

Federal Reserve System Is "Shock Absorber"

After Year's Operation Bankers Declare It Is To Be Nation's Credit Foundation.



C.S. Hamlin



Frederic A. Delano



AFTER a year of building, the Federal reserve system constitutes, in the words of Benjamin Strong, Jr., Governor of the Federal Reserve Bank of New York, a new and stable foundation upon which the credit and currency of the United States rest.

Frederick A. Delano, vice-governor of the Federal Reserve Board, calls the new system a "shock absorber." It capably "absorbed" the shock of the European war and safely retired \$385,000,000 of emergency currency that had been issued under the Aldrich-Vreeland act without causing a ripple in the financial sky.

Leading bankers say the operation of the system has caused confidence in all lines of business activity, as it gives the manufacturer and merchant the assurance that no situation will intervene to deprive them of the credit and funds necessary to finance their business requirements.

It has lessened to the least degree the danger of financial panics. It is a safety valve for the vast machinery by which the business of the Nation is performed.

The Federal reserve system will have been in operation for a year on November 16. Although all the features of this great innovation in banking will not become effective for two years more, leading financiers are agreed that the system can be called a success. It has revolutionized methods of banking in the United States; finances have been mobilized and centralized, and the danger of frequent commercial disturbances which existed under the old system of banking has been removed. Bankers are contributing their energy, experience and cordial co-operation to make the system realize the blessings and advantages for which the Nation had so long striven.

The war necessities of other countries has given the United States its opportunity to become a creditor Nation. Evidence of this is furnished by the huge balance of trade that has piled up in our favor in the last 12 months, and the new banking system provides the improved facilities for extending credit to exporters and importers, which makes it possible for them to expand the country's foreign trade.

The Federal reserve system is the outstanding triumph of the Wilson Administration—the one reform which really has been tried. The war in Europe, cutting off as it has the imports of other countries, thus far has not allowed the tariff law to be tried to its full extent. But not so with the Federal reserve act, which when but an infant weathered the storm of financial chaos resulting from the outbreak of the war, the closing of the stock exchanges, the disruption of the cotton market and the wrecking of long-established lines of trade.

Within the last year the United States, by means of the institution of the Federal reserve system, has obtained—

An elastic currency.

A means of rediscounting commercial paper.

A more effective supervision of banking in the United States.

The opening of the Federal reserve system sent to the country a tremendous wealth of reserves held in the National banks of the country, in accordance with the antiquated banking act, but regarded by expert bankers as wholly unnecessary. This release of reserves was accomplished by cutting down the percentage necessary to be held by National banks to meet their obligations.

Amounts in Reserve Unknown.

Just what was the total of the reserves thus released Treasury officials do not know. They say that the intricate system of the old banking law, with its intertwined deposits, never will permit of a correct estimate. Guesses as to the amount vary from \$500,000,000 to \$1,000,000,000.

One thing is certain, however, within the last year the wealth released by the National banks has made loans much easier and has tended to keep interest rates at a correct estimate. In view of the unsettled conditions of the last year, this alone is regarded as a great achievement for the Federal reserve system.

When asked what the reserve system has accomplished in the last year, Mr. Delano, vice-governor of the Federal Reserve Board, said:



Federal Reserve Board

into operation, it became necessary for the Treasury to issue \$385,000,000 of emergency currency, under the Aldrich-Vreeland act. The Federal Reserve Board worried somewhat about the retirement of this vast sum, for no one knew what the effect would be. We proceeded cautiously, and succeeded in retiring the whole amount. And it never caused a ripple in the financial sky.

"It seems to me the first big result of the Federal reserve system has been to bind together all the National banks of the country into 12 strong regiments. These 12 banks—the Federal reserve banks—were in each district from 255 to 952 member banks, with a nominal capital ranging from \$4,808,000 to \$21,624,000, only half of which is paid in. The 12 banks were not created to do business directly with the public, but as reserve banks, as their name implies, for the purpose of holding the reserve deposits for the member banks.

"One of the important services which they may give to their member banks is the right to discount their paper and issue bank notes against it. By discounting good commercial paper and in turn selling it (i. e., rediscounting it) to the Reserve banks the member banks have a way to earn money for themselves, as well as making credit much easier. They do not have to carry the load themselves.

"It has been a great work to bind together the National banks of the country. There are approximately 7,000 of them. Who is there who will doubt that this alone is a great advantage, even if the act accomplished nothing else?

"Imagine a police force composed of 7,000 officers, all reporting to one chief. Could there be any effective work done by such a force? Any experienced man who might be asked to put the force on a better basis of efficiency would immediately divide the force into divisions, with suitable headquarters, putting subordinate officers in charge of each. In this way the chief would be in touch with the subordinate officers, who in turn would be close to the men. The reason that better results could be obtained is apparent.

"Under the old system, which was in effect for 50 years, the banks all operated independently. It is true, of course, that there developed a method of depositing the reserves of smaller banks in larger banks, but it developed much that was bad, and from the viewpoint of a banker, unsafe.

"Not only serious duplication of reserves developed, but, because of active competition for deposits, there resulted many vicious practices, such as paying high rates of interest and granting special privileges. Altogether it was a scheme of 'you tickle me and I'll tickle you.' They got along—on paper.

"We have taken the public into our confidence in working out the system, and if we have been successful I believe that that is part of the reason. The public has been aware of every step we have taken. We have not gone so rapidly as we might have gone, but we have gone carefully, as was manifestly our duty as trustees of an immense reserve fund.

"Of course there still remain two

years before all of the features of the act will go into effect. There are some important features yet to be worked out. The biggest single job yet to be undertaken, I think, is a system for the clearance of the checks of member banks, but it will not be long before this can be accomplished.

Self-Adjusting System.

"I have on various occasions referred to the Federal Reserve system as a 'shock absorber.' I mean by that that the system is capable of adjusting itself to meet all conditions which might arise, lessening to the least degree the danger of financial panics.

"This new law, designed to make each district self-sustaining, makes it possible for a district with plenty of money to help a district which is short of funds and is in need of assistance. In order to accomplish this one Reserve bank is permitted to rediscount the commercial paper for another bank. In case of need the Federal Reserve Board is empowered to compel this rediscounting.

"Stated in a different way, there is provided a basis of management where each Reserve bank may operate as an independent unit, but where in time of need the resources of several banks can be called upon to some extent to relieve the strain.

"In addition the Federal Reserve banks are empowered to act as Government depositories and as fiscal agents. Sub-Treasuries are not abolished, but there are many advantages for the use of the banks in this capacity:—the taxpayers' money of the people—the Reserve banks is there for the promotion of trade and commerce.

"Second—It is safe, because back of the Federal Reserve banks is the guarantee of the member banks, which own them.

"Third—The function of fiscal or disbursing agent for all Government drafts or checks, aggregating approximately more than \$1,000,000 a day, can be performed by the banks effectively and with a great saving to the Government."

Opens Ports to Foreign Trade.

Another achievement of the new system has been the institution of an arrangement whereby foreign shipments may be financed by means of bankers' acceptances. Under an amendment to the Federal reserve act passed at the last session of Congress any Federal reserve bank may discount acceptances which are based on the importation or exportation of goods and which have a maturity at the time of discount of not more than 90 days and are indorsed by at least one member bank. The board, in a recent ruling, provided that these acceptances may be renewed for 90-day periods.

The effect of this arrangement is that exporters need not have their funds tied up in goods which are in transit. The reserve banks shoulder the credit, indorsed by the member banks, giving the exporter or importer the benefit of his money, whereas, if he had to wait until the merchant to whom the goods were consigned got ready to pay, he would not be able in some cases to continue operations.

This step, officials believe, will give American merchants a great opportunity to capture large portions of the foreign trade, allowing them to extend to reliable merchants in other countries reasonable credit. In this way they are able to compete with the systems of other foreign countries, which have been giving long credits for years.

The Federal Reserve Board's system of collecting data about business conditions of the country is more complete than any operated before by a Government agency. The reports are sent in monthly from Federal reserve agents of the 12 districts and cover crop conditions, manufacturing, the business of railroads, the effect of the weather on trade and agriculture, shipping, the volume of loans, retail trade and the outlook for the future.

All this detailed information is published by the board each month in a publication of the board printed at the Government printing office in Washington entitled the Federal Reserve Board Bulletin. The data are arranged according to the districts, which are: No. 1, Boston; No. 2, New York; No. 3, Philadelphia; No. 4, Cleveland; No. 5, Richmond; No. 6, Atlanta; No. 7, Chicago; No. 8, St. Louis; No. 9, Minneapolis; No. 10, Kansas City; No. 11, Dallas; No. 12, San Francisco.

In August it became clear to the Federal Reserve Board from reports from the banks in the Southern States that there possibly would be a shortage of funds for the financing of the cotton crop. The surplus funds in the other banks of the country indicated that there would be sufficient money to finance the other crops, even though they appeared to be unusually large.

As a result, William G. McAdoo, Secretary of the Treasury, soon afterward announced that he would deposit in



W.P.G. Harding

the Federal reserve banks of the cotton states, Richmond, Atlanta and Dallas, \$30,000,000 of Treasury gold to be used for loans on cotton. The effect of this, according to reports received by the board, was extremely beneficial to the South.

Mr. McAdoo, to remove any criticism of partially, offered to deposit similar funds in the banks in Minneapolis, Kansas City and St. Louis. These banks replied that they had sufficient money to move the crops.

Within the last month a branch of a Federal reserve bank, the first of its kind, has been opened. It is at New Orleans, which tried hard for one of the 12 main banks, but failed. This branch bank is operated as part of the bank at Atlanta.

Another innovation of the system is the power of the Federal Reserve Board to allow National banks to act as executors, trustees, administrators and registers of stocks and bonds. Many of these banks, where state laws permit, have obtained permission from the board to perform these functions ordinarily vested in trust companies.

Organization of Federal Reserve Banks.

"The actual work of organization—that is, securing banking offices, assembling a staff of competent men and providing the mechanical means for conducting the business—is now about completed," said Mr. Strong, governor of the New York Federal Reserve Bank, "notwithstanding that the work was undertaken on very short notice and without time for adequate preparation."

"The offices we now occupy were rented and arranged to suit our needs, a staff of employees, largely temporary was selected and the necessary machines, stationery and supplies were obtained within a space of three weeks, immediately prior to November 16, 1914. On November 16 \$100,000,000 of reserve deposits was received, and by about November 20 a total of about \$110,000,000 in capital stock payments and reserve deposits had been transferred to the bank, and thereafter it was performing a limited number of its various functions. For some months after November 16 much time was devoted to investigating and employing the permanent organization and directing the men in the work of preparing a safe and economical system of accounting and office management.

"Practically all of the work of the bank is new and differs materially from that of a National or state bank, and consequently forms and methods of accounting required special study and preparation. It was, of course, equally important that reasonable uniformity should prevail in all the reserve banks as to methods of conducting the business, keeping records and interchange of business and information. This has been accomplished through frequent meetings with the Reserve Board and by a series of conferences held by the governors of the 12 banks and similar conferences of the Federal Reserve agents and accountants and auditors drawn from the 12 banks, as well as the experts in charge of the collection departments.

the bank's officers are held at fairly regular intervals, the discussion at the meetings generally resulting in agreements as to uniform methods, which are reported and considered by the Federal Reserve Board. The banks have taken the first steps in the development of a plan for handling checks for the member banks, the plan varying somewhat in the different banks to meet the varying needs of the different districts. The natural sequence of this step has been the establishment of a fund of gold administered by the Federal Reserve Board in Washington for the purpose of settling balances arising out of exchange transactions between the reserve banks.

Much Work Accomplished.

"A superficial view of what has been accomplished by the management of the reserve banks gives but a slight indication of the vast amount of work involved. This is illustrated by the problem which confronted us in ordering supplies of Federal reserve notes. When this bank undertook some months ago to order about \$300,000,000 of notes it required some weeks of preliminary study of the whole subject of currency circulation in order to arrive at a fair estimate of the denominations that should be ordered. The bank now keeps on hand a supply of \$250,000,000 of notes of various denominations.

"Through the courtesy of the Federal Reserve Board the officers of the reserve banks have been afforded an opportunity to discuss and assist in the preparation of the various regulations governing the transactions of the reserve banks. These regulations apply to practically all departments of the bank's activities and have almost the same force in governing the transactions of the bank as does the statute itself. Great care is, therefore, required in their preparation, and these regulations have been the subject of constant study and investigation, in co-operation with the Reserve Board.

"Since this bank was organized its membership has been increased by the transfer from the Philadelphia district of the National banks located in the 12 northern counties of New Jersey, so that the New York Reserve Bank now has 610 members.

"It also has been necessary to develop a policy in respect of investing the funds of the bank. Up to the present time its investments at interest have consisted in a very small part of discounted paper sent in by the member banks, by far the greater part of the money invested consisting of the obligations of various municipalities, issued in anticipation of the collection of taxes and of drafts accepted by responsible banks and bankers. The principal market for paper of this character is New York City, and it has, therefore, been necessary for this bank to execute orders for a large volume of such investments in behalf of the other reserve banks.

"In order that we may be in a position to meet the requirements of the member banks for discount of their commercial paper, as contemplated by the statute, it also has been necessary to assemble files of information in regard to the business, management and condition of all the member banks of this district, and work of that character is continuous.

"Suggestions of forms for statements to be made by borrowing customers of member banks have been furnished to all the banks of this district, as well as other necessary forms to enable them to conduct their transactions with this bank.

"Reviewing the work of last year, I think it is safe to say that few enterprises ever have been undertaken in this country which presented more novel problems to be solved and required a greater degree of care in their solution. As indicating the extent of the work, the last conference of governors of the reserve banks discussed a programme containing no less than 76 topics.

"Notwithstanding the inactivity of our business at the present time, there is a constant and steady growth of deposits and note issues that is rather impressive as to the future possibilities of the system.

"On December 1 of last year the bank had \$3,322,000 of paid-in capital, \$108,700,000 deposits and \$870,000 of notes of emergency.

outstanding. At the present time the bank has a paid-in capital of \$10,897,700; gross deposits, \$174,221,000, and \$1,620,000 of notes outstanding.

"Including the gold held by the Federal Reserve agent as security for notes, it holds \$218,700,000 cash, of which \$202,000,000 consists of gold. It also holds about \$15,000,000 of investments at interest.

"The work of the organization is now completed. This bank, and I believe the other 11 reserve banks as well, are now prepared to perform their legal functions, and in their present position, with cash resources exceeding \$400,000,000, they afford a new and stable foundation upon which our credit system rests."

How Prominent Bankers Regard the Federal Reserve System

BY LOUIS G. KAUFMAN, President Chatham and Phoenix National Bank of New York.

IT IS a recognized fact that money panics never can occur again under this system. It gives us recourse to a tremendous amount of new currency which can be put into circulation on short notice and affords the banks additional facilities for extending credit by making it possible to rediscount commercial paper in large amounts.

It is the duty of a bank to go the limit in financing commercial requirements. The merchant or manufacturer who counts on using \$500,000 in his business during the year must have assurance that the funds will be forthcoming when he wants them; otherwise he lacks confidence to carry on and expand his enterprise.

The operation of the Federal Reserve system gives him that confidence. He now knows that no situation will intervene to deprive him of the credit and funds necessary to finance his business requirements.

Fear causes panics, and this system has removed the cause for fear.

We never expect to see an unusual situation develop in the future which cannot be met with the aid of the Federal Reserve Banks, unless it should be some great calamity, the nature of which cannot now be foreseen. It will take generations to outgrow the situation which has been developed through the operation of the Federal Reserve system.

It is a safety valve.

BY ALBERT H. WIGGIN, President of the Central National Bank and Chairman of the New York Clearing-House Committee.

We believe that the records of one year of operation have demonstrated that the Federal Reserve system will be a benefit to the mercantile and banking interests of the country, and that the purpose of its framers—to prevent extremely high rates in the money market—will be effective.