

**THE WHITE HOUSE
WASHINGTON**

February 16, 1937

MEMORANDUM FOR GOVERNOR ECCLES:

The President has asked that
I pass along to you the attached correspondence from Dr. Irving Fisher.

A handwritten signature in dark ink, appearing to read 'M H McINTYRE', written in a cursive, slightly slanted style.

**M. H. McINTYRE
Assistant Secretary
to the President**

February 16, 1937

My dear Dr. Fisher:

The President was awfully glad to receive the pre-publication copy of your article, "100% Reserve System". He asked me to be sure and thank you for your thoughtfulness in sending it along. Confidentially, he has asked me to pass it along to Governor Eccles for his information.

With all good wishes,

Sincerely,

M. H. McINTYRE
Assistant Secretary
to the President

RB/mm

Dr. Irving Fisher,
460 Prospect Street,
New Haven,
Connecticut.

PROFESSOR IRVING FISHER
460 PROSPECT STREET
NEW HAVEN, CONNECTICUT

*More to thank
I send to
you
Enclosed -*
February 10, 1937

President Franklin D. Roosevelt
The White House
Washington, D. C.

sent 2/16/37

My dear President Roosevelt:

Enclosed please find pre-publication copy of an
article on the "100% Reserve System." The article is
expected to appear soon in one of the important bankers'
publications.

Very sincerely,

Irving Fisher

As you know I regard this

IF:M *as one of the most essential parts of
a monetary program.*

*Inciidentally it would help
solve your budget problem.*

100% RESERVES
"
An Old System Adapted to Modern Needs

-by-

IRVING FISHER

Professor Emeritus of Economics
Yale University

The recent action of the Federal Reserve Board in raising reserve requirements in order to prevent inflation brings up anew the question of raising the reserve requirements, for demand deposits, up to 100%.

This project is commonly regarded as a novel one--only three years old. But it is over three centuries old. It was, in fact, the earliest form of demand-deposit banking. It was, and is, the most conservative form. If it seems otherwise--being a radical departure from established practice--it is only because our recently established practice has departed so radically from the once established and more conservative practice of the past. Established practices, when **retrogressive**, have to be disestablished. Bank affiliates are an example. The subject of this article is another and more important example.

The Bank of Amsterdam, founded in the seventeenth century, conducted a 100% demand-deposit system. Every deposit was as literally a deposit as is today the deposit of valuables in a safety deposit vault. The Bank of Amsterdam was expected literally to keep in vault the full amount of the money deposited. This money did not belong to

the Bank but to the depositor. The paper instruments for transferring this deposited money were what originated the modern checking system. These deposits were the soundest of sound money.

The Bank of Amsterdam failed after 182 years, not because it used the 100% system but because it gave it up. It gave it up surreptitiously, lending out as much as it dared of its depositors' money to the city of Amsterdam. In other words, it betrayed a trust. It tried to get interest on other peoples' money without their knowledge and in addition to the service charge already paid.

Later the practice of lending out money deposited became the standard practice of banks, no longer secret nor a breach of trust but consented to by the depositor and the law. The service charges were dropped, and instead of the depositor paying the bank for keeping and handling the transfers of his money, the bank paid the depositor for permission to lend.

The 100% plan now being proposed is simply part of a general modern movement back toward the older and sounder system. This movement has already included the dropping of interest payments on demand deposits, has revived in some degree service charges, and has at last, even raised reserve requirements. Why not raise them back to the original 100% and put a stop to weak fractional reserves altogether?

As far as I know, the only real objection to so doing is the fear of the banker that he will not make as much money under the 100% system as he does now. One object of this article is to show that, on

the contrary, he can make more. Several bankers, those who have most studied the problem, agree that this is true. Just as, in the long run, it is true that honesty is the best policy, so is it true that, in the long run, a sound reserve system is the best policy. In my opinion, the unsoundness of the present fractional reserve system was the chief cause of the depression. The screw loose was that, behind every \$100 of demand-deposits, there needed to be, in the vaults of the Federal Reserve Banks, only \$3.50 or 3½%. Even now there needs to be only 7%. Even our Federal Reserve notes have a 40% reserve; and they are real money already, not needing as high a reserve as deposits, which are not real money.

This inverted pyramid in which \$7 of real money supports \$100 of mere credit money was the chief basis of the depression, and the losses in money, in moral set-back and in political attacks which the depression brought to the bankers are a fit punishment for employing such a fractional reserve system. That is, American bankers have had to pay the same kind of penalty as did the Bank of Amsterdam for departing from the original safe and sound 100% system.

The depression was, first and foremost, a money famine--a famine not of pocket-book money but of "check book money" or demand deposits. These constitute our chief circulating medium, although it is one provided by bankers, not by the Government.

According to the best estimates I know this kind of "money" shrank between 1929 and 1933 from 22 to 14 billion dollars. It was this shrinkage of 8 billions that constituted the essence of the depression. Between 1933 and today, check-book money expanded again, from 14 to 23 billions. It was this recovery, in the volume of our circulating medium

which has constituted the essence of the recovery from depression.

Such a see-saw was inevitable under our fractional reserve system. When a bank lends or invests, it extends credit, i.e. creates check-book money. When it gets loans paid or sells investments, it contracts credit, i.e. destroys check-book money. In normal times such creation and destruction of money roughly balance. But when they do not balance, the nation's money is inflated or deflated and causes a boom or depression.

Under the 100% reserve system, on the other hand, no action of the banks could alter the circulating medium in the least. Suppose the banks, in 1929, had possessed the 22 billions in actual cash lying in their vaults or at their beck and call. And suppose 8 billions then to be withdrawn. The result would be 8 billions shrinkage of demand-deposits, check-book money, but 8 billions expansion of pocket-book money. The combined total of the two would remain unchanged.

Furthermore, no such withdrawals would ever occur under the 100% system; for few demand depositors ever demand their deposits unless they fear they cannot get them. "I want my money," shouted the panic-stricken depositor--"that is, if you haven't got it. If you have, I don't".

But how can we now get back to the ancient 100% system? There are many ways of reintroducing this system without causing any great disturbance. These are described in my book "100% Money". In my opinion, one of the best ways is the following:

Let Government bonds be counted (at par) as
part of the required 100% cash reserve, the rest being
actual cash.

Let the Government lend to any bank so desiring enough new paper money to bring its reserve in cash plus bonds against its demand-deposits up to 100%.

Thereafter, let the bank be required to maintain such a 100% reserve in cash-plus-bonds.

Permit no bank to increase its reserve in bonds.

Let the Government always stand ready to purchase of any bank its reserve-bonds at par, paying in new money.

The above plan is a combination of plans proposed by several others, including Mr. Robertt H. Hemphill, formerly Credit Manager of the Federal Reserve Bank of Atlanta, James W. Angell, Professor of Economics at Columbia University, and Professor Henry Simons who, with his colleagues of the University of Chicago, seems to have been the first to propose a 100% plan as a remedy for such depressions as that of 1929-1936. The plan as here proposed would not, at first at least, be strictly a 100% cash reserve plan. It would be in part, a "bond secured currency" plan. But it would, in effect, be an all cash plan since all cash demanded, if not already existing, can be brought into existence instantly. The plan also would have the advantage of avoiding, at this time, any appreciable disturbance in the market for Government bonds, an important practical consideration.

These reserve requirements would practically be identical with the reserve requirements imposed as to new deposits by President Roosevelt on "restricted" banks at the time of the bank holiday. It would also do for deposits what, under the English Bank Act, has been done for bank notes, namely - allow a maximum reserve in securities but require all reserve above that maximum to be 100% in cash.

In fact, the present proposal is merely to finish the job undertaken by Sir Robert Peel in 1844. He did not foresee that demand-deposits would replace bank notes as the dominant circulating medium and so require the same treatment; namely, a 100% reserve.

It may be observed that there is another analogy between the present proposal and the experience of the Bank of England. The above described analogy is with the Bank's "Issue Department" and relates only to notes. This form of currency has not made any further trouble in England since the Bank Act of 1844. As is well recognized, the Act has operated somewhat to moderate the severity of crises in England. But the deposit currency, wholly overlooked in the law of 1844, soon began to make trouble. In 1847 the other of the two great departments of the Bank, the "Banking Department", was confronted with a run or pressing demand for cash. With the approval of the Government, though unauthorized by law, it borrowed cash of the Issue Department. This cash was new money, specially manufactured for the purpose and transferred to the Banking Department in exchange for securities. This "Suspension of the Bank Act" as it is misleadingly called, was soon validated by Parliament. Being recognised as in the public interest, the same procedure has been followed in subsequent crises.

Its success has been so invariable that its essential nature has been little analyzed. It is a further step toward the 100% plan. Both the permanent set-up of the Issue Department and the emergency set-up of the Banking Department are plans to strengthen reserves, one reserve being gold (now Government paper) behind the Bank's note liabilities, the other reserve being notes behind the Bank's deposit liabilities. The latter reserve could readily be so specified as to become a 100% reserve,

like the former, So specified and made applicable at all times and to all banks, it would have finished the job in England which Peel begun. It would then be substantially the 100% plan here described.

Through this plan, as above outlined, banks would not have any temptation to dump Government bonds on the market. If a run were conceivable, its only effect could be to force the banks to sell bonds at par to the Government in order to get cash for demand depositors, exactly as the Bank of England's Banking Department now does in an emergency. This cash for the public would not come out of the public as it does in a run now. It would, as already stated, be newly created like the emergency notes of the Bank of England.

The deposits, being convertible into cash, would be, in effect, guaranteed deposits. This guarantee would operate like the Aldrich-Vreeland Act, which provided for new money in emergencies. It would, even more, be like the Canadian Branch Banking System under which in the case of need, the cashier of the Branch Bank can reach under the counter for notes in blank, ready for his signature to be made into full-fledged new money.

It is strange how generally the importance and function of new money in an emergency is overlooked, despite our experience, all favorable, with various sorts of such money-clearing house certificates, local ~~strip~~ in this recent depression, even the curious wooden money in Tenino in the State of Washington, as well as much corresponding experience abroad. In one English panic the day was saved by the fortunate discovery in a forgotten pigeon-hole of a large quantity of bank notes.

It is high time that so obvious a remedy be no longer left to chance and

that the lessons of experience should be incorporated into a permanent provision of law. This is what the 100% plan would do.

This form of insuring bank deposits would apply to all deposits and not simply to those below \$5,000 as does the present form of insurance under the F.D.I.C.

Furthermore, the new insurance would be costless--except for trivial items like the cost of engraving the new money. The present costly form of insurance would then be left as a needless burden on the banks, and ought to be abolished.

Finally, the new form of insurance would be fully effective--bound to work under all circumstances--which can scarcely be said of the present system. The F.D.I.C. now guarantees a redemption of deposits, or check-book money, in pocket-book money, although there is not enough such pocket-book money in existence. If the demand for such money - cash - were ever great enough, and sudden enough, the F.D.I.C. might, some fine day, be severely put to it to find the cash, just as is a bank, caught in a "run". What we need to satisfy excessive claims for cash in an emergency is new cash. Our present system is wrong in permitting the manufacture of new credit but not permitting the manufacture of new cash; that is, it can add to the claims on cash which make the system so precarious, but cannot add anything to the cash itself which would make the system safe. As deposits tend to expand with the expansion of business, it is important to provide the reserves needed for such expansion.

The monetary authority (presumably the Federal Reserve Board) should therefore be authorized and directed, on the slightest signal of deflation, as registered by an index number, to issue more new

Contrariwise, if ever there should be the contrary signal, namely, a rise in the index number indicating inflation, money should thereupon be withdrawn. The issue of money and the withdrawal of money could, among other methods, be brought about by means of the now familiar open-market operations. The Government would buy its bonds or the reverse. In most cases it would buy not sell, since the country would be needing more, not less money.

Thus, for supplying the country with the circulating medium it requires - manufacturing money itself instead of letting the banks manufacture money, the Government would be progressively acquiring its bonds and therefore extinguishing its debt. A yearly addition to the nation's money of 5% would extinguish our existing debt in a little over fifteen years.

The new money would gravitate into the banks as deposits no matter how or to whom it was paid out in the first instance. It would sometimes go directly to the banks in purchase of bonds, and so become a Government deposit. Sometimes it would be deposited by individuals or corporation. In either case, it would become part of the 100% reserve behind demand-deposits.

There is no need to discuss here convertibility into gold. The 100% plan has no relation to that problem. It would be the same plan whether gold were used or not, just as the 100% plan for the notes of the Bank of England has not been substantially affected by the fact that, in 1931, England gave up gold for paper. In the United States, the only monetary convertibility which has really failed us in this generation is the convertibility of demand-deposits into cash, that is of check-book money into pocket-book money. The 100% plan is designed, among other

things, to solve that problem.

But convertibility of any kind is not the main point. The main point is to stop the lawless alternation of inflation and deflation from which we now suffer, as recently exemplified by the fluctuations of 8 and 9 billion dollars in our demand deposits. These fluctuations occurred because each of our thousands of checking banks has been acting as so many little independent mints, creating and destroying the nation's money.

Article I of our Constitution clearly aims to have the central Government exercise sole control over the nation's money. This is the only sound way. President John Adams thought it scandalous to have any bank or other private agency issue the nation's money or any part of it.

The 100% plan would restore to the Government this governmental function. Moreover, if we thus render unto Caesar the things that are Caesar's, banks would be freer to pursue their proper business, that of loaning money. It is not their proper business to create or destroy money. Their main business would then become investing their time deposits and savings deposits, while their demand deposits would merely consist of government-made money entrusted to their care by its owners. It is true that even the demand deposit business can be made profitable through service charges.

If this complete divorce were effected, between money as a governmental function and loaning as a banking function, almost all the present vexatious laws, rules and regulations restricting banks might well be repealed. The Government could then be kept out of the banking province which, under our present unsound system it has been forced to enter in the

last six years, all because banks have not kept out of the Government's province.

And the bank would then make more money than now, for at least four reasons:

First and foremost, depressions, such as this last, so costly to bankers would become impossible, since demand-deposits could not shrink by 8 billions nor even by a single dollar.

Secondly, as soon as a bank had its demand-deposits backed, potentially at least, by 100% cash, one of its chief worries would immediately disappear and much expense would disappear with it. This worry is that of managing, through highly-paid experts, its demand liabilities in relation to its quick assets. After the 100% plan was put into force, the demand deposit department of an average commercial bank could almost be run "by a man and a boy".

Thirdly, if the 100% system were enacted now, the rate of interest would immediately rise. It has long been abnormally low "because of excess reserve", which simply means because banks have not only been lending money to the Government but manufacturing the money which they lent, instead of lending the savings of the public.

Fourthly, the volume of the people's savings, in other words the field or market for bankers, would grow faster and more steadily when money famine depressions no longer afflict us. Bankers can prosper only as business prospers.

Little has been said here as to service charges, because I wished to confine attention to the plan which would cause the least change in banking and not enter into any unnecessary controversies.

Some of the bankers, however, who favor the 100% plan, favor

a somewhat different version, in which service charges are depended upon for the main revenue, rather than interest on government bonds. Certain banks, and a company of which I am Chairman of the Board, have demonstrated the feasibility of such charges for small accounts. I have also been told of a bank in the South which recently made 30% on its capital largely by way of such service charges. Ultimately, I suspect, we shall reintroduce service charges even more completely and systematically than we have done already, so that each depositor will pay for what he gets. Rightly or wrongly, I believe that this is a sound principle and will prove more profitable than the principle of gratuitous services granted to the depositor for the sake of obtaining his demand deposits. The bankers have found these deposits of very precarious value to them even if they do not realize as clearly as they should that these deposits, insufficiently backed by cash, have produced the depression.

It may be asked why we need 100% reserves rather than some lower figure such as 80% which has been suggested. There are many reasons. One is that, if any lower figure is used, the same question will be raised again. "Why not lower it some more?" And we shall be on our way again toward a depression-making system.

Another reason is that a 100% system is qualitatively different from even a 99% system. In the eye of the law, under a 99% system, the reserves belong to the banker. Under a 100% system they belong to the depositor.

A third reason is that the 100% system can be understood by the general public while the 99% system would puzzle them fully as much as the present system. Under this present system there is a confusion not only in that the depositor thinks he owns "money" which he has "on deposit"

and "in the bank". It is hard for him to realize that he owns no "money" but only a promise to furnish money, a debt of the bank; that this debt is his only "deposit"; and that the only real money the bank can get for him is not "in the bank" at all nor even in the Federal Reserve Bank, but in his own pocket book and the pocket books of his neighbors.

But all this mystifying mixture of money and banking disappears as soon as, under the 100% plan, deposits represent genuine physically deposited, pocket-book money. All money becomes the same sort - pocket book money. There will simply be two pockets, one in the trousers and the other in the bank. The money on deposit in the bank will then literally be money, will literally be in the bank, and will literally be a deposit.

Of course, savings "deposits" and time "deposits" are even worse misnomers than demand deposits. They never were and never should be deposits. They are investments. Only demand deposits should be made into true deposits, worthy of the name; for they alone are used as the nation's circulating medium and so should be controlled, as to their total amount, by the Government. The 100% plan, and only the 100% plan, will do that fully. Applied at the present time, it would, immediately and completely banish the menace of inflation.