

provided out of current revenue, nor can the work of restoration be postponed until the reparation due from Germany under the treaty of peace has been received. Under these circumstances the powers represented at the conference recognize that the capital sums required for this restoration may properly be raised by market loans in anticipation of the reparation payments provided by the treaty and that the restrictions which they desire to see placed on new borrowings do not apply to loans and credits raised for the purpose of meeting this abnormal capital expenditure.

(8) The powers represented at the conference have taken under consideration article 235 and cognate articles of the Treaty of Versailles and the passages in the letter addressed on the 16th June, 1919, by the Supreme Council to the German peace delegates, which contemplate that Germany shall make proposals for fixing the total of the payments to be made by her by way of reparation and that facilities may be given her to obtain necessary foodstuffs and raw materials in advance of payments being made by way of reparation. The powers are agreed that it is desirable in the interest, alike of Germany and her creditors, that the total to be paid by her for reparation should be fixed at an early date. They observe that under the protocol to the treaty a period of four months from the signature of the treaty was provided during which Germany should have the right to make proposals of the kind referred to, and they are agreed that in the circumstances as they exist to-day such period should be extended.

Call Money Rates.

On March 8, 1920, the Senate adopted the following resolution:

Resolved, That the Federal Reserve Board be, and is hereby, directed to advise the Senate what is the cause and justification for the usurious rates of interest on collateral call loans in the financial centers, under what law authorized, and what steps, if any, are required to abate this condition.

In its letter of reply, under date of March 27, 1920, the Board invited attention to tables published in the Federal Reserve Bulletin (March 1920, pp. 286-287) showing discount and interest rates prevailing in various centers in all Federal Reserve districts during the two most recent 30-day periods ended, respectively, January 15 and February 15, 1920. "It will be seen from these tables," the letter continues, "that the maximum and minimum rates on demand loans secured by collateral are approximately the same as those for commercial paper in all cities except Boston and New York. While the legal rate of interest in Massachusetts is 6 per cent, higher contract rates are authorized, and consequently the 6 per cent limitation is occasionally exceeded.

"The only financial center in this country in which there is maintained a call money market of national importance is New York City, and while the rates charged there on call loans are frequently in excess of the legal rates allowed for commercial paper, they are not "usurious" under the laws of the State of New York, which specifically exempt collateral call loans from the 6 per cent limitation which lenders must observe on other loans on pain of incurring the penalty prescribed for usury. Section 115 of the banking law (L. 1914, ch. 369; Consol. L., ch. 2) provides that upon advances of money repayable on demand to an amount not less than \$5,000 made upon warehouse receipts, bills of lading, certificates of stock, etc., or other negotiable instruments as collateral, any bank may receive and collect as compensation any sum which may be agreed upon by the parties to such transaction. The section reads:

"*Sec. 115. Interest on collateral demand loans of not less than five thousand dollars.*—Upon advances of money repayable on demand to an amount not less than five thousand dollars made upon warehouse receipts, bills of lading, certificates of stock, certificates of deposit, bills of exchange, bonds, or other negotiable instruments, pledged as collateral security for such repayment, any bank may receive or contract to receive and collect as compensation for making such advances any sum which may be agreed upon by the parties to such transaction.

"Section 201 of the banking law, identical in language with section 115 above quoted, makes the same provision in the case of collateral loans by trust companies. In the general business law (L. 1909, ch. 25; Consol. L., ch. 20) there is the following general provision of a like character:

"*Sec. 379. Interest permitted on advances on collateral security.*—In any case hereafter in which advances of money, repayable on demand, to any amount not less than five thousand dollars, are made upon warehouse receipts, bills of lading, certificates of stock, certificates of deposit, bills of exchange, bonds or other negotiable instruments pledged as collateral security for such repayment, it shall be lawful to receive or to contract to receive and collect, as compensation for making such advances, any sum to be agreed upon in writing, by the parties to such transaction.

"*National-bank act.*—The national-bank act provides that national banks may receive and charge on any loan or discount interest at the rate allowed by the law of the State, Territory, or District where the bank is located. The applicable provision reads:

"*Limitation upon rate of interest which may be taken.*—422. Sec. 3197. Any association may take, receive, reserve, and charge on any loan or discount made, or upon any note, bill of exchange, or other evidences of debt, interest at the rate allowed by the laws of the State, Territory, or District where the bank is located, and no more, except that where, by the laws of any State a different rate

is limited for banks of issue organized under State laws, the rate so limited shall be allowed for associations organized or existing in any such State under this title. When no rate is fixed by the laws of the State or Territory or District, the bank may take, receive, reserve, or charge a rate not exceeding seven per centum, and such interest may be taken in advance, reckoning the days for which the note, bill, or other evidence of debt has to run. And the purchase, discount, or sale of a bona fide bill of exchange, payable at another place than the place of such purchase, discount, or sale, at not more than the current rate of exchange for sight drafts in addition to the interest, shall not be considered as taking or receiving a greater rate of interest.

"It will be observed that the effect of the foregoing provisions is to authorize in the State of New York on collateral call loans of not less than \$5,000 rates of interest which may be in excess of those permitted for loans of other character, and that such higher rates are not prohibited as usurious.

"As to the 'cause and justification' of the high rates of interest which it thus appears may legally be charged on collateral call loans in New York, and as to the 'steps * * * required to abate this condition,' there is, as is well known, a wide difference of opinion among persons who have given thought and study to the question. Indeed, broad and fundamental questions of general economic and social policy are involved—in the last analysis, the whole question of the utility of speculative dealings in securities and commodities or organized exchanges is involved; and more immediately, the question of the methods and practices of the leading speculative markets of the country, margining, stock manipulation, and kindred matters also susceptible of abuse. As to these the Board has never had occasion officially to form an opinion; the Federal Reserve Act specifically precludes the purchase or discount by Federal Reserve Banks of 'notes, drafts, or bills covering merely investments or issued or drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities, except bonds and notes of the Government of the United States.' The Board could not undertake to form a judgment upon the matters above referred to without study and investigation of such a comprehensive nature as would seriously interfere with the conduct of its regular work and which, had the Board the requisite authority, would require the services of experts and assistants for the employment of which the Board does not feel authorized to expend funds accruing from statutory assessments on the Federal Reserve Banks for the purpose of defraying the ordinary expenses contemplated by the Federal Reserve Act.

"There is submitted as an appendix hereto a memorandum prepared for the information of the Board by the Federal Reserve Agent in New York, explaining in general the nature and operation of the New York call money market and causes of high and fluctuating rates for call money in that center."

Respectfully,
W. P. G. HARDING,
Governor.

The PRESIDENT OF THE SENATE.

[Appendix.]

THE NEW YORK CALL-MONEY MARKET.

Definition of call loans.—Collateral call loans, in the general acceptance of the term, are made chiefly in New York City, which is practically the only important call-money market in the United States. They are loans which are payable on demand of the lender without previous notice, secured by the pledge of investment securities, i. e., stocks and bonds, generally those which are dealt in on the New York Stock Exchange. The interest rates on these loans, as on other classes of loans, are on the basis of a rate per annum.

The borrowers.—The loans are made for the most part to houses which are members of the stock exchange and the money so borrowed constitutes a portion of the funds employed ordinarily in purchasing and carrying securities for their customers and sometimes for themselves.

The lenders.—The principal supplies of money for collateral call loans are loanable funds of banks and bankers located both in and outside of New York City, including foreign banks and agencies of foreign banks; and similarly the loanable funds of firms, individuals, and corporations seeking temporary investment. The proportion of the whole fund loaned by these several interests varies seasonally and in accordance with the attractiveness of other opportunities for investment, either locally or in other markets. The bulk of call money is lent on the floor of the New York Stock Exchange at "the money post," where through various brokers loanable funds are offered and bids for funds are received. Most of the business is done between the hours of 12 noon and 2.45 p. m. The important relation to the money market of the present system of daily settlement of balances resulting from the purchases and sales of securities on the stock exchange will be discussed more fully hereafter.

Commercial requirements have the prior claim.—In the matter of the supply or attraction of funds to the call-money market, there is generally a definite and well-understood obligation on the part of banks to accommodate first their own commercial clients, so that it is only the excess of loanable funds which they may have from time to time that is available for the collateral call-money market or for the purchase of commercial paper in the open market. This excess of loanable funds available for employment in the securities market varies, therefore, according to the commercial requirements of the country. It has long been recognized that for assurance of a sufficient amount of money to finance the volume of business in securities, reliance can not be placed on a rate of interest limited to the rates which obtain or are permitted in commercial transactions whose prior claim on banking accommodations is universally conceded.

CAUSES AFFECTING PRESENT CALL-MONEY RATES.

The reference in the resolution to the present high rates for call money in the financial centers and the inquiry as to

their causes require, it is felt, a survey of the operations of the money markets and the reflection therein of the underlying economic conditions which govern, in varying degrees, all money rates, including those for call money.

Present changed conditions of supply.—In former times, and specifically prior to the institution of the Federal Reserve system, bankers, especially in reserve centers, were accustomed to look upon call loans as their principal secondary reserve on the theory that inasmuch as those loans were payable upon demand, funds so invested could always be promptly obtained on short notice to meet withdrawals of deposits or for other use. In these circumstances there was ordinarily available for collateral call loans a supply of funds sufficient for ordinary market requirements and at low rates, although at times the rates rose to high levels as the supply of funds diminished, or the demands increased.

This attitude of the banks toward call loans as their chief secondary reserve has been greatly modified by two causes. The first was the closing of the stock exchange at the outbreak of the European war in the summer of 1914, when it became practically impossible to realize on call loans secured by investment securities, which became, therefore, "frozen loans." This resulted in a more or less permanent prejudice against dependence upon call loans as secondary reserves. The second and more important factor was the creation of the Federal Reserve system.

Under the terms of the Federal Reserve act provision is made for the rediscount of commercial paper, but the rediscount of loans for the purpose of carrying investment securities, other than United States Government obligations, is excluded. Consequently, in order to maintain maximum liquidity, with suitable provision for secondary reserves that can be immediately availed of, banks, including foreign agency banks, now invest a greater proportion of their resources in assets that can be realized upon at the Federal Reserve Bank. Another changed factor in the present situation grows out of the fact that the war and postwar conditions have rendered unavailable supplies of money which formerly came from foreign banks. Since the summer of 1914, while total banking resources have largely increased, the volume of bank money available to the securities market at low or normal rates has not increased proportionately, but on the contrary has probably decreased. All of these circumstances explain in some measure the increased rates which have often been required during the past year for money loaned in the securities market.

Present changed conditions of demand.—Changed conditions are also present in the factors governing the demand for money. Prior to the armistice agencies of Government were employed to restrict the issue of new securities for purposes other than those which were deemed essential for carrying on the war. At the same time, as the Treasury undertook to sell large amounts of certificates of indebtedness and Liberty bonds bearing low rates of interest, the question arose as to whether the competition of the general investment markets might not prejudice the success of the Government issues. In these circumstances, with full understanding on the part of the Treasury Department, the officers and members of the New York Stock Exchange undertook to limit transactions which would involve the increased use of money for other purposes, in consideration of which the principal banks of New York City endeavored to provide a stable amount of money for the requirements of the security market.

After the armistice these restrictions were removed and ordinary market forces reasserted themselves. The issuance of new securities was resumed in unprecedented volume and consumed a vast amount of capital and credit

when bank credit was already expanded by the necessity of carrying large amounts of Government securities which the investment market was not prepared to absorb. Thus arose a further cause for the increased cost at times of accommodation on collateral call loans.

Since the armistice these causes have been augmented by the increased volume and velocity of transactions in securities generally. Before examining the figures, it should be explained that the amount of call money employed by the securities market fluctuates according to the amount of other funds available for this purpose, i. e., customers' money invested and time money borrowed, and also as the volume of business varies.

Volume.—The volume of money outstanding on call if more or less constant, fluctuating only over relatively long periods, and the amount which is loaned from day to day is but a small proportion of this constant volume. The constant volume of outstanding call loan bears a rate of interest which is determined daily and is known as the renewal rate. The daily borrowings, either in replacement of loans called for payment or representing new money borrowed, are made at rates which may or may not be the same as the renewal rate and which frequently vary during the same day.

Turning to the figures, it appears that over a period of years during the prewar period the volume of all money, both time and call, employed in the securities market was estimated at about \$1,000,000,000, of which the average on call was about 60 per cent and the average on time about 40 per cent, or a normal volume of call money, say, of \$600,000,000. The daily turnover in call money, i. e., old loans called for payment, loans made in replacement thereof, and new money borrowed, ranged from \$15,000,000 to \$30,000,000, and averaged about \$20,000,000. The daily turnover during the year 1919, however, ordinarily ranged from \$25,000,000 to \$40,000,000, and averaged about \$30,000,000. Moreover, it is important to notice there has been a disproportionate increase in the amount of call loans, as distinguished from time money, with the consequence that the former, it is now estimated, constitute about 75 per cent of the total money employed in the securities market. At a time of such heavy credit requirements as the present the greater volume of borrowings, not only in the aggregate but in the day to day demands, naturally often results in high rates for the money loaned. Indeed, so reluctant have the bankers been during the past few months to supply the large demand for credit based on securities that the occasional loaning of relatively small amounts of money at very high rates often represents a desire not to secure the high rate quoted but to prevent the rate from going very much higher with the consequent demoralization which might result.

Intermittent factors.—There are certain other factors, the influence of which is principally manifested in intermittent wide fluctuations in the daily rates or in the rates which apply for brief periods. The increased volume of demand loans called daily for payment noted above, coupled with the decreased amount of time money loaned on securities, produces more or less apprehension on the part of borrowers as to their ability to reborrow money called for payment. This apprehension, quickened by the number of insistent borrowers bidding at times when momentarily loanable funds are exhausted or are offered in small quantity, frequently results in competitive bidding for funds which advances the rates for a day or part of a day beyond the actual necessities of the situation.

Another active and important influence which has recently affected the supply of funds available for collateral loans and precipitated at times a rise in the rates, has

been the periodic transfers of Government deposits from depositary banks to the Federal Reserve Banks in connection with the fiscal operations of the Treasury. Such withdrawals result in the depositary banks calling money from the securities market, which causes sharp advances in the rate bid for call money in replacement of the loans called for payment.

RATES ARE DETERMINED BY THE OPERATION OF THE LAW OF SUPPLY AND DEMAND.

The underlying cause of fluctuations and especially of increases in call money rates is the operation of the law of supply and demand. In other words, as the supply of loanable funds diminishes in proportion to the volume of the demand, the rate for collateral demand loans advances. However, in the case of the daily borrowings of call money—to which the abnormal high and low rates apply and which represent but a comparatively small proportion of the total outstanding loans—other factors, incidental to the temporary circumstances and conditions of the market, tend in times of stress to greater fluctuations in rates than result from the more normal operation of the law which is reflected in the renewal rate for the greater volume of the outstanding call loans. The renewal rate is regarded as the real barometer of market conditions and its fluctuations throughout the longer periods more nearly reflect the relation between the amount of the loanable funds and the amount of the demand. In other words, high renewal rates are mainly due to other demands for credit, resulting in part from the increased requirements of the commercial community and in part from other temporary factors, such as depletion of bank reserves resulting either or both from credit expansion or loss of reserves through gold export, speculation in commodities and real estate, and congestion of commercial transactions incidental to slow or interrupted transportation.

Commercial rates are similarly and independently determined.—The operation of the law of supply and demand is equally effective in determining the rate for commercial loans and all other borrowings. In fact, rates for commercial loans and rates for collateral call loans have a common root in the law of supply and demand, and the conditions which affect one, in the main affect the other, although not in like degree, as is demonstrated by the far wider fluctuation of call rates and the higher points to which they go. The rates for call money do not determine and have not exerted an important influence on the rates for commercial borrowings. It is the universal custom of the banks to satisfy first the commercial needs of their customers. They feel an obligation to customers but none to those who borrow in the open market on securities. Besides, as the resources of the banks mainly come from the commercial customers, their own self-interest compels a preference in favor of their commercial borrowers, since failure to grant them reasonable accommodation would induce them to withdraw their deposits and so reduce the ability of the banks to do business. Although the money of the banks and trust companies comprises by far the greater proportion of the money loaned on the securities market, an examination of the prevailing rates on commercial paper at times when the call-money market is particularly strained indicates that there is little causal relation between the rates for call-money and those on commercial loans. Exhibits ¹ Nos. 1 and 2, showing respectively the rates for call money on the New York Stock Exchange during the years 1906–1919 and the rates for commercial paper in New York for the period from 1915 to 1920 are attached.

¹ Lack of space precludes publication in the FEDERAL RESERVE BULLETIN of the several exhibits referred to in this article.

POSSIBILITIES OF CHANGE IN THE CONDITIONS AND METHODS OF THE CALL-MONEY MARKET.

So long as collateral call loans are made under prevailing conditions it is difficult to see how the present situation can be altered, because of the impracticability of controlling the underlying cause of high rates, which, in the last analysis, is the excess demand over supply.

An attempt to control the rates for call loans by the establishment of an arbitrary limit at a low level, without the ability to modify the causes above enumerated, which operate to increase rates, would be distinctly hazardous, for the reason that up to the point where the arbitrary rate would limit the supply of new money, speculation and expansion might proceed unchecked and the natural elements of correction or regulation would not obtain. In other words, high rates act as a deterrent to over-speculation and undue expansion of credit. On the other hand, should the supply of money available at a fixed maximum rate become exhausted, liquidation might suddenly be forced, because the demands for additional accommodation for the consummation of commitments already made could not be met. The effect of such liquidation would be to embarrass not only investors and dealers in securities, but frequently might affect dealers and merchants in commodities as well. As an example of the latter, the case might be cited of a commitment to purchase a round amount of cotton on a certain day. Many of the houses on the cotton exchange are also members of the stock exchange and frequently borrow very largely on the stock exchange against investment securities to provide funds for settling their transactions in cotton. If, therefore, when an important cotton settlement is imminent, borrowings on securities could not be availed of, the cotton transaction could not be consummated and a drastic liquidation through sale either of securities or of the cotton might be required to avoid default. Similar consequences might obtain in the cases of transactions by members of other commodity exchanges who are also members of the stock exchange and have recourse to the call-money market.

THE IMPORTANCE OF A "CALL-MONEY" MARKET.

Call money in some form is indispensable to every important financial center. There must be not only an outlet for the employment of funds temporarily idle, but a large volume of call and short-time money is essential to the successful and economical conduct of business. It is particularly essential to the international and domestic commercial business, but the diversion of the use of the major portion of such money to the securities markets is not in accordance with sound banking principles. It is to be noted that in no great world market, other than New York, is the call-money market so dependent upon investment securities and so susceptible to speculative influences. In other markets the reverse is true, as their call money is based principally on commercial paper upon which realization can be had at the central bank, at a price, in case of need. We have seen that in this country call loans on securities lack this essential quality of liquidity required for quick and certain realization, and that this fact has now been more generally taken into consideration by our lenders. But the safe and successful divorce in this country of the use of call money from its dependence upon investment securities as a basis requires careful study in order that safe and adequate methods may be substituted for the present methods of the securities market.

Term settlements.—The achievement of this end probably depends upon the successful development of a plan for term settlements of the balances resulting from operations on the stock exchange, in lieu of the present method of daily

settlements. The principal effect of such a change of the method of settlements would be to relieve the call-money market from the necessities of the securities market and release funds now used in collateral call loans based on investment securities for employment in call loans based on the collateral of more liquid securities, of a commercial nature, generally recognized abroad as the preferred bases for demand loans. From this change a broader discount market would naturally develop. Under term settlements the borrowing required by the securities market would be on the basis of short-time accommodation, i. e., for the term between settlements, whether they were weekly, fortnightly, or at other intervals.

Agitation for the improvement of the present method of settlement of stock exchange contracts has extended over some years and as the result of extensive studies and deliberations of officers and members of the New York Stock Exchange, as well as bankers, an important step has been taken to provide enlarged clearing facilities through the organization of a new corporation known as the Stock Clearing Corporation, which is expected to begin operations in April, 1920. A general description of the purposes and contemplated operations of the corporation is contained in the pamphlet attached hereto as Exhibit No. 3. The functions of this corporation include providing facilities for clearing contracts between members; for the receipt and delivery of securities between members and banks, trust companies, and others; and for the clearing of collateral call loans. It is not asserted or expected that the institution of these operations will materially affect either the amount of money loaned from one day to another on the call-money market or the rates of such loans, but it is expected that it will operate materially to decrease the amount of bank certifications on day loans, which the present practice requires in the interval between paying one call loan and replacing it with another on the same day. It should be noted that the mechanism afforded by the corporation is an indispensable prerequisite to the establishment of a system of term settlements.

The more recent and definite development toward the substitution of term settlements for the present system of daily settlements may be said to have had its inception in the action of the American Acceptance Council at its annual meeting on December 4, 1919. At that time the following resolution was adopted:

"Whereas the present method of daily stock-exchange settlements, with its dominating and often unsettling effect on the call-money market, influences adversely the development of a wide and healthy discount market in the United States:

"Resolved, That the chairman of the executive committee be authorized to appoint a committee consisting of members of the executive committee and other individuals to study the advisability, ways, and means of modifying the present system of settlements on the New York Stock Exchange and substituting therefor some system of periodical settlement, with power to take such steps as may seem advisable in the case."

A copy of the annual report of the American Acceptance Council is appended hereto as Exhibit No. 4, in which the resolution appears on page 5 and the report of the chairman of the executive committee appears on pages 16 to 27, inclusive.

The committee thus provided for was appointed and held two extended conferences in which the problem was fully discussed, both from the point of view of the banks and of the stock exchange. For illustration of the subject matter of the discussion there is attached hereto as Exhibit No. 5, a detailed report compiled by one of the members of the committee, Mr. Samuel F. Streit, chairman of the Committee on Clearing House of the Stock

Exchange, describing the term settlement operations in London and on the European continent, which presently will be published by the American Acceptance Council. Through its courtesy an advance copy of the report has been received. There are also attached, as Exhibits Nos. 6 and 7, respectively, two other publications of the American Acceptance Council, "Acceptance Corporations," by F. Abbott Goodhue, vice president of the First National Bank of Boston, Mass., and "The Acceptance as the Basis of the American Discount Market," by John E. Rovensky, vice president of the National Bank of Commerce, New York, in which, on pages 14 and 22, respectively, the necessity for term settlements as a means of relieving the call-money market from the necessities of the securities market and as a precedent to a broad and stable discount market is discussed.

The members of the committee have unanimously expressed the opinion that the adoption of a term settlement by the stock exchange would offer advantages in that it would eliminate duplication of the handling of securities and in payments. The committee holds, however, that, inasmuch as the adoption of a term settlement by the exchange would involve changes of great importance, both the banks and to members of the exchange, it will require the most careful study of the subject by the committee, and in any case the term settlement can not be put into operation until the new system of daily stock exchange settlements through the Stock Clearing Corporation, above referred to, has been perfected and has been in practical operation for a reasonable time.

Report of the Bank of France for the Calendar Year 1919.

Recent financial and monetary conditions in France and relations between the Bank of France and the French Government are discussed in the 1919 report of the bank. A condensed translation of the more important portions of the report follows:

The year 1919 has been a year of transition. It has inaugurated an era of reorganization and of peace-time labor, but has been deeply influenced by the temporary and the permanent results of the long period of hostilities. After 52 months of devoting most of its energies to war, the country now faces the problems of a readjustment to normal life.

This readjustment has encountered many difficulties that grew out of the war and by no means ended with its close; the scarcity of labor, which demobilization could only gradually restore to industry; the dearth of raw materials, fuel and fertilizers; depletion of stocks; the worn-out condition of tools; difficulties of transportation and uncertainty in regard to prices.

In spite of these obstacles, there is renewed activity, of which much is being applied to restoring the devastated districts. This began with the retreat of the invader; it has been steadily carried on by the population, whose courage nothing could break.

Investigations made from time to time by the Minister of Industrial Reconstruction show that by the end of the first six months of 1919, about half the factories in the devastated Departments were being restored or worked again. Since then this proportion has become much larger.

In the other parts of France, not actually invaded, there has also been an intense effort to reorganize and develop