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Hamlin Class

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BY
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The Boards of Trade of Massachusetts and of the United States may well take pride in the present unexampled prosperity of our country. They should take even greater pride in the realization that we have underlying this prosperity a firm foundation in the Federal Reserve Banking System.

I shall not undertake today to discuss the question as to whether our present prosperity is caused by the Federal Reserve System or by what it is caused. The real test of a banking system comes not in times of prosperity but rather in adversity. We have had eras of great prosperity throughout the United States, quickly followed by severe crises, but we can all now rejoice in the fact that in any future trouble which may threaten us we have for our protection a system of banking probably as sound as any system in the world.

The vast resources of the Federal Reserve Banks have been scarcely touched as yet, and, with the exception of the foreign trade now in a material degree financed by our own banks with the help of the Federal Reserve System, the operation of the Federal Reserve Banks has been necessarily guided by the necessity for earnings rather than the necessity for assistance to member banks.

The Federal Reserve System is in splendid condition. All the twelve Federal Reserve Banks are earning their expenses. Taking the system as a whole, for the eight months ending in August, 1916, the combined earnings of the twelve Federal Reserve Banks were over 2.7 millions of dollars, and the total current expenses were 1.3 millions, leaving an

excess of earnings over current expenses of 1.4 millions. For the month of August the excess of earnings over current expenses showed an equivalent of 7.2% dividends earned.

We all take pride in the prosperous condition of the Federal Reserve Bank of Boston. Under the Federal Reserve Act there has been a very rapid development of the acceptance business in connection with our import and export trade. Since the opening of the Federal Reserve Bank of Boston it has purchased, for its own account, acceptances amounting to over 36 millions, and has distributed acceptances among other Federal Reserve Banks to the amount of over 16 millions. These purchases have assured a market to member banks for such commercial obligations, and have provided our exporters and importers with the means of financing their operations more economically than they have ever been able to do before. At the same time it has enabled member banks to develop an entirely new class of business. With the exception only of New York City, Boston has developed a much larger acceptance business than any other point in the country. These acceptances have covered an infinite variety of commodities, among which has been hides, leather, wool, Egyptian cotton, chilled beef, and machinery. While this business is still in its infancy, there is every evidence of its rapid development.

In the matter of rediscounts of commercial paper, there has not been very much activity in Boston because of the abundance of funds in the district since the opening of the Federal Reserve Banks. A year ago, however, because of the low price and extremely large crop of potatoes in Northern Maine, the growers in that section were unable to liquidate their obligations with the banks. The banks came to the Federal Reserve

Bank for assistance, which was freely given, and the whole situation comfortably carried over until this season when a very profitable season has put the farmers on their feet again, resulting in ample funds in the banks in that district. Because of the assured assistance of the Federal Reserve Bank the banks in Northern Maine were able to carry their customers through the winter without anxiety, and undoubtedly saved the Maine farmers from heavy losses which they would have experienced had they been obliged to clean up their obligations to the banks.

At one time the Federal Reserve Bank had rediscounts amounting to about 4 millions of dollars from city banks, arising out of a somewhat abnormal temporary demand.

The development of the check collection system is also of great importance in this district. An agreement was entered into by which the Federal Reserve Bank took over the system of collecting country checks developed by the Boston Clearing House, and since July 15, 1916, the system has been operated by the Federal Reserve Bank. Today in all New England there is not a single bank that does not remit at par on receipt of checks sent by the Federal Reserve Bank of Boston. Since this system was taken over by the Federal Reserve Bank there has been a steady increase of business, and the cost has been considerably reduced.

The bank has been well managed. Its officers are men of the highest standing, and under their administration everything looks bright for New England.

As I have said, the real test of a banking system comes in times of adversity rather than of prosperity. I am confident, however, that the Federal Reserve System will demonstrate its power to cope successfully with any and all problems which the future may have in store for us.

Our vast credit system rests upon confidence, and until the passage of the Federal Reserve Act our banking system, with its independent reserves and re-deposited reserves loaned out on stock exchange collateral, contained little which could inspire confidence, but rather the reverse. At the present time, however, the consolidated reserves of the Federal Reserve System, the power to issue an elastic currency rising and falling with the movement of trade, does inspire us with confidence. When at the end of three years from the opening of the Federal Reserve Banks all reserves of the member banks are carried either in their own vaults or with the Federal Reserve Banks, we can rest secure that the United States has a system of banking which can do all for our country that any sound system could do.

Our confidence in the new system, however, does not rest entirely upon what we believe it will accomplish in the future. On the contrary, it has already, even before the opening of the Federal Reserve Banks, demonstrated that our business men and agriculturists had faith in it, and at a time when every sign pointed to trouble, similar to that which we had to undergo in the panic of 1907. I refer to the threatened panic in 1914 at the outbreak of the European War. It will be remembered that the Federal Reserve Act, while enacted into law in December, 1913, did not become, in effect, operative until the opening of the Federal Reserve Banks on November 16, 1914. At the outbreak of the European War, therefore, the Federal Reserve Banks had not been opened. The fact, however, that the system would soon be in full operation, operated powerfully to restore confidence to the people.

From time to time, however, I meet bankers who believe that the

threatened panic of 1914 was not averted by the Federal Reserve Act but that the country was saved by the issue of so-called Aldrich-Vreeland notes, under the Aldrich-Vreeland Act of May 30, 1908.

As a fact, however, while the issue of over 385 millions of dollars of emergency currency was authorized between August and November, 1914, not a dollar of this currency was issued under the original Aldrich-Vreeland Act of May 30, 1908, for the good and sufficient reason that said Act expired by limitation on June 30, 1914, before the war had begun. During the six years in which the Act was on the statute books not a dollar of emergency currency was asked for or authorized to be issued.

It is true that under Section 27 of the Federal Reserve Act the Aldrich-Vreeland Act was extended for one year, but its provisions were so changed by the Federal Reserve Act and by the later Act of August 5, 1914, that it would be almost a misnomer to describe the emergency currency issued as Aldrich-Vreeland notes. If the Aldrich-Vreeland Act, when it was continued for a year, had not been radically amended, it would not have proved workable in the threatened panic of 1914. While under its terms it might have been useful in clearing up the wreckage of a panic after it had come upon us, its provisions were such that it would have been of little or no avail in preventing a panic from arising.

The reason for radically amending the Aldrich-Vreeland Act and extending it for a year was that Congress knew that in all probability the Federal Reserve Banks would not be opened for some time, and that consequently the new elastic currency known as Federal Reserve notes could

not soon be issued. It was, therefore, deemed advisable, first, to radically change the Aldrich-Vreeland Act, and then to permit emergency currency to be issued under it temporarily until the Federal Reserve Banks could be opened and could issue the new Federal Reserve notes.

I have said that the Aldrich-Vreeland Act, before it was amended by the Federal Reserve Act, would have been of little service in averting a panic. You will remember that the Aldrich-Vreeland Act fixed 5% as the initial rate of interest to be paid on the emergency currency. This interest increased month by month by 1% until the rate finally reached 10%, at which it remained permanently. It will be realized at a glance that starting with the rate of 5% and increasing 1% a month it would hardly be practicable for the banks to take out this emergency currency until, at least, a panic had actually struck us.

The Federal Reserve Act, however, amended the Aldrich-Vreeland Act by lowering this rate of interest to 3% for the first three months and then providing for an increase of 1/2 of 1% per month until 6% was reached, which was the maximum. This made it practicable for banks to take out emergency currency with a view of avoiding trouble, and for the first time the Aldrich-Vreeland Act was made a workable law.

There were many other restrictions in the original Aldrich-Vreeland Act which made it most difficult to take out emergency currency. For example, no bank could take out such currency unless at the time of its application it already had outstanding National bank notes secured by United States bonds to an amount not less than 40% of its capital stock, and this requirement would have prevented some of the strongest banks in the country from taking out such currency. It also provided that the

total amount of notes taken out, including both the National Bank notes and the emergency currency, could not exceed the amount of the capital and surplus of such applying bank. It further limited the total issue of currency to 500 millions of dollars, and provided for its equitable distribution between the various sections of the country.

Under the Act of August 4, 1914, the Secretary of the Treasury was authorized to suspend these limitations, and this greatly facilitated the issue of currency under the Act. The original Aldrich-Vreeland Act also required a 5% redemption fund in lawful money to be kept with the Treasurer, but the Federal Reserve Act amended this so as to authorize the Secretary of the Treasury to require a sufficient amount of gold to be deposited for redemption purposes, in no event less than 5%.

Furthermore, this emergency currency could not be taken out until an association of at least ten banks was formed, with a minimum total capitalization of 5 millions of dollars. Each bank was liable on the currency issued through its association in the proportion that its capital and surplus bore to the total capital and surplus of the banks in the association.

Furthermore, the Act provided that currency could be taken out against the deposit of commercial paper only up to 50% of the capital and surplus of the applying bank; that currency could be issued against other securities unhampered by this limitation but that no currency could be issued in excess of 75% of the cash value of the securities or commercial paper deposited as collateral. It provided, also, that currency could be issued upon the deposit of State, County, City, Town and other

municipal bonds up to 90% of their market value. It was thus very clear that much of the security against which this emergency currency could be issued was not liquid. As a fact, in New England and the Eastern States less than 50% of the collateral consisted of liquid commercial paper, the percentage rising in the Middle, Southern, Western and Pacific States to from 80 to 85%. When, however, it is considered that only a 5% lawful money reserve had to be carried against this currency, it must be apparent that the currency left much to be desired in the way of soundness and safety from the banking point of view.

Undoubtedly the issue of this emergency currency under the amended Aldrich-Vreeland Act was of great assistance to our people. From the banking point of view, however, it could hardly be said to inspire much confidence. The Aldrich-Vreeland Act, even as amended, simply gave currency and not confidence to the people. Surely under such an Act little confidence could be inspired from the fact that the banks were permitted to increase their liabilities in the form of notes on security much of which was unliquid, and on a reserve of only 5%.

The Federal Reserve Act, however, went to the root of the difficulty. The chief trouble in times of banking crises is that banks cannot loan to legitimate borrowers. What the borrower needs at such time is a loan upon which he can draw his checks, and by issuing such emergency currency a bank does not enlarge its loaning power except to the extent that it protects its reserves in issuing such notes.

The real problem, however, is the increase of its loaning power by providing means for rediscounting short term commercial paper, and that is just what the Federal Reserve Act accomplishes.

Under this Act Federal Reserve Banks can take out Federal Reserve notes but they have to pledge with the Federal Reserve Agent, dollar for dollar, liquid commercial paper, that is, notes, drafts, bills of exchange and bank acceptances, discounted or purchased by the Federal Reserve Bank and against all such notes in actual circulation a minimum gold reserve of 40% must be carried. As a fact, today, the gold reserves carried by the Federal Reserve Banks against both their note and their deposit liabilities, for the whole Federal Reserve System, is in excess of 70%.

These Federal Reserve notes are not only redeemable at the Federal Reserve Banks in lawful money, but also by the Government in gold, and they constitute a first lien on the assets of the bank putting them in circulation.

If the Federal Reserve Banks had been opened during the threatened panic of 1914, they could easily have issued the necessary Federal Reserve notes and, incidentally, the profits arising from the discount of the commercial paper pledged for the notes would have covered their expenses and left a handsome margin of profit to credit to dividend account.

As I have stated, it must be apparent that the issue of the Aldrich-Vreeland emergency currency, while offering a supply of currency, yet this currency in itself did not reestablish confidence. These notes supplied a currency and not confidence.

It would be almost absurd to expect the people to have much confidence in a situation requiring the issue of over 300 millions of notes based upon an average of about 40% unliquid securities, with only a 5% reserve.

The real reason for the confidence entertained by the people during the fall of 1914 was that it was appreciated that a sound banking system had been established, based upon consolidated reserves and ^a sound elastic currency had been authorized. The restoration of confidence was also helped by the knowledge that the Reserve Banks would soon be opened and that upon their opening the lower reserve requirements prescribed by the Federal Reserve Act would become operative, thus releasing some hundreds of millions of reserves which would afford the basis of additional credits.

Leaving out of the question the released reserves redeposited with approved reserve agents, the required vault reserves just prior to the opening of the Federal Reserve Banks was about 888 millions of dollars. The day after the banks opened, however, the required reserve was only 373 millions of dollars, there being released about ^{5/2} ~~515~~ millions. Deducting from this amount the reserves required to be transferred to the Federal Reserve Banks, - about ²⁴³ ~~250~~ millions of dollars, - assuming that all these ^{payments} ~~loans~~ were made out of the vault reserves, there is left the sum of ²⁷⁰ ~~275~~ millions of dollars released from the vault reserves in the National banks which instantly became available for new loans.

The effect of the opening of the Federal Reserve Banks, therefore, was the same as if ²⁷⁰ ~~275~~ millions of dollars of gold had suddenly been imported into the United States for the purpose of granting additional credit facilities, and it is easy to see how quickly confidence was restored under these conditions.

In addition, the action of the Federal Reserve Board in collecting

the gold pool, so-called, of 100 millions of dollars, and the cotton pool of 135 millions of dollars, materially helped to restore confidence.

By the first of January, 1915, 60% of the emergency currency issued had already been retired. Gold quickly reappeared in circulation and a tide of unexampled prosperity set in, which, it is believed, is still far below its maximum.

Even in the midst of our great prosperity, however, the necessity for caution and conservatism must be apparent to all. No such unexampled development as that through which we are now going could take place without some manifestation of undue speculative activities, and the market which shivers one day at rumors of peace, and is temporarily unstrung on the next day at the propinquity of war, requires careful and conservative control.

The bankers of the United States have so far held the situation well in hand and I believe they can be relied upon to keep our development within normal bounds, repressing speculative tendencies. The burden of so doing is upon them and I see no reason to doubt that they will successfully maintain this burden.

From time to time we hear it stated that there has been a decrease in the number of National banks, and a resulting increase in the State banks and Trust Companies, and one would almost infer from such statements that the National Bank System is in a waning condition. The very reverse, however, is the truth. The National Banking System was never in a more flourishing condition than it is today, thanks in a great measure to the supporting influence of the Federal Reserve System.

Sooner or later the State banks and Trust Companies must realize that they must join our system to obtain the benefits of its consolidated reserves, or must establish a parallel system of their own, - which is hardly within the range of probability.

As so cogently stated by the Comptroller of the Currency in his recent admirable address before the Convention of the American Bankers Association, at Kansas City, the National banks are manned by an army of 75,000 men, with a pay roll of nearly 100 millions of dollars a year; with a total capital of over a billion dollars contributed by 441,000 stockholders, and with over 14 million depositors. There are today approximately 7,600 National banks. Since the opening of the Federal Reserve System down to the present time, excluding consolidations of National banks, the number of existing National banks which have increased in capital, plus the number of new National banks chartered, exceeded by 243 the number which, during the same period, have gone into liquidation or which have reduced their capital. Furthermore, the capital increase of existing National banks, plus the capital of the new chartered banks, for the same period, exceeds by over 20 millions of dollars the capital of all National banks which have gone into liquidation or which have reduced their capital.

During the last three years, while the increase in deposits of the National banks is not as large as that of the State Banks and Trust Companies, because of their greater number, yet the ratio of increase for the National Bank System has been $33\frac{1}{3}\%$ against only 28% for the State Banks and Trust Companies. In other words, the deposits

of the National banks since the passage of the Federal Reserve Act have been increasing at a greater ratio than the deposits of the State Banks and Trust Companies. Furthermore, the recent figures of the Comptroller thus far received, indicate that the National banks, for the current year, will earn approximately 16% on their capital of over one billion of dollars.

These figures convincingly demonstrate the prosperity of National banks under the Federal Reserve System, and it is confidently believed that the amendments to the Federal Reserve Act just made by Congress, giving, among other things, the power to member banks to accept bills of exchange in the domestic trade as well as in foreign transactions, will greatly add to their prosperity.

Furthermore, the last report of condition of our National banks shows a most gratifying distribution of the money of the country, away from the large centers where it was, under the old system, largely concentrated. Comparing May 1 of this year with September 12, we find a material reduction of deposits in certain large centers, and a corresponding increase in others, yet the decline in these large centers has not interfered with their healthy growth and business activities, rates for money continuing as low or lower than was ever known before.

This diffusion of wealth and banking power throughout the smaller centers is a most gratifying demonstration of the widespread prosperity of our country. With care and conservatism there is every reason to believe that this condition of prosperity may be retained

even though there must inevitably be radical industrial changes following the close of the European War.

10/20/16.