B_B93
Reserve Requirements 1971

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CHAIRMAN OF THE BOARD OF GOVERNORS
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551

May 21, 1971

Burns asks for required reserves on all federally insured banks; ~~mostly because~~ his main argument is that this will improve monetary control

The Honorable John Sparkman, Chairman
Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, D. C. 20510

Dear Mr. Chairman:

The Board of Governors recommends legislation (1) to authorize a more flexible system of graduated reserve requirements, (2) to apply such requirements to the demand deposits of all depositary institutions that accept deposits subject to withdrawal by check, and (3) to authorize the Reserve Banks to extend credit to such institutions on the same basis as they extend credit to member banks.

Since 1964 the Board has recommended that the Congress extend Federal Reserve reserve requirements to all federally insured banks. In this connection I would like to bring to your attention the following observations based on the enclosed data:

(1) The rate of growth in deposits in nonmember banks has consistently exceeded the rate of growth in deposits in member banks during the last decade.

(2) Nonmember bank deposits now constitute approximately 18 per cent of the money supply.

(3) Within the money supply total, the nonmember bank component has regularly responded less and more slowly to monetary restraint than has the member bank deposit component; in fact, in the years (1966 and 1969) when the Federal Reserve was trying hardest for monetary restraint, nonmember banks added more to the money supply than did member banks.

The Board believes that, rationally and equitably, all of our nation's institutions that offer checking deposits should be required to maintain reserves against those deposits in the same amount and form that are applicable to member banks.

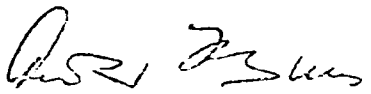
Otherwise, if present trends continue, reserve requirement changes as a tool of monetary policy will, sooner or later, become practically ineffective. Even now, the incentive to avoid reserve requirement costs by shifting to a nonmember status is a factor that the Federal Reserve must reckon with in considering any increase in reserve requirements to achieve stability goals.

Because of economies of scale in banking, the application of reserve requirements to deposits in small institutions is more onerous than the application of those requirements to deposits in large institutions. Accordingly, in applying reserve requirements to small institutions, whether member or nonmember banks or other nonmember depositary institutions, the Congress might consider it appropriate to establish graduated reserve ratios for demand deposits. By authorizing the imposition of lower reserve ratios against some or all of such deposits (say, the first $5 or $100 million), the Board would be able to develop a rational and equitable reserve requirement system consistent with the effective implementation of monetary policy.

As in the past in recommending extension of Federal Reserve reserve requirements to nonmember banks, the Board believes that all institutions subject to such requirments should have access to Federal Reserve credit facilities on the same basis as member banks.

A draft bill based on the foregoing considerations is enclosed. The Board urges its introduction and enactment.

Sincerely yours,



Arthur F. Burns

Enclosures