Industry
Credit and Banking

An Address by

JAMES J. HILL

Delivered at the
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Mr. Chairman;
Members of the American Bankers' Association:

The banker buys and sells credit. Credit is based on wealth and character. Will a man be able to pay, and will he be willing to pay at the maturity of his obligations, are the two questions on whose answer depends the grant or the refusal of credit. It follows that the banker is more closely concerned than the man in almost any other occupation with the processes and prospects of wealth production.

When communication between countries was slow, difficult and beset with chances of loss, credit concerned itself mostly with commerce. Costly cargoes drawn from distant sources required financing, and represented wealth in a tangible form readily convertible into credits. In the Merchant of Venice, credit hangs the issues of life and death on the safe arrival of a merchant ship. The great sea routes of the world sustained the banking institutions that rose and flourished at its principal ports.

In the modern era manufacturing became the main source of fortune; and on its raw material, its finished products and its immense plants a greatly expanded credit system was established. Governments have not yet freed themselves from the delusion that this is the corner-stone of wealth production and the main prop of financial institutions. But those who carefully investigate the question as a whole know better. One true law is now pretty well established in the minds of thinking men—that agriculture, as the ultimate source of all wealth except the relatively smaller portion drawn from the sea, the forest and the mine, should be the especial care of those interested in maintaining a credit system at once ample and sound. Within recent years this has been recognized formally by various State Bankers' Associations and by the American Bankers' Association.

A sharp and continuous campaign should be waged along this line, because the course of national development, as directed by national economic policies, follows a curve that moves toward future disaster. No country ever yet put all its eggs into one basket, by fostering permanently one form of industry at the expense of others, and escaped the penalty. Whither we are moving appears in the statistics of our foreign trade, jubilantly announced by many who cannot read in the imposing figures their real sinister meaning.

The total exports of the United States in the last fiscal year were $2,466,000,000, having almost doubled in the last ten years. If this increase is well distributed, it becomes matter for congratulation. What is the fact? According to the official report of the Department of Commerce, manufacturers' materials increased from $409,000,000 to $731,000,000; manufactured articles from $468,000,000 to $1,187,000,000; foodstuffs, which were about $510,000,000 in 1903, were $502,000,000 in 1913. But, says a bulletin of the Department, commenting on this showing, "this equality in values indicates a reduction in quantity, in view of the advance in prices meanwhile." Fresh beef exports fell from 255,000,000 to 7,000,000 pounds; and all meat products outside of cattle from $176,000,000 to about $150,000,000. Translated into pounds, the deficit would be much greater.

Now it is not difficult to interpret the lessons of these figures. The number of mouths to be fed increases progressively. We occupy our workers more and more in supplying with manufactured goods, under artificial stimulus, the markets of the outside world; markets from which we may at any time be partially excluded by foreign legislation over which we have no control, by competition, by changes in the wage rate, by international disturbances. We have to feed all the workers in these industries. Hence our exports of food products decline. In a few years we may be buying food abroad. The cost of living rises day by day. The very industrial features over which we boast are bound to make it higher. After all that has been spoken and written about conservation, one should not need to point out the economic short-sightedness of exhausting our natural supply of valuable resources whose total is limited by nature and cannot be replaced. That means future scarcity and industrial decline. Of our great export total for 1913, almost exactly one-fourth consisted of manufactures of iron and steel, mineral oil, coal and copper and its manufactures. All of these come under the above description. It is the rapid exhaustion of resources, to placate a fixed and false economic idea, that no ingenuity can ever restore.

Our exports of manufactures of iron and steel alone last year amounted to nearly $305,000,000. For cheap iron ore we depend upon the Lake Superior district, because of high grade, ease of extraction and nearness to cheap transportation. It cannot long stand such a drain. At the rate of 50,000,000 tons a year, it will be necessary in thirty years from now to use more expensive mining processes and to utilize inferior ores. Pig iron will be made from ore containing from 25 to 40 per cent, instead of 55 to 60 per cent of iron. This will raise the cost of steel fully $3 or $4 per ton. Since the deposits of iron ore in the United States are known and their capacity is limited, our cost of production will prevent us from competing with other countries in the world's markets where we are now dumping our treasures. At the same time it will admit the foreign product into our own markets over any tariff that the people could or would stand. We lose at both ends. We may hereafter be buying not only bread but manufactures of iron and steel abroad. What, then, will support a top-heavy industry, and a prosperity founded on conditions obviously temporary? With what can we pay our debts at that future settling time? Would it not be better for us to quit boosting these interests and hurrahing over the rise in exports, while we try to re-arrange our industrial system on the basis which the distribution of natural wealth and the demands of civilization impose eventually on all countries and on all people.

Sound economic policy and business sense advise us to increase the number of those engaged in farming; educate them in better methods; insist upon the care and improvement of the soil; increase production per acre; and, in particular, promote the raising of live stock by which money can be made, industry diversified, our food product enlarged and the soil raised to a higher degree of fertility. In so far as the banker can assist this change by granting agricultural credits wherever it is wise to do so, and especially by conditioning loans upon the use of right farming methods, he will strengthen and safeguard his own interests at the same time that he helps to build up the country and to give to its industrial fabric a firm and consistent future.

In our foreign trade which, though secondary, is of much importance to the country, the general public still mostly overlooks or undervalues what has risen to be a prime factor. We exult in the fact that in the value of domestic products exported we are now almost neck and neck with Great Britain. We exult in the showing of a balance of trade exceeding $650,000,000. But we do not analyze. Our eyes look eastward or southward, and we are eager for new ventures in those directions. We squabble and higgle and refuse to understand the trade advantages already ours and those that we might now enjoy if we had looked toward the north instead during the last ten or fifteen years.

The rise of our trade with Canada to a commanding place is a striking phenomenon. The total of that trade for the last fiscal year was nearly $536,000,000. In 1903 it was a little over $178,000,000. In the ten years the increase was over 200 per cent. For the single year 1913 as compared with 1912 it increased 22.3 per cent. Our total exports to Canada last year, amounting to $415,260,000, were $83,000,000 more than those to Germany and three times those to France. They were $67,000,000 greater than our exports to all the other countries of the Western Hemisphere combined. They came within $131,000,000 of equaling those to England. At this rate it is a question of only a few years when Canada will become our best customer. We have but one better today.

Distribute the balance of trade for 1913 in which we so rejoice. It amounts, for the whole world, to $653,000,000. Of that total Canada contributed $294,688,000, or 45 per cent. Almost one half of the net receipts of the United States from its commerce with other nations comes from this one country. We spare no trouble or expense to drum up trade with the countries to the south of us. We have spent a great many millions of dollars on the Panama Canal. The main argument in its favor was the increased facilities that it would furnish for trade with the west coast of South America. San Francisco is preparing an international exposition to celebrate the opening of this great waterway between the oceans. The mother country of Canada declines to participate; and, under her courteous explanation, few doubt that the deciding reason was what many good lawyers, as well as common sense, declare to be a violation of treaty by remitting canal tolls on our own shipping and so discriminating especially against the shipping trade of Canada. The keynote of the approaching opening of the canal is the importance of our trade with the countries of the south to which it offers us a shorter and quicker route. Well, see what that amounts to. Our balance of trade last year with all North and South America, including Cuba and the West Indies, with this hemisphere from Greenland to Cape Horn put together, was $183,869,000. If we leave Canada out, our trade with all the remainder shows a balance against us of $110,000,000, mainly to pay for coffee. It is not difficult to decide what is the most valuable trade to us in the Western World. It is not difficult to discover who, if we consider only the amount and rapidity of growth in commercial relations, is our most desirable customer today.

To maintain that trade, to free it from every unnecessary burden, to cultivate the most cordial relations with the people who furnish it, these things are a proper care for all business men. Between the bankers of the United States and those of Canada there now exists an understanding fostered by the conduct of a business whose principles are universal, and whose practice crosses political lines without having to produce a passport or pay a duty. I am sure that you need no urging to do whatever may be within your power to unite more closely the business interests of these countries which nature herself presents as the two great factors, co-operating, each in its own way and its own independent sphere, for the development of this continent and the progress of the world.

If the importance of agriculture to a nation is a lesson pretty well learned, if our commercial relations with Canada have lately come to be looked upon from a less parochial point of view, it would seem that we still lag behind in all that relates to a national system of currency and banking, in so far as that depends on the law-making power. Our monetary system is the wonder of intelligent men abroad and the despair of intelligent men at home. A definite proposal to change it has been before Congress and the country for months past. No other subject can be so germane to this time and this meeting. It has had the benefit of study and criticism. This Association should not hesitate to express its opinion and to offer its advice. This will be given in a spirit of entire helpfulness and good will. The subject of banking in its relation to a national monetary system remains, as it has always been, the most difficult with which the law-making power has to deal. Even those who make finance their daily business are at times at a loss to make the best application to practical affairs of its abstract general principles. Such criticism as may be offered upon the plan presented for banking and currency changes, and such suggestions as may be made for its possible improvement, will be inspired solely by the spirit that has moved, I am sure, this Association and the individual members of it throughout;—a spirit of desire to co-operate helpfully in a labor large enough and difficult enough to call for the best efforts of the banker, the business man and the public patriot as distinguished from the mere politician. In the presence of so many who are rightly regarded as experts, I shall do no more than set out a few respects in which it seems to me that the proposed measure invites and is susceptible to modification and improvement.

One serious defect is that the bill will not and cannot do what on its face it proposes to do. It professes to aim at a comprehensive reform of currency and banking by establishing a logical and permanent system. We have never had that since this government was founded. We will not have it if this bill should become law. It does not simplify the currency. It does nothing with the greenbacks; it leaves the silver certificates where they are; it proposes to retire the outstanding national bank notes only in the course of time. Our currency will be just as confused and unscientific as before. Another failure in frankness at least is the repudiation of the central bank idea in name and the acceptance of it in fact. The proposed national and local reserve associations are merely variations on the principle of a central national bank with local branches. Concealing that identity, they would naturally be considerably less effective than if they could come into the open. I am not contending that the central bank principle is either desirable or undesirable. I do not think that its rejection in form and adoption in substance is as little promising as the proposal to simplify our currency system by adding a new element to its already heterogeneous mass.

There are practical working weaknesses even more serious. First among these is the projected political control of the currency and banking of the country. The establishment of a federal reserve board, vesting control of our banking, credit and note issues in men chosen necessarily with some reference to political considerations, and at least partly subservient to party demands, is a proposition that sets reason and all our experience at defiance. The fundamental objection on this score cannot be more tersely or forcibly expressed than in the words of Mr. F. A. Vanderlip, of the National City Bank: "If such a board as is proposed were formed by appointing the seven leading bankers of the United States—whoever they may be—and these men became dissociated from the daily conduct of actual affairs and sat at Washington, directing at arms' length the operation of the several reserve banks, they would very rapidly lose the power to direct wisely." But they are not to be bankers. Such participation as the bankers, as a body, may have, will be in an advisory capacity, and without power to affect decisions reached. What, then, is to be expected? Speaking of the old United States Bank and the Bank War, Professor William G. Sumner, one of the ablest students of finance in this country since Alexander Hamilton, has said: "When, in any arena, a power is present which might be of decisive importance as an ally of one party or the other, it is inevitable that its alliance will be contended for by them. Its efforts to remain neutral will be vain and will expose it to greater danger from both than an alliance with either. The Bank War may be held to demonstrate that a National Bank in this country is impossible, because it would be sure to become an object of conflict between political parties." It is, in effect, a National Bank of issue that is now proposed. The truth concerning it remains exactly what it was eighty years ago.

The details of the plan, so far as one can discuss fairly a measure whose final authentic shape cannot be predicted confidently, contain other minor features just as doubtful or objectionable. The managers of a nation's finances are to be paid $10,000 a year, when bankers in charge of financial interests relatively small command $50,000 or more. The position is not made attractive by life tenure, like that of a justice of the supreme court. What sort of ability can be purchased, for a term limited to eight years, for a salary at best not over one-fifth as much per annum as less onerous services would command in private life? Necessarily the political possibilities must become the chief inducement to serve.

Naturally, this board being a political instead of a financial body by the law of its constitution, its seat is placed in Washington. There will be gathered the gold reserve required by the new measure, in addition to the immense stocks of coin and bullion held against the other forms of paper currency which are left outstanding. The objection to the mental atmosphere of the capital is matched by the physical objection of placing the most important collection of gold in the world at the mercy of a foreign navy. Nobody knows today exactly what modern warships, where guns have a range of ten miles, can do; but we do know that cities near the seaboard would be at their mercy. The mere presence of such a treasure within striking distance is an incentive to hostilities and would at least create a widespread feeling of distrust and apprehenson liable to culminate in panic. A glance over the world today does not tend to reassure anybody who wishes to believe in an increasing pacific disposition among men or nations.

So far as one can see, most results of real value to be accomplished by the bill under consideration might equally well be obtained under existing law providing for the issue of emergency circulation. But one of its least excusable defects is its exclusion from the approved securities for discounted notes or investments of those which are actually most desirable and safest of all. Government bonds, state bonds, bonds of cities and counties are, in different capacities, recognized as good, safe investments or collateral. A first-class railroad bond is not. The discrimination, like the proposed system of banking control, is purely political. There can scarcely be a man at Washington ignorant of that fact.

Suppose that American bankers, in some time of financial stress, need to draw upon the foreign store of capital. There is plenty of it. But it asks for recognized security. A man approaches a banker in London, Paris or Berlin, asking a big loan or attempting to realize on securities, with notes of merchants in the United States, which are the foundation of reserve note issues, or with municipal or state bonds, the latter being an authorized investment. The foreign banker knows nothing of our private business interests. He knows little more of our local public credit. "Have not," he would probably say, "some of your states repudiated their bonds? True, it was some time ago; but your people are extravagant, great borrowers and spenders, and I cannot know when it may happen again. Your paper is not satisfactory to me." Grant that he is wrong; that he does not understand our local conditions. He does not have to. He has the money, and he makes the terms.

On the other hand, he knows a first-class American railway bond as well as he does the securities of his own city. The name is familiar to him, the record established. A bond of a road that has regularly paid interest and dividends uninterruptedly for twenty or thirty years looks good to him. If it has a satisfactory surplus and a good margin of receipts over operating expenses, it looks all the better. Where the interest charge is only a small percentage of net earnings, the bond is well known, the facts familiar, and the security gilt-edged. Such a bond can be exchanged for cash or credit in any market.

In assured convertibility, which is the all-important qualification in time of financial stress, first-class railroad bonds are unequaled. Their cash value shrinks less, in time of depression, than that of any other security. This is not a mere opinion, it is proved and supported by the judgment of the men in charge of those institutions that regard their investments as a sacred trust. The great life, fire and other insurance companies, which are liable to be called on unexpectedly at any time for large sums, by experience hold good railroad bonds as a preferred investment. The savings banks of the several states are, as a rule, encouraged and almost directed to prefer real estate mortgages in making investments. They have learned by experience that when public confidence is impaired and there is a sudden and continuous demand for cash, they cannot realize on these, but can depend on first class standard railway bonds to bring them the ready money with the least shrinkage.

Not without reason does the credit of the best railway bonds stand high. The resources behind them are not estimates, but values publicly known and vouched for by authority. The revenues are, within narrow limits fixed by varying conditions of the seasons, perfectly sure. Even confiscatory legislation would be halted by public opinion long before it could touch the percentage of the property value represented by the bonds. Hence the confidence of investors in this form of security. United States bonds are a favorite standard for safety. Yet our government has seen the time when it had to suspend specie payments because it could not meet its obligations. Through all that period, including the Civil War and the financial fluctuations that accompanied and followed it, many of the old and stable railways of the country discharged every obligation in full and paid a good profit to the investor besides. No wonder their bonds are a synonym for high credit.

To exclude from any plan of credit extension this security, while admitting others confessedly inferior, is a discrimination of which congress cannot afford to be guilty. When we are establishing a permanent credit and investment basis, to shut out railroad bonds, representing an interest which, next to the land on which we live, is the largest in volume in the country, a security proved to be convertible into cash more readily than any other and with less shrinkage, would be a blunder without economic defense. That it has been so much as considered can be explained only as another cowardly political blow at a great interest which bankers serving the country and business men and honest men in public life should make heard their protest against. The country cannot afford, in order to satisfy an unjust prejudice or cater to a political discrimination, to be deprived of this asset, whose solidity and value are established and admitted in every money center of Europe and America.

Some other details of the bill are open to and have received fair and kindly criticism. But there is one comprehensive objection and one danger of practical failure which have been too little emphasized. The objection is that the bill in its present form is too socialistic to suit the temper of the body of our people. Observe that it is not merely supervision and regulation, even so minute as are exercised in the case of the railroads, that is proposed. The banking business, so organically related to the solvency of every institution and the prosperity of every man, is to be taken over almost in its entirety. National banks must join the new association or be dissolved. They must contribute the entire capital with which the reserve banks are operated. These reserve banks are as completely under governmental and political control as is the Interior Department. The Central Reserve Board is an autocracy. It is responsible to nobody but the President, who can make and remake it at will. It can suspend banks and bank officers, compel one bank to rediscount the paper of another, suspend all reserve requirements at pleasure, and issue and retire, without any check from the outside, credit notes which are declared upon their face to be obligations of the United States Government. Even the profits of the banks so rigidly controlled are not to rise above five per cent. The plan differs essentially but little from the direct assumption by the government of complete ownership and control of the banking business.

Out of these onerous conditions and the choice which they may impose springs the danger to the plan and to the whole country. There appears an assumption that the banks must accept any terms; that they will pay any sum rather than surrender a charter which entitles them to be called

"National." In truth, this is very far from the case. The bankers of the country have met the situation with real patriotism, have shown every willingness to co-operate, have expressed their objections to the scheme as framed with good temper and moderation. They are, as a body, as sincerely desirous as any men in the country to maintain public credit and to serve the public good; and have shown themselves ready to make concessions and to bear their full share of the necessary burdens of currency reform. Let them do their whole duty in a spirit of fairness and truth. But no persuasion or compulsion can urge them beyond a reasonable limit. They cannot be obliged to accept any new system. They have always the option of surrendering their charters and operating under State laws.

The popular idea that this would involve a costly sacrifice is mistaken. Indeed, a change is now going forward that shows the natural drift of banking business. State banks everywhere are growing more rapidly than ever before and competing successfully with the national banks for business. The deposits of state banks and trust companies in New York are reported to be $360,000,000 greater than those of national banks. The state banks of Minnesota have increased their deposits $15,000,000 in the last year. State banks are growing faster than national banks in Boston and Chicago. It is clear that the advantage of the title "National" is about balanced by the restrictions that accompany it. Tighten those limitations, increase those burdens, and there is great danger or practical certainty that many or even most of the national banks would feel it due to their stockholders and depositors to refuse to enter the new association, surrendering their charters instead, and electing to operate under state laws. If this should happen because conditions are made too onerous for acceptance, not only must a plan based on the assumption of their co-operation fall to the ground, but such a situation could scarcely fail to bring with it distrust, disturbance and more than a probability of a monetary crisis and great business depression. Federal banks without money cannot serve the country.

To avoid these possible perils, to frame a system not for today but for all the future, founded on justice and financial experience, co-operation between the bankers, the executive and the legislative authority is indispensable. I am sure that you are ready to do your part. The prospect before you widens, the difficulties increase. That is one of the penalties of life and growth. As intelligence and the experience necessary to deal wisely with our problems grow, the problems themselves also grow in number and complexity with the advance of civilization. It may be that you, as representatives of a mighty national function, have been too little united in opinion or too modest to express and maintain it. But your influence is powerful, your conclusions will be respected. It may be that the time has come when you should assume a more active position, a more direct and forceful leadership. That is for you to decide. But the country needs the best service that you have to offer. The history of banking, the monuments to credit which this country has to show, the wise employment of our capital, the cordial desire to ascertain and to serve the public good shown by your rank and file, not only in the great centers and in times when panic threatened to shake the solid bedrock of the nation itself, but in every little community large enough to boast its bank, and among the thousands of toilers there who count you as their friends and helpers, advise the country that such policy will not be unjustly assumed or unwisely or unpatriotically administered.