

THE NATIONAL BANKS IN WAR TIME. -- THEIR PROBLEMS AND WORK.

FROM AN ADDRESS OF W.P.G.HARDING,
GOVERNOR OF THE FEDERAL RESERVE BOARD,
BEFORE THE NATIONAL BANK SECTION OF
THE AMERICAN BANKERS ASSOCIATION AT
CHICAGO, ILL., WEDNESDAY, SEPTEMBER
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In these stirring times our thoughts are constantly with our sons and brothers who are in the fighting lines in France, or who are keeping watch upon the high seas. We are thrilled by the accounts of their military prowess, our hearts are gladdened by their constant advance against a formidable enemy and we are inspired by their courage and unswerving determination to overcome the enemy.

Within a short while there will be more than two million men in khaki on the other side to support the gallant troops of England, France, Belgium, Italy and Greece, and the Czecho-Slovaks, in their battles to free the world from the curse of German militarism and autocracy;

-2-

and we know that their numbers will be steadily increased until the full fruition of our hopes and aspirations shall have been attained. But human activities in this great war are not confined to the military fronts; the battle lines are not alone in Siberia, in the Balkan Peninsula, in northern Italy, in Lorraine, Picardy and Flanders, but they extend throughout the civilized world. There is an American front, manned by millions of men and women who constitute the great home guard, and who must furnish the munitions and supplies and the transportation facilities for those who are actually exposed to the shot and shell and poisonous vapors of the enemy. Without the work which is being done at home, and which must be carried on in constantly increasing measure, the efforts of our soldiers and sailors could not be long exerted.

Important sectors of our home front are held by the bankers of America, who are on the financial firing line, and it is of their work and of their problems which I wish to speak today. The national banks of the United States have in other times and in other wars proved their loyalty and efficiency. In fact they were born in the midst of the convulsions of a country torn by civil war and their creation is due to the desperate needs of the nation in those dreadful days.

Through the establishment of the national banking system not

-3-

only was a market afforded for United States bonds, but facilities were provided for the issuance of a national currency capable of circulating without discount in all sections of the country. So rapidly did the national banking system grow that in 1865, shortly after the close of the Civil War, there were 1517 national banks, having aggregate assets of \$1,359,867,074, included in which were United States bonds to secure circulation of \$272,634,200. and about \$75,000,000 government bonds held as investments.

In 1898, when we were at war with Spain, consciousness of our banking strength undoubtedly had much to do with the ease with which \$200,000,000 of 3% bonds were sold to the public at a substantial premium; but the national banks coordinated under the Federal reserve system are now engaged in the most stupendous work they have ever undertaken, and in according to the national banks their meed of praise, I do not wish to slur nor underestimate the importance of the work which has been done by the state banks, savings banks and trust companies as well. There is no question, however, that through the operation of the Federal Reserve system the vast fiscal undertakings of the government have been successfully carried out thus far without any undue disturbance to our financial structure and without a money panic of priests of any kind.

For three years the burden of supporting the Federal Reserve

system was borne almost entirely by the national banks, - all through those times when many of the banks could not perceive that any substantial benefit would be likely to enure from membership, and when stock in the Federal Reserve banks was looked upon as a dead investment. Even a year ago, five months after the United States had entered the war, there were only 86 non-national banks which were members of the Federal Reserve system. It is gratifying to note however, that henceforth the responsibilities and privileges of membership will be shared by the state institutions which are now coming over in constantly increasing numbers and that today about 750 state banks and trust companies are members, with total resources of nearly six and three quarters billions of dollars.

The problems of the American banker have always been more complex and difficult than those of banks in other countries and their work is more varied and exacting. This is due, in part, to our wide expanse of territory and to the amount of pioneering which has to be done incident to the building up and development of a new country. It is due also to the fact that the spirit of American institutions demands independence of action and that the tendency in this country has been toward a large number of independent banking units, most of them of small and moderate capital, rather than toward a compact group of highly capitalized banks conducting their operations throughout the

-5-

country through the medium of branches. The need of some means of coordinating this large number of independent banks, of reserving a portion of their resources for the common defense of the financial front, the necessity for providing a more elastic currency which could expand and contract in accordance with business requirements, and of establishing a broad discount market, are some of the causes which led to the establishment of the Federal Reserve system. It is not my intention, however, to attempt to discuss your routine work or your every day problems, but I wish instead to touch upon some of those questions which confront you, and those militant duties which are imposed upon you, in your work of holding the financial trenches in the great battle now raging for liberty and civilization.

The Liberty Loan organizations are about to begin the campaign for the fourth Liberty Loan. The success of this campaign depends upon the cooperation of the banks, - not upon a half-hearted or complacent acquiescence on their part in the plans adopted, but upon their active, incessant and aggressive cooperation, given in a genuine American spirit worthy of the cause for which the loan is to be raised. For weeks past most of you have been taking your allotments of Treasury Certificates of Indebtedness which are issued in anticipation of this loan, just as you have done in the case of the certificates which anticipated previous loans. In order to meet

your allotments you have been obliged no doubt to reduce your regular discount lines and to decline to take paper which, in ordinary circumstances, would have been attractive to you. But you have made it possible for the government to meet its financial requirements and you have also provided means, to the extent of certificates held, of taking care of the payments that you will be called upon to make for the Liberty Bonds which will be subscribed for by your customers. The opinion and advice of every good banker on financial matters is constantly being sought; your influence is great, and your value as an educational force is incalculable. Banks are the great distributing agencies through which the bonds pass into the hands of the public and it is desirable, wherever practicable, that the bonds should be placed with the customers of banks, and with those who are not depositors, rather than taken for investment by the banks themselves. But it is expected, of course, that banks will do their full part in placing the bonds in the hands of the public, by continuing their practice of lending freely against bonds as security, calling in turn upon the Federal Reserve banks for such assistance as may be needed.

The Liberty Loan is essentially a popular loan. No issue since the first has full exemption from income taxes. The second,

-7-

third and fourth loans therefore, pay a higher return in the hands of men of moderate means than they do when held by the millionaire. The discount rates at Federal Reserve banks are so adjusted as to enable banks to lend at approximately the rate borne by the bonds, with a small margin of profit. Previous issues have been widely distributed, and each issue has shown a larger number of subscribers than the preceding one, the number in the case of the third Liberty Loan being more than 17,000,000. The Comptroller of the Currency is authority for the statement that of the total amount of bonds issued up to this time only 4% were held on June 29th as investments by the national banks, or 2.29% of their resources, while they were carrying at the same time loans secured by Liberty Bonds amounting to \$475,000,000, or 2.56% of their resources.

The Federal Reserve Board, from the time when it became evident that this country would be forced into the war, has spared no pains to fortify the position of the Federal Reserve banks, in order to enable them to meet all legitimate demands which may be made upon them and to render the greatest amount of assistance to the member banks in the performance of their war time duties to the government. Upon the recommendation of the Federal Reserve Board, Congress amended the Federal Reserve Act in several important particulars on June 21, 1917. The effect of these amendments has been to bring into the system a large number of state banks, besides enabling the Federal Reserve banks more effectively to control the country's gold which had been widely diffused, having been

X-1214

-8-

used for purposes of circulation and held in vaults of member and non-member banks. As you know, all the lawful reserves of member banks are now kept on deposit with the Federal Reserve banks, and as Federal Reserve notes may be issued without limit against deposits of gold or gold certificates, the gold holdings of the Federal Reserve banks have ^{been} augmented to an amount exceeding \$2,000,000,000, and the discounting power of the Reserve banks has thereby been greatly increased. Both the member and non-member banks have been urged repeatedly to transfer their gold as it accumulates to the Federal Reserve banks, and the appeal has not been in vain, for the response has been very general and gratifying. In the vaults of the Reserve banks gold is available either as a basis of new note issues or as a means of extending their loaning facilities, while in circulation or distributed among the 25,000 or more commercial banks, it is of no more value than any other form of currency. There still remains in circulation and in bank vaults however, about \$900,000,000 in gold certificates and coin, most of which can be deposited and should be deposited, their place to be taken as far as necessary by Federal Reserve notes. In mobilizing the gold of the country into the vaults of the Federal Reserve banks, it is not the intention to increase the volume of loans beyond the amount actually required, but these are war times, and any inability on the part of Federal Reserve

-9-

banks to respond to legitimate demands made upon them would be disastrous. It is clear that in proportion as the gold holdings of the Federal Reserve banks are increased, the ability of such banks to extend accommodation to other banks or to issue notes is enlarged. As reserve holdings are curtailed, the lending power of the banks is correspondingly reduced.

The national banks of the country can render good service at this time by informing the people in their respective communities of the absolute falsity of the statements which have been made occasionally and which appear to be the result of a deliberate propaganda, that it is the intention of the government to confiscate bank deposits. Such a statement is absurd upon its face, but is well calculated to alarm the ignorant, and, although it has been denied and denounced in the strongest terms by the Secretary of the Treasury and other high authorities, it is evident, from the proportion of the money paid out every week in payrolls which does not return to the banks, that large amounts in the aggregate are being hoarded or carried upon their persons by workmen who are now receiving unusually high wages. Banks should give especial attention to the problem of bringing into sight any money hoarded in their communities, and should urge its investment in war savings stamps or

-10-

Liberty Bonds, as well as the establishment of bank accounts. There is good reason to believe that the present is an opportune time, in industrial communities especially, for organizing systematic campaigns for bringing concealed money into the vaults of the banks, or for effecting its exchange for government obligations.

One of the most important functions of any bank is the granting of credits. This is a power which should be exercised with prudence and discretion in any circumstances, but under present conditions there are many new and perplexing features to be considered. As the paramount business of this country at present is war, and as the government is the largest purchaser of all essential commodities, it is clear that the banks of the country should do their part, not only in aiding the government to obtain the funds and credits needed, but that they should so readjust their own lending operations as to contribute most effectively toward supplying the government with necessary articles and commodities. Therefore the question of credit conservation has been a vital one for months past. War expenditures are essentially different from any which are ordinarily made in times of peace. Instead of contributing toward a permanent addition to the national wealth, the large payments which the government is making for the maintenance and equipment of our military and naval establishments involve waste and destruction, -- inevitable concomitants of war.

-11-

This process necessarily tends to inflation, which, together with concentrated demand and the need for quick deliveries, brings about rapid advances in the price of necessities. Infinities such as are dealt with in higher mathematics, have no place in the arithmetic of war financing, even though the figures run into the billions. The supply of credit, of goods, and of man power is limited, and as far as possible these resources should be conserved and set aside for the use of the government, whose abnormal demands -- inevitable and necessary in the present circumstances -- must be counteracted by greater economy on the part of our civilian population, whose efforts should be directed toward decreasing the normal waste incident to our business pursuits and to our every day life.

Credit extended for non-essential purposes involves the use of labor, of transportation, of material, and of reserves which ought to be kept free for purposes of the government. Unrestricted credit means unnecessary competition with the government, and tends to impede and delay its operation, and needlessly advances prices.

At a time when the supreme business of the country is war, it is idle to talk of business as usual, for our accustomed business and personal habits cannot in many cases be continued without interfering with the government's work and the consequent infliction of serious injury upon the nation. Uncle Sam, at this time, is a world banker -- he is extending credits in large amounts to foreign

-12-

countries associated with him in the war and his power to continue to play the part of "Uncle" in the financial sense depends upon the extent of his resources in men, goods and gold, and the avoidance of unnecessary credit. Needless recourse to the facilities of the Federal Reserve banks weakens proportionately his gold reserve, and this gold reserve is the financial backbone of civilization. Any waste of the raw materials and manufactured products of the country adds to our financial burdens by increasing the amount which we must import from other countries, and such waste at the same time reduces the volume of goods which should be available for export purposes — the best means of paying for imported commodities.

The far sighted banker does not content himself by considering merely present problems, but he turns his eyes to the future and endeavors to lift the veil in order that he may see the shadow of coming events and make his plans accordingly. Many thoughtful bankers feel, therefore, that the preservation of our economic strength is of the greatest importance in making provision for that period of readjustment which will follow inevitably the re-establishment of peace. By refraining from buying luxuries and by restricting the use of necessities to the actual requirements of health and reasonable comfort, a reserve purchasing power can be created which

-13-

will be of the greatest value in bridging over our industries during the period of reaction and reconstruction which will follow the war, when "swords will be beaten into plow shares" and Mars will give place to Mercury and Ceres.

An intelligent and prudent use of credit will be an important factor in strengthening the national resources during the period of the war, in aiding its successful prosecution, besides maintaining our economic strength for the time when our armies will return to the employments of peace. It is important, however, that a wise discretion should be exercised and that there should be a careful discrimination between essential, less essential, and non-essential credits.

It is difficult to suggest any fixed and definite rule to govern in distinguishing between these various classes of credits. A loan might be desired for what appears at first glance to be a non-essential purpose, and yet failure to obtain the credit might create a condition which might indirectly have a distinctly harmful effect upon the ability of productive enterprises in the community to obtain credit. It is important, therefore, that bank officers should inform themselves as to the ultimate use to which the proceeds of a proposed loan will be diverted. Present conditions

-14-

fully justify the banks in taking such steps as may be necessary to restrain speculation, but at the same time, a general refusal to make loans on good security would seriously impair the liquidity of investments and would force liquidation which might disturb very seriously the whole financial situation. It is important to avoid sharp and radical readjustments of credit and wherever possible lines should be reduced without undue hardship to the borrower or without causing a shock which would render the granting of necessary credits more difficult.

The problem of non-essential credits is, however, not entirely one for the consideration of the banks. The question will be determined for them in many instances by the Capital Issues Committee and by other governmental bodies such as the War Industries Board, which has large powers in the determination of the character and quantity of production and of priorities in the delivery of materials and goods.

In normal times great enterprises and large developments are the result of credits previously arranged by bankers, but the military necessities of today have changed the order so that in many cases developments are predetermined, and bank credits are adjusted to conditions instead of creating them, thus becoming an effect instead

-15-

of a ~~cause~~. Your problems gentlemen, are by no means confined to placing proper restrictions upon non-essential or less essential credits, but they include means of sustaining through adequate credits, the vast number of enterprises and industries whose operations are essential or contributory to the conduct of the war and to the health and necessary comfort of the public. In addition to direct advances to the government, you are being called upon to furnish funds for use of the mercantile community and for the payrolls of mining and manufacturing and transportation companies, and for the production and movement of crops and livestock. In these operations you will find your membership in the Federal Reserve system of the greatest value, for not only can you rediscount freely with your Federal Reserve banks the notes which represent your loans in most of these transactions, but you can effect through these banks such exchange transfers as you may desire and can call upon them to send you any currency that you may need. Shipments from Reserve banks or branches can reach most of you within twenty-four hours, and in order to facilitate your transactions and to encourage a freer movement of domestic exchange, serious consideration is now being given to having the Federal Reserve banks absorb all costs incident to transfers of currency for member banks, both from and to Federal Reserve banks. You have also recourse to the War Finance Corporation, which is authorized to make advances

-16-

to banks, bankers, or trust companies, and to savings banks, upon terms and conditions set forth in Sections 7 and 8 of the War Finance Corporation Act.

Your attention is directed to the great importance of increasing our supplies of food stuffs, of cotton and wool, of coal, and of all manufactured articles of an essential character, and it is hoped that you will extend your credit lines with this object in view as far as may be consistent with the principles of sound banking and business prudence. While it is desirable that you should remain free to exercise your own discretion as regards ^{the security of loans and} the details of your business, it is necessary nevertheless, that we should all work together in carrying out a general policy. The exigencies of the times require that banking policy must be determined in Washington to a greater extent than would normally be the case, but every confidence is felt that the splendid patriotism which has been manifested in the past by national bankers in the hour of the nation's peril, ^{continue to} will be exhibited today when our country is engaged in the greatest war of all history, and that through your cordial and effective cooperation complete victory will crown our military undertakings, to be followed by a lasting and American peace.