WHAT THE FEDERAL RESERVE SYSTEM HAS DONE
SINCE THE ARMISTICE TO SUPPORT AGRICULTURE.

Released for Afternoon Papers
Wednesday, February 28.

ADDRESS OF
JOHN R. MITCHELL
MEMBER, FEDERAL RESERVE BOARD
WASHINGTON, D.C.

Before the

NORTHWEST AGRICULTURAL STABILIZATION CONFERENCE
St. Paul, Minn.
February 27-28, 1923.

X-3642

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

It is a pleasure and privilege to be here today to discuss with you the Federal Reserve System and its relation to agriculture. Before approaching the particular phase of that subject which has been assigned me, viz.: "What the Federal Reserve System has done to support agriculture since the armistice," I would ask your attention for a few minutes to a brief consideration of the nature of the Federal Reserve System. To many of you, undoubtedly, these facts will be familiar, but my warrant for repeating them is the amazing ignorance and misconception of the System which is evident throughout the country and is disclosed even in debates in Congress.

First, the Federal Reserve Act was never intended as a panacea for all economic ills. It was adopted solely for what it was, a banking reform which would put the commercial banking system of the country in a better position to serve the needs, especially the short term credit needs, of agriculture, commerce, and industry. As set forth in the title of the Act, it was designed as, "An Act to provide for the establishment of Federal Reserve Banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes." In no sense was it planned as a price regulating machine, nor was it considered that the System should provide capital to be loaned out for long periods.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Drafted while the memory of the panics of 1893 and 1907 was still fresh, the framers of the Act sought to prevent the recurrence of such panics, when banks were unable to realize upon their reserves, and depositors were unable to receive in currency the funds due them. To that end the old system of pyramided reserves which had failed repeatedly was abolished and the reserves of all national banks and those of such state banks as chose to enter the System were put on a more scientific basis, and were mobilized in the Federal Reserve Banks. It is these reserve deposits, amounting now to about $1,300,000,000. - the reserves of sixty per cent of the bank deposits of the country - that the Federal Reserve Banks are called upon to protect.

Right here, let me call your attention to the fact that the interests of the depositors as well as the interests of the borrowers of a bank are entitled to the fullest protection. Were it not for the depositors, there would be no banks, as we know them, and I think this is a fact that has been toooften overlooked.

That the Federal Reserve Act has provided the public with an elastic currency abundantly able to meet all requirements during the most severe crisis in the history of the country has been fully demonstrated. That elasticity is made possible by the operation of section 13 of the Act, whereby member banks in need of funds to make good their reserves may rediscount their eligible notes with the Federal Reserve Bank.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

And here let me say that it was never contemplated that any bank should continually lean on the Federal Reserve Bank for support. Rather, it was the purpose that the banks should operate upon their own resources, but would find ever ready help at the Federal Reserve Banks in times of seasonal expansion of credit, such as planting or crop-moving time, or in times of emergency.

But the facts are that during the critical years just passed many banks were obliged to borrow steadily from the Federal Reserve Bank. While the amount of necessary borrowings in some instances was startling, excessive borrowings today are pretty well liquidated, showing how it is possible for agricultural and live stock districts to grow out of abnormal financial difficulties, when proper time and encouragement are extended.

In this respect I say the Federal Reserve Banks have gone the limit.

Just a word now as to the organization:

The Federal Reserve System is not a central banking system, nor is it a government bank, - for the government has never invested a cent in the capital of any of the Federal Reserve Banks, nor do government deposits form any considerable proportion of the system's resources which are composed chiefly of contributions from member banks in the form of capital and reserve deposits; nor is it a system whose operations are dictated or controlled by any set of government officials or by a bureau in Washington. There are instead twelve separate Federal Reserve Banks, each an individual unit, under government supervision, but managed by its own board of directors, composed of residents of the district. In the Federal Reserve Act careful provision is made that the directors of a Federal Reserve Bank, nine in number, be fully

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

representative of all interests of the district. Three of them are appointed by the government through the Federal Reserve Board, and they can have no connection with any other bank. Three others, known as Class A Directors, are elected by the member banks as their representatives, and they are practically always officers of member banks. Three others, known as Class B Directors, are also elected by the member bank stockholders, but these directors are representative of the industrial, commercial, and agricultural - the borrowing interests - and can be neither officers nor directors of any bank.

Further precaution has been taken to insure that all interests are properly represented, accordingly, the member banks are divided into three groups, according to size, the large banks in one group, those of medium size in another, and the smaller banks in a third. Each group then elects one Class A and one Class B director, thus insuring fair representation.

The Federal Reserve Board is a supervisory body and defines by regulation what classes of paper may be discounted at the Federal Reserve Bank, in accordance with the law. But, the Federal Reserve Board cannot compel a Federal Reserve Bank to make any loan which it does not care to, nor can it prohibit a Federal Reserve Bank from making any legal loan. The only control it has over the loaning policy of the Federal Reserve Banks is to authorize, and compel if necessary, one Federal Reserve Bank to come to the assistance of another.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Such authorization has been granted whenever requested, but at no time has it ever been necessary for the Federal Reserve Board to order one bank to help another, as they have always co-operated to the fullest extent. In 1920, for instance, the Federal Reserve Bank of Cleveland was lending more funds to the hard-pressed agricultural districts than it was to its own member banks.

One other point must be borne in mind:

The Federal Reserve Banks have no dealings with individuals or with private corporations. They receive deposits only from banks and from the government and make loans only to member banks.

With this sketchy explanation of the Federal Reserve System let us come to the subject at hand and review briefly the economic conditions since the armistice.

When on November 11, 1918, the armistice was signed by General Foch and by representatives of Germany, the world was emerging from the worst struggle in history. Men and treasure had been destroyed at a fearful rate for more than four years; large stretches of territory had been devastated, and the entire economic machinery of the belligerents had been diverted to the one end of producing war materials. In the United States the situation was similar, but in proportion to our population and resources, much

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

less acute. While four millions of our men were withdrawn from productive activity and were actually taking part in the war or training for it, and while much of our industrial machinery was engaged in satisfying war requirements, nevertheless our fundamental industries - agriculture, iron and steel, coal, textiles, etc. - were in a prosperous condition, and, though requiring some readjustment, prepared to continue operations in times of peace.

The credit mechanism, as well as the industrial plants all over the world, had been diverted from the service of the civil population to the service of the States and their military needs. In this respect also America, though affected by the same influences, had suffered less than her allies. Currency inflation everywhere was great, and in the United States prices were about double their pre-war level.

The years immediately following the armistice, 1919 and 1920, were generally speaking, characterized by continued business activity and credit expansion, which developed into a world-wide post-war boom. Prices were high and rising, production continued at a high rate, and here in the United States prosperity was general. In Europe the belligerent countries were endeavoring to reconstruct their economic foundations. Their own resources were exhausted by the long struggle, food supplies were low, raw material stocks were almost all gone, and there was urgent need of imports in order to feed the populations and to resume productive activity. While these countries had little

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

with which to pay for imports, they still had large unexhausted war credits with the United States Treasury, and they were permitted to utilize these credits to secure food and raw materials from the United States.

Funds supplied directly by the United States Government in 1919 paid for no less than $3,000,000,000. of our exports to Europe. In addition European countries were able to borrow large amounts privately from our banks. As a consequence, our exports reached unprecedented heights in 1919 and 1920, the value of exports of agricultural products alone in 1919 being $4,100,000,000. and in 1920 $3,500,000,000.

It was not until the spring of 1920 that the period of post-war prosperity and speculation began to show signs of a possible turn. With Government credits exhausted and private credits increasingly hard to obtain, European countries were no longer able to buy our food and raw materials in such large quantities, or to pay such good prices. Prices of all commodities, as well as of agricultural commodities reached their peak about June, 1920, and then declined spectacularly. Once the turn had come, the downward movement gathered momentum as speculative booms collapsed and speculative holdings were thrown on the market. All through the rest of 1920 and the first part of 1921 prices continued to decline; only in the latter part of that year did they become relatively stabilized, and not until 1922 did a rise occur.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Prices of agricultural products, which are peculiarly sensitive to foreign demand, and, as raw materials generally more quickly responsive to economic changes, dropped lower than those of other commodities.

Keeping this situation in mind, let us now see what the Federal Reserve System did to support agriculture. This should be considered from two points:

First, to what extent did the Federal Reserve System extend credit; and second, what was the attitude of the Federal Reserve Board, expressed through its regulations and rulings, towards agricultural paper.

Accommodation extended by the Federal Reserve Banks to their member banks is measured primarily by the volume of bills discounted for member banks, the direct means by which a member bank in need of funds may obtain accommodation from its Federal Reserve Bank.

In this connection I wish to emphasize the fact, referred to before, that Federal Reserve Banks cannot create credit, nor can they make direct loans to individuals or corporations. The assistance of the Federal Reserve Banks is extended to agriculture and industry through the member banks, which must first pass upon the borrower's application for an extension of credit. The member bank is, of course, familiar with the needs of its community, with the reliability and integrity of the borrower, and the sufficiency of the security which he offers, and will not be disposed to deny credit to a customer who is entitled to it, so long as funds are available for the purpose.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

It is here that the function of the Federal Reserve Bank appears in so far as the extension of credit is concerned, which is to furnish the member bank with needed funds by the discount of eligible paper.

This chart tells the story of how the Federal Reserve Banks came to the aid of agriculture much more clearly than any number of statistical tables. These three curves show the course of prices, the 1913 average price being taken in all instances as 100. The black line representing the price of all commodities shows that in November, 1918, the average price stood at 203, and then increased steadily until May, 1920, when it was almost 250, or two and a half times the average 1913 price. Then followed the sudden drop, as shown by the curve. The blue curve representing live stock prices shows that for part of 1919 they stood slightly above the general average of prices, then broke sharply, recovered slightly, and then in October, 1920, several months after the slump in other prices, declined to about the same level as crop prices, since when they have fluctuated together at a level considerably below that of the prices of other commodities.

Prices of crops are shown by the red line, which starts at November, 1918, at a level of 215, somewhat above the average price of all commodities. Then followed a rapid rise until August of 1919, when there was a sharp break, which did not, however, bring the price

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

down to the general average. This decline lasted but three months, following which came a rapid and continual rise until a peak of 304 was reached in June, 1920, about a month after the prices of other commodities had started to decline. Then came the almost perpendicular decline which soon carried them below the level of other commodities, where they have remained ever since.

Meanwhile, what was the Federal Reserve System doing?

Throughout the war period there had been a rapid increase in the amount of discounted paper held by the Federal Reserve Banks, and on November 15, 1918, four days after the signing of the armistice, the Federal Reserve Banks held under discount for member banks a total of $1,800,000,000. of eligible paper, the largest amount of accommodation extended to member banks by the Federal Reserve System at any one time up to that date. But the post-armistice period saw an even greater extension of credit to member banks by the Federal Reserve System, for there was an almost continuous increase in the amount of discounted paper during the next two years, culminating on November 5, 1920, in the stupendous total of $2,827,000,000., which marks the high point in the history of the Federal Reserve System. That declining prices should ultimately result in a lessened requirement for accommodation at the Federal Reserve Banks was only to be expected, but as the chart shows, this reduction did not begin until late in 1920, five months after the break in prices began. Thereafter it ran a practically parallel course with the price decline.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

These being the facts, how can the statement be justified that the Federal Reserve System, by curtailing credit, brought about the decline in prices?

An analysis of Federal Reserve Bank discounts during this period made for the Joint Commission of Agricultural Inquiry, shows that the decline in the loans of the Federal Reserve Banks began in the industrial and financial sections of the country, and that while liquidation of loans was occurring in the East, loans in the agricultural districts were increasing in volume.

Again I say, in the face of these facts, how can the Federal Reserve System be said to be responsible for the decline in agricultural prices? Such an accusation is ridiculous.

That the rapid increase in prices which marked the year 1919 and the first half of 1920, and the consequent increase in credit requirements could not go on indefinitely is self-evident, and the fact that the break in prices which came was not confined to the United States, but was common to practically all of the civilized world, further indicates that its cause is not to be found in the credit or discount rate policy of the Federal Reserve Banks.

Inter-Federal Reserve Bank accommodation through the rediscount or sale of paper discounted for member banks or purchased in the open market, as I have said, is the means provided to enable one of the Federal Reserve Banks to obtain assistance from another in time of need. Rediscount operations were resorted to

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

on a small scale for the first time late in 1917 and frequently thereafter during the war. It was not until the post-war period of expansion, however, that the ever increasing demands of member banks for accommodation at the Federal Reserve Banks occasioned any misgivings as to the ability of the Federal Reserve System to meet any legitimate demand for credit, without having recourse to the provision in the Federal Reserve Act authorizing the Board to waive the minimum reserve requirements.

By the end of 1919, the reserve ratio of the Federal Reserve System - that is the ratio of its gold and lawful money reserves to its combined deposit and Federal Reserve note liabilities - had fallen to 45%. Throughout 1920 this ratio ranged between 42 and 45%. During the early post-armistice period the Federal Reserve Banks in the Middle West had an excess of lending power beyond the needs of their districts, and they were able to rediscount paper for other Federal Reserve Banks in need of assistance. Just before the prices of farm crops began their precipitous decline, the situation was reversed and the increased demands of member banks in the Middle West, not only forced the Federal Reserve Banks in the Middle West to withdraw their assistance to other Federal Reserve Banks, but compelled them to rediscount substantial amounts of their paper with other Federal Reserve Banks.

One point which I wish to stress is that the only way in which the Federal Reserve Banks can extend credit is through the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

member banks, and in so far as eligible banks refrain from joining the System, just so far is the Federal Reserve System handicapped in its efforts to aid. At the present time there are about 9,900 member banks, of which over 1600 are state banks and trust companies. There are, however, approximately 9500 eligible state banks and trust companies which are not members of the Federal Reserve System. These non-member banks are, of course, chiefly the smaller banks, but it is evident that the number of eligible state banks and trust companies that have remained outside of the Federal Reserve System is nearly equal to the total number of member banks, including all national banks.

While the Act expressly provides that member banks shall not act as agents for nonmember banks in discounting their paper with the Federal Reserve banks, when need arose the Federal Reserve Board waived this provision and authorized the Federal Reserve Banks to rediscount for member banks paper which they had received from nonmember banks, in this way extending the aid of the system to practically every bank in the country.

We have now arrived at the point where we can consider the attitude of the Federal Reserve Board as expressed through its regulations and rulings, towards agricultural paper.

When the Federal Reserve Act was enacted Congress discriminated in favor of agriculture by permitting the Federal Reserve Banks, to discount agricultural paper having a maturity up to six months, whereas the longest maturity of all other paper eligible for rediscount with

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

the Federal Reserve Banks was fixed at ninety days. The law provides that the proportion that agricultural paper may form of the entire assets of a reserve bank shall be fixed by the Federal Reserve Board; and the Board fixed this ratio at 99% and has never reduced it.

The regulations of the Federal Reserve Board defining what may be considered as agricultural paper eligible for discount with

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

maturities up to six months are of necessity somewhat technical in language but may be summarized as permitting Federal Reserve Banks to rediscount for six months any loans which are in the proper form and which are used to finance any one or more of the steps of planting, cultivating, harvesting, or marketing a crop or of breeding, fattening, or marketing live stock. Moreover, one of the normal phases of marketing agricultural products is carrying them for a reasonable time in order to affect their orderly marketing, rather than dumping large quantities on the market at one time, and paper which is used to finance the carrying of a crop pending its orderly marketing may be eligible as agricultural paper.

The Federal Reserve Board has also been partly responsible for a change in existing laws, which has been very helpful to the agriculture interests. You bankers are familiar with Section 5200 of the Revised Statutes, which contains the limitation on the amount which a national bank may lend to any one person. This limitation is, in general, 10% of the lending bank's capital and surplus, with certain classes of paper excluded as not being considered loans of money. The Board felt that the classes of paper excepted from this loan limitation might properly be broadened in a way that would enable the farmers and cattle raisers to obtain additional credit from national banks without contravening any principles of sound banking, and it recommended certain amendmentsto Section 5200 of the Revised Statutes to accomplish this purpose.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Following this recommendation, Congress amended Section 5200 by an Act approved October 22, 1919, so as to permit a national bank to lend to any one borrower in excess of 10% of its capital and surplus, but not to exceed 25%, provided that the loans over and above 10% are represented by notes, secured by shipping documents, warehouse receipts, or other similar documents covering readily marketable non-perishable staples, including live stock. At the same time, Congress also broadened the class of paper known as "bills of exchange drawn in good faith against actually existing values", which national banks may discount without limit, so as to include drafts secured by shipping documents conveying or securing title to goods shipped, demand obligations when secured by documents covering commodities in process of shipment, and bankers' acceptances of the kinds described in Section 13 of the Federal Reserve Act. These amendments, by increasing the power of national banks to extend accommodations on the security of farm products and live stock, have proven of great value to farmers and cattlemen in their financial problems.

At this point I would like to say a few words about bankers' acceptances, which have lately been coming into continually greater use as a desirable form of credit instrument. Bankers' acceptances, as you know, are drafts or bills of exchange drawn on and accepted by a bank or trust company or other banking concern, and the law authorizes Federal Reserve Banks to rediscount bankers' acceptances under certain conditions. For this purpose, such acceptances must be indorsed by a member bank, and must be drawn to finance the importation

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

or exportation of goods, the domestic shipment of goods, or the storage of readily marketable staples. Acceptances which grow out of the domestic shipment of goods or the storage of readily marketable staples must further be secured at the time of acceptance by shipping documents or warehouse receipts conveying or securing title to the goods or staples in question. Under existing law all bankers' acceptances, whether used to finance agricultural or commercial needs, must be limited in maturity to three months in order to be eligible for rediscount.

Bankers' acceptances have not been used very extensively in connection with the shipment of agricultural products, although the Board recently had occasion to rule that a national bank may accept a draft drawn upon it, if secured by a bill of lading covering a shipment of cattle to a cattle raiser who has purchased them with the intention of fattening and re-selling them, and that such acceptances may be eligible for rediscount. This was a very liberal ruling in permitting the acceptance credit to cover the period required to fatten the cattle and was a distinct advantage to farmers, since the Board has always ruled that acceptances drawn to finance the manufacturing or processing of industrial materials are ineligible. Bankers' acceptances, however, used to finance the storage of agricultural products pending orderly marketing have recently been coming into more general use, both by individual farmers, and more particularly by cooperative marketing associations.

Most of the rulings on agricultural credits made since the armistice have been in connection with cooperative marketing associations,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

which have been of so much assistance in the orderly marketing of agricultural products and in securing for the farmers a fair return for their labor.

The Board recognizes that cooperation in marketing crops under proper management is a step in the right direction that farmers may take toward improving their credit standing and their general economic condition, and it has gone as far as existing law permits in encouraging the extension of credit to cooperative marketing organizations. A very recent evidence of the Board's desire to provide more ample credit facilities to the agricultural interests, is the amendment to its Regulation B, dated December 19, 1922, which makes eligible for purchase by Federal Reserve Banks in the open market, bankers' acceptances with maturities up to six months, drawn by farmers or by cooperative marketing associations to finance the orderly marketing of staple agricultural products, and secured by warehouse receipts covering such products. Such acceptances were formerly eligible for purchase only with maturities not in excess of three months, and their present eligibility for purchase with longer maturities should prove the means of furnishing much of the additional credit needed in such transactions.

The Board recently also issued a number of very liberal rulings designed to secure to farmers operating through cooperative marketing associations the maximum credit facilities possible under present law. These rulings were made from time to time as questions were submitted from various sections of the country. They involved farm

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

produce differing as widely as fruit from California, wheat from the Middle West, and tobacco and cotton from the South, but the same principles of sound financing were involved in all, and in each case the cooperative association was a non-stock, non-profit corporation, the members of which consisted exclusively of growers of the particular crop which the association was organized to market. The growers agreed to sell and deliver their entire crops to the association, title passing at the time of delivery, and the association assuming absolute control over the commodities and their re-sale. Generally speaking, the commodities were pooled according to grades and after all of a particular pool had been sold the proceeds were distributed pro rata. It should be understood that the Board's rulings on this subject would not necessarily apply to associations operating on a materially different plan.

Several kinds of borrowings are involved. If the grower desires to do the borrowing himself, he can borrow on his own note, using the note or its proceeds to finance the carrying of his product for such reasonable period as is necessary in order to effect orderly marketing. Such a note constitutes agricultural paper, and may be rediscounted with maturities up to six months. Or he can draw a draft on the cooperative marketing association at the time he delivers his crop, the association accepting it. He then discounts the draft at his local bank, which, under the Board's rulings may rediscount it at a Federal Reserve Bank as agricultural paper with a maturity up to six months, if the grower uses the proceeds for an agricultural purpose. If the association itself wishes to borrow money directly from a bank in order to make

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

payments to the growers for produce delivered, its notes are eligible for rediscount, but the Board has held that under existing law such notes are commercial notes, the maturity of which must not exceed ninety days, because the proceeds of such notes are used for the commercial purpose of buying the commodities from the growers.

There was considerable discussion over the case where the grower draws his own draft on the association, as to whether the draft should be considered agricultural and have a six months' maturity. The point was made that the grower in all probability would use the money so obtained in paying debts previously incurred, and that unless this could be held to be an agricultural purpose, little agricultural, or six months' credit could be obtained in this way. The Federal Reserve Board ruled, however, that when a farmer or grower delivers his crop to a cooperative marketing association actually engaged in orderly marketing and when he is obliged to borrow money for ordinary general purposes, such as the payment of obligations previously incurred in growing or harvesting the same crop, a draft drawn by him on the association may properly be considered as drawn for an agricultural purpose, because it puts him in funds so that he can carry his crop pending its orderly marketing. As I said before, the carrying of agricultural products for such periods as are reasonably necessary in order to accomplish orderly marketing is a legitimate and necessary step incident to normal distribution and constitutes an agricultural purpose. The Board pointed out, however, that there is a distinction between carrying products for such periods as are reasonably necessary

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

and mere speculative withholding from the market in the hope of obtaining higher prices. Under the Federal Reserve Act paper drawn to finance speculation is ineligible for rediscount.

Another very liberal ruling which has been of material aid to cooperative marketing associations is the ruling that bankers' acceptances drawn to finance the domestic storage of commodities pending orderly marketing by such associations are eligible for rediscount. The association arranges with some national or state bank to accept drafts secured by warehouse receipts, and, after acceptance, such drafts are eligible for rediscount by Federal Reserve Banks with three months maturity. Under the new amendment to the Board's regulation they may also be purchased in the open market with maturities up to six months.

One of the most recent, and also one of the most liberal, rulings of the Board on this subject was to the effect that where a member of a cooperative marketing association delivers his crop to the association and at substantially the same time draws a draft on the association, which is accepted by it and discounted by the drawer at his own bank, the draft is a "bill of exchange drawn in good faith against actually existing values". By virtue of this ruling, such a draft is not subject to the 10% limitation prescribed in the Federal Reserve Act on the aggregate amount of paper of any one borrower which a Federal Reserve Bank may rediscount for any one member bank.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

These are probably the most important rulings made by the Federal Reserve Board on this subject, but, of course, there are other classes of eligible paper that can be used in borrowing by cooperative marketing associations. The point I wish to emphasize is the past and present willingness of the Board to assist the cooperative marketing movement in every appropriate way.

I have shown how the Board is limited by the terms of the law in ruling upon the eligibility of paper for rediscount and how it has gone as far as it could under the terms of existing law in fostering the need of agriculture for broader credit facilities. Under these circumstances, only Congress has power to provide additional credit facilities to agriculture by liberalizing the provisions of existing law, or by creating new credit machinery.

The post-war period of expansion and inflation, followed quickly by the inevitable deflation, with its particularly harmful effect on the agricultural interests, made it evident that the existing credit machinery of the country was inadequate to care for the needs of the farmers. The Federal Reserve System can properly supply only short term credits, because the assets of Federal Reserve Banks furnish the basis for a large part of the country's currency, and they must be kept liquid. The Federal Farm Loan System, on the other hand, provides long term credits, but there is an obvious need for some machinery to provide what may be called intermediate credits of from six months to three years.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Among the many bills introduced in Congress designed to extend additional credit facilities to the agricultural interests, perhaps the most important are the bills recently introduced by Senator Capper and Senator Lenroot. These bills have been passed by the Senate and are now being considered by the House, and unless something unforseen develops, it seems probable that a bill embodying the best features of each, will become law during the present session of Congress. You are, no doubt, familiar in a general way with the provision of these bills, so that I need not discuss tham at length, even if time permitted, but I wish to point out how the Federal Reserve Board has supported the agricultural interests by recommending the enactment of such a bill, and by recommending also the passage of other legislation which would provide still further credit facilities to the farmers.

As frequently happens with regard to legislation affecting banking and credits, the Board was requested to consider and comment on the so-called Capper and Lenroot bills. In response to this request, the Board on December 21, 1922, addressed a letter to the Chairman of the Senate Banking and Currency Committee, expressing its approval of the general purpose of both bills and making detailed comments on certain provisions in them. Except for expressing its general approval of the purpose, the Board refrained from commenting on those portions of the bills, which contain provisions creating new machinery to supply agricultural credits of an intermediate type, running from six months to three years, because such matters were not properly within the Board's jurisdiction. The Board confined itself rather to the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

provisions of the bills which amended the Federal Reserve Act or directly affected the operations of the Federal Reserve System, and offered a few constructive suggestions designed to safeguard the elasticity and soundness of the currency issued through the Federal Reserve Banks, and also to make the proposed amendments more liberal and effective.

In that letter the Board recommended that the maturity of a certain type of farmers paper eligible for rediscount at the Federal Reserve Banks be extended from six months to nine months.

It further recommended that certain paper of cooperative marketing associations be expressly declared to be agricultural paper, and thus eligible for rediscount with maturities up to nine months. Under the present law some of this must be classed as commercial paper eligible for discount only with maturities up to three months, and some of it must be classed as finance paper and not eligible at all for discount.

The Board also recommended that bankers' acceptances, drawn for agricultural purposes and properly secured be made eligible for rediscount with maturities up to six months. Such acceptances are now eligible for rediscount only with three months maturity, but the Board endorsed this amendment to the law, as being in line with the recent amendment to its Regulation B, which I have already discussed and which makes such acceptances eligible for purchase in the open market with six months maturity.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Both the Capper and Lenroot bills proposed to amend the Federal Reserve Act by lowering the amount of capital which banks are now required to have as a condition to becoming member banks. These amendments are designed to attract more banks to membership in the Federal Reserve System, and thus make the resources of the System more widely available, and the Board expressed its approval of them.

In addition to these recommendations the Board suggested and urged that sight or demand drafts drawn to finance the domestic shipment of non-perishable, readily marketable, agricultural staples, be made eligible for rediscount or purchase by the Federal Reserve Banks, when properly secured. Under existing law such drafts are ineligible for rediscount at Federal Reserve Banks because they have no definite maturity. Such drafts are largely used in financing the movement of crops and I believe the passage of the amendment will be of much assistance to agriculture.

I wish to emphasize that in this statement of the attitude of the Federal Reserve Board towards pending rural credits legislation, I have been substantially quoting from a letter which the Board wrote to Congress in response to a request for an expression of the Board's views on this legislation. This letter, then, is an official statement of how the Board regards the pending legislation designed to improve the credit standing and economic position of the farming interests, and I think you will agree with me that the Federal Reserve Board has shown itself to be ready and willing to place the vast resources of the Federal Reserve System at the service of agriculture, so far as is consistent with the principles of sound banking, which I do not believe the farmer himself would care to see violated.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

I have outlined what the Federal Reserve System has done to support agriculture and live stock interests during recent years. What follows is my personal observation of what might be done to assist agriculture.

Before this consideration, however, I want to dwell briefly upon the great benefits that have been derived not only in the Northwestern states but throughout all agricultural and live stock sections from the operations of the War Finance Corporation. A more helpful, constructive piece of work has never been accomplished by any governmental organization. Every assistance possible was rendered by the Federal Reserve Banks in facilitating the corporation's operations.

The plight of the farmer today is not due, in my opinion, to a lack of credit facilities. The causes are more fundamental. Mention has been made of how the short term credit needs of agriculture are provided for by the commercial banks and the Federal Reserve System, and of how the pending rural credit legislation is designed to satisfy the need for intermediate credit.

In this connection it is interesting to note that the estimated borrowings at banks of the 6,448,000 farmers on personal loans, secured and unsecured, amount to approximately $3,870,000,000, or an average borrowing per farmer of $600.. It has been stated that one of the difficulties confronting the farmer is that he is paying too high a rate of interest. Even if true, and if a reduction of 4 percent could be made, it would mean a saving of

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

only $24. per year to the average farmer, and I submit that there is morethan a $24. difference between success and failure with the average farmer. Consequently, a lower interest rate, although particularly to be desired, would not help the farmer out of his difficulties to any appreciable degree. It can be stated that the organization of the proposed intermediate agricultural credit associations would without doubt provide the farmer with a lower rate of interest than he is now paying and be greatly beneficial in this respect. But they would not by any means be a panacea for all of his troubles.

There remains the question of how the government has provided for the long term credit needs of agriculture.

The Federal Farm Loan Act has made it possible for the farmer to borrow a liberal percentage of the value of his farm at more favorable terms and for a longer period than any other line of business enjoys. The reason for this is the fact that the income of securities issued by the Federal Farm Loan System is exempted from all taxation of every kind and description. The total amount of farm loans outstanding December 31, 1922, made under the Federal Farm Loan System, was approximately $860,000,000. During 1922 alone total loans made by the System amounted to approximately $363,000,000. It is estimated that the total mortgage indebtedness of the farmer is about $7,800,000,000 so it would seem that within a few years a large pro-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

portion of the farmers mortgage indebtedness will be in the Federal Farm Loan System.

To sum up, it is my personal opinion that the credit facilities of this great country are abundantly sufficient to meet all legitimate demands of agriculture, commerce and industry, if properly used.

A great amount of stress has been laid on the importance of the organization of co-operative marketing associations for the purpose of bringing about an orderly marketing and distribution of agricultural products. The Federal Reserve Board is in full accord with this plan of co-operation among the farmers, and appreciates the benefits derived by the grower when the co-operative marketing association has been properly administered. The success of this plan, of course, depends entirely upon how the association is managed. In many cases most satisfactory results have been accomplished, while dismal failures have been experienced in others. While the extension of this movement may bring great relief to the farmer, it cannot solve all of his difficulties. There still remains the question: "What will bring about the restoration of the farmer and put him back on his feet?"

Before making any suggestion along this line I want, if possible, to clear up some mistaken ideas which the farmer has about what has happened to him, since the signing of the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

armistice.

In the first place, while the farmer has had many things happen to him for which he was unprepared, his business was by no means the only business that was adversely affected. There is not a business of any kind or description that was not adversely affected just as was that of the farmer. Many bank failures have occurred, many re-organizations of industrial enterprises have been necessary, and reductions in inventories of jobbers and retailers at one time threatened to put nearly all of them out of business. But, fortunately, for the farmer, as well as for all other individuals, a recovery has been made and the country industrially and commercially is gradually getting back on its feet.

That the farmer has not recovered to the extent that it is most necessary he should, is well known and for that recovery we all here today are trying to work out a solution. It is the easiest thing in the world for silver-tongued orators to offer destructive criticism, but what we want is constructive criticism. We want to know what to do and how to do it.

The farmer has been told that the Federal Reserve System set about the deliberate inflation of the currency of 1918 and 1919, and in the spring of 1920 commenced a ruthless deflation.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

I want to say something right here, and I hope you will take it back home with you, and get your own people to thinking right about the Federal Reserve System. What I want to say is this: The Federal Reserve System, including the Federal Reserve Banks and Federal Reserve Board had no more to do with the cause of the inflation of the currency or the deflation in the prices of agricultural products than you had. The reason for the inflation in the currency of the country and also in prices of all commodities and wages was that we were engaged in war. Inflation always has been and always will be the natural resultant of war.

Is it not possible for the people of this country to realize that the Federal Reserve System enabled our side in the great conflict to come out vistorious? Had it not been for our monetary system, the establishment of which

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

borders on providentiality, I venture to say that today and for many years to come we would still be settling our reparations contracts or bills to Germany.

But to return to the situation of the farmer. When he goes to market, he finds that the purchasing power of his dollar is only about 68 per cent of what it was before the war. In other words, since 1920, there has been a gradual increase in the costs which the farmer must pay in manufacturers, wages, freight rates and taxes,

while everything the farmer produces is sold on about the same scale of prices prevailing in pre-war times, with the exception of wool, cotton, and flax. The inevitable law of supply and demand has gotten in its work. The reason for no appreciable increase in prices of agricultural products is that there has been an over-production, as compared with the amounts which Europe can purchase.

As is well known, the price at which the exportable surplus is sold fixes the price for the whole crop, and Europe makes her purchases where prices are the cheapest. If our farmers persist in raising more wheat than is consumed in this country, the only price that they can expect to receive is the Liverpool price less the charges for laying our wheat down in Liverpool. This is because the wheat grower in this country is in competition with the wheat growers in Canada, the Argentine, Australia, and India, in which countries everything

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

to be considered in the operation is much lower than in this country, including price of land, labor and taxes.

How can an American farmer compete in the world markets in the growing of wheat under these conditions? He has competed in the past, but in those successful years he was able to buy his life necessities for about one-half of what he is now paying and all of his farm costs were low.

There is absolutely nothing in sight that indicates any lowering in the cost of living or lower prices for what the farmer has to buy. Every industry practically is running on a normal basis. The building trades are commanding the highest wages ever paid. When it takes more than the entire proceeds of two big acres of wheat yielding the average return in the Ninth Federal Reserve District to pay a single days wage of a plasterer in the East, something is radically wrong and should be corrected.

It is estimated that the building program for 1923 totals approximately $5,000,000,000. Prosperity appears to be the outstanding feature in every line of business but agriculture. Is it possible to have a return of normal industrial activity without a restoration of the purchasing power of the farmer? My answer would be no, but we seem to have that return right now, in some sections of the United States, but the question is, how long will it last?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

There would seem to be two ways by which the farmer can work himself into a position where it is possible for him to show a profit at the end of each year out of his operations.

First: Curtail the production of all agricultural commodities that are exported in competition with products produced in foreign countries to such an extent that our farmers would be producing slightly less than our domestic consumption. This would mean for example that the production of wheat would have to be reduced to around 600,000,000 bushels, and the price the consumer would have to pay would be the Canadian price plus the tariff and cost of transportation. This would mean that today the farmer would receive around $1.65 for his wheat.

Such curtailment would not necessarily mean a decrease in productive activity but would entail a re-arrangement of the farmer's operations all along the line. It would mean, in other words, a better balancing and diversification of crops. It is most necessary that every farmer produce practically everything he eats and have farm products to exchange for those necessities he cannot raise.

There is no reason why the farmers should not raise

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

167

more flax than is now being raised in this country. A fair average of the annual amount of flax imported into this country from 1914 to 1922, inclusive, would be approximately 12,000,000 bushels. The farmers could well increase their production of flax -- say ten million bushels -- or employ one million acres without affecting the price they are now receiving which is the Argentine price plus the cost of transportation and the tariff. Would that the producers of wheat were in the fortunate positionthat the flax grower is !

Let me ask you the question: Would the United States Steel Corporation manufacture a surplus over domestic demands if the price at which the surplus had to be sold fixed a price for the entire product that was less than the cost of production? The answer is: Most certainly No. But the wheat growers of the country are in a comparable situation today.

There can be no sound argument why the farmers of this country should raise wheat and sell it at a lower price than it costs to produce the wheat. If we only grew as much wheat as our domestic consumption requires, there would not be any suffering abroad. It is claimed that Canada has potential wheat producing possibilities sufficient to supply the requirements of the world. It should be an easy matter if such is the case for Canada to increase her production 200 million bushels, if necessary. In addition to Canada's potentialities, it is certain that Russia will sooner or later again be a competitor in the raising of wheat.

The second method would be to secure a reduction

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

in the prices of all commodities the farmer is obliged to purchase. But such a reduction does not seem to be in prospect, nor is it clear how any action by any agricultural group could bring it about? This can be accomplished only by a reduction in wages which can best be obtained by a liberalization of our immigration laws, and a modification of our tariff laws.

The conclusion would then seem to be forced upon us that to work out their salvation the farmers must approach their problems as a business problem and solve it along business lines, must organize to gain all the advantages that lie in co-operative marketing associations, but above all, seek to plan their production with relation to the demand.

It is just as important that the business of farming be conducted along sound, business lines as any other business. It is folly and a sheer waste of time even to try to change economic laws by legislative action. The successful man, in any kind of business, achieves his success not by opposing economic laws but by adapting his operations to them.

That the future of agriculture is bright seems to mecertain. It is estimated that in ten years our population will have increased to such an extent that our present wheat production which is said to have reached practically our full producing capacity will be entirely consumed by domestic consumption. This is no sound argument for letting nature take its.course.What will become of the/ farmer in the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

meantime?) If a plan can be worked out that will provide for the farmer during this interval it will, in my judgment, solve for all time to come the problem now confronting us. As for the future, it appears to me that it is only necessary for one to take his pencil and paper and do a little figuring. In all probability our population will increase at an average rate of one and one-half millions during the next ten years. The average consumption of wheat, per person, in this country, is approximately 6 bushels, which means an increased annual consumption of 9 million bushels, amounting, in 10 years, to an increase of 90 million bushels per annum. In addition to this increased consumption of wheat, there will, of course, be an increased consumption of all other agricultural products. The question naturally arises what agricultural sections will take care of this increased consumption? I do not believe any one would say that New England can expand to any extent agriculturally, neither can the Middle States. The only sections left are the South and West. The section that has the brightest future, agriculturally, is, in my judgment, this great Northwest. Its business is that of providing necessities

for a rapidly increasing public which must be fed, and a public accustomed to the highest standard of living.

I am sure that agriculture will ultimately recover, but this recovery can best be accelerated by the fullest cooperation between all the forces at work, the United States Department of Agriculture, the Agricultural Colleges, such organizations as the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

the Farm Bureau, the Farmer Banker Council, and all others that are working for one common end - the welfare of the farmer. Let them all pull together along sound lines and the farmer will be restored to that position he is justly entitled to, and be the Monarch of all he surveys.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis