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ADDRESS BEFORE TRADE ACCEPTANCE COUNCIL

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For at least three years after the automobile made its appearance there still were men and women who argued passionately that the people who used it were snobs and murderers, and that such machines should not be permitted on the public highways. The exponents of this view, at that time, were still dealing with the automobile as with a theory; they did not realize that, while they were debating, the automobile had already proven its worth, had been definitely adopted and had begun to gain an ever-growing importance in the economic life of all nations.

I well remember that similar discussions took place concerning the Federal Reserve System during the first year or two of its operation. People were still urging that it was an impossible system conceived by theorists and doing violence to old banking practices; an expensive luxury that might be dispensed with. The men who expressed these views did not realize that, while they were protesting, the system had driven its roots so firmly into the ground that it could no longer be removed. It is now recognized by even its severest critics of the past as the backbone of the banking organization of the United States.

A similar condition prevails at present with respect to the trade acceptance. It is at this time the subject of heated debate. Some consider it impracticable and not suited for the use of American business men; others consider it dangerous and think it ought not to be encouraged or perhaps even permitted. But, as in the two cases just cited, while the trade acceptance is being discussed as a theory, it already had become a fact. The trade acceptance is here - it has proven its worth in thousands of cases, it has come to stay, and now that the first and most difficult step in popularizing it has been taken, its general use will grow by leaps and bounds.

In this discussion concerning the merits and demerits of the trade acceptance, both sides, to my mind, have made the mistake of over-stating their case. The champions of the trade acceptance are not warranted in saying that it is the only proper instrument of credit, that it should, or will, drive out rapidly all single name paper <sup>and the cash discount system,</sup> that to use it is the highest degree of patriotism and that to refrain from using it shows a lack of public spirit. On the other hand it is equally unwarranted to assert that the use of the trade acceptance by the business men and bankers in the United States is impracticable, or that its adoption makes for bad and unsound business habits.

Why should anyone who sells goods for cash be expected to change his method and attempt to sell his goods on long term credit for the mere satisfaction of using trade acceptances, unless he finds that the cash discount which he offers, in order to avoid the granting of credit, is so heavy that it would pay him better to make the change, or unless he finds that in particular cases he may render a public service by permitting his purchasers to pay by trade acceptances.

While, therefore, we readily concede that it is foolish to believe or to argue that the trade acceptance should be used in settlement of any and all business transactions, it is equally foolish to deny that hundreds of millions - some estimate      billions of dollars - worth of goods are sold today on so called "open accounts", and wherever that is done there can be no vestige of doubt that it makes for better business methods when seller and purchaser agree upon a definite obligation to pay on a certain date and express this in a negotiable instrument, permitting the seller to finance himself on favorable terms for the period of the credit granted by him to the purchaser of his goods.

The Trade Acceptance Council informs me that there are today over 4,000 firms that have adopted the trade acceptance, and the list of these firms embraces concerns of great importance as well as small houses. It includes the

flour mills of Oregon as well as the lumber mills in Florida. During the last month two trades of great importance have declared themselves in favor of using the trade acceptance. The Raw Silk Trade Council passed a resolution that "On and after July 1st, 1918 all raw silk, except for transactions based upon Bankers letter of credit or the drawing of foreign drafts direct upon the buyer, shall be sold, or contract of sale made with buyers, without any exception whatsoever, upon terms of cash settlement, prompt or within ten days, or trade acceptance, if other than cash terms are agreed upon. Such trade acceptances are to be given by the buyer to the seller within not later than thirty days from date of invoice. All trade acceptances shall be made payable at a bank, located preferably at a free or discretionary point, otherwise the cost of collection is to be charged to and paid by the acceptor". The buyer is not, however deprived of the privilege of offering cash less proportionate discount, at the rate of six per cent per annum, in settlement of an invoice calling for trade acceptance, but he must do either one or the other within thirty days from the date of the invoice rendered.

This change of terms is made on the conviction that the adoption of the trade acceptance method of settlement will eventually work out to the benefit of both seller and buyer.

The circular sent out giving notice of this agreement is signed by thirty-six of the leading firms in the silk trades.

A highly important action was taken on June 8th at a meeting of a Committee, appointed on May 4, by the National Association of Cotton Manufacturers, representing spinners, cotton shippers and bankers. Governor Harding was present at the conference. A resolution was unanimously adopted, recommending that in addition to present facilities, the bankers' acceptance and the trade acceptance

be used whenever practicable and as far as possible in financing next season's cotton crop.

These developments speak for themselves.

Moreover it is of no small significance that other countries, whose financial methods (since the adaption of the Federal Reserve System) we are approaching more and more, are using the trade acceptance almost exclusively. It is inconceivable that in these countries the trade acceptance should so excellently serve its purpose if it were really as devoid of merit as its critics assert.

About two years ago I had the honor of addressing the Credit Men's Association at a meeting in New York upon the topic of the trade acceptance, and since then so much has been said about the advantages in the use of that method of financing that it would be needlessly taxing your patience were I to undertake to demonstrate again to you that the trade acceptance, when properly used, turns a frozen asset into a liquid one, and that the firm which organizes its business on the basis of the trade acceptance is placing itself in a very much stronger position than its competitor who refuses to modernize on the same lines. It would be needless repetition were I to reiterate the other arguments with which you are familiar. It may, however, be useful to analyze this question: Why is the adoption of the trade acceptance so vigorously opposed by some bankers and business men? Let us consider first the reasons given by the bankers: Some bankers assert that in buying a promissory note the mere fact that they are conscious of buying the naked note of a customer furnishes a reason for their feeling obliged to carefully analyze the statement of the customer and to judge the merit of the borrower upon the statement of the latter's financial condition.

They allege that this practice is safer than that of purchasing a trade acceptance issued by the same firm because, as they say, in that case they are likely to rely on the legitimate character of this double name paper without examining as cautiously as they otherwise would the general condition of the borrower; the likelihood of their adopting that course, they urge, might lead to the manufacture and sale of fictitious accommodation acceptances on the part of their borrowers, and they cite experience in support of their contention.

Other bankers state with great force that they are opposed to the trade acceptance because they would not feel justified in continuing to buy the single name paper of a borrower who has adopted the habit of selling his trade acceptances. The reason given for this view is that whoever buys a trade acceptance acquires the first lien on what would otherwise have represented one of the accounts receivable of the concern which drew the acceptance, and in addition to that lien, in case of bankruptcy of the drawer of the acceptance, the holder of that acceptance would rank equally with the unsecured noteholder as a general creditor for any part of the acceptance which the acceptor might not have paid. As you can readily see, it is impossible that both of these opposed views should be correct; one banker asserting that he will not buy trade acceptances because he does not think they are safe enough, the other that he opposes the trade acceptance because it is so good as to render unsafe the purchase of

- 6 -

single name paper of any customers having sold trade acceptances. Which of the two arguments is sound? To my mind neither. It has never been contended by the champions of the trade acceptance that these acceptances should be bought by anyone who has not familiarized himself thoroughly with the financial condition of the maker of the paper; he should take this precaution just as if he were buying a single name note and as long as he does that there is no reason whatever why he should not be capable of judging solvency and standing from the statement of a borrower who sells the trade acceptances he receives just as he can today from the statement of a firm which borrows only on its own note. Indeed - one of the main virtues of the trade acceptance is that it clarifies the statement, inasmuch as it shows on the asset side exactly how much there is available in liquid items, amongst which are the trade acceptances funds owned, against outstanding liabilities. If the borrower wishes to obtain/ on his single name note, in addition to trade acceptances sold (which would be shown as a contingent liability), he would have to satisfy the banker that these funds are required for temporary working capital or for the purchase of material used in the process of manufacturing; unless, indeed, the borrower were paying for the purchases by giving his own trade acceptance.

In the latter case the trade acceptance would show as an obligation on the liability side.

This leads us to the objection made by the banker who is unwilling to buy the single name note of a firm which sells trade acceptances. The Canadian and European methods indicate, I believe, the proper answer. In Canada and England and on the European continent it is quite customary for banks to grant a customer an overdraft credit. Such a "line" repre-

- 7 -

sents the sum on which the customer may count with fair regularity. In addition to that, the Canadian bank will buy freely the customer's trade acceptances, though of course within given limits. Generally speaking, it may be said that if the customer be strong and solvent, and if he be considered fairly conservative in choosing his purchasers, the bank will be found ready always to buy a handsome amount of trade acceptances in addition to the regular overdraft granted, relying on the fact that even in case of insolvency on the part of the customer the larger percentage of these trade acceptances will usually be paid, the risk being so largely divided.

When our banks begin to look upon the trade acceptance from this, let us call it, Canadian point of view, I think they may well conclude that it is perfectly proper and safe for them to buy a certain amount of single name paper (corresponding to the overdraft) and in addition to take a liberal amount of the customers' trade acceptances, provided they use care in scrutinizing the statement of the borrower. I believe many of them will be willing to admit that the flagrant cases cited by them of losses on fictitious trade acceptances were those where the bankers neglected to ask for or to insist on getting the customers' statement. It may be timely for me to add that since the beginning of the operations of the Federal Reserve System, the Board has done all in its power, by regulation and admonition to insist on full and frank statements on the part of business firms, as well as of banks, and bankers themselves. In banking and business the greatest safety lies in publicity and frankness.

I am willing to admit that I have a lingering suspicion that certain banks which oppose the trade acceptance may be somewhat influenced by the fact that single name paper offers a better interest return than the trade

acceptance. I am glad, however, to state my belief that the vast majority of the banks take a different point of view in this respect, and that to them the facts that the trade acceptance has been recognized as a preferred type of paper by the Federal Reserve Banks and that it has a wider and more favorable market than single name paper, are of sufficient force to make them very willing and even anxious to buy these trade acceptances in spite of the lower interest return, just as they buy, by preference, bankers' acceptances on account of the greater liquidity of the latter, even though at present such acceptances net only  $4\frac{1}{4}\%$  as against the commercial paper rate of  $6\%$  or more.

Now let us examine the reasons why some business men oppose the development of the use of the trade acceptance. Some, I believe, fight it because they are jealous of maintaining their business on a cash basis - that is to say, they are willing to pay even a high premium in order to avoid the cares and risks of sales on credit. That is a question which every business man must decide for himself, and, as I said in the beginning, we should not attempt to force anyone to do anything in this respect that he does not consider to his own best advantage. It is impossible, however, for me to understand why any business man should be alarmed, or excited, because of the use of the trade acceptance by others who are obliged to sell their goods "on open account". Valid objections could be raised only by one of two classes of business men: -weak or unreliable purchasers who object to binding themselves to a definite obligation to pay on a certain date (in which case, however, the reasons for the opposition on the part of the purchaser ought to be the very arguments for the preference on the part of the seller); or certain firms of great



financial or commercial strength, who desire to preserve their position of advantage as against weaker competitors. When borrowing on its own note, the strong firm, with well established credit, can obtain larger loans and on more favorable terms than its small competitor, and it is, therefore, in position to finance its purchases and its sales on a more favorable basis than the small firm. It gains the advantage both as to the larger scope of business it can do and the lower interest rate it enjoys. True, it could probably do a larger business than at present by adopting the trade acceptance plan, but by thus adopting the trade acceptance basis small firms would probably profit more in proportion than the larger ones; -their handicap would be lightened.

The general use of the trade acceptance is likely to tend towards greater standardization of banking paper and greater equalization of interest rates, and I am inclined to think that we might call it a step towards greater democracy in commerce and banking. That is one of several reasons why the Federal Reserve Board favors the policy of granting a preferential rate for trade acceptances. But, speaking broadly, the Federal Reserve System is interested in seeing the business of the country done on the soundest possible basis. Whatever makes for prompt payment may be considered an actual gain at a time when our efforts must be bent upon saving as much as possible, not only in material and labor, but also time and credit.

It is one of the most difficult problems at this juncture when hundreds of millions of dollars have to be shifted every day, to shorten the many circles in which it travels, not only in the large operations of the government, but in every individual transaction. It is in the general

interest that money paid out for wages and material return as fast as it can to the producer when his goods are sold. Pending the return of the monies due to him he must rely on bank credit, which naturally is limited, and consequently he has to adjust the scope of his operations to the speed with which his "turn-over" can be completed. The trade acceptance plays a most important part in this respect. By securing trade acceptances, even though he may hold them to maturity, the manufacturer can figure with greater exactness what are his obligations and his available cash assets, and, by removing elements of uncertainty, he is enabled to carry on a larger business and to do it in greater safety.

At a time when so much depends upon using every possible advantage in order to speed up production, so as to avoid an unnecessary tie-up of funds, the use of the trade acceptance may be considered a contribution to the national welfare. It must not be said that whoever fails to use the trade acceptance is unpatriotic, but it may be said that it is essential that every one do what lies in his power to remove anything that stands in the way of securing the greatest possible efficiency of our country at this time, and anything done in this direction is patriotic.

It has lately been explained to me that canneries are facing a rather difficult situation, inasmuch as all prices for cans, boxes and wages have risen so much that during the coming canning season the credits usually available for the canneries may not be sufficient, the amount of money involved having doubled and the 10% limit in many cases prohibiting the country banks from providing locally the necessary advances. In discussing this problem and trying to suggest means of relief, I asked the question "How do the canneries pay for their cans and their boxes?" I was told that they pay cash.. I inquired "Could not the can manufacturers take trade acceptances in payment for their cans?". The answer was that

- 11 -

the can company must pay cash itself for the tin that it buys from the steel manufacturer; that possibly next year something of the sort might be arranged, but that for this season it would be too late. I did not have the time to look further into the matter, nor is it my intention to venture any opinion as to whether or not it might be practicable for these important companies to change their methods of selling their goods. No doubt they consider themselves better protected in selling for cash and probably they control the market sufficiently to enable them to insist on cash terms. On the other hand, it is clear from the situation that I have described that great relief could be given in this particular case to the canneries, -provided, of course, that their credit warrants it - if they could be permitted to pay for their tins and their boxes by 90-day trade acceptances. The process of canning is so rapid that probably even a shorter term than 90-days of credit might prove sufficient. As soon as the <sup>process</sup> canning is completed, I am told, the canners are able to secure their loans by warehousing and pledging their finished product, and the difficulty of financing is overcome. But for the short period of the peak of the load the use of the trade acceptance might be of the greatest advantage to them.

Facilitating the process of manufacture of food products is certainly a service which contributes to the national interest at this time, and, while I have mentioned this case merely for the purpose of illustration, I hope that it will not be taken amiss if I venture to urge the large industrial concerns in dealing with this question not to consider it exclusively from the point of view of what is to their own best advantage, but to bear in mind that in many cases they have the opportunity of

rendering a distinct service to the national interest, an opportunity which, when once clearly recognized, they will not wish to miss at this juncture.

In this connection, it may be useful to remind you of a ruling given by the Federal Reserve Board (printed in the March 1917 Federal Reserve Bulletin) to the effect that a trade acceptance, if drawn within reasonable time after the shipment or delivery of the goods, may be considered as a bill of exchange drawn against actually existing value, so that a national bank may buy such trade acceptances from its customers even after it has reached the limit of 10% of its capital and surplus, which constitutes the maximum credit such bank may grant a customer on his single name note. In view of the greatly increased price of practically all goods and the consequent larger amount of money involved in production, the facility thus afforded by the use of trade acceptances may prove of the greatest service, as you may readily see from the problem of the canneries just described.

Great efforts are being made at present to reduce bank loans as far as possible where they are made for the carrying on of business transactions not strictly compatible with the public interest - that is to say, not absolutely necessary for the successful prosecution of the war or the health and necessary comfort of the people.

- 13 -

The single name note easily serves as "camouflage" . It is very difficult to trace exactly what transaction is being financed by any particular note. The trade acceptance, on the other hand, bears on its face the evidence of its legitimate character - it is capable of proving a most convincing "alibi" where there is doubt as to the purpose for which the proceeds have been used, and it may, therefore, be a great help to the banks in carrying out the national object of conserving to the utmost material, labor, transportation and credit.

It may be proper for me to avail myself of this opportunity of pointing to the great importance to the Federal Reserve System of finding ways and means of discriminating between essential and non-essential credits. The great speed with which new dollar values are being created at this time and the enormous demand of governments for goods render it imperative that we counteract the resulting inflation of prices by setting the brakes upon every unnecessary use of credit or material. Normally these brakes would be applied by enforcing higher interest rates. In view, however, of the necessity of keeping the money market in a condition of sufficient ease to enable the government successfully to carry through its vast financial operations, it would be to the greatest public advantage if contraction of credit could be brought about by voluntary discrimination rather than by the compulsion of higher rates. May I enlist, therefore, your earnest interest and hearty co-operation in this most important phase of "War Economy"?

Owing to the Government's heavy demands upon the investment market it has become very difficult for industrial corporations to raise money

on reasonable terms through the sale of securities. This is a source of embarrassment felt more keenly by the large corporations, which normally depend upon the securities market for their financing, than for the smaller concerns normally operating upon bank credit. In consequence a good deal of pressure has been brought to bear upon the Federal Reserve Board by these corporations in order to enlist its interest in securing legislation permitting the rediscount of notes secured by bonds or stocks. The Board could not possibly favor such a step since it would tend to undermine the liquid character of the Federal Reserve Banks' investments; but it encouraged these corporations to study carefully the question whether it would not be possible for many of them to avail themselves of the facilities of the Federal Reserve Banks by financing some of their purchases or sales in the form of trade acceptances. In some cases that has been done; before long it is likely to be done on a much larger scale.

As the war proceeds an increasing burden will be placed upon the Federal Reserve Banks. The rapid increase of deposits and loans, <sup>of the banks of the country,</sup> which we must look forward to as incidental to the unparalleled scope of war expenditures, will create a constantly growing demand for means with which to maintain the corresponding increase in the reserve balances required by law. The only reliable key to the Federal Reserve Banks' credit facilities is "eligible paper" and the most liquid paper which outside of the Federal Reserve Banks commands the widest market and the lowest rates is the "Acceptance", be it the bankers' or the trade acceptance. The market for both is certain to grow in importance. On the one hand our banks, and particularly the country banks, will become regular and eager buyers

as they realize in increasing numbers that instead of keeping balances with other banks they do better in holding acceptances which produce a higher interest return and serve at the same time as a reliable secondary reserve. On the other hand several discount companies, recently established, or organizing, will prove important new factors, as purchasers as well as distributors, in widening the market for trade acceptances. A growing volume of such paper, coupled with a growing habit on the part of the banks of investing therein, will furnish an additional and most valuable element of safety in the present emergency, and it is sincerely to be hoped that the banks and the business men will join their efforts in promoting the widest possible use and development of this important means of exchange.

There has been quite a prolonged discussion as to whether the community of the buyer or the seller should carry the trade acceptance; indeed the critics of the trade acceptance state as one of their objections that it is apt to throw the burden of financing primarily upon the seller's community. The truth of the matter is, however, that in case a wide market is developed for bankers' and trade acceptances, they will be carried by that community which is the most eager to invest its funds, be it the seller or the buyer's community, or one that is neither the one nor the other. It is one of the main virtues of the acceptance system that it makes for greater fluidity of credit. Instead of permitting one section of the country to become overloaded in consequence of local seasonal requirements, absorbing all available cash resources, bankers' and trade acceptances bring relief by flowing into discount markets of other districts where money is more plentiful. The adoption of the plan of financing the coming cotton crop largely through bankers' and trade acceptances ought to result in greatly easing the burden to be carried by the South during the coming season.

In closing, may I be permitted, on behalf of the Federal Reserve Board, to express its genuine and warm appreciation for the excellent work done by the Trade Acceptance Council. For the benefit of the country you have unselfishly undertaken a difficult task, a campaign of education, which requires energy, consistency, patience, intelligence and tact. The trade acceptance can win only if the particular characteristics and requirements of each trade are studied carefully and sympathetically; only where a basis can be found which permits the adaptation to the use of the trade acceptance without undue violence or harm may we expect quick and permanent success. In meeting all these ~~agencies~~ your Council has shown itself fully equal to its task.

From experience of my own, I believe I may safely say that nobody knows better than members of the Federal Reserve Board that campaigns of education in banking exact a maximum of patience and persistence. The very experience, however, of the Federal Reserve Board will, I hope, serve as an encouragement to the Trade Acceptance Council.

There was as much active and passive resistance to the adoption of the bankers' acceptance as there now is exhibited in opposition to the trade acceptance. Today no one doubts any longer that the bankers' acceptance has come to stay and that it has proved its worth as one of the most important media of exchange, an additional element of strength, and an indispensable component part of the vast structure of liquid assets upon the solidarity of which the safety of the Federal Reserve System and with that the safety of the country is predicated.

If the trade acceptance, in years to come, should occupy a similar position and render a similar service - as I hope and trust it will - the Trade Acceptance Council will enjoy the keen satisfaction of having done its full share in a development so greatly to the benefit of our country.