

National Budgeting Warrants Many Defaults in Financing

Economist, Declaring Production's Thing, Warns Against Regarding Financial Machinery as an End in Itself—Reserve Banks May Be Impaired by Ever Increasing Proportion of Non-Self-Liquidating Assets

By E. M. Patterson

Of the University of Pennsylvania THERE is no doubt in the minds of careful observers that the first great economic task before the people of the United States to-day is production. By this is meant not only the raising of agricultural products, the extraction of ores and the processes of manufacture, but also the transportation of men and materials to our seaboard and to Europe. Our second task is to save from our annual production the amounts needed by our allies and ourselves in the conduct of the war. If we could increase our production by this amount the saving might be accomplished with no curtailment of our ordinary expenditures and with no lowering of our standards of living. Since a great part of the amount needed cannot be secured in this manner, there must be a reduced standard or we shall not furnish to our allies the promised assistance. To secure this saving with the maximum of fairness and in a manner that will not lessen our productivity is our second task. The third is to devise the most satisfactory method of transferring to the government the ownership of the wealth that we produce and save. Congress has made unprecedented appropriations, tax legislation has been enacted and huge bond issues have been authorized. A vast fiscal program has been evolved and its machinery set in motion.

In the midst of these activities stands our banking system, including many varieties of banks, but especially the Federal Reserve banks and their members, which are for the most part national banks. This structure performs numerous functions, but three are of particular concern in this discussion. (1) The Federal Reserve banks are fiscal agents of our government, while both Federal Reserve banks and member banks are depositaries of government bonds and certificates of indebtedness are marketed. They are thus an important part of the government's fiscal machinery. (2) These banks issue various kinds of money for use in the community. From the national banks come the national bank notes and from the Federal Reserve banks the Federal Reserve bank notes and the Federal Reserve notes, while on the deposit liabilities of all of them are drawn checks and drafts—the most important part of our currency. (3) These banks directly and indirectly make loans to private individuals and corporations, furnishing the financial aid required by our business institutions.

Federal Reserve System Essentially Commercial

This paper attempts to analyze the influence of this banking system in performing the three great economic tasks mentioned. Primarily, the system is concerned with assisting in the transfer to the government of the ownership of our wealth, but in doing this it may exercise a very important influence upon the other tasks in which we are engaged—the production and saving of wealth. Although only a device for facilitating transfers of wealth, it may greatly affect our whole national budget. A powerful banking machine will either help us to mobilize effectively our economic power, encourage production, stimulate saving, and thus increase our wealth for war uses; or, improperly utilized, will retard production, discourage saving, encourage extravagance and prevent our acquiring the funds we so much need.

The Federal Reserve System (a term which may be used to include both Federal Reserve banks and member banks) exists primarily to aid commercial banking as distinct from other financial operations, particularly speculative and investment banking. The national banks have always been restricted in their functions, not being allowed to own or deal in stocks, to acquire real estate (except for their own accommodation in the transaction of business), nor, except to a very limited extent, to lend on mortgage security. Even bonds may be acquired by them only because of a somewhat technical interpretation of the national bank act, and until 1913 savings accounts were not legally authorized. National banks are expected to specialize in commercial banking. Their customers are, for the most part the business men of the community, who are concerned primarily with transferring goods from producers to consumers. Accordingly their funds should not become impelled in speculative operations, nor be invested in transactions from which they cannot quickly be withdrawn. In other words, the assets of any bank must be safe, but those of a commercial bank must also be liquid, i. e., easily converted into cash.

Redeeming Paper

Under the national bank act there was not the desired liquidity, and the entire system lacked elasticity. To remedy these defects and others the Federal Reserve act was passed in 1913. The leading provisions need not be repeated here. It will suffice to point out that the entire act places emphasis on the importance of the banks of the Federal Reserve system having liquid assets. The liabilities of the Federal Reserve banks, i. e., their notes and deposits, are demand liabilities, and their customers are chiefly member banks whose liabilities are of the same kind. Therefore the Reserve banks must above all things keep their assets liquid. To this end they may discount their member banks' only "notes, drafts for agricultural, industrial or commercial purposes, or the proceeds of which have been used, or are to be used for such purposes." Further, the notes, drafts, checks, and bills covering merely investments

the serious, if not fatal, weakness of not being liquid. 4. Against the assets the banks are increasing their liabilities in the form of note issues and deposits subject to check and draft. If the assets were really short of obligations of a self-liquidating character, they would, as they matured, be paid and the banks could at once be relieved of their liabilities. If they were purchased by the general public the same result would follow. In practice many of these assets are being held not for liquidation but for the purpose of increasing their liabilities. Our current fall-garment banks are under pressure to continue to become greater rather than less.

The Menace of General Rise in Prices

Reserve notes to the amount of \$1,526,000,000 are in circulation. Redemptions have been learned with such rapidity as to raise serious doubts as to the ability of the Reserve banks to meet their obligations. With this in mind, it is not surprising that the Reserve banks may be expected to show in the future. Although the amount of gold held by the Reserve banks has doubled, the ratio of gold to net deposits has fallen in the past year from 83 per cent to 61 per cent. That the relation of cash holdings to deposits is present unsafe is not contended. This paper has merely set forth that our banking system permits inflation, that such has already occurred and that the pressure for more is increasing with alarming rapidity. In perfecting our banking machinery, mobilizing our resources and strengthening our credit we have changed our policy always in such a way as to make possible expansion of credit. With this machinery at hand the pressure on our Reserve bank officials is nearly irresistible. Demands for rediscounts are direct loans are hard to refuse, and our members are clamoring for expansion. The Reserve banks their high-grade commercial paper and their own notes secured by United States promises as collateral, are being used to raise their rates, but did it only slightly, and even now the rediscout rate on commercial paper is at only 5 per cent. Treasury bills of foreign governments said to be 4 per cent, and 4 1/2 per cent for the rate for member banks' fifteen-day collateral notes which they can absorb by investors through the market and Richmond, where it is 4 1/2 per cent.

We are, or should be, familiar with the effect of all this on the people with the least amount of knowledge. The rapidly rising price level has more serious effects on the people than the more serious effects on the people. The rapidly rising price level has more serious effects on the people than the more serious effects on the people. The rapidly rising price level has more serious effects on the people than the more serious effects on the people.

How Inflation Affects Industrial Production

1. When the price level is changing there is much uncertainty attached to business transactions. Doubt as to the costs of materials and labor causes hesitation, and commitments for a long period of time are entered into with caution. A large steady volume of production is more difficult to secure. 2. At such times many wages lag behind the prices of many of the commodities. The result is a real wage of the real wages of the worker. Under these conditions malnutrition and inefficiency occur and lowered productivity is the result. 3. In so far as wages rise, the result is often to divert laborers from one plant to another, and then perhaps back again. The rate of labor turnover is high, and production is retarded. Illustrations of this to-day are numerous.

Assets Needed That Are Self-Liquidating

Pressure has come from another direction. It will be recalled that with minor exceptions only short time commercial paper may be rediscounted at the Federal Reserve. Investment paper is definitely excluded from liquidation. In every case the determining consideration is the nature of the security behind the paper and not the form of it. Short time paper issued to finance a permanent investment, the maker expecting to renew the notes from time to time, is not self-liquidating and is clearly debarré. Yet within the last year two large, well known corporations, finding it difficult to borrow to advantage, have issued notes to finance their needs over a period of several years by issuing ninety-day notes to be renewed repeatedly, with the understanding that these notes should be accepted by the Federal Reserve banks. To this proposal emphatic objection was made, and the plan was dropped. It is mentioned here only to show that the pressure is upon our system to acquire assets that are not self-liquidating and that are not readily salable elsewhere. Attention may also be called to the act regarding the issue of certificates of indebtedness to the amount of \$3,000,000,000 instead of the former limit of \$1,000,000,000.

Centralization of Banking Is Needed

Financial machinery which will increase this advance should be kept under control for the sake of those who always suffer in a period of rapidly rising prices. The subject of banking power during war is a most important part of the mobilization of economic resources. It is essential to our success in the war in so far as this is true we may say that rising prices encourage industrial friction. Other influences are at work, but we should not blind ourselves to the fact that a large steady volume of commodities as recorded by Bradstreet's index number rose 113 per cent from July 1, 1914, to April 1, 1918, of which 45 per cent has been in the last twelve months.

Centralization of Banking Is Needed

1. We should not pass legislation that will permit further inflation and thus place upon our Treasury officials and our bankers all of the responsibility for the result. Suggestions have been made that the States should be responsible persons that we may secure more "capital" by lowering further our reserve requirements. Serious proposals to that end, and probably the best, are being made. A scientific analysis with all the energy of which we are capable. 2. Heavy governmental and private borrowings encourage inflation, and for this reason if for no other much heavier taxes should be imposed. Taxes, more taxes, and still more taxes should be the rule. Our fiscal plans to date have been formulated to meet the needs of the sources of supply for the next ten years or more. It will be strange indeed if many of the needs of the future are not met. A few conclusions from this analysis may now be stated in a less technical manner. 1. Our Federal Reserve system was conceived primarily as a commercial banking system, with the added duty of acting as the fiscal agent of our government. 2. The effect of the Federal Reserve act and of its recent amendments has been in general most salutary, but we now have a great financial machine whose operation, especially under war conditions, will be very hard to control and which may conceivably work a tremendous amount of harm. 3. In all of our thinking and talking on this subject we should bear in mind the subject of war finance the emphasis should be shifted from our financial machinery to the need for enlarged production of essentials and to the maximum of economy in both public and private expenditures. Financial machinery is, after all, only a means to an end. There are grounds for fearing that the United States Steel Corporation for having done more dollars' worth of business in 1917 than in 1916 but overlook the serious fact that its production of steel has declined about 5 per cent. Our judgment is awry. National budgeting is hindered, not helped, if banking machinery is utilized as a means of inflation.

Active Securities

Summary of Stock Exchange Dealings

Table with columns: Stocks, Yesterday, Day before, Week ago, Year ago. Rows include Railroads, All stocks, Bonds, U. S. Government, etc.

Record of Stock and Bond Averages

Table with columns: Stocks, Range, January 1 to date, 1918, 1917. Rows include Railroads, Industrials, Stocks, Bonds, etc.

(By The Associated Press) Trading in stocks yesterday did not get beyond the nominal stage, the market bearing the many familiar aspects of a week-end summer session. Interest was wholly professional and concentrated in a very few issues, notably metals, oils and other shares of like speculative character. Extreme gains in these groups ran from 1 to 2 1/2 points, with extremely narrow fluctuations in representative stocks, such as rails, United States Steel and the usual leaders. Some of the latter were subjected to slight pressure, but hardened at the steady close. Bonds were irregular, Liberty issues easing slightly. United States 2s and 4s (old issue) declined 3/4 per cent on call during the week.

Yesterday's Transactions in Listed Stocks

Table with columns: High, Low, Div., 1918, 1917, Sales, Open, High, Low, Close, Net. Rows include Advance Rmely, Advance Rmely pr., Alaska Gold Mines, etc.

Foreign Government and Municipal Bonds

Table with columns: Am Foreign B 5s, Dom of Can 5 1/2s, Argentine Gov 6 1/2s, etc.

Railways, Other Corporations

Table with columns: Am Ag Ch deb 5s, Am H & L 6s, Am T & E 6s, etc.

Bonds

Table with columns: U. S. Government Bonds, (New York Stock Exchange Quotations), (Closing Quotations), Saturday, Friday.

Price of Crude Oil Must Not Be Raised

A Chairman Bedford Issues War Committee Warning to Petroleum Producers The United States government is opposed to any further increase in the price of crude oil, and so announced about six weeks ago, but notwithstanding the notification a few cases have been reported of additional premiums being offered, and now it is stated by Thomas A. O'Donnell, representing the fuel administration, that Federal authorities are insistent that at the present time there shall be no increase in the price of petroleum products. There must be no bidding among refiners for the existing supply of crude oil which might cause a dislocation in the basis of production, and the government will seriously object to any diversion of oil from present channels. This was made known yesterday through a statement from the Chairman A. C. Bedford of the National Petroleum War Service Committee. He said: "The committee has for some time been in session considering methods of stabilizing the price of petroleum. The specific plan which could prevent the payment competitively of premiums over and above the established price of crude in order to obtain a preferential delivery of oil at issue primarily involved the production and distribution of petroleum in the Kansas and Oklahoma fields, it was decided to make a plan which could be made to the associations of refiners and producers in that field with the request that through their committees and through their various suggestions be reached upon an agreement he recommended for adoption by the National Petroleum War Service Committee and put into effect with the sanction of the Federal fuel administration and committees in the Oklahoma and Kansas fields were requested to make their definite report back to the committee on Friday, June 28. "A representative of the fuel administration was in attendance at the meetings of the National Petroleum War Service Committee, and was requested by the fuel administration to notify the whole oil industry that the government would regard with serious concern and disapproval any further increase in the price of petroleum; in other words, that until a definite plan of stabilization is worked out there shall be no change in the price of petroleum with the exception of the fact that it is frankly recognized that at the present time there is an excess of refining capacity in the United States over the current production of crude oil. The National Petroleum War Service Committee, with the cordial cooperation of the oil division, is accordingly striving earnestly both to stimulate the maximum production of crude oil and at the same time insure to all refiners, both large and small, that their supply of crude in relation to the quantity available as a whole shall not suffer from dislocation. "The policy of the National Petroleum War Service Committee is in its cooperation with the government in dealing with this delicate situation seeking to develop the largest possible supply for the use of the nation and our allies, as well as for the commercial needs of the country, to act with the fuel administration in stabilizing prices and to protect to the utmost the interests of both the large and small factors in the industry; in other words, to preserve the industry in the highest state of efficiency and prosperity, not alone for the war itself, but for whatever opportunities and obligations the after-war period may develop. "To sum up, the National Petroleum War Service Committee is carefully considering the whole problem in consultation with the government and with the interests of both the nation and the trade, and it is confident that a solution is worked out the committee is strongly of the opinion that any disturbances of the present price basis would be contrary to every interest involved."