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December 21, 1922.

Honorable George P. McLean, Chairman,
Banking and Currency Committee,
United States Senate,
Washington, D. C.

My dear Mr. Chairman:

The Federal Reserve Board has received your letter of December 7th requesting its views on two bills, S. 4063 and S. 4103, introduced by Senator Capper and Senator Lenroot, respectively, to provide additional credit facilities for agriculture.

The Board has studied these bills very carefully, and desires to express its approval of the general purpose of both of them. Senator Lenroot's bill, S. 4103, appears to be a re-draft of his earlier bill, S. 3051, the enactment of which was recommended in the report of the Joint Commission of Agricultural Inquiry and which received the approval of the Federal Reserve Board in a letter addressed to you by Governor Harding on behalf of the Board, under date of January 26, 1922, a copy of which is enclosed herewith.

Senator Capper's bill, S. 4063, is similar in many respects to a bill, H. R. 11763, introduced in the House of Representatives by Representative McFadden which was commented on favorably by the Federal Reserve Board in a letter addressed to the Secretary of the Treasury under date of July 12, 1922, a copy of which is enclosed herewith. Furthermore, Senator Capper's bill contains features which the Board thought should have been incorporated in H. R. 11763 so as to provide additional credit facilities for agriculture in general as well as for the live stock industry.

The major portion of each of these bills consists of provisions creating facilities for supplying the need pointed out in the report of the Joint Commission of Agricultural Inquiry for agricultural credits of an intermediate type, running from six months to three years, to finance the production and marketing of agricultural products and the breeding, raising, fattening and marketing of live stock.

The Board will confine itself in this communication to the provisions of these bills which amend the Federal Reserve Act or otherwise directly affect the Federal Reserve System. It has studied these provisions with especial care. There are certain comments and constructive suggestions which the Board desires to call to your attention, with a view of safeguarding the elasticity and soundness of the currency issued through the

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Federal Reserve Banks, and also of making the proposed amendments more liberal and practicable.

Both bills would make certain classes of agricultural paper eligible for rediscount by Federal Reserve Banks with maturities up to nine months. The Board calls your attention to the fact that this would in a measure affect the elasticity of the Federal Reserve Note currency based thereon, but believes this might be done if restricted within the limits prescribed in S. 4063.

The provision of Senator Lenroot's bill designed to make nine months paper eligible for rediscount was not in his earlier bill which received the approval and support of the Federal Reserve Board as indicated above. It would amend Section 13 of the Federal Reserve Act by changing the proviso at the end of the second paragraph thereof to read, in part, as follows:

"PROVIDED, That notes, drafts and bills of exchange drawn or issued for agricultural purposes, including the preparation for marketing and the orderly marketing of farm products, by the producers of such products or their cooperative organizations, or based on live stock, and having a maturity at the time of discount of not more than nine months, exclusive of days of grace, may be discounted in an amount to be limited to a percentage of the assets of the Federal Reserve Bank to be ascertained and fixed by the Federal Reserve Board."

This is a very broad provision and would not only extend the class of paper eligible for rediscount as agricultural paper to include paper drawn to finance the preparation for market and orderly marketing of farm products by cooperative marketing associations but would also make eligible for rediscount with maturities up to nine months all agricultural paper, whether drawn to finance the marketing of a crop which has already been harvested or to finance the production of a crop which has not yet been planted. The Board favors that part of this amendment which extends the class of paper eligible for rediscount as agricultural paper to include paper drawn to finance the preparation for market and orderly marketing of agricultural products by cooperative marketing associations composed exclusively of growers, and would have ruled heretofore that such paper is eligible as agricultural paper had the terms of existing law permitted. The Board is of the opinion that that part of the amendment which would extend the maturity of eligible agricultural paper to nine months, should be limited to paper secured by warehouse receipts or other such documents conveying security title to readily marketable, non-perishable, staple agricultural products, or at least that no paper with maturities in excess of six months should be accepted as collateral security for Federal Reserve notes unless so secured. There is undoubtedly an important distinction be-

tween paper drawn to finance the storage or marketing of a crop which has already been harvested and that drawn to finance the production of a crop which may not even be planted and which is subject to conditions beyond the control of the grower, such as drought, frost, hail, blight, or the ravages of the boll weevil, which may cause a complete crop failure. The former class of paper is recognized as sound, especially when secured by warehouse receipts or other such documents covering non-perishable, readily marketable, staple agricultural products which are being marketed or stored pending orderly marketing, because there is something tangible already in existence out of the sale of which the borrower can reasonably expect to obtain the funds with which to liquidate his obligation. The latter class of paper, however, is subject to such hazards as to make it undesirable as a basis for the issue of note currency, because the borrower must succeed in growing and harvesting a crop and then selling it at a fair price in order to realize the funds with which to pay off his obligation, and through no fault of his own he may have a crop failure which will deprive him of the means of meeting his obligation, thus making it necessary for the bank to carry the loan for a year longer and probably make him an additional loan to enable him to produce his next crop.

That part of Senator Capper's bill, S. 4063, which would make nine months paper eligible for rediscount is contained in a proposed new section to be inserted in the Federal Reserve Act and designated Section 13 (a), and is limited to paper drawn to finance the orderly marketing of agricultural products or the fattening of live stock for market. It also requires such paper to be secured by warehouses receipts or other negotiable documents conveying or securing title to readily marketable, non-perishable agricultural products or by chattel mortgages on live stock.

The second paragraph of Senator Capper's proposed new Section 13 (a) of the Federal Reserve Act would also make paper of cooperative marketing associations eligible for rediscount as agricultural paper whenever the proceeds (a) have been or are to be advanced by such an association to any members thereof for any agricultural purpose, or (b) have been or are to be used by such an association in making payments to any members thereof on account of agricultural products delivered by such members to the association or (c) have been or are to be used by such an association to meet expenditures incurred or to be incurred by the association in connection with the grading, processing, packing, preparation for market, or marketing of any agricultural product handled by such an association for any of its members. The Federal Reserve Board has not ruled as to the eligibility of paper of class (a); but such paper might be held to be ineligible under existing law, and the Board considers it desirable that such paper should be made eligible for rediscount as agricultural paper by an express amendment to the Act. Paper of the kinds described under (b) and (c) is now eligible for rediscount as commercial

paper with maturities not in excess of ninety days, and the Board also approves of the amendment making such paper eligible for rediscount as agricultural paper. In its letter of July 12, 1922, which is referred to above, the Board has heretofore gone on record as approving a provision of H. R. 11763 making paper of classes (a) and (c) eligible for rediscount as agricultural paper. The Board, therefore, approves of all the provisions of this paragraph. It would suggest, however, the insertion of a proviso making it absolutely clear that the enumeration of three classes of paper of cooperative marketing associations as eligible for rediscount is not intended to carry the implication that other paper of such associations is necessarily ineligible. The Board has ruled that several other kinds of paper of cooperative marketing associations are eligible, and would regret to see such paper made ineligible.

The proposed new section 13 (a) which would be added to the Federal Reserve Act by Senator Capper's bill is scientifically planned and unusually well worded, and the Board advocates its adoption in its present form except for the slight amendment just mentioned.

Senator Lenroot's bill, S. 4103, would authorize Federal Reserve banks to rediscount agricultural paper for Federal Land Banks as well as member banks (provided it does not bear the endorsement of non-member State banks or trust companies which are eligible for membership in the Federal Reserve System), and to buy and sell bonds and other such obligations issued by Federal Land Banks. The Federal Reserve Board has previously approved a bill containing these provisions but rather doubts the advisability of its enactment.

Senator Lenroot's bill also contains a provision amending Section 7 of the Federal Reserve Act so as to permit Federal Reserve Banks to pay to their member banks an extra dividend up to 3% in addition to the 6% cumulative dividend to which they are now entitled, whenever their net earnings exceed 12%. The Board approves this amendment in principle but suggests that all reference to the payment of dividends out of surplus be omitted.

Both bills contain provisions to amend Section 9 of the Federal Reserve Act so as to permit State banks in places of not more than 6,000 inhabitants to be admitted to membership in the Federal Reserve System with a minimum capital of \$30,000, if their applications are accompanied by adequate undertakings to increase their capital to \$50,000 within three years, and to permit State banks located in towns of not more than 3,000 inhabitants to be admitted to membership with a minimum capital of \$15,000 if their applications are accompanied by similar undertakings to increase their capital to \$25,000 within three years. These provisions are similar to those of a bill introduced by Senator Harris, S. 3531, which was approved by a majority of the members of the Federal Reserve Board, and which passed the Senate on July 8, 1922. The Board, therefore, approves these provisions.

Senator Capper's bill would also amend Section 13 of the Federal Reserve Act so as to permit bankers' acceptances drawn for agricultural purposes and secured at the time of acceptance by warehouse receipts or other such documents conveying or securing title covering readily marketable staples to be rediscounted with maturities up to six months, whereas, they are now eligible for rediscount only when they have maturities at the time of discount not exceeding three months. The Board approves of this provision, as it is somewhat in line with a recent amendment to its Regulation B permitting Federal Reserve Banks to purchase in the open market bankers' acceptances with maturities not in excess of six months which are drawn by growers, or by cooperative marketing associations composed exclusively of growers, of non-perishable, readily marketable staple agricultural products, to finance the orderly marketing of such products and secured at the time of acceptance by warehouse, terminal or other similar receipts conveying security title to such products.

Senator Capper's bill would also add a new paragraph at the end of Section 14 of the Federal Reserve Act to be designated Section 14 (f) which would authorize Federal Reserve Banks to purchase and sell in the open market either from or to domestic banks, firms, corporations or individuals, acceptances of agricultural credit corporations organized under Title I. Such corporations are authorized to accept drafts drawn for agricultural purposes with maturities not exceeding nine months when secured by warehouse receipts or other such documents conveying or securing title to non-perishable, readily marketable agricultural products or by chattel mortgages or other like instruments conveying a full and paramount lien on live stock which are being fattened for market. The Board approves of the purposes of this amendment, but suggests that the term "Federal Agricultural Act" appearing in the amendment as now drafted, be changed to "Rural Credits Act" to conform to other portions of the bill.

There is one amendment not covered by either of these bills which the Federal Reserve Board would like to suggest in this connection, because it believes that it would be of distinct benefit in assisting the marketing of staple agricultural products and would not inject any undesirable paper into the Federal Reserve System. It appears to be the custom of many member banks to discount during crop moving periods large volumes of sight drafts secured by bills of lading covering the shipment of agricultural products, and such drafts are not eligible for rediscount at Federal Reserve Banks because they have no definite maturity. It has been represented to the Board that these drafts constitute the most liquid kind of paper and usually are paid with great promptness. The Board believes that to permit the rediscount of such drafts would greatly assist member banks in financing the movement of crops and, therefore, recommends that the following paragraph be inserted in Section 13 of the Federal Reserve Act immediately after the second paragraph thereof:

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"Upon the endorsement of any of its member banks, which shall be deemed a waiver of demand, notice and protest by such bank as to its own endorsement exclusively, and subject to regulations and limitations to be prescribed by the Federal Reserve Board, any Federal Reserve Bank may discount or purchase bills of exchange payable at sight or on demand which are drawn to finance the domestic shipment of non-perishable readily marketable staple agricultural products and are secured by bills of lading or other shipping documents conveying or securing title to such staples: PROVIDED, However, that all such bills of exchange shall be forwarded promptly for collection, and demand for payment shall be made with reasonable promptness after the arrival of such staples at their destination: PROVIDED, Further, that no such bill shall in any event be held by or for the account of a Federal Reserve Bank for a period in excess of 90 days. In discounting such bills Federal Reserve Banks may compute the interest to be deducted on the basis of the estimated life of such bill, and adjust the discount after payment of such bills to conform to the actual life thereof."

If the Board can give you further information on this subject or be of any assistance in any way it will be very glad to do so.

Very truly yours,

(signed) Edmund Platt

Acting Governor.