

X-647

REMARKS OF H. P. WILLIS.

January 16, 1918.

Mr. Chairman and Gentlemen

Your Secretary in inviting me to be present this morning suggested that I speak to you on "Financial Problems". I suppose that he framed the topic in this way out of the largeness of his hospitality, in that in so broad a field almost anyone could find an agreeable corner. I know that he did not expect me to try to cover all financial problems, or even all that are pressing for attention at the present time. Had he done so the duration of this Convention would have to be considerably extended. I suppose that the ideas I can to best advantage present to you this morning are those which relate to the financial problems by which the business man himself is confronted at this particular moment - that is to say, those especial problems growing out of our financial and credit position which are most pressing at this time.

You have all heard much of questions of bond issue, loans, necessary savings, and taxation, and he would be a bold man who should endeavor to add anything to your information on these topics. There is, however, a field of thought in this connection that has had comparatively little attention - the business man's own direct and especial relationship to war financing.

No point has been more clearly brought out in the course of the discussion of the war than this, - that what the Government, indeed all governments, needs is not money, but is men, goods and services. The business man, like every other good citizen, shares in the task of furnishing men by giving up himself and his children to the service of the State - at home, at the seat of Government, or in the field, according to especial aptitude. His duty does not differ from that of any other good citizen. It is in supplying goods and services that his peculiar duty becomes conspicuously apparent. We all admit that the economical use of our food and our resources in general is essential to our success in the war. But, while we freely admit this as an abstract proposition, it is true here, as in so many other fields, that a

little knowledge is a dangerous thing. Many misinterpret the idea of economy and perhaps do as much harm in their misinterpretation as those who reject it. It is the business man's duty of leadership and insight in connection with the production and consumption of goods that embodies his particular responsibility at this time.

The business man is either a producer, a distributor or a retailer, and in each of these capacities he has his own individual function to perform. As manufacturer, it is incumbent upon him to avoid attempting to encourage or even to maintain those forms of consumption that are obviously wasteful and have a tendency to destroy materials without any corresponding return. In your own trade, you have not been free from fault in this regard for some years past, and to the ordinary layman, or consumer, it would seem that the function of restricting the different types of boots and shoes available on the market to those that are of some service and fall within the limits of common sense, is an important one. Every manufacturer must, I think, recognize the duty of attempting to confine his production to rational lines in which public demand is unquestionably legitimate and, so far as he reasonably can, to curtail the production of those articles which are obviously of a purely luxurious character and do not satisfy any well-marked want. This responsibility runs through all of the trades which cater to direct personal consumption. Too much stress can scarcely be laid upon this responsibility on the part of the manufacturer in shaping his goods so as to curtail luxurious and wasteful uses, while at the same time fully supplying the needs of the community for sound and staple articles. It is perhaps the most unfortunate economic phase of the war that at a time when basic necessities are subject to great shortage there is often a super-abundance of luxuries, frequently at prices lower than ordinary. Necessary commodities not infrequently rise in price, while luxuries decline. The abnormal redistribution of wealth through readjustments of wages and through the earning of unexpected profits shifts buying power out of normal channels in which it has been exerted into new and unexpected lines. Fortunately manufacturers can, if they will, control many of the vagaries of consumption which are likely to result from this state of affairs, and if they are wise they can protect the community's interest quite fully by adjusting their output to legitimate or normal necessities. In the same way the retailer, whose usual effort is to increase consumption by every legitimate device and even

- 3 -

artifice, finds himself, like most other persons, in a position where he is called upon to give up his ordinary lines of thought and to substitute new ones. The community asks him not to encourage wasteful or luxurious consumption either through the carrying of unduly varied stocks or through extensive advertising, or through the extension of unsound credit. It asks him to apply a rational method of conducting business and to substitute for conceptions purely individual, personal and private, that of service to the community. He has become one of the channels of distribution by which the public is to be supplied and sustained, and in performing this function his earlier and selfish standpoints of conduct have been set aside. It may be, in many cases it will be, true, that due to the changed conditions of trade and the vastly increased scope of demand his profits will not be less on the new basis than upon the old, but this, in any case, is only an incident, for the necessities of his service have become superior to those of his personal income.

This is a day of governmental interference in all lines of trade. Sumptuary legislation has gone to unheard of lengths abroad, and though we have not fully accepted it in this country we have taken some decided steps in that direction. Government ownership has already been applied in many lines and is proposed in others. Yet there are reasoners who believe that it is entirely possible for business men of a distinct trade or profession so to conduct their businesses with an eye single to the public welfare that they can obtain results superior to those to be had through the intervention of outsiders. This, undoubtedly, is more largely true of those lines of business which have to do with the supplying of personal consumption than in others, and it is, therefore, true of you. But in applying any general standards of regulation or control to the direction of business, nothing is so powerful and influential as sound and wise standards of individual responsibility and credit. This is true at all times, but it is doubly true at moments like the present. We seek above all things else in times of peace, by the use of our competitive machinery to bring about the apportionment of goods, on the basis of wise consumption, to those communities or individuals who are entitled to them, and who, in accepting and consuming, will incidentally produce the means of paying for what they have thus been allotted from the general stock. True it is that vagaries of competition have in times past, indeed almost constantly, brought about disturbed conditions of business which would not have developed had there been due regard for the welfare of the community and the broader ethics of business. Many of the panics of the past have

been the result of unsound credit widely extended and as the result of competition between sellers of goods which lead them, in their anxiety for profits, to foster undue expansion of demand and consumption. Such disturbances of normal conditions are always to be deplored, but at the present time they are worthy of the most serious reprobation. Much as we are in the habit of insisting upon economy in the consumption of goods, we have had comparatively little to say with reference to the parallel economy in the use of credit as extended both by commercial houses and banks. Yet it is this very economy of credit that lies at the root of all true economy in goods. The business man who establishes a careful check upon the credit of his customers and who in every transaction is governed by sound standards in his estimate of the amount of credit to be extended is not only protecting himself against the time when changed conditions will supervene, but is protecting the community against extravagance on the part of individuals as well as against that expansion of liability which in the last analysis is likely to lead to disaster.

The demand of the moment is undoubtedly for the utmost watchfulness on the part of business man, be he manufacturer, distributor, or retailer, with a view to assuring himself that every credit extended is as nearly liquid as human watchfulness and judgment can make it. Competitive conditions in times past have led to the extension of long credits and the abuse of selling terms. Advance datings, improper and unearned discounts, and a multitude of other concessions made for the purpose of enabling the retailer, and through him the consumer, to absorb goods that they should never have taken, have been the order of the day. Those of us who still believe in the old economic doctrine of "laissez faire" believe that these wanderings from the path sound judgment eventually bring their own retribution and so correct themselves, though often, it is true, at a heavy cost to the innocent as well as to the guilty. The present is no time, however, to permit experimentation. Every capable establishment knows approximately the limits of the safe and unquestioned credit of its customers and should restrict takings of goods to the limit thus established. It should concede no deviation from the path thus marked.

I know that there are many who reject this counsel because of the sacrifice it entails. There are some who are disposed to seek an improvement in the older methods of credit by merely changing their form. They seem to reason that an alteration of appearance will serve the same purpose as a change in actual conduct. As the requirements of war financing absorb a larger share of the

- 5 -

capital available in the financial market, there is a disposition on the part of buyers to put their paper into a form available for discount at Federal Reserve Banks in order that it may gain a wider field of sale, and may be enabled to take advantage of the lowest possible rate offered at any time. This in itself is a good development; yet it is most undesirable that in this process of reshaping the commercial paper of the country there should be developed any kind of paper technically eligible for discount but in fact not in conformity with the spirit and purpose of the Federal Reserve Act and of sound banking principles. I may mention as an example of what I mean, the plan recently put forward for financing corporations for long periods by means of a series of notes issued under an agreement and providing for many renewals. In the same way there has been in some quarters, a growth of so-called trade acceptances representing old or slow accounts. They are, of course, no better than the credit underlying them, and the mere fact that they have been put into form which is intended to suggest liquidity in no way alters their character or the danger which adheres in the granting of credit on this basis. Three years ago, in its first series of circulars, the Federal Reserve Board laid down the general principles which should govern the extension of banking credit in the following words:

"Safety requires not only the bills held by the Federal Reserve Banks should be of short and well distributed maturities, but, in addition, should be of such character that it is reasonably certain that they can be collected when they mature. They ought to be essentially "self-liquidating" or, in other words, should represent in every case some distinct step or stage in the productive or distributive process - the progression of goods from producer to consumer. The more nearly these steps approach the final consumer the smaller will be the amount involved in each transaction as represented by the bill, and the more automatically self-liquidating will be its character.

"Double name paper drawn on a purchaser against an actual sale of goods affords, from the economic point of view, prima facie evidence of the character of the transaction from which it arose. Single name paper, now so freely used in the United States, may represent the same kind of transactions as those bearing two names. Inasmuch as, however, the single name paper does not show on its face the character of the transaction out of which it arose - an admitted weakness of this form of paper - it is incumbent upon each Federal Reserve Bank to insist that the

- 6 -

character of the business and the general status of the concern supplying such paper should be carefully examined in order that the discounting bank may be certain that no such single name paper has been issued for purposes excluded by the act, such as investments of a permanent or speculative nature. Only careful inquiry on these points will render it safe and proper for a Federal Reserve Bank to consider such a paper "self-liquidating" investment at maturity."

The principles thus set forth are permanent in their nature, and are as valid at one time as at another. They are, however, of especial importance at the present moment, where there is urgent need of restricting consumption to those articles and to those individuals and concerns whose productive contribution to the community's wealth entitles them to be consumers. Reliance upon ultimate collections to be made by some process involving conversion of capital into a means of payment, as well as loans secured by what are practically mortgages upon future income should be avoided, not merely, now as always, for the sake of the safety of the concern itself, but because of the public duty involved in this conservation of credit and this protection of the community against waste due to the transfer of goods to persons who have no right to them on the basis of their current income production. Let each man's consumption be based upon and in proportion to his current contribution to the wealth of the community and the first long stride toward genuine economy has been made. It will have been made, moreover, as it should be, through the use of the natural engine of control afforded by our credit system. The suggestion has been heard in the past in a number of quarters that by carrying out the principle of conservation of credit on a large effective scale there should be adopted either through the informal and joint action of the banks, or through the authority of some Governmental organization, a system of priorities whereby the preference would be given in the granting of bank credit to those industries which manufacture necessary articles. It has been suggested that the producers of unnecessary articles should be restricted in their access to field and material as well as to bank credit, and that in this way there be brought about the centering of the community's productive efforts which has been so often urged, and which has been regarded by foreign countries as the essential element in the conduct of the war. Others have strongly insisted that every banker in passing upon a loan should inquire into the purpose for which it is made and if not satisfied that it is designed to serve a distinctly useful

economic need, refuse it. It is much to be doubted whether any such result can be obtained through the united action of bankers. Self-interest and difference of opinion will, in the banking field as in all others, militate against such harmony and unity of view. Neither is it to be expected that a perfect system of control can be evolved by the Government or by any Governmental body. Such supervision and intervention is always imperfect and incomplete. It may succeed in marking out broad lines of procedure but it can seldom if ever do more than this. The question will always recur, whether those things which are necessary to one individual or group of individuals may not be luxuries to another, and whether the drawing of a purely artificial line between classes or grades of men might not do more harm than good, might not so discommodate large classes in the community as to reduce their productive power, and so render them less efficient. What is certainly feasible is that every banker in granting credits should confine his advances to those items of paper which are unmistakably the product of live commercial operations. We know that bankers, like others, in the words of the Roman poet often "see the better way but follow the worse". Every banker, as a result of the stress of business, is likely to have a certain element of paper in his portfolio which represents renewals, and is to be regarded rather as investment of capital than as advance of commercial accommodation. It is this element of bank assets whose elimination is now earnestly called for by the requirements of war. So great are our national needs, so relatively little is the volume of bank accommodation left over after these national needs have been satisfied, that it is essential that the commercial paper of the country shall be, exclusively as possible, of a liquid, short term, early maturing variety which ensures settlement upon the due dates. If bankers and business men will cooperate in restricting their grants and their demands for accommodation to transactions of this description they will establish the best of all systems of priority - the priority which depends upon liquidity and productive power, and which assures liquidation at the prescribed time because of the fact that production has taken place as a result of the credit extended.

Does this reorganization of this credit system involve any serious hardship to the business man? I can see that it may do so in not a few cases, yet, as I have said, it is the course indicated by public spirit. Not only is this true, but it is also the course demanded by a wise consideration of private welfare. We cannot expect the present fabulously high prices to continue indefinitely. Already the Bureau of Labor shows an increase of

- 8 -

some 50% during the years since the opening of the European War. Our net gold gains since the beginning of the war have been more than \$1,000,000,000; our increase of paper currency has been some 50% of its former amount. A like increase in our bank deposits or credit currency has also taken place. There are some reasoners who regard these changes as the cause of the current high prices. Others think of the high prices as the result of shortage of commodities accompanied by unproductive consumption. I will not attempt to enter into this controversy but will confine myself to suggesting that whichever school of thought may prevail the outcome will in either case be the same so far as the business man is concerned. Evidently there must be a shrinkage of prices either through the natural redistribution of gold which will follow the close of the war or through the restoration of the same normal balance between consumption and production. When that time comes those business men who find themselves with extended lines of credit or with dead assets represented by paper which, while technically liquid, is subject to renewal or extension in one form or another, will have to face the familiar conditions which grow out of falling price levels and reversal of the currents of demand. It will be a time when those who have set their houses in order will have reason to rejoice in their foresight, for when that time comes no power in the economic world will be able to save them. The world will face a short supply of capital and goods, and consequently banking credit with interest rates correspondingly affected. He will be a wise man who is willing to sacrifice some present profit for his own future welfare, if not for that of the community; by keeping his credits within the limits of prudence and wisdom.

The business man's financial problems are thus now, as always, nothing more than the observance of sound principles and conservatism in the maintenance of his business. It happens to be conspicuously true at this time that the observance of such principles is a material service to the community by restricting uneconomic consumption and so saving goods and credit. But just here it is worth noting that one remarkable effect of the European War, exhibited in many different lines, is proving to be that of emphasizing the necessity of doing continuously what we now find ourselves compelled to do as a measure of temporary necessity. The War will undoubtedly show, as one of its chief consequences, changes in methods of production and distribution, avoidance of round-about factory methods and abandonment of obsolete types of organization. Perhaps this will be one of the most beneficial results of the struggle; it is, at all events, one that may be of very great significance to industry. In the field of mercantile credit, it

- 9 -

ought to be true at all times that the public opinion of the trade suffices to check unsound and dangerous practices which, if persisted in, may bring about undue extension and unwholesome conditions both of production and competition. It is not necessary to insist upon the view that these conditions have often appeared in the past. We are, as I have said, now seeking to curtail them for the sake of our success in war, and doubtless we shall succeed in so doing in a greater or less degree. Is it not fair to expect that the conclusion of the war will find our business men determined to retain whatever lesson may be learned from this harsh experience? It would seem only fair to suppose so. In that view of the case, let me close my remarks by suggesting what seems to me to be the desirable type of credit organization to be maintained, for we can not and ought not to expect that control of consumption will extend beyond the termination of the war, or that producers will reasonably be called upon to do more than refrain from unwholesome methods of stimulating purchasers and consumers. Their efforts after the close of the war will naturally be more and more confined to the positive task of making their own methods as sound as possible, and less and less devoted to supervision of consumption and the habits of others. They will aim to strengthen their credit organization with a view to preventing the extension of credit to unsound, extravagant, or unreliable dealers. They will strengthen all existing credit mechanism with a view to ascertaining and interchanging information concerning business conditions and credit ratings upon a more efficient basis than at present. They will, above all things, endeavor so far as practicable to bring about economic distribution of commodities among the different sections of the country, and in so doing they will make chief use of the banking mechanism of the country because they will know that it is this mechanism which can best be relied upon to gauge the consuming and absorbing power of the different communities. From this point of view the task of financing the local retailer will gradually be transferred from the wholesaler and jobber, to whom it never belonged, to the local banker, who knows the community in which he is situated and stands ready to prove his confidence by providing the capital needed for the making of short term loans, designed for the conduct of live commercial operations. The commercial paper of the country, whatever form it may assume, or however it may be drawn, will be made to conform to this general conception of liquidity and promptness in payment. In this way losses will be checked, inflation of prices and overbuying will be kept to a minimum, and the firm of sound and established credit will be given access to the lowest and most favorable rates of accommodation to be had at any time for its kind of security. If these changes can be promptly introduced today as the result of common and united action intended to promote soundness and efficiency, a result will have been attained which, in ordinary commercial times would have been long delayed because of mutual doubt and selfishness. Let it once be accomplished by common trade action and we shall all wonder that a result at once so easy and so beneficial had never been accomplished.

1/14/16