

X-3198  
September 15, 1921.

My dear Sir:

I acknowledge receipt of your letter of the 12th instant, and thank you for the information given regarding financial conditions in your State.

The Federal Reserve Board has always stressed the importance of sustaining the agricultural and live stock interests of the country and its policies have always been shaped with a view of encouraging member banks to extend all reasonable accommodations to those engaged in these vital industries. I am sending you under separate cover a copy of the Federal Reserve Bulletin for August, 1921 and would invite your attention to a letter which I addressed some time ago to Hon. Reed Smoot, United States Senator from Utah, which appears on the first and succeeding pages of that publication.

The liquidation which has taken place, at least so far as this liquidation is reflected in the statements of the Federal Reserve Banks, shows that the reduction in loans has been mainly in the large cities and in industrial centers. Federal Reserve Banks are not permitted by law to make loans direct to individuals, firms or corporations and they can rediscount only paper which bears the endorsement of a member bank. Consequently, in order for a Federal Reserve Bank to render financial assistance to those engaged in agriculture or the raising of live stock, it is necessary that the loans first be negotiated with member banks. Neither the Federal Reserve Bank nor the Federal Reserve Board has any control over the loan policy of any member bank. We can not compel a member bank to make a loan which it does not desire to make nor can we restrain it from making a loan which is not forbidden by law.

About one-third of the member banks in the Kansas City District have been very heavy borrowers during the past year, another one-third have been only moderate borrowers, while the remainder have not borrowed at all. It is possible that the Federal Reserve Bank may have called the attention of some of the larger borrowers to the advisability of reducing their discount lines at the Federal Reserve Bank, but in no case has the Federal Reserve Bank undertaken to say to a member bank just what particular loans it should call or ask be reduced.

I was formerly in the banking business myself and know something of banking psychology. Banks as a rule do not like to admit to customers that they are short of loanable funds nor do they like to stir up enmity in declining to make loans or in asking for reductions. I know that in many cases they have found the Federal Reserve Bank or the Federal Reserve Board a convenient buffer and have stated to

borrowers or would-be borrowers that they would like to grant extensions asked for or to make loans desired, but that the Federal Reserve would not permit it. Such a procedure has a tendency to relieve the situation as far as the local bank is concerned but it is not altogether fair to the Federal Reserve System. The Federal Reserve Board has repeatedly issued public statements calling the attention of the banks of the country to the importance of granting adequate credits to farmers and cattle men, and while the Federal Reserve Board is not a central bank and can not discount any paper itself, it is assured by all Federal Reserve Banks that they are ready to extend liberal accommodations to all member banks in the way of rediscounting eligible paper.

The functions of the Federal Reserve Board is to define eligible paper in accordance with the terms of Section 13 of the Federal Reserve Act, but the question of determining the goodness of paper offered for discount rests entirely with the directors of the Federal Reserve Bank. I am sending a copy of your letter to the Governor of the Federal Reserve Bank of Kansas City and have called his attention particularly to your statement that your last Legislature passed a grain warehouse law which provides for the taking of receipts for grain that is housed on the farm. You ask if those receipts may not be used as a basis for credit to farmers in Nebraska. The use of such receipts does not affect in any way the eligibility of paper offered for discount and while the usual banking custom in making loans on warehouse receipts is to require that the receipt be issued by some warehouseman entirely independent of the borrower, the question of using farmers' own receipts is one primarily for determination by the bank to which the farmer applies for a loan and secondarily, in case the paper is offered for rediscount to a Federal Reserve Bank, by the officers and directors of the Reserve Bank.

You call attention to the desirability of aiding and encouraging the farmer in the successful conduct of his business through the extension of reasonable credit at a rate of interest that he can afford to pay. The Governor of the Federal Reserve Bank of Kansas City will, I am sure, inform you that the Kansas City Bank is ready to rediscount good and eligible paper for member banks, but neither the Kansas City Bank nor the Federal Reserve Board can require any member bank to make a loan which it does not wish to make and neither the reserve bank, the Federal Reserve Board nor the Comptroller of the Currency has control over the rate of interest charged, provided it is not in excess of the maximum rate authorized by the laws of the State in which the lending bank is located.

I understand that the laws of Nebraska authorize a maximum interest rate of ten per cent per annum. The progressive rate which prevailed for some months at the Federal Reserve Bank of Kansas City was abrogated last June and all rediscounts made by that bank are now at a flat rate of six per cent per annum, regardless of the amount of accommodation extended to the borrowing member bank. I have before me a report of bills discounted for member banks by the Omaha Branch of the Federal Reserve Bank of Kansas City on September 9, 1921. This report shows that 111 notes, aggregating \$1,031,835.09, were discounted for

twenty-one member banks, by the Omaha Branch Bank on that date, all at the rate of six per cent per annum. The report shows also the rate of interest charged the customers by the borrowing member banks. This report shows that in the case of 52 notes the borrowing banks charged their customers 10%, on 21 notes they charged 9%, on 2 notes  $8\frac{1}{2}\%$ , on 14 notes 8%, on 13 notes  $7\frac{1}{2}\%$ , on 5 notes 7%, on 2 notes  $6\frac{1}{2}\%$  and on 2 notes 6%.

Under an ideal operation of the Federal Reserve System, it is not intended that a member bank should make a profit on its rediscount transactions with the Federal Reserve Bank. The object of the Federal Reserve System is to afford a ready discount market but member banks generally, especially in the West and South, seem to have an idea that they should make a profit on such transactions. In some states where the maximum legal rate of interest is six per cent and the Federal Reserve rate is also six per cent, no profit is possible, but in states where the laws permit of rates as high as ten and twelve per cent, there is, of course, an opportunity for a very substantial profit. For example, where a bank in Nebraska is able to rediscount at the Federal Reserve Bank at six per cent per annum paper which it has taken from its customer at ten per cent, the profit is  $66\frac{2}{3}$  per cent. If the paper is taken at nine per cent, the profit is 50%, or if at eight per cent, the profit is  $33\frac{1}{3}$  per cent.

I sincerely hope that banks generally will recognize the fact that by charging lower rates of interest they would be building up their own communities and would in the long run reap greater profit themselves, than would be the case if they should continue to charge all the law allows or all the traffic will bear.

The abrogation of the progressive rate has made it possible for banks in Nebraska to make a large percentage of profit on their rediscount transactions with the Federal Reserve Bank, but the daily statements made to the Board do not indicate that the Nebraska banks, as a rule, have shared this advantage with their borrowers. Is there any reason to believe that in case the discount rate at the Federal Reserve Bank of Kansas City should be still further reduced the Nebraska banks would give their customers lower rates than they do at present?

Very truly yours,

(Signed) W.P.G. HARDING

G o v e r n o r .

Hon. Samuel R. McKelvie,  
Governor of Nebraska,  
Lincoln, Nebraska.

COPY

STATE OF NEBRASKA  
EXECUTIVE OFFICE

X-3198a

Lincoln

September 12, 1921.

Hon. W.P.G. Harding,  
Governor of Federal Reserve Bank  
Washington, D. C.

My dear Sir:

As the result of an inquiry that I have just concluded among Nebraska bankers, I am convinced that financial and business conditions are improving throughout this State, but I am also convinced that there is need for credit relief for the farmers and cattlemen in this territory now, and it is regarding this situation that I address you.

The simple fact is that the urgent demand for liquidation and the contraction of credit during the past twelve months has imposed unusual and extraordinary hardships upon the farmers and cattlemen. In order that these demands could be met, the farmer has taken heavy losses in the sale of grain and livestock. It is true that bank deposits and reserves have improved during this period, but this improvement has been accomplished at the expense of interests that should have been protected and conserved.

The question now is whether this policy of enforced liquidation is to be continued, or whether the farmer is going to be aided and encouraged in the successful conduct of his business through the extension of reasonable credit at a rate of interest that he can afford to pay. You will bear with me, I am sure, while I point out some of the tangible results of the system that has been invoked during the past twelve months.

The losses that have been taken by cattlemen during this twelve months have represented actual financial ruin to many, and the permanence of the cattle breeding and feeding industry in this territory is actually menaced now. In addition to the ruinous losses that have been taken on stock that was properly fitted for market, there has been a very large disposition of partially finished stock, of breeding stock and of young stock that should never have gone to market at all. The injury to the cattle industry from this source will be felt for years to come and something should be done to encourage this industry. As it is now, cattlemen are actually being forced out of business, in

order that they may meet their obligations. Nor does this include merely the speculator or the one who used bad judgment in his operations. It includes the most substantial and forehanded breeders and feeders that we have in this section.

The grain growers have been affected similarly. For instance more than half of this year's wheat crop has been marketed. The price has been around \$1.00 per bushel, and while this would hardly remunerate the farmer for the cost of production, there has been no general complaint against the price. Now the terminal markets are congested and the farmers are being counselled by no less an authority than Hon. Herbert Hoover, Secretary of the Department of Commerce, to withhold shipments. This counsel, however good it may be, could not have been followed had it come even before the wheat crop was harvested, for a very large number of farmers were compelled to sell in order that they could meet pressing obligations. The danger that lurks in this situation is not that the farmer has sold at a price that was not entirely satisfactory, or that the terminal markets have been flooded, but that there is the strong probability of a higher price for wheat before another crop is grown, and should this condition obtain, it is quite apparent that the farmer is not the one who will receive the benefit.

The corn crop in this territory is unusually large, and there is a very considerable percentage of last year's corn crop still on hand. The price ranges around 30¢ per bushel at country elevators. This price is so far below the cost of production that the returns from this year's crop will scarcely maintain the operations of the farmer, to say nothing of meeting the obligations that he is now being pressed to pay. If this corn crop must be forced upon the market as the wheat crop has been, then the price will probably go still lower.

Much of the corn crop will be fed to hogs. If prices continue at a fair level this will afford a source of very satisfactory relief. Some of it will be fed to cattle and this, too, will prove profitable if present prices prevail, but it will take time and credit encouragement to enable this, and I believe that the farming interests of this country have a right to look to the Federal Reserve Bank System for this encouragement.

I am not unmindful of the relief that is being offered now through certain private banking sources, as well as from the War Finance Corporation. These are good and the work that is being done by them should not in any sense be disparaged, but with the Federal Reserve Banks holding 70% of the reserves, it seems apparent that here lies the medium through which additional credit may be afforded at a much more reasonable rate of interest than is now required.

Especial consideration should be shown to the cattle interests, both to breeders and feeders. If this is done, it will also greatly aid the grain growers, for it will afford a profitable outlet for a product that must otherwise be sold at a loss.

Our last Legislature passed the Grain Warehouse Law, which provides for the taking of receipts for grain that is housed on the farm. I am wondering if these receipts may not be used as the basis for credit to farmers in this State.

I do not want to burden you with a further enumeration of these facts, though I may say that I have only touched the high spots. Nor would I have you believe for a moment that I would have the Federal Reserve Bank System encourage an extension of credit that would result in unwise inflation or speculation. Too much of that has been done already. But I would like to see the Federal Reserve System operate as an agency for financial relief at a time when it is most urgently needed. May I be advised of anything that you think may be done to help us out?

Very truly yours,

(Signed) Samuel R. McKelvie.

Governor.