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FEDERAL RESERVE BOARD.

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THE FEDERAL RESERVE SYSTEM

The general purposes of the Federal Reserve System are well defined in the title of the Federal Reserve Act, which was passed in 1913 and approved on December 23 of that year. The full title of this Act reads as follows:

> "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."

The two principal functions mentioned in the title of the Act are thus to furnish an elastic currency and to afford means of rediscounting commercial paper. Both of these purposes clearly indicate that the Federal Reserve System is intended primarily to supply short-term credit, because elastic currency must necessarily be based on current transactions, and the rediscounting of "commercial" paper means the extension of credit on paper arising out of the current needs of production or distribution in agriculture, industry and trade. Both functions, therefore, indicate that the Federal Reserve System is a commercial banking system organized to finance current short term operations, as distinguished from the Farm Loan System and the Intermediate Credit Banks, which were organized for the purpose of providing longer term credit. The limitations upon the character and maturity of the paper eligible for discount by the Reserve Banks, therefore, arise from the fundamental purposes for which the System was created.

MEMBERSHIP

For purposes of Reserve Banking the United States is divided into twelve districts, each district having a Federal Reserve Bank, which in many respects is entirely independent of the other Reserve Banks and of the Federal Reserve Board. All the national banks in a district belong to the Federal Reserve System and must subscribe as their share to the bank's capital an amount equal to six per cent (6%) of their own capital and surplus, three per cent (3%) of which must be paid in cash at the time the membership is acquired; the remainder being subject to call. Banks having state charters are permitted to join the Federal Reserve System if they so desire and if their capital and the character of their business are such as to make them eligible for membership. Upon joining the System they are required to subscribe to the capital stock of the Reserve Bank on the same ratio as national banks. State banks which join the System retain all their charter privileges so far as they are not in conflict with the Federal Reserve Act and State banks may withdraw from membership at any time upon six months' notice. The Federal Reserve System, therefore, is owned by its member banks who are the stockholders and no part of the stock belongs to the Government. It is not a Governmental institution, but a co-operative enterprise of bankers owned and largely controlled by them.

ORGANIZATION

The Federal Reserve Banks are administered by a Board of nine (9) Directors divided into three classes: Class "A" Directors are selected from among leading bankers in the district; Class "B" Directors represent commercial, industrial, and agricultural interests in the district, and Class "C" Directors are appointed by the Federal Reserve Board to represent the Government and the general public. Class "A" and Class "B" Directors are elected by the Member Banks, the Government appointing only one-third of the Directors. For the purpose of selecting Class "A" and Class "B" Directors the banks in each Federal Reserve District are divided into three groups, consisting respectively of large, medium and small banks, each class having in the aggregate an equal number of votes. This insures the Federal Reserve Banks from being controlled largely by the big banks as they would be if the votes were in proportion to resources, or by small banks as would be the case if every member bank had one vote regardless of its size. This plan assures the banks of a directorate representative of the business interests and of the various classes of banks in the district.

The Federal Reserve Board consists of eight members, the Secretary of the Treasury and the Comptroller of the Currency ex-officio, and six other members appointed by the President of the United States and confirmed by the Senate. "In selecting the six appointive members of the Federal Reserve Board, not more than one of whom shall be selected from any one Federal Reserve District, the President shall have due regard to a fair representation of the financial, agricultural, industrial, and commercial interests, and geographical divisions of the country." So that the Federal Reserve Board is a body of men selected from various parts of the United States who are representative of the various activities of the country, and to these men is entrusted the function of welding the twelve regional Reserve Banks into one System which is operated on consistent principles and can be depended upon for united action when emergency arises.

There is a clear distinction between the Federal Reserve Banks and the Federal Reserve Board. This distinction is very often overlooked when criticisms are offered as against the function or operation of the System as the Board is often criticised for action taken, when, in reality, it is the action of the Federal Reserve Bank, and vica versa. As the Federal Reserve Banks are held responsible for their capital stock, and as the business of banking varies in different sections of the country, Congress deemed it advisable to make each Federal Reserve Bank a separate corporation and defined the limits of a bank's corporate powers in the act, while it left to the Federal Reserve Board the determination of broad questions of policy in order that the banks might function harmoniously as a unit and rally to the aid of each other in times of special stress or combine their force in case of a national emergency.

FUNCTIONS OF THE BANKS.

The chief functions of the Federal Reserve Banks may be briefly described as follows: (A) Rediscounting for Member Banks. When a member bank finds that its customers are in need of more credit than it is able to give them on the basis of its own resources, it can turn to the Federal Reserve Bank and rediscount with it some of the paper upon which it has made loans to its customers. This paper, however, in order to be eligible under the law must generally arise out of an actual transaction connected with the production or distribution of commodities. Paper cannot be rediscounted with a Federal Reserve Bank if the proceeds were used for speculation; for permanent investment, or for carrying stocks and bonds, except obligations of the United States Government. So that the Federal Reserve Banks' operations are specifically intended to serve current credit needs. Another limitation upon the paper, having the same general purpose, is in connection with the length of time for which Reserve Banks are permitted to discount paper. For ordinary commercial and industrial paper the maturity is limited to 90 days and for agricultural paper to nine (9) months. The reason that agricultural paper is allowed longer maturity is that agricultural operations generally require a longer time for their completion than do commercial and industrial operations. There is in this no departure from the principle that Reserve Bank credit must be employed to finance short-term current operations rather than long-term enterprises. In extending credit to their members the Reserve Banks are guided by their Boards of Directors and by loan committees appointed by Directors who have complete discretion in the matter under the law. In rediscounting paper or obtaining advances from the Federal Reserve Banks, the Member Banks deal only with the Federal Reserve Banks and the Federal Reserve Board cannot interfere so long as they act within the law. The Federal Reserve Board cannot require any Federal Reserve Bank to make any loan or rediscount any paper nor can it require any Federal Reserve Bank to refuse any loan or to refuse to rediscount any paper which is eligible for rediscount.

(B) The Federal Reserve Banks are authorized to issue Federal Reserve Notes in exchange for gold or for paper eligible for discount. Through this power of note issue the Reserve Banks are able to supply the Member Banks with liquid currency that allows them to meet every legitimate demand of the district for additional credit beyond the banks' own resources. If I might presume to give you a clear picture of this idea in practice I would assume that a given community has an actual need for additional credit. The need is apparent by the requestsfor loans at the local bank. The bank, in order to meet the needs of its customer, turns to the Reserve Bank and borrows say $100,000 from its Federal Reserve Bank by rediscounting some of its eligible paper. The Federal Reserve Bank needing additional funds to take care of the needs of its Member Banks, pledges this $100,000 of rediscounted paper with the Federal Reserve Agent and obtains $100,000 in Federal Reserve notes, which it pays over to its Member Bank for the paper rediscounted by it. The Member Bank lends or pays out this $100,000 of Federal Reserve notes in its community, and thus they are put into circulation and the total volume of currency in circulation increased or "expanded" in the amount of $100,000. When the rediscounted paper pledged as security for the Federal Reserve notes matures and is paid off, the Federal Reserve Bank must either substitute other collateral (eligible paper or gold) or retire the notes. If the credit needs of the community have decreased in the meantime, the notes probably will have been returned to the Federal Reserve Bank, either through its Member Bank or through other Federal Reserve Banks, and it will retire them. Possibly some of them will be paid to the Federal Reserve Bank in payment for the very paper which it had pledged as collateral for their issuance, and their retirement will be practically automatic. When the underlying commercial paper is paid off and the Federal Reserve notes are retired the total value of currency in circulation will have been decreased or "contracted" $100,000. In this way the total volume of Federal Reserve note currency automatically expands and contracts to accommodate the changing needs of commerce, industry and agriculture. A Federal Reserve Bank cannot get Federal Reserve notes without putting up 100% commercial or agricultural paper or gold itself as security, and when the volume of available commercial or agricultural paper decreases it must either retire the currency or put up gold as security.

If I have made myself clear you have in your mind a picture of how the elastic currency of the Federal Reserve works in practice. You have seen (1st) where the necessity for it originated out in the district; (2nd) how the Member Bank acquired it by offering eligible paper of its customers equal to 100% as security; (3rd) how the money went into general circulation through the channels of trade and industry; (4th) how the currency is retired automatically when the credit needs of the community no longer require its circulation.

The Reserve Banks have no power to issue notes except in exchange for gold or eligible paper. They cannot create currency out of nothing. The need for the notes must arise out of the actual requirements of the community. The Federal Reserve Notes are first liens on the assets of the Reserve Banks and are also obligations of the United States Government. They are redeemable in gold at the Treasury of the United States and in gold or lawful money at any Reserve Bank, and a 40 per cent minimum gold reserve must always be maintained againstthem.

In the early periods of the system, the use of Federal Reserve Notes as additional currency credit was not generally resorted to <u>in times of increased demand or necessity for additional credit</u>, but as the World War continued and finally involved America the demand for currency with which to carry on and adequately finance the business needs on account of the great inflation in prices, increased very rapidly. On January 1st, 1917, just before we went into the war, the outstanding Federal Reserve Notes amounted to $17,588,100. On January 1st, 1918, the amount was $1,350,764,225.

On January 1st, 1919, the amount had increased to $2,859,843,920.

On January 1st, 1920, this amount had increase to $3,295,789,145.
And on December 23rd, 1920, it reached its peak of $3,404,931,000. in actual circulation.
Since that date the tendency in the main has been downward and on November 28th, 1923, it stood at $2,246,000,000.

The high discount rate of six per cent (6%) effected by the Reserve Banks in January and February, 1920, was undoubtedly to be taken as a warning that expansion was reaching a high point and having its effect on legal reserves which were declining, with the thought, undoubtedly, that this high rate of discount would have the effect of slowing down the demand for money. On the contrary - and to the surprise and astonishment of all, past experiences and practices reversed themselves and the demand for money began to increase. Early in June the rate was increased in four of the Reserve Banks to 7% without any apparent effect upon the demand for money which reached its high point in December, 1920, when the total amount of Reserve notes issued and in circulation totaled - $3,404,931,000.

The statement made by a former Comptroller of the Currency to the effect that the largest amount the National Banks of the country had ever borrowed in one year prior to 1913 through rediscounts and bills payable was - $100,000,000 brings most forcibly to our attention the almost incomprehensible figures to which the country's credit had been expanded since the inauguration of the Federal Reserve System.

The discount rates of the System have varied greatly at different times, However, when we recall the conditions through which the country has passed since the System was established in 1914, it does not appear in any sense unjustified. In view of the abnormal conditions resulting from the World War with its attendant inflation, so natural to carrying on war activities, the Post-War period when every line of production was more or less over-stimulated together with the tendency toward extravagance and speculation and added thereto, the further obligation of the Federal Reserve System to act as Fiscal Agents for the Government in financing the war which required the floating of over $20,000,000,000 of Bonds together with a large amount of short time government obligations, it quite naturally was to be expected that discount rates should or would vary quite materially.

The discount rate of six per cent (6%) was established with the System in 1914. Between 1914 and January, 1920, the rate varied but never again reached 6% until the latter part of January, 1920, and later in 1920, went up to 7% in Boston, New York, Chicago and Minneapolis.

(C) The Federal Reserve Banks hold all the lawful reserves of the Member Banks, that is, nothing that a Member Bank holds, not even gold or other cash in its vaults, counts as reserve by law, except the amounts held on deposit with the Federal Reserve Bank. The concentration of reserves and making them available at any point within the System, and at any time, has made it possible to reduce reserve requirements and at the same time renders banking much safer throughout the country. The Reserve Act has reduced the requirements for reserves on demand deposits from twenty-five per cent (25%) in reserve cities to ten per cent (10%), and on time deposits from twenty-five per cent (25%) to three per cent (3%); and in country banks the reduction has been from fifteen per cent (15%) to seven per cent (7%) on demand deposits and from fifteen to three per cent (3%) on time deposits.

There is no doubt that the Federal Reserve System through its reserve policy is rendering the country a great service in maintaining the integrity of deposit reserves, and in pooling these reserves in order that they may be available in time of need to the Member Banks and to any other function of the System.

One of the greatest deficiencies in the old banking system prior to the enactment of the Federal Reserve Act, was the system of maintaining bank reserves consisting partly of cash in vault and partly of balances with correspondent banks which in turn carried part of their reserves in the form of balances with other banks which were permitted to lend a large part of such reserve deposits to their customers so that the ultimate reserves of the country were invested in loans which might not be collectible in the time of need. And the greatest deficiency in our present banking system results from the continuance of this very same practice by banks which are not members of the Federal Reserve System. A reserve intended to protect the depositors of a bank which consists largely of loans to the patrons of the correspondent banks cannot in its final analysis be considered any more of a reserve than the notes in the portfolio of the original bank, and it cannot compare as a deposit protection to the reserves held in the Federal Reserve System, which must always be protected by a gold reserve of not less than thirty-five (35%) and in addition having the advantage of being available for use at any point of emergency.

The history of past financial panics which have caused so much trouble and worry to bankers and depositors will show in practically every instance that the reserves which were intended as a protection to depositors, had in nearly every case, been dissipated and as a consequence reserve protection was not available in the time of need. This cannot happen under Federal Reserve Banking.

(D) In addition to clearing intra-district checks the Federal Reserve

System has set up a machinery by which balances between districts can be settled by book entries without the shipment of cash. This is done through the gold settlement fund in Washington held in custody by the Federal Reserve Board. Each reserve bank has placed with the Reserve Board a part of its reserves and whenever one reserve bank wishes to transfer funds to another it does so by wiring to the Board to make an appropriate entry on the books of the gold settlement fund. The Board daily notifies each Reserve Bank of the total debits and credits to its account and of the amount of gold it owned at the end of the previous day's business. This plan has done away with exchange charges for drafts within the country; has eliminated much time lost and expense incurred in the shipment of currency and has made business dealings between different parts of the country more expeditious and economical.

EARNINGS.

Par. 55 - Section 7.

> "After all necessary expenses of a Federal Reserve Bank have been paid or provided for, the stockholders shall be entitled to receive an annual dividend of six per centum on the paid-in capital stock, which dividend shall be cumulative. After the aforesaid dividend claims have been fully met, the net earnings shall be paid to the United States as a franchise tax except that the whole of such net earnings, including those for the year ending December 31, 1918, shall be paid into a surplus fund until it shall amount to 100 per centum of the subscribed capital stock of such bank, and that thereafter 10 per centum of such net earnings shall be paid into the surplus."

The plan for providing a surplus equal to 100% of the subscribed capital was not a part of the original Act but came as an amendment in March 1919. At this time the Federal Reserve Banks with the exception of the Federal Reserve Bank of Dallas, Texas, have a reserve of not less than 100% built up out of net earnings. The last statement as to net earnings and their distribution was as follows for the System:

Dividends paid	$ 37,395,205.
Transferred to surplus	218,369,549.
Franchise tax to Govt.	135,387,941.

Under this system of a fixed dividend, the incentive for earning unusually large profits is largely removed. The earnings of the Reserve Banks are largely governed by the volume of credit needs of the country and necessarily will vary in accordance with the volume of business.

During the years when the Reserve Banks were handling the governmental war finance activities 1920-1921, the Reserve Banks paid the Government $120,000,000; in 1922 they paid about $10,000,000. The necessity of meeting all overhead expense of the Federal Reserve System including the expense of the Federal Reserve Board at Washington, is a direct obligation of the Reserve Banks, as the Government is under no expense for or on account of the Federal Reserve System or any of its branches. The surplus which the Banks accumulate belongs to the Government in case the bank or banks should be liquidated. The member banks under the law can under no circumstances receive more than the return of their capital and six per cent (6%) interest on their investment.

I hope I have made this point clear to you. The earnings in this institution to its stockholders can in no event exceed six per cent (6%). The earnings during the years America was actually engaged in the war were very heavy on account of the large volume of Government financing that was cleared through the Reserve System, and in addition thereto, the profit that naturally accrued to the system through the large volume of note issues and rediscounting necessary to care for the increased volume of business that on account of high prices necessarily required a greater volume of credit in order to function. Observations of the past few months as to the tendency of income would lead one to the conclusion that under normal conditions the problem of the future will be how to meet the overhead expenses of the system, rather than one of curtailment of net earnings.

To go into minute detail of the operation of the Federal Reserve System would take a great deal of time and in the end would no doubt leave you so confused as to query, what is it all about. I have endeavored to give you a clear picture of the fundamental principles and how they operate:

1st As to the purpose of the Act

2nd As to the membership of banks in the system

3rd The organization of the twelve original banks

4th As to the class of paper eligible for rediscount

5th. The power of note issue.
6th. The method of note issue.
7th. The purpose of the rediscount rate.
8th. The reserves and how the Act changed the legal requirements.
9th. Distribution of Earnings.

If I might ask your further indulgence without encroaching too largely upon the time of others, it would be for the purpose of commenting briefly on the System both from the standpoint of its shortcomings as well as its advantages as I have come to understand them during the past few months' experiences.

Many complaints have come to me especially from the Middle West with respect to the high interest rates prevailing in many States. The remedy for the criticism which in many instances is warranted must come from the hands of the legislators of those states where exorbitant rates are exacted. Many, if not all, states have an established maximum legal rate and the custom in the States is to adopt it as the current rate for loans. The remedy is- the State; as the Federal Reserve Board has no power to control interest rates charged borrowers by member banks.

The Federal Reserve Banks at this time have a uniform discount rate of $4\frac{1}{2}$ percent. The rate is the same to all banks in the System. No discrimination is permitted in the established rate of the Federal Reserve Bank as against any of its members. The rate to the borrower, however, in many States, appears to be very much in excess of the reserve rate and in some instances, the spread between the Federal Reserve rate and the legal rate is so wide that it tends to encourage banks in borrowing from the Federal Reserve and loaning to their customers for the profit that can be made on the spread. Where the practice is followed of loaning money at maximum legal rates as fixed by State laws, naturally follows that a low Federal Reserve rate could have no bearing on the rates paid by the customer of the bank, as they are governed by the State Law.

It must be said, however, in fairness to the banker that the practice of holding closely to a maximum legal state rate does not appear to be the general rule as there are many evidences in different parts of the country that money is loaned on a very small margin, while, in others the criticisms made are justified as the spread appears to be too wide.

The principle underlying the Federal Reserve System is not one that encourages profiteering by member banks. The evident intent of Congress was that the Federal Reserve Bank should be regarded as an institution to be used in times of emergency, or to meet seasonal requirements for additional credit and finance whenever local banks were unable to do so out of their own resources.

It is not inconceivable that the custom of following legal state rates as a guide for current rates, may have contributed largely to the expansion in our credits that developed so rapidly in 1919 and 1920. The evident intent of the Federal Reserve Board in increasing the rate to 6% in January, 1920, was to warn the country of the dangers that would follow if the expansion of credit continued, as the reserves, at that time, indicated a rather material reduction in the ratio. But, contrary to all precedent or expectation, the reverse of what was hoped for happened, as the increase in the rate did not lessen the demand for credit. And a few months later the rate was raised to 7% in four banks of the System; evidently, with the same intent and purpose in mind. Here again the increase in the rate was without immediate results as the expansion continued for several months following; and it might not be an unreasonable deduction to infer that the borrowers in the country (the Middle West and South were heavy borrowers) were not fully informed of the serious expansion that was taking place throughout the country and could not be disturbed by any increase in the discount rates they were and had been paying, the maximum state rate which could not have the effect of acting as a note of warning as the rate was not unusual. It did, however, serve as a warning to the bankers of the country. They were men of experience who knew that this great increase in the Federal Reserve rate had for its purpose but one object and that was: to, in some manner, effect a slowing down in the demand for credit. This warning should have been heeded, and in all probability, was to some extent; but in many instances the natural prudence and caution that was to be expected from the conservative banking class was either submerged in their desire for profits; or the situation had gone beyond their control.

The record shows that the Federal Reserve System was quite generally used by the member banks for rediscounting paper after America entered the war and later on member banks discounted very extensively for non-member banks. In the Mississippi Valley, where production is heavy and the marketing of farm commodities, including live stock, assumes large proportions, there is a great necessity for heavy financing throughout seasonable portions of the year. This is especially true where co-operative marketing has developed to the point where it is handling the larger portion of farm products of that area. The Middle West section was a heavy borrower throughout the years of 1919 and 1920 which at its height became very embarrassing to some members of the Federal Reserve System. The records of membership disclose the fact that not over one-third of the banks in the Mississippi Valley were members of the Federal Reserve System and that many of those that were members of the Federal Reserve System were not discounting any paper, consequently, were giving no extra service to the community beyond their own resources.

The Seventh District, which is served by the Chicago Federal Reserve Bank, showed that on December 30th, 1920, that bank had a membership of 1421 banks in the district; 358 of which were state banks and 1063 were national banks. There may have been some slight increase in the membership at this date, but the records will show that since the 1923 Amendment to the Act there are 3074 eligible banks in the Seventh District. The high point for loans in this district was reached in October, 1920, and on that date there was a total of 813 banks borrowing and located in the following states of the District: Illinois - 175; Indiana - 103; Iowa - 369; Michigan - 104; and Wisconsin - 64; thus we have at the time of emergency only 813 out of approximately a total of 2000 eligible banks in the district that were endeavoring to be of service to the district at a time of national emergency such as prevailed in 1920. This lack of membership contributed greatly to the embarrassment of the discounting banks and curtailed very materially the efforts of the Reserve Bank to serve the district. The disinclination of the country banks to become members of the system worked a hardship on such banks as attempted to serve the country in that they were obliged to rediscount or borrow to such an extent that their condition soon became overextended and dangerous. The practice of country banks functioning through correspondent city banks has grown enormously and it is not unusual for city banks to act as correspondent for hundreds of individual country banks. And in order to retain the country bank accounts, the city banks pledge themselves to come to the financial aid of the country banks in times of need, and, in order to do so, often find it necessary to borrow very heavily from the Federal Reserve Banks in amounts wholly out of all proportion to their capital and surplus.

Under the old system of national banking, banks were permitted to rediscount to the amount of their capital stock and surplus; under present conditions the reserve banks have fixed the basic line for borrowing member banks at considerably beyond that point. To illustrate, take a hypothetical case - The basic line in most cases would be $2\frac{1}{2}$ times its capital, or $1,500,000 for a bank with a capitalization of six hundred thousand dollars. Its individual deposits total seven million dollars. ($7,000,000). This bank borrowed from the Federal Reserve Bank of its district Four and One-half Million Dollars ($4,500,000), or seven times its capital. Common sense and ordinary business prudence would cause any man in this audience to inquire as to how the Directors in a bank of that kind could justify this condition. While the illustration is not an actual picture of any bank, it is typical from the standpoint of Reserve and Capital to its rediscount liabilities. To illustrate further, suppose this bank had, approximately, two hundred country banks as clients. Would it not have been the better part of wisdom for those two hundred country banks to have joined the System and placed their institutions in a position to make their loans direct with the Federal Reserve Bank and by so doing avoid the additional charge to the correspondent bank and allowed this charge to accrue to the benefit of borrower, which in itself would have been a substantial saving, when considered in the light of the large volume of rediscounting necessary in this country? The liability to the Federal Reserve Bank would have been no greater than it was to the city bank, and the local bank would have been in a much better position to serve its customers according to their needs and the needs of the community.

The incentive of the borrower should be to undertake to procure his necessary loans at the very lowest rate and his bank should be willing to offer every facility that would enable him to do so. It should be the purpose of the local bank to reach as directly and cheaply as possible the fountain-head of its emergency resources and this can be done through a membership in the Federal Reserve System.

There are, as I view it, many obstacles to overcome before the membership in the system will reach the point that will enable every community to get the most direct benefit. Some non-member banks, in many instances, have not reached the point where they can see any advantage in being a member. Others are not members because of reasons that apply only to the material side of business - profits. It is perfectly natural that any banking institution should be alive to the necessity of earning dividends on its capital, but the necessity for giving service and protection to its patrons is a prerequisite to earnings. When the customers of a bank have knowledge that their deposits are protected by a reserve that cannot be dissipated, it becomes more of an asset to the bank than could possibly accrue to it from 2% on the small reserve now required.

The most serious drawback to the Federal Reserve System at this moment is the attitude of many of our people toward the Federal Reserve Board and the Federal Reserve Banks. It is regrettable that the business and farming interests and borrowing public generally have not been taken into a more intimate confidence and more fully informed on the objects, purposes and intent of this system, in order that they might intelligently understand its functions and comprehend its effectiveness. The majority of letters I receive indicate very clearly that the Federal Reserve System in its policies and functions is not understood and many people are wholly uninformed or misinformed as to its objects. If we were dealing with an ordinary piece of legislation or some academic problem the matter would right itself because it would have the support of the interested classes who would see that it was properly presented, but here we have a corporation -

semi-public in its nature (by reason of governmental supervision). It is probably the most powerful and at the same time, the most far-reaching in its function of any system that the world has ever known, and, in a word, it is least understood. I, personally, can lay no claim to any great amount of superior knowledge of the System but it can be understood and should be understood by all the people through the best of information that can be had as well as the widest distribution of same. I have no thought of going into a discussion over the charge so often made that the Federal Reserve Board had arbitrarily ordered deflation. I deem it my duty, however, to leave with you the information I have on the subject which I obtained largely from the records of the Reserve Board and without going into details, I will say that I find no record in the official minutes of the Board where an order was promulgated or acted upon in any manner. I have repeatedly had assurance from two members who were members of the Board in 1920 that no action of any kind having for its object a demand for liquidation, was ever taken.

The Conference of May 18, 1920, which many people claim was called for the purpose of demanding liquidation, was one of the conferences which are held each year in accordance with the provisions of the Reserve Act, and, in order that you might have the full text of the Conference at first hand and be able to study it at your leisure, I have brought every available copy with me and same can be had at the Secretary's table.

It would be well to keep always in mind the thought that the Federal Reserve Members are only human and subject to human limitations, experience proves that humanity is prone to err. There is no doubt but what the

Federal Reserve Board made mistakes; the Federal Reserve Banks have made mistakes; the bankers of the country make mistakes; business men make mistakes and farmers are not immune from mistakes. No one who had to do with the eventful times and conditions can claim absolute immunity from blame. What the attitude of the individual Reserve Banks was during those eventful days is unknown to many. What the Member Bank demanded from its customers, I have no way of knowing. What the correspondent city bank demanded of the local country bank will probably never be made public. What the country bank told its customer can only be imagined. What the status of the borrower was and whether his loan was essential or non-essential, he alone must be the judge. But, in the course of time the history of our age will be recorded. To a great extent it will be a repetition of the experiences of war periods that our country has passed through since its existence as a nation. We have been told of the experiences of the Revolutionary period and the disastrous conditions that followed the war.

The history of the War of 1812 records the same identical experience and the same after-war disastrous effects. In 1837 the agitation and subsequent legislation which disorganized the United States Bank brought about a national calamity.

Following the Civil War we had the usual period of contraction and the record of our own time will show that the ages had not been able to teach the American people how to profit by experience and that they have not come to an appreciation of the disaster they would encounter in the post-war years of the World War and which are now known to have been the most disastrous that America has ever experienced.

That something out of the ordinary must have added incentive to the deflation in commodity prices in 1920 seems reasonable to believe. Personally, I have had many men of unquestionable integrity assure me that arbitrary demands were made for liquidation and that liquidation to them meant bankruptcy. I hope that those who have had such an experience will speak up and tell how and by whom and under what circumstances, they were required to liquidate in order that full responsibility for any unjust deflation could be established. Nothing can come from any further agitation on the subject except as it serves as the means of enabling us to create such safe-guards as will obviate and prevent such disastrous results.

My statement as to what was said and who said it and when and where, will always be a subject for discussion without a solution as to who was at fault unless those who had such experience will speak up and tell what happened. The Federal Reserve System is recognized as an established institution and its value to the country in times of emergency and financial need is acknowledged even by its enemies. That it is the last word in finance and credit and that it has functioned efficiently in every instance is not our contention. Many suggestions are offered from time to time and many amendments have been made by Congress in order to increase the efficiency of the System to the borrowing public. It is entirely probable that additional changes will be made in the System from time to time and these will be largely based upon the knowledge we have gained from our past experiences.

To one who has been privileged to observe the operations of the

Federal Reserve System in practice and compare it with the financial machinery of other nations, there comes the thought that the mind that conceived the idea was that of a genius. It not only has stood the test of the World War which involved the most severe credit strain that history has ever known, but also brought our country to a financial position far above that of the other nations engaged in the conflict.

I hold that the first essential to the maintenance of a successful credit and currency system is a loyalty of its members that will command the confidence of the people with whom they deal.

The Federal Reserve Board at Washington and the Directors of the different Federal Reserve Banks do not deal directly with the public, consequently, have nothing but indirect contact and second hand information as to what is actually transpiring. This is unfortunate in one respect in that it does not give the Federal Reserve Board or the Directors of the Federal Reserve Banks the personal contact with people of the country that is necessary to a thorough understanding and more intimate knowledge of conditions at first hand. The inability or neglect of the Member Bank to make clear to its customers on every occasion the reasons for the bank's inability to meet requests for credit has created a situation that will be years in the undoing.

In order that this statement might not be misinterpreted or that the impression might go forth that it was a personal feeling and more or less prejudicial, I want to quote you verbatim what a very prominent banker of Chicago has said on this subject in a speech delivered at Atlantic City, in September, 1923, to the assembled delegates of the American Bankers' Association:

"Nevertheless, the harm done by the publicity given to the conditions of those engaged in agriculture is almost immeasurable and all of us are to some extent responsible, because in some way most of us have contributed to the farmers' feeling that he is not so much the victim of the circumstances of his own industry, as of the machinations of all elements of business, finance and government.

"As bankers, we contributed to this feeling when we sought to blame our demand upon the farmer for payment on the cruel activities of the Federal Reserve Bank and the Federal Reserve Board. Our cowardly action in failing to tell our farmer friends the truth, which was that we had loaned too much money and were hard up and needed to collect rather than that we were being made to do so by some government agency, is bearing abundant fruit today, and we have ahead of us a tremendous task to correct the false impression for which we are responsible."

If the System cannot have the most loyal support and hearty co-operation of its members, it will be difficult, indeed, to hope for a permanent continuance of its success. Its efficiency will always depend upon the manner in which the banks as well as the public support it. It is recognized by many as the institution in America that is to act at all times as a barometer of finance and credit and its efficiency in serving the people will always depend upon the manner in which all of the agricultural and business interests of the country are willing to be guided by its warnings.

In conclusion, I, personally, can see nothing in the present credit situation that in any way appears alarming. The country as a whole appears to be in an easier situation financially than a year ago.

Agriculture, on the whole, has made substantial progress toward recovery and while there are many reasons for the optimistic feeling over the partial return of a more prosperous condition, the situation is not one to warrant the farmer in indulging in any extraordinary extravagance. That there has been a large amount of liquidation on the part of the farmer is conceded; however; this has not been due entirely to profits on current operations, as the mortgage indebtedness on farms has been materially increased during the process of liquidation that has been going on, and this gave color to the thought that farmers have to some extent reduced the loans made for current obligations by increasing mortgage indebtedness on farms which is literally true in many cases, and until that problem has been met and permanently adjusted, agriculture cannot be said to have met all post-war readjustments.