2512

FEDERAL RESERVE BOARD

WASHINGTON

X-215

June 16, 1917.

Dear Sir:

Numerous questions have recently been presented to the Federal Reserve Board with reference to trade acceptances, and I have in consequence been instructed to make some inquiry about the present situation in the matter, and to report the results to the Board.

I know that considerable work has been done in your district with reference to the trade acceptance, and should be very much obliged if you would send us a complete set of all matter issued by your bank on the subject, and also any other material, or copies of correspondence showing the position of business men and bankers on the subject, that you feel at liberty to transmit for the information of the Board.

Yours very truly,

Secretary.

X-216

REMARKS OF H. P. WILLIS

before

AMERICAN INSTITUTE OF BANKING

at

Toledo, Ohio,

June 18, 1917.

Mr. Chairman and Gentlemen:

The participation of the United States in the war against Germany has raised a multitude of pressing national questions which are calling for immediate solution. It is natural and unavoidable that in preparing ourselves for our share in this struggle we should direct our attention, first of all, to those matters whose immediate urgency is such as to admit of no delay. We must arm and equip large forces, provide transportation on land, build an enormous quantity of tonnage, and in manifold ways adjust our social and industrial conditions to the special needs of the moment. More important, perhaps, than anything else, is the requirement that we furnish at once the funds that are needed for the support of our undertakings both at home and abroad, and for those of the nations with which we are allied. Fortunately we are perhaps better equipped in the matter of banking and finance than in any other branch of public activity for meeting and bearing the unprecedented duties and burdens which war has brought us.

In all this, however, we must remember that immediate, must not be provided for at the expense of future, necessities. Wise advisers have told us that it is not safe to count upon a short war, and the experience of other nations enforces this counsel. We hope that the duration of the struggle will be brief; we earnestly look to the coming of peace as a way of deliverance for the world from evils that are, if anything, worse than those that have yet been suffered. Nevertheless, we recognize that perhaps the surest way to hasten the early conclusion of peace is to act as if such an outcome were not probable. This is true in every branch of our activity; it is conspicuously true in banking and finance. Every step that we take must be chosen with a view to its eventual effect upon our financial future, remembering that this future includes not merely our success in the war, but our industrial and economic position as a nation in the long years of peace that are to follow it.

The Federal reserve system is the nation's basic reliance in its financial preparation; the central mechanism for coordinating and uniting the various elements of national strength; the only means by which we can hope for the proper development and marshalling of the country's resources of credit and money. Every step that it takes, every policy that it outlines, must be tested, not by its immediate success, but by its eventual bearing as illustrated by experience and tried financial principles.

The United States has recently struck a telling blow on the side of the Allied nations. It has furnished them in round numbers a billion dollars of advances with which to meet their maturing obligations for supplies, munitions, transportation and the thousand and one requirements which must be provided if the war is to go on. Many persons think of this as our only contribution thus far. The truth is that this is only the latest contribution of the United States to the war. For three years past we have been exporting at a rate never before dreamed of. Since the middle of 1914 we have sent abroad $12,000,000,000 of goods - a net merchandise balance of over $6,000,000,000 - and we have accepted in payment of this net indebtedness probably $2,000,000,000 of our own securities which have been returned to us, $2,000,000,000 of foreign securities, and opened our own credits amounting to another billion. No one probably would have imagined, before the beginning of the European war, that any such aid could be so promptly furnished by this country. Yet through our financial organization it has been possible to render the aid in question without shock to our banking or financial mechanism. The cost, however, has already been great. We have suspended the extension of our railroads; we have checked our building enterprises; we have discontinued the development and enlargement of our internal undertakings in many lines. More important still, we have submitted to an enormous increase in the cost of living, which has borne heavily upon every man in the land, and particularly upon those whose incomes are fixed, whether they be drawn from labor or from invested capital. Some classes of labor have succeeded in obtaining advances of pay roughly corresponding to the rise in prices, but even they have not kept pace with the growing costs of all classes of necessaries. Strong as we are in material wealth, efficient as we have become in industry, we have already accepted a great burden, and now that we are called upon to increase this burden perhaps many times over, we must take serious account of ways and means and must adjust our undertakings to our capacities.

Let me review for you in briefest outline what the Federal reserve system has already done as a basis for discussion of what it may yet be able to do. Even before the coming on of actual war, the System had prepared itself for any sudden pressure or strain. Early in the present year it placed very large orders for Federal reserve notes, and when these had been printed it distributed them throughout the country at the various subtreasuries and mints in order that they might be readily available upon demand. There has never been a moment when the System did not stand ready to supply to banks in need of currency that emergency relief of which so much has been said in public and which has been so unfortunately lacking in moments of crisis and stringency heretofore. The Federal reserve system has, from its very inception, moreover, sought to conserve its strength from the credit standpoint. It has recognized that notes, however desirable and valuable, could not be of much service unless they were backed by ample reserves held by institutions conservatively managed and in thoroughly sound and liquid condition. It has, therefore, discouraged long-term investments by the various reserve banks and has at times recommended to them moderation even in the purchase of paper of recognized liquidity which, under other conditions they would have been glad to take over as a part of their assets. At the beginning of the year 1917, as a result of this policy of conservatism, the Reserve banks found themselves possessed of assets amounting to $769,500,000 of which $474,600,000 consisted of gold or lawful money. Since then effort has been made to secure accumulation of a still larger quantity of reserve money in the System, and legislation in process of adoption has made provision for transferring a still larger share of the vault cash of the banks to the reserve institutions. Without this legislation the reserve banks could probably supply accommodation additional to that already furnished by them in an amount varying from one billion to twelve hundred millions of dollars. With this legislation in effect, they could probably add $350,000,000 to the amount I have mentioned. Since the beginning of the war every effort has been made to prevent these resources from being dissipated and to place them reasonably at the disposal of the Government in the process of financing that has been in progress. Not only have the reserve banks endeavored to do their utmost as fiscal agents of the Treasury Department, but they have, by making special rates of discount in favor of paper secured by public obligations, sought to further the flow of immediate funds from the banks and the people to the Government. The Government, on its part, has wisely refrained from initiating any policy that could result in depleting the store of cash either in the reserve banks or in the vaults of the members or nonmembers. Every arrangement has been made for maintaining the funds on deposit, for facilitating their easy and natural transfer from one part of the country to another, for providing exchange in such a way as to avoid unnecessary friction and for relieving the banks of any of the older limitations of law with reference to reserves that seemed likely to stand in the way of the safe and efficient placing of the new securities. The great loan of two thousand million dollars offered by the Secretary of the Treasury a few weeks ago has thus been successfully put on the market. It is a satisfaction to know that after the great effort already made by the banks and people since the beginning of the European war, they were nevertheless able to supply this sum, unprecedented as it is in American finance, for the immediate requirements of their own Government. It is a splendid record of public service for the financial community in general and the Federal reserve system in particular.

If we were now at the end of our requirements for additional financing we might, perhaps, give ourselves no further concern about the unusual banking problems growing out of the war. But this, as we all know, is far from being the case. The Secretary of the Treasury has estimated our costs for the first year of war at perhaps ten billions of dollars. How can we supply this immense sum? Can we confidently look to the Federal reserve system to do the work? Can we expect the banks of the country to absorb and carry any considerable part of this immense volume of securities? Can we believe that our banking credit as such is sufficient to shoulder such a burden? I do not underestimate in the least what has already been done by the people of the United States in purchasing the bonds of their Government; but I believe it is true that in too many cases there is a fancied security resulting from the very greatness of the resources of our banks which has led many to withhold their direct assistance. They look to the financial institutions to carry the load as if it were possible for them to go to almost any length they might choose in investing their funds in long-term securities. The bonds, they well know, are wholly safe; they are the premier security of the world to-day --- then why should the banks hesitate to purchase them in any quantity that their resources will permit? Is it only a reluctance to invest in a security that bears interest at so low a rate as $3\frac{1}{2}\%$? If so, the average man may, with safety, look to the banks to absorb any portion of securities that may not have been subscribed through popular participation. This is not a new point of view. It was adopted in England at the beginning of the war when the Government practically looked to the banks for support, and when they absorbed vastly more of the short-term issues thus poured out upon the market than, under other conditions, they would have dreamed of accepting. Something of the same kind occurred in the other belligerent countries. It was not for a long time that the public became aware, even in a remote degree, of the nature of the transactions that were going forward and the real consequences to be expected from the absorption of securities by commercial and banking institutions. To-day it is recognized that inflation of bank credits, unduly large purchases of bonds by banking institutions, congestion of these bonds in bank vaults, due to the fact that investors cannot, or will not absorb them, and loss of specie in consequence of the inflation policy, mean high prices, weakened financial credit, extravagance on the part of individuals, and, if not checked, eventual bankruptcy. There are too many, even among our financiers of light and leading, who fail to appreciate the real efforts of undue enlargements of banking credit. At the outbreak of the Civil War American bankers were asked to absorb great issues of Government bonds. When their purchasing power was exhausted, issues of legal tender notes came in to take the place of bank loans. Gold was driven from circulation, prices rose enormously, and the country received a lesson as to the bad consequences of currency inflation that it has never entirely forgotten. To-day we have the greenback still with us, but we know the evils of an unrestrained issue of bank notes.

What we have less clearly recognized as a nation has been that inflation could occur quite as easily through the over-extension of banking credit as through the over-issue of currency. There is no difference in principle between the issue of a bank's notes and the establishment of a credit upon its books. Both represent purchasing power, and in both the bank itself stands obligated to make immediate payment upon demand. Both can and will be used by those who obtain them as a means of purchasing goods in the market, and both, therefore, add to the power of the holder to raise prices by exerting his demand for commodities. So long as the note or the bank credit represents actual lines of immediate purchase, its creation is beneficial and not injurious. The man who obtains an advance designed to put him in funds at the present moment, knowing that he is sure to receive from others within the next 90 days fluid means of liquidating his account, has merely facilitated the exchange of goods against goods. He has been helped to render his real purchasing power available, but he has thereby received no greater control over goods than that which he enjoyed in the first place. If, however, he receives a loan upon some long-term security, be it ever so sound and reliable, he has been given a means of obtaining the goods on the market at the moment against a promise to pay some long deferred debt in the future. He has thus been enabled to make a demand for the current products of industry, notwithstanding that he had no right or title thereto as a purchaser. His long-term capital has been rendered immediately available as an offset against consumable articles, and the effect is to raise the prices of those articles in preparation. On the other hand the bank which grants this accommodation has placed itself in an ambiguous position. It may have every reason to believe itself safe and solvent, but it has undertaken to pay something upon demand and to keep it redeemed in specie despite the fact that it has not arranged for any corresponding claim upon specie in the near future. As a result, its specie tends to dwindle as the claims against it are presented for cashing, and if the process goes far enough, the bank is irresistibly driven towards the suspension of specie payments. It tends to fall into the same position as a Government which issues legal tender notes which it has no immediate means of paying because the volume of the notes and the Government's own necessities are so much larger than what it can collect in current funds.

Language is hardly strong enough to depict with adequate force the effect of such a development upon the individual and through him upon the nation at large, as prices are raised and his cost of living increases out of all proportion to his efforts. Relations between the debtor and creditor are deeply disturbed. The man who has agreed to pay a specific sum in money finds that he is really returning to his creditor a very much smaller control over goods than he had originally received. The receipts of the Government from taxation dwindle in value because they now no longer buy what they were originally supposed to command. Every element of production is disturbed; every industrial process is thrown out of gear. Every business relationship depending upon stability for its soundness and strength is rendered doubtful.. The financial foundations of the community are shaken.

Such a condition must not occur in the United States. How can it be avoided? First and most important of all, we must not look to our banks as the ultimate holders of long-term bonds or other obligations. Their assistance as distributors is not only desirable, but absolutely essential. But this assistance is a very different thing from reliance upon them as ultimate investors or holders. If they are called upon to purchase and carry bonds in undue amounts a beginning has been made for all of the evils that I have set forth. It is to the individual investor and buyer, and to him alone, that we must look for the strength to furnish what the Government requires, and to conserve the power of the banks in their true capacity as commercial agencies for facilitating the transmission of funds and the maintenance of the liquid condition of the nation.

How far can he be expected to go in thus sustaining the fighting power of the nation? Before the coming on of the war, the wealth of Great Britain was estimated at some eighty billions against which she had an outstanding debt of over three billions of dollars. The wealth of the United States was estimated at one hundred and eighty billions, and some estimators have since raised this figure to two hundred and fifty billions. England to-day has a war debt of about fifteen billions, and there are some who think that reckoning upon a like basis we can support an indebtedness for war purposes of perhaps thirty-five to forty billions in addition to such taxes as we may be called upon to pay. If this be true, all that is required in the United States is a campaign of education designed to induce the average man to save, save, save, and bring his savings to the support of the Government. It is of vital moment for us to reach a positive conclusion on this question, since by so doing, we shall test our power to bear the great responsibilities by which we are now confronted, and shall ascertain the true limits of our capacity to save and invest. No figures of absolute accuracy with reference to our national income have, so far as I am aware, ever been compiled. Some recent estimates fix the gross total at thirty billions of dollars, an estimated average family income of less than $1,500. Our annual savings fund is placed at from five to six billions. How much can this latter figure be increased? There are some who point out that an annual additional saving of $250.00 per family would yield an additional five billions a year, and would give us what we need for our war aims. Analyses of figures show us the difficulty of sustaining such an inference. Two-thirds of the families of the United States, it is estimated, have only two-fifths of the incomes. They are to a great extent, below the margin of saving since their average income is much below $1,000. They can contribute something, but the total will be relatively small. The recipients of higher incomes can, and should do much more in bearing the load of such compulsory saving. Here, however, there is another difficulty. The man of higher income who begins to save finds that his saving much be judicious or it will be ineffectual for our purposes. If he abandons certain favored outlays, he will take work from men of specialized ability whose incomes will cease, but who must be set at work elsewhere in order to make the sacrifice bear fruit. Even if they are at once transferred to productive enterprise, it will remain a question how much they can for a good while contribute. Unfortunately the measure of the real saving brought to pass is not the money put aside by the owner of income, but the increased production effected by those whose labor has thus been set free. What can be done by them must be done through a general process of reorganizing our resources. What we do must, however, be judiciously done, if the real benefits are to be realized. When by a process of experimentation we have ascertained what we can do, and have done it, we shall have accomplished our utmost, and more can not be expected.

In a very special and peculiar way the economic problem of the nation is an unprecedented problem. In all other wars or times of stress, the nations have been able to induce other nations to divide the load with them. They have induced others to save by paying high rates of interest that would suffice to call forth the necessary resources. It was in this way that the European belligerents at the opening of the present war secured from the United States and elsewhere the goods that they required. This expedient is now closed. To all intents and purposes, the United States is the last reservoir of liquid capital in the world. We cannot sell our bonds to Mexico or China. We must take and purchase them ourselves. It is in carrying out this process that the real test is supplied, the real measure of our contributing power furnished.

This is a genuine national problem, a problem for every man in the land. Financial issues are often thought of as something distant, vague, to be settled by experts. Yet in their real bearing they are not so. The present situation shows how the settlement of the pressing issue now at stake must be worked out in the home, the factory, the field - though not at the bank. Fortunately we have smoothed away by wise legislation the problems of banking operation that in times past have troubled us. To-day we have ready to hand a highly perfected, smooth-working, financial machine. We can, if we will, - and we must - take from our pockets with the minimum of friction and lost motion the utmost we are willing to part with. Banking, however, is a process of exchange and not of production, and it is production that counts. We must produce by creating goods, or by abstaining from their consumption, before we can, by the use of our banking mechanism, transfer such goods, new or old, to public uses. If we refuse to do so, if we say to our banks and our administrators that they must carry the burden, we suggest that they by the mere creation of credits, bid up prices and buy the goods away from the consumers who have been purchasing them in the past. Such a process may result in supplying the goods called for, but only at a tremendous sacrifice, far greater than that required by the act of saving them in the first place.

We must make of ourselves a nation of experts and wise counselors, on this great economic problem, surpassing as it does in its significance any that has been presented in the past. We must also present to the world an example of wise and conservative self-denial in comsumption, carrying nothing to excess overdoing nothing, but sanely and calmly setting ourselves to husband our strength and to apply it to our purpose. Last but not least, we must comprehend the issue in its essentials and possess ourselves of the strength of mind that will measure our capacity to the task, and attempt only what we can carry through. We have now no choice in the matter. Conditions, not theories, require to be dealt with. Not only our success in war, but our future as a solvent nation able to fulfill the duties of reconstruction that will come when the war is over, require that we conform to this high standard. We must not jeopardize our essential powers in the doing of it, we must not deceive ourselves as to the real problems that are presented. In a very unusual and peculiar way the successful conduct of our financial and banking affairs depends upon the decisions of the average man. The Federal Reserve System is the instrument through which his judgments and conclusions can and will be carried out, but the responsibility for those judgments, the soundness of those conclusions will rest ultimately with him.