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ADDRESS REPLY TO
FEDERAL RESERVE BOARD

November 24, 1920.
X-2071

Subject: Agricultural Implement Paper.

Dear Sir:

The Federal Reserve Board receives from time to time inquiries with reference to the eligibility for rediscount by Federal Reserve Banks of paper arising out of the purchase of agricultural implements and farm machinery of various kinds. In view of these inquiries the Board has made the following ruling:

Definition of Eligible Commercial and Agricultural Paper

The regulations of the Federal Reserve Board define eligible commercial and agricultural paper as notes, drafts or bills of exchange which have been issued or drawn, or the proceeds of which have been used or are to be used in the first instance in producing, purchasing, carrying, or marketing goods (including goods, wares, merchandise or agricultural products, including live stock) in one or more of the steps of the process of production, manufacture or distribution. If a note, draft, or bill of exchange has been issued or drawn, or the proceeds have been or are to be used, for an agricultural purpose, that note, draft, or bill of exchange may be eligible for rediscount if it has a maturity at the time of rediscount of not more than six months exclusive of days of grace. On the other hand, if a note, draft, or bill of exchange has been issued or drawn, or the proceeds have been or are to be used, for a commercial purpose, it will not be eligible for rediscount if it has a maturity at the time of rediscount in excess of ninety days exclusive of days of grace. The Board's regulations further provide that no note, draft, or bill of exchange is eligible for rediscount if the proceeds have been or are to be used for permanent or fixed investments of any kind, such as land, buildings, fixed machinery, or for any other capital purpose. A copy of the Federal Reserve Board's regulations, Series of 1920, is enclosed, herewith, Regulation A of which deals with the subject of the eligibility of paper for rediscount by Federal Reserve Banks.

Two general classes of Eligible Agricultural and Commercial Paper.

It will be observed that there are two general classes of eligible agricultural and commercial paper, (1) paper which is eligible because issued or drawn for an agricultural or commercial purpose, and (2) paper which is eligible because the proceeds have been or are to be used for an agricultural or commercial purpose.

Notes given in payment for Articles Purchased.

Since the purchase and sale of goods of any character is a commercial transaction from the standpoint of the seller, a note of a buyer given to the seller in payment for articles purchased is a note which has been "issued or drawn" for a commercial purpose. Such a note may, therefore, be eligible for rediscount irrespective of whether or not the articles purchased will constitute a permanent or fixed investment in the hands of the ultimate producer. This is true whether the buyer is a dealer, purchasing articles for re-sale, or is a farmer purchasing articles for his own use.

Notes the Proceeds of which are used to Purchase Articles.

If a note is not "issued or drawn" for a commercial or agricultural purpose, its eligibility or ineligibility for rediscount must be determined by the purpose for which the proceeds have been or are to be used. The use of proceeds to purchase goods for re-sale is a commercial purpose even though the articles are of such a character that they must be considered permanent investments in the hands of those who ultimately purchased them. Consequently the note of a dealer discounted by him at his local bank to provide funds to purchase articles for re-sale may be eligible for rediscount as commercial paper irrespective of the character of such articles. A note of a farmer, however, discounted by him at his local bank to provide funds with which to purchase articles for agricultural uses is eligible or ineligible for rediscount according to the character of such articles. The farmer's note is ineligible for rediscount if the articles are in the nature of a permanent or fixed investment, but on the other hand if they are articles which are for agricultural uses and which have to be replaced from time to time the farmer's note may be eligible for rediscount as agricultural paper.

Articles in the Nature of Permanent or Fixed Investments.

Whether or not given articles are in the nature of permanent or fixed investments as that term is used in the Board's regulations, is a question which depends upon the circumstances in each particular case. The Board has ruled that farm tools, agricultural implements and machinery, and other farm operating equipment do not constitute permanent or fixed investments when they are of such a character that they have to be replaced within a comparatively short time, so that it may be assumed that a farmer will have to spend a certain amount of money annually and regularly for the purchase and replacement of equipment of this kind (F.R. Bulletin, Feb. 1916, page 67). So also, the Board has specifically ruled that a tractor, like horses and mules, bought for farm work and purchased with several years' use in view, does not constitute a permanent or fixed investment, and that a note, the proceeds of which are used to pay for such a tractor, may be eligible agricultural paper. (F.R. Bulletin, Apr. 1918, page 309). On the other hand, the Board has ruled that a silo is a permanent or fixed investment and that a note the proceeds of which have been used to build a silo is not eligible agricultural paper. (F.R. Bulletin, Oct. 1918, page 971). The Board has also ruled, upon the basis of the facts in the particular case, that an electric system furnishing light and power for an individual farm is in the nature of a permanent or fixed investment within the meaning of the Board's regulations.

Distinction between Agricultural Paper and Commercial Paper

The purchase and sale of any articles or commodities including agricultural products is a commercial rather than an agricultural transaction. Consequently the note of a dealer, whether it is given in payment for articles or commodities purchased for re-sale or is discounted by the dealer at his bank to provide funds with which to purchase such articles or commodities, can be eligible for rediscount only as commercial paper, even though the articles or commodities will be used by the ultimate purchasers for agricultural purposes. Such a note can be eligible for rediscount, therefore, only when it has a maturity at the time of rediscount of not more than ninety days. The note of a farmer, however, given in payment for articles or commodities purchased, may be considered agricultural paper which is eligible for rediscount when it has a maturity at the time of rediscount of not exceeding six months, provided that the articles or commodities purchased are to be used by the farmer for agricultural purposes and are not in the nature of permanent or fixed investments. So also, of course, the note of a farmer, discounted by him at his local bank for the purpose of providing funds to purchase such articles or commodities, may be eligible for rediscount as agricultural paper when it has a maturity at the time of rediscount of not more than six months. Since the purchase and sale of agricultural products is a commercial rather than an agricultural transaction, a note given to a farmer in payment for agricultural products grown by him cannot be eligible for rediscount as agricultural paper, but may be eligible as commercial paper if it has a maturity at the time of rediscount of not more than ninety days.

Same principles apply to Drafts as to Notes.

In the foregoing statements and discussions of hypothetical cases where payment for goods purchased is made by the buyer giving to the seller a negotiable instrument representing the buyer's obligations, it has been assumed for the sake of brevity that the negotiable instrument would be a note of the buyer. As a matter of fact, in such cases the buyer may either make his own note or accept a draft drawn on him by the seller. In either case, however, the same principles will apply in determining whether the instrument representing the buyer's obligation is commercial paper, which cannot be rediscounted if it has a maturity in excess of ninety days, or agricultural paper, which may be rediscounted with a maturity not in excess of six months.

No Obligation to Rediscount Paper even though Eligible.

It should be understood, of course, that even though a bill or note may technically be eligible for rediscount, a Federal Reserve Bank is under no obligation to rediscount it, but may accept it or refuse it in the exercise of its discretionary power.

Yours very truly,

Governor.

To Governors and Federal Reserve Agents.