition" with the member bank.

I know the arguments that are being advanced that the rulings of the Board may be changed and that, therefore, it may be possible, under a different personnel of the Board, to reverse the present arrangement and subject the State banks to the examinations, reports, and rulings of the Comptroller of the Currency. But that is not likely to happen, and if it did, the State bank or trust company could exercise its privilege to withdraw from membership in the system.

Let us assume, however, that joining the

Federal Reserve System does involve certain sacrifices, some of which are necessary and some of which may be thought unnecessary. If you throw into one side of the scales all the benefits accruing to the banks and the nation by the creation of the Federal Reserve System, and into the other the sacrifices to be made by its members, there can not be any doubt whatsoever that the advantages will outweigh the disadvantages a thousandfold. The Federal Reserve Act is one of the most constructive pieces of legislation that ever was put upon our statute books. Nobody could be foolish enough to expect that a law which is so complicated in its nature, so far-reaching in its scope, and a comprimise in so many details between opposing views, could be absolutely perfect. It is a wonder that, from the beginning, it has proved as workable as it

has.

Personally, I am on record as having opposed several of its features of detail. But, when the President honored me by inviting me to become a member of the Board, I accepted because I felt that the fundamental principles were sound and that the Act, as it stood, would redound to the greatest benefit of the country. I felt confident that if after sincere and unbiased efforts in the operation of the Reserve banks, defects should develop that needed correction, we could confidently count on a patient and sympathetic hearing before Congress. And let me remind you, gentlemen, that several of my colleagues and the able men who accepted to serve at the head of your Federal Reserve Bank of New York, all joined in the same spirit; they did so for the purpose of serving their

country even though they had to make material sacrifices in doing so.

In one of his admirable speeches, entitled "Ideals and Doubts", Oliver Wendell Holmes, Associate Justice of the Supreme Court of the United States, makes the following statement concerning the topic of legal reform:

> "To know what you want and why you think that such a measure will help it is the first but by no means the last step towards intelligent legal reform. The other and more difficult one is to realize what you must give up to get it, and to consider whether you are ready to pay the price."

These are golden words of wisdom which, at the present juncture of our economic history, every bank president in the United States ought to have constantly before his eyes.

For generations we have lived shackled and constantly menaced by a defective and old-fashioned banking system; for years we have

toiled to secure reform. We have at last brought it about and, whether or not it pleases everybody in every detail, it behooves us all to do our share in making it a success for the greatest possible benefit of our country, no matter whether it involves some small or even a heavy sacrifice. That is the principle which members of the Board have laid down for themselves, and if they are to be faithful to their trust and successful in their task, there is no other principle upon which they can deal with the banks of the country. That is why, though sincerely appreciating the hardship it entails for the country banker, and fully sympathizing with the difficulties of his position, we must say to him: "Forget these exchange charges. We think our new clearing plan is fair and equitable, free from unsound principles and bound to become a very effective instrument for the general good. It offers to take from you at par all your checks on any member bank of the entire United

States, and certain State banks in addition, and will refund you any actual expense that you may incur in case you have to remit currency. All it asks of you in return is that you remit without charge to your Federal Reserve Bank in payment of checks drawn on yourself. But even if we did not believe that, by the service we render and by relieving you of the necessity of maintaining bank balances all over the country, we shall compensate you for what you think will be your loss, we have to hold to the view that you must pay the price - whatever your little share may be - for the larger benefit of all."

The new system brings new opportunities, as an illustration, let me remind the country banker that his exchange loss will appear to him very unimportant if he will adopt the habit

of paying for his deposits a fluctuating rate of interest, which should always remain a certain percentage below the ninety day discount rate of his Federal Reserve Bank. The unreasonable rates paid for deposit money are a serious menace to the safety of our banking system and the economic development of our country.

And, with this same spirit, and even with greater emphasis, we must say to the State banks and trust companies:

At this momentous period of its financial history, the country is entitled to have its banking system attain its maximum strength. Irrespective of burdens involved - imaginary or real - it is the duty especially of these large State institutions to come in promptly and contribute their share, making whatever suggestions they think helpful as friends and members rather

than as critics from the outside. I am glad to state that one of our largest trust companies expressed precisely this broad point of view when applying for membership.

The Federal Reserve System will grow stronger with every coming day, and the stronger it grows and the more it perfects its organization, the more apparent will its benefits become for all its members.

A great deal of pressure has been brought to bear upon the Federal Reserve Board, particularly during the early stages of the development of American bankers' acceptances, to cause discrimination against the acceptances of non-member banks. So far the Board has been disinclined to favor such a policy as it was thought to be in the general interest of the country to give encouragement to the freest and fullest

development of this acceptance business, which is of the greatest benefit to the trade of our country. The Board thought further that time should be given to the State banks and trust companies to acquaint themselves fully with the policies to be pursued both in dealing with State institutions in general and the acceptance business in particular. Nor does the collection plan just approved by the Federal Reserve Board contain any element of discrimination against non-member State banks collecting, at par without cost, their out of town checks through member banks of the system. The Board believes, however, that the time has now come for these large institutions to recognize their duty to join the system. It will not be long before the banks that stay out of the system will become conscious of the fact that member banks will command the greater

confidence, and there is no doubt that the public will begin to resent having its interests sacrificed for the benefit of institutions unwilling to join the general protective system, and that before long their resentment will have to be heeded.

Before closing, I should like to make it clear that, though speaking to the New York State Bankers' Association, whatever I have said is meant to apply to the State institutions of the entire country. I should not wish to give the impression that I am particularly critical of the New York institutions. Quite the contrary, I am very glad to have this opportunity of testifying publicly to the spirit of good citizenship that you have manifested in every phase of the development of the system from the very first

beginnings - when we were dealing with the gold and cotton funds in the fall of 1914. In the negotiations, resulting in the creation of these two funds, there asserted itself for the first time in our financial history a broad national spirit uniting in a work of patriotic cooperation national banks, State banks and trust companies of every section of the country. That was the first effect of the coming of the Federal Reserve System, the physical organization of which at that time had not even been completed. It is this same spirit, this larger conception of banking functions and ideals, that will ultimately lead into the Federal Reserve System all elements worth having - that is, all elements of financial and moral strength.

I trust that my frankness will not be misunderstood by you. There is an old adage that "imitation is the sincerest form of flattery."

I venture to paraphase this saying into: "frankness is the sincerest form of flattery," because it shows that you respect the intelligence and moral fibre of your audience.

I believe that our future looms large beyond measure;

I believe it our duty to be financially prepared on the broadest possible scale;

I believe that we should use the months ahead of us, not to expand any further, but rather to consolidate our strength;

I believe that, through the Federal Reserve Banks, we should strengthen our hold on the gold in circulation and that the stronger the gold holdings of these banks, the better shall we be equipped to cope with the problems ahead of us, of helping ourselves and of helping the world;

I believe it to be the duty of every bank in the country to contribute its share in equipping our nation for this task;

I believe that State institutions which are strong enough should come in now and do their share, no matter whether or not they are in full accord with every detail of the Federal Reserve machinery;

I believe that, as we proceed and gain in experience, whatever may prove harmful will be remedied. The tendency of the country is for a fair deal for fair people;

While I believe that the country expects that strong State institutions should do their duty and join, we are neither begging nor clubbing anybody to come in or to stay in;

But I firmly believe that the future will

belong to those banks - national or State -
that are members of the Federal Reserve
System.

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May 26, 1916.

Memorandum for the Board in re interpretation to be given to the language "substantial competition" as used in the recent amendment to the Clayton Act.

The Clayton Act is entitled "An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes".

In so far as it relates to the business of banking it provides in substance that (Section 8) -

(1) No banking association organized or operating under the laws of the United States, and located in a city of more than two hundred thousand inhabitants, shall have as an officer, director, or employee a private banker or an officer, director, or employee of another bank located in the same city.

(2) The same person shall not be an officer, director, or employee of two banking associations organized or operating under the laws of the United States if either has deposits, capital, surplus, or undivided profits aggregating more than five million dollars.

(3) That no banking association organized and operating under the laws of the United States shall have as a director a private banker or a director of a state bank

or trust company which has deposits, capital, surplus and undivided profits aggregating more than five million dollars.

There are certain exceptions contained in the original Act to the foregoing restrictions which, for the purposes of this note, it is not now necessary to consider.

Considering the general purposes of the Act it may be reasonably assumed that Congress intended to prevent the same person from exercising control over two or more banking associations by serving as an officer, director, or employee of both associations where the exercise of such control would have a tendency to destroy or restrain competition between such banks and thus to create a monopoly.

Having constitutional authority to legislate on the subject of bank "organized or operating under the laws of the United States", Congress undertook to accomplish this object by prescribing qualifications of officers, directors, and employees of such banks. It was evidently due to this fact that the particular language used in Section 8 was adopted and in considering the purpose and intent of Congress this fact should be borne in mind.

While the purpose of the Act, as its title implies and as the context shows, was to prevent unlawful restraints and monopolies, the particular language used in Section 8, if construed literally, would prevent the same person from being an officer, director, or employee of two different banks under certain circumstances whether or not such banks were in competition.

The effect of the amendment of May 15, 1916, is to restore this element of competition as a factor in determining under what circumstances the same person may serve as an officer, director, or employee of two banking associations. To illustrate, under the Act as passed the same person could not serve as a director of two national banks in the same city of two hundred thousand inhabitants even though such banks were in no sense competitors. Under the amendment of May 15, 1916, however, the Federal Reserve Board is vested in a discretion to determine first whether such banks are in substantial competition and, if not, to permit a person to serve as a director of both banks. This amendment provides in terms that -

"Nothing in this Act shall prohibit any officer, director, or employee of any member bank, or Class C director of a Federal reserve bank, who shall first procure the consent of the Federal Reserve Board * * * * from being an officer, director, or employee of not more than two other banks * * * if such other bank * * * is not in substantial competition with such member bank. "

It is, therefore, necessary for the Board to determine under what circumstances two banking associations located in a city of more than two hundred thousand inhabitants may be said to be in substantial competition, or when a banking association having more than five million dollars in deposits, capital, surplus, and undivided profits may be said to be in substantial competition with another banking association.

It must be assumed that Congress intended this language to be given its usual or ordinary interpretation. The definition given by Webster of the word " competition " and adopted in a number of cases, is

"The act of seeking or endeavoring to gain what another is endeavoring to gain at the same time; rivalry; mutual strife for the same object" (State v. Port Royal & A.Ry. Co., 23 S. E., 363, 369, 45 S. C. 413, (quoting Burke v. Big Four - Ohio.- 22 Wkly. Law. Bull. 14).

In the case of State v. Central Lumber Co. 123 N. W., 504, the court says -

> "'Monopoly' and 'competition' being the exact opposites, anything tending to destroy competition tends toward monopoly."

The Clayton Act having for its purpose the prevention of monopolies, it seems clear that it was intended, as above suggested, to prevent two banks from having the same officers or directors when such banks are competing for the same business.

The word "substantial" was incorporated in the amendment of May 15, 1916, as a qualification of the word "competition" and its inclusion was in effect a legislative sanction of the decisions of several of the courts in cases dealing with this subject. For example, in the case Kimball v. Atchison, T. & S. F. R. CO. (U. S.) 46 Fed. 888, 890, the court says -

> " * * * that when the statute speaks of competing roads it evidently means roads that are substantial competitors for business; it refers to competition of some practical importance, such as is liable to have an appreciable effect on rates, and in that sense the road to Union was not, in my judgment, a competing line."

In the case of the State v. Central of Georgia R. CO., 35 S. E. 37, 38, 109 Ga. 716, 48 L. R. A. 351, the court says :

> "The question is, at last, one of fact, and in its adjudication in any particular case the court should be governed by the fundamental principle as to whether there was such a creation of a monopoly or defeating of competition as would result in injury to the public. "

In the more recent case of the Standard Oil Co. v. United States, 231 U. S. , 1- 63, the court says -

> "In substance, the propositions urged by the Government are reducible to this : That the language of the statute embraces every contract, combination, etc., in restraint of trade, and hence its text leaves no room for the exercise of judgment, but simply imposes the plain duty of applying its prohibitions to every case within its literal language * * * .
>
> The merely generic enumeration which the statute makes of the acts to which it refers and the absence of any definition of restraint of trade as used in the statute leaves room for but one conclusion, which is, that it was expressly designed not to unduly limit the application of the act by precise definition, but while clearly fixing a standard, that is, by defining the ulterior boundaries which could not be transgressed with impunity, to leave it to be determined by the light of reason, guided by the principles of law and the duty to apply and enforce the public policy embodied in the statute, in every given case whether any particular act or contract was within the contemplation of the statute."See also-

Louisville & Nashville Ry. Co. v. Kentucky, 161 U. S.677,698;
Pearsall v. Great Northern Railway, 161 U. S., 646,676;
Dady v. Georgia & A. Ry., 112 Fed. 838, 844;
Rogers v. Nashville, C. & St. L. Ry. Co., 91 Fed., 299, 318;
East St. L. Connecting Ry. Co. v. Jarvis, 93 Fed., 735, 742;
E. L. & Red River Ry. Co. v. The State, 75 Tex. 434, 436.

It should be borne in mind that the purpose of the Act is to encourage , or at least to preserve, competition between banks.

The terms of the Act, however, are not applicable to all national banks but only to banks of a certain size, or banks located in cities of a certain size. For example, the director of a national bank in a city of less than two hundred thousand inhabitants may be a director of any number of other banks located in cities or towns of less than two hundred thousand inhabitants, provided, none of such banks has deposits , capital, surplus and undivided profits of more than five million dollars.

The theory of the Act appears to have been that all banks in cities of more than two hundred thousand inhabitants are presumably competing associations and that every bank with aggregate resources of more than five milmion dollars is presumably a competitor of every other bank regardless of its location. The effect of the amendment of May 15, 1916, known as the Kern amendment,is that

this presumption may be overcome by the facts in any given case. On this theory the burden is on the applicant in each case to show by some affirmative evidence that the two banks with which he wishes to be connected are not in substantial competition.

The Board is, therefore, confronted with the difficulty of determining the kind and character of evidence it will require to rebut the presumption that the banks in question are active or substantial competitors.

Generally speaking it should appear that the two institutions are not seeking the same business- that is to say, they are not seeking to make their earnings from the same sources so that the increase of the business of one should not be expected to have any appreciable effect upon the earnings of the other.

It is accordingly necessary in each case to consider whether the earnings of one bank are likely to be appreciably affected by an increase of the business of the other. This necessarily involves a consideration of the source of the earnings of each bank. As a general proposition a bank's earnings are derived from those relations which it has with its customers or patrons. The customers may be divided into general classes -

(1) The depositors, or those who furnish funds to the bank;

(2) The borrowers, or those who pay to the bank interest or discount for the use of the bank's funds.

It is in this respect that the banking business differs from that of corporations engaged in trade or commerce. A manufacturing corporation, for example, derives its profits from the use of its own funds. Such a corporation is a competitor of others in the matter of the sale of its products. A bank, however, competes first in procuring funds or deposits and also in the investment of funds so procured. To increase its earnings to any great extent it must increase its deposits.

The Board must, therefore, determine first whether the two banks are seeking the same class of depositors in order to increase their loanable funds, and, secondly, whether they are making the same class of loans or investments. In either case the two banks may be competitors but it is the degree of competition that must be determined.

If one bank receives only deposits subject to check and makes short-term commercial loans and discounts

while the other receives only time deposits or savings accounts and does not make commercial loans, the case would seem to be free from difficulties. Where both banks receive checking accounts but one makes commercial loans while the other does not, the question of competition is involved but the fact that both receive the same class of deposits is by no means a conclusive test. This question can not be determined solely by the character of deposits received or the character of the loans made. It is entirely conceivable that both banks may engage in a strictly commercial banking business and yet may not be substantial competitors.

Where the banks are located in different cities or communities the character of deposits and character of loans and rediscounts may be similar and yet the two banks may not be active or substantial competitors. Where they are doing business in the same general locality, however, the character of deposits and character of loans and investments become of greater importance in determining the degree of competition.

In a city of two hundred thousand inhabitants the Board might conclude that taking into consideration

the amount of commercial business in that city every bank engaged in a purely commercial banking business is in substantial competition with every other bank engaged in the same character of business.

On the other hand, in a city of two million inhabitants the commercial business may be of such volume that the question of the degree of competition will depend upon the location of the banks in the city. Banks in the wholesale district may not come into competition to any appreciable extent with banks in the retail district.

It is manifest that each case must be determined upon the facts submitted and that no fixed rule can be prescribed by the Board to govern all cases.

In order to assist the Federal Reserve Agents in making recommendations, however, the following factors should be called to their attention.

First : As the banks organized and operating under the laws of the United States are engaged primarily in the commercial banking business, and as such bank is authorized by its charter to do a banking business in a particular city, town, or village, consideration should be given to the volume of commercial business engaged in by bank customers in the place in which the banks are located.

Second: If the two banks are doing business in the same general locality special consideration should be given -

(1) to the character of deposits received as indicated

(a) by the amount of deposits subject to check;
(b) by the amount and terms of time deposits and savings accounts;
(c) interest paid ;
(d) conditions of deposit - that is to say, whether an average balance is required;

(2) to the character of loans and investments made as indicated by

(a) amount of short term loans and discounts;
(b) investments in real estate;
(c) investments in stocks, bonds, and other long time securities.

Third: The capital and total resources of the two banks may be considered as a factor. The large bank may make loans of a size that could not be made by a bank of smaller capitalization and for this reason they may serve the same communities without coming into competition to any substantial extent.

After considering these several factors and after determining whether the two banks are actual competitors

the Board must still determine whether the extent of this competition brings them within the prohibition of the statute. To do this, it is necessary to determine what form of evil Congress intended to correct. Was it the purpose of Congress to insure to each bank an equal opportunity to increase its earnings by preventing the directors of one bank from controlling the operations of another competitive association, or was this Act intended merely to insure to the public the benefits to be derived from actually competing associations?

To illustrate by concrete example, if the same directors control two competitive banking associations they might give preference in the matter of investments and otherwise to the one in which they have the largest number of shares and may in this way deprive the stockholders of the other from their just proportion of earnings. On the other hand, viewing the matter from the standpoint of the public, if there are only two banks in a given community and both are controlled by the same directors preference may be shown to certain customers in the matter of loans made, interest charged, etc., which would not be shown if the two banks were active competitors for the same business.

Under the common law contracts in restraint of trade were void as a matter of public policy and the so-called anti-trust laws which were amended and supplemented by the Clayton Act are in a sense a development of the common law rule against those contracts which destroy competition or restrain trade.

The Board should, therefore, take into consideration the effect on the public in reaching a conclusion as to whether two banks are in substantial competition. That is to say, it should consider whether any control of one by the other can affect the public in any way, as for example, by resulting in a decrease of interest rates paid to depositors or an increase in interest rates charged on loans. It should consider in each case whether the control of the bank by the officers of another can affect the earnings of either bank, or the business of either in its relation to the public. As stated, the burden is on the applicant to show by affirmative evidence that the banks are not in substantial competition.

Respectfully,

M. C. ELLIOTT,

Counsel.

6/6/16.

1358

FEDERAL RESERVE BOARD

WASHINGTON

June 6, 1916.

Dear Sir:

At the meeting of the Federal Reserve Board on June third, 1916, the question of a re-hearing of the Connecticut bankers was discussed and I am instructed to inform you that, while the Board is willing to give the Connecticut bankers another hearing in the month of June if they should so desire, the Board prefers to postpone such hearing and definite action until after the summer months.

A new clearing plan is about to be put into operation and the Board has been assured by those in charge of the Boston Federal Reserve Bank that every effort will be made, by making special arrangements between Boston and New York, to satisfy the convenience of the Connecticut banks.

Under the circumstances the Board would prefer to see the results of operation of the new clearing plan before giving a further hearing, but, as stated above, in case the Connecticut banks should wish to be heard at this time in spite of the information above given, the Board will be pleased to fix the date.

Yours truly,

Governor.

June 6, 1916.

MEMORANDUM ON SECTION 8 OF THE CLAYTON ACT.

To All Federal Reserve Agents:

The provisions of Section 8 of the Clayton Anti-Trust Act which relate to interlocking bank directorates go into effect on October 15, 1916. As originally enacted by Congress, this Section provided in substance

(a) That no person shall at the same time be director or other officer or employee of more than one bank or trust company organized or operating under the laws of the United States, provided either of such banks or trust companies has resources aggregating more than $5,000,000.

The phrase "organized or operating under the laws of the United States," has been construed to apply not only to national banks, but also to State banks and trust companies which are members of the Federal Reserve System.

(b) That no private banker or person who is a director in any State bank or trust company whose resources aggregate more than $5,000,000 shall be eligible to serve at the same time as a director in any bank or banking association organized or operating under the laws of the United States. It will be noted that this particular provision applies only to directors and not to officers and employees.

(c) That no bank or trust company organized or operating under the laws of the United States located in any city of more than 200,000 inhabitants shall have as a director or other officer or employee any private banker or any director or other officer or employee of any other bank or trust company located in the same place.

The Act makes certain exceptions to these provisions:

(a) They do not apply to mutual savings banks not having a capital stock represented by shares.

(b) They do not in any way prohibit a person who is a Class "A" director of a Federal reserve bank from being an officer or director or both an officer or director in one member bank.

(c) They do not apply to banks or trust companies where the entire capital stock of one is owned by stockholders in the other.

On May 15, 1916, Congress passed an amendment to Section 8 of the Clayton Act which is intended to make further exceptions to its restrictions, provided the consent of the Federal Reserve Board is first obtained. This amendment provides that nothing in Section 8 of the Clayton Act shall prohibit any officer, director or employee of any member bank or Class "A" director of a Federal Reserve Bank who shall first procure the consent of the Federal Reserve Board from being an officer, di-

director or employee of not more than two other banks, banking associations, or trust companies, whether organized under the laws of the United States or any State, if such other bank, banking association or trust company is not in substantial competition with such member bank.

This amendment, which is in the form of a proviso, does not affect or alter the classes of ineligible directors, officers, etc., as defined by Section 8 before amendment. It merely provides that a person who is an officer or director of a member bank may, with the approval of the Federal Reserve Board, be an officer or director of not more than two other banks or trust companies, whether State or national, in which he otherwise would have been ineligible to serve, provided such other banks or trust companies are not in substantial competition with the member bank of which he is andirector or officer.

Under the provisions of this amendment it will be necessary for every director, officer, or employee of a member bank to apply for the approval of the Federal Reserve Board to serve as a director, officer, or employee of any other bank or trust company which comes within the inhibitions of Section 8 of the Clayton Act and which is not in substantial competition with his own bank. In this connection it may be mentioned that if a director of a member bank desires to serve as a director of

two State banks or trust companies which are not members of the Federal Reserve System, the sole test is whether such other State banks or trust companies are in competition with the member bank and it is immaterial whether they are in competition with each other.

The Federal Reserve Board, before passing upon these applications, will in each case call upon the Federal reserve agents for a report. It will, therefore, be necessary to lay down for the Federal reserve agents certain broad lines that will be observed in dealing with these applications.

The most important task will be to define what the Board will consider "substantial competition".

Perhaps it may be the easiest way of approach to consider and decide first what shall not constitute "substantial competition".

Answering this question, it should be said that the mere fact that two banks ("bank" hereinafter will include national banks, trust companies or State banks) are in the same locality or of similar size, or that they both belong to the same class of "banks" or that they both are buying commercial paper or securities, or take deposits, or are doing a trust company business, does not constitute "substantial competition". If the mere fact that two banks are taking deposits or are buying commercial paper or bonds should be considered to be "substantial competition", it would be

paramount to excluding directors, officers or employees (hereinafter called "directors") from serving on any other "bank", because they all would be in "substantial competition".

The question is, then, not on the broad character of the functions exercised by these banks, but the determining point of criticism must be the extent and manner in which these functions are exercised.

Two men in the United States each wanting a glass of water can not be said to be competing with each other where they are standing on the banks of a stream affording sufficient water for all. If, on the other hand, two men in the desert need water, there will indeed be very substantial competition for a single glass of water, the supply being limited to that amount.

Two such extreme cases are fairly obvious. The question becomes more difficult of determination, however, as the facts in each case converge from those extremes. Take, for instance, a community supplied by a single reservoir of water, Though there may be an ample amount for all, it is apparent that severe competition or a tendency to monopolize may result from an effort on the part of one to succeed in supplying himself plentifully at the expense of the others, securing thereby a stronger position either for fixing the market price of the water or for arbitrarily discriminating in offering or permitting its enjoyment. In dealing then, first with the object competed for it is clear that if it is

of such broad and general nature and existing in such generous supply that it may be considered a general commodity with a wide market, the mere fact that two banks require such commodity would not make them competing. It would make them competing only if the commodity which they both desire and can reach were of so restricted a nature that, in trying to acquire it, they would materially affect each other's supply. In other words, where both banks take the same kind of deposits, buy the same kind of paper and securities they must for a substantial portion of their regular business be tapping the same limited or individual field in order to be considered as substantially competing.

This test should apply irrespective of the location of the two banks in question, though the distance from each other may be an important factor in determining how much each depends upon the same sources of supply. There may be the same class of banks not remote from each other - conceivably in the same city - which do not compete because the main business carried on by them may be of an entirely different character. The one may be in the business center, taking business accounts and making business loans and not paying interest on deposits; the other may be an up-town bank, having private accounts, not making business loans and paying interest on deposits of individuals. It is well conceivable that such two banks may be considered as not in substantial competition, even though, for certain investments, they

might have to resort to the same class of investments, but find them in broad market, such as call loans, time loans or commercial paper.

It is possible, on the other hand, that banks of the same class, even though remote from each other, might be doing substantially the same kind of business, and might, therefore, be competing in precisely the same fields and for the same commodities. Such banks are those whose business are so important in scope that they reach into far-distant territories. To illustrate, certain large banks in Chicago and New York, for instance, have ceased to be local institutions. They are banks that have their connections all over the country, that compete with one another in dealing with the deposits of large corporations in purchasing their securities, and it is conceivable that such large banks with such ramifications may be considered as competing even though geographically remote from each other, while two smaller banks in the same cities doing substantially the same character of business would not be held as competing. The degree of such competition must depend upon the facts of each case, and whether the banks in question are "in substantial competition" must be decided by the Federal Reserve Board after a review of such facts and the recommendations or report of the Federal reserve agent.

The Board proposes to adopt the method of advising each Federal reserve bank of the applications made by each director. To illustrate, if a Philadelphia director should wish to retain a directorship in New York and, at the same time, one in Chicago, all three Federal reserve agents will be advised of the three directorships involved in the case. They will be requested particularly to investigate the local concern involved in the application and will all three receive copies of the reports of their fellow Federal reserve agents, so that they will be in a position to study the entire case before making their recommendations. The Federal Reserve Board's special committee, after having heard from all Federal reserve agents involved in the application, will make its final recommendation to the Board.

6/6/16/

LETTER FROM A WORCESTER, MASSACHUSETTS, NATIONAL BANK.

Referring to the Par Collection System which you are to put in operation about July 15th, I have no doubt you are hearing from a great many banks who are against the adoption of this system, but hear very little from the many banks who are in favor of it. Some of the Texas bankers are back of a propoganda to stir up all the banks of the country in opposition to the Par Collection System.

The banks in New England are much in favor of the adoption of this system for the reason that in New England something similar to this was adopted several years ago by the Boston Clearing House, by which all country banks remit to the Boston Clearing House at par, as you know. This has been very successful and very satisfactory to the country banks as well as the city banks.

I well remember the opposition of some of the country banks at that time. Their arguments were the same as the Texas bankers are making now, - that they were going to lose the exchange charges which they were making. They did not seem to figure that these items would be made up by their not having to pay exchange on items which were deposited with them on other banks. In fact, many of them did not realize that they were paying exchange, for their city correspondents were taking out several days' time which amounted to the same thing.

I trust you will not be deterred by this opposition which, as I understand, comes from the Southwest, and I venture to predict that after it has been in operation for a year, they will all realize that it is a good thing for all.

6/7/1916.

FEDERAL RESERVE BOARD

WASHINGTON

694.

June 9, 1916.

Dear Sir:

Inquiry has been made as to what changes will be necessary in Form 34 in order to provide for the new general ledger accounts which may have to be opened on July 15, in connection with the new Clearing Plan.

The Board at this time is not prepared to issue detailed instructions regarding the matter, leaving it to the judgment of the banks to open such additional general ledger accounts as may be necessary properly to record and report the collection operations of the bank. In order to insure uniform treatment and classification of the items, it is suggested, that in preparing the Daily Bank Statement (Form 34) and the weekly telegraphic reports, the accounts named below be composed as follows:

RESOURCES

"Due from Other Federal Reserve Banks", (Code word "BARE")

This account should show the gross amount of items forwarded to other Federal reserve banks for collection and credit.

"Due from Banks and Bankers", (Code word "BISE")

This account should include items sent to non-member banks for collection and remittance.

"Deferred Debits (Transit Account)", (Code word "BUMP")

Items which have been sent to member banks for collection but which have not been charged to the account of member bank on the books of reserve bank.

LIABILITIES

"Due to other Federal Reserve Banks" (Code word "CHOP")

This account should include the following items:
(a) Balance of funds collected,
(b) Deferred credits to other Federal reserve banks. Items received upon which credit is deferred.
Accounts (a) and (b) to be shown separately in Mail Reports (Form 34) only.

"Due to member banks", (Code word "CLAY")

Gross amount of balance and items received for ~~immediate~~ credit of member banks.

"Deferred Credits - Member banks", (Code word "CORK")

Items received but not credited to the account of member bank on the books of the reserve bank.

The amount upon which reserve is to be computed will be ascertained in the same manner as at present; namely, subtracting "Total deduction from Gross Deposits" from "Gross Deposits", as shown in Form 34.

For the information of the Division of Statistics, you are respectfully requested to furnish the following:

1. Half a dozen copies of all circulars sent to banks in connection with the collection system which will be inaugurated July 15.

2. Description of method of recording on books of the reserve banks:
(a) Items on member banks;
(b) Items on non-member banks collected through member banks;
(c) Items on non-member banks sent direct for collection and remittance;
(d) Items on member and non-member banks sent to other Federal reserve banks for collection and credit.

3. Information as to additional general ledger accounts which will be carried to cover clearing operations.

4. Whether daily statements to member banks will show gross balance or net balance.

Respectfully,

Assistant Secretary.

First Draft. Washington, D. C., June 16, 1916.

A CONSIDERATION OF THE MERITS OF THE QUESTION AS TO WHETHER FEDERAL RESERVE NOTES SHOULD OR SHOULD NOT BE ACCEPTABLE AS RESERVE MONEY.

I

The Federal Reserve Act provides that Federal Reserve notes should not be accepted as reserves for national banks. Presumably the reason the framers of the Act had for making this restriction may be briefly stated as follows:

(1) Federal reserve notes are intended to exist solely as an elastic credit currency which shall expand and contract in volume with the demands of commerce. There is no question whatever about the goodness of Federal reserve notes.

(a) They are good because they represent 100 per cent of high-grade commercial paper, endorsed by a member bank;

(b) Because there is carried by the issuing bank a reserve against them of at least 40 per cent of gold;

(c) They are a first and paramount lien against all the assets of the issuing bank, which bank is guaranteed by its stockholding members by a provision for double liability upon their stock;

(d) The notes are guaranteed by the United States Government; that is, they are an obligation of the Government.

Notwithstanding these reasons, the framers of the Act might very properly say that though the notes are amply protected, there should be no confusion of ideas between the goodness of the notes and their availability as reserve;

(2) The view of those who believe in authorizing the Reserve Banks to issue a credit currency is that the reserves of the issuing banks must be absolutely above and beyond reproach; that is, to say, they must be metallic reserves, either in coin, or the representative of coin.

(3) The only guarantee against a possible inflation of a credit currency rests upon its redeemability when it is no longer required.

II

On behalf of those opposed to the above views, that is, the opponents of this provision of the Act, and those who believe that it is proper to let Federal Reserve notes be counted as reserves by member banks, the following statements may be made to epitomize the arguments:

1st: They concede the desirability of having the currency elastic; but they say that because Federal Reserve notes have been emitted by a bank in times of currency demand does not in any way prevent a contraction of the currency, when the reverse is true, even though the notes emitted remain in circulation. Indeed, it may be argued that the framers of the Act had this very thing in mind. Suppose, for example, $100,000 of notes are issued for $100,000 worth of three months' commercial paper: at the expiration of the three months the member banks who endorsedthe paper, and received the credit, pay

it off at the Federal Reserve Bank. There is no certainty, however, that the $100,000 worth of notes put into circulation would thereupon return to the issuing bank simultaneously, and the issuing bank is indifferent whether they return or not, provided it has received $100,000 in gold or the equivalent, which it may hold as an offset to its own notes still in circulation;

2nd: The opponents further argue that, granting all the arguments of the framers of the Act, they will say that they are confronted by a condition and not a theory. Let us consider what these conditions are at the present time: National banks, represented in round figures by 7600 individual banks, about one-third of the total number of banks in the country having deposits equal to about one-half of the total of bank deposits, are permitted at the present time to count as reserves the following:

(a) Gold or gold certificates;

(b) Silver or silver certificates. (Silver may be considered to be from forty to fifty per cent Government fiat).

(c) Greenbacks; (the direct obligation of the Government, supported by thirty-five per cent of gold; therefore, representing sixty-five per cent fiat).

On the other hand, State banks are permitted very generally to count as reserves Federal Reserve notes and National bank notes. It is therefore argued that if it is proper for National banks to count as reserve silver and silver certificates, which are from forty to fifty per cent Government fiat, and greenbacks, which are sixty-five per cent Government fiat; or, if it is safe and proper to permit State

banks to count National bank notes, supported wholly by the direct obligations of the Government (U. S. bonds), it is rather absurd to say that National banks shall not be permitted to count as reserve Federal Reserve notes which are not only better supported than any other currency except gold and gold certificates, but are, in addition thereto, the direct obligation of the United States Government.

3rd: Viewed from the standpoint, even of credit currency, it is illogical to permit a National bank to count as reserve a credit obtained through the rediscount of commercial paper, entered upon the books of the Federal Reserve Bank as a deposit and as such transferrable anywhere and convertable at the will of the depositing bank into cash or gold, while not permitting them to count as reserve a similar credit taken in the form of Federal Reserve notes;

4th: If the experience of the last fifty years of American banking means anything, it means that member banks will generally take credits from their rediscount operation in the form of book credits, rather than in the form of currency. The smooth and successful working of a general clearing system will certainly aid greatly in bringing this about;

5th: It must be borne in mind that the Federal Reserve Banks do not control the situation. It is to be hoped that they will in time do so, but as yet, and so long as the National banks only represent one-third of the total number of banks numerically and one-half of the total deposits, it is obvious that they will not control and

therefore that we must take into consideration the existence of the State banks. So long as Federal Reserve notes and National bank notes can be counted as reserve by State institutions, it must be admitted that that fact alone gives a great advantage to those institutions, while it throws upon the Federal Reserve System the burden of printing and emitting the notes and the responsibility of sustaining the credit of the country;

6th: Furthermore, there is a condition which applies to all National banks which is open to serious objection; to wit: the constant sorting out of different classes of currency. For example, a National bank keeps at the base or foundation of its reserve fund gold and gold certificates. Next above this will come the silver and silver certificates. Next, the greenbacks. These three kinds of money, or substitutes for money, may be all classed as legal reserves, but, in addition to this, the bank may find it necessary to use three other forms of currency: National bank notes, Federal Reserve Bank notes, and Federal Reserve notes. In times of active demand for money, when banks are holding little, if anything, in excess of their minimum of reserves it becomes obviously necessary to push out this other currency, which can not be legally counted as reserves. If equally times come the effect of this policy is at once to cause the general public to differentiate between the various kinds of currency, and some times this differentiation goes to the extreme of hoarding the lawful reserve money, and pushing out currency which is not reserve. It is in times

like these that State banks, while having the advantage of calling any kind of currency reserve, may at the same time, serve the useful purpose of enabling National banks to get rid of the currency which is not reserve - at least an anomalous situation.

7th: Those who are strongest in favor of counting Federal Reserve notes as reserves, even if it is only to a limited extent, point out that it is not proposed to let Federal Reserve notes be counted as reserve by the issuing Reserve Banks nor by any other Federal Reserve Bank. They admit that such a policy would be bad and would run counter to the general principles of credit currency. They further argue that to permit Federal Reserve notes to be counted as reserve to a limited extent by National banks in the Districts where issued is not dangerous because the Federal Reserve Board has, through its control of the re-discounting privilege, an absolute control of the emission of such currency. If, instead of only twelve banks of issue, there were 100 or more, it is quite conceivable that the issue power might lead to enormous inflation, but considering that this power is limited to 12, at the most, and considering the control of the Federal Reserve Banks over the rediscounting privilege, it is, they argue, perfectly safe to permit member banks to count as reserve to a limited extent Federal Reserve notes of their own Districts.

8th: It is a notorious fact that in ordinary times all forms of currency pass readily as of equal value and it is only in times of stress that <u>real money</u>, such as <u>coin</u>, becomes of special value as the basis of credit currency. Based on this fact it is urged that it is

wise for the Central or Regional Banks to accumulate or impound gold. Thus a Reserve Bank which may have emitted one million of Reserve notes may at the end of three months have its rediscounts paid off in gold or the equivalent. It is wiser, it is argued, for the bank to keep out its notes and hold the gold than to pay out the gold and retire its notes, for the reason that the gold is of greater potentiality in times of trouble.

9th: For obvious reasons it is most important that everything in reason should be done to strengthen the regional banks, as reserve institutions. As has been often said, the Aldrich-Vreeland Act was an adequate scheme for the issuance of currency in times of stress. The Federal Reserve Act, on the other hand, aims to accomplish far more than that and not simply to act as an emergency bank even though amply endowed with currency issuing functions. It seeks among other things to accomplish the important function of steadying and equalizing interest rates and fortifying the country in advance against possible or sudden market fluctuations or heavy withdrawals of gold, due to changes in trade balance. If you permit the Federal Reserve Banks, it is argued, to reinforce themselves with gold in times when money is abundant, they will be the better able to act as shock absorbers in times of stringency, or great demand.

III

In conclusion, after giving the matter very full consideration, it is believed that Congress may safely grant National banks the right to count Federal Reserve notes of their own district as reserves, to the extent of say one-quarter or one-third of the reserves required to be held in their own vaults.

It is believed that the effect of such a provision will tend to strengthen the Federal Reserve Banks and cause a gradual flow of gold to them.

It is further believed that in times of actual demand for credit, when National banks are running close on reserve, they will not hesitate to take Federal Reserve notes; whereas, if they are not permitted to hold Federal Reserve notes as partial reserve, there will be a disposition to regard Federal Reserve notes as inferior to other forms of currency.

Furthermore, if, in the opinion of Congress, it is desirable gradually to replace National bank notes with Federal Reserve notes, it can be accomplished far more easily if Federal Reserve notes can be counted as reserve.

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