

OFFICE OF MR. WARBURG,
FEDERAL RESERVE BOARD.

Referred to the Secretary of the Federal Reserve Board

For—

Acknowledgment

Action of the Board

Preparation of reply and return for signature

Investigation and report

Previous correspondence

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The Committee appointed to report upon the question: "How soon can the Federal Reserve Banks be opened and what steps must be taken preceding such opening?" begs to report as follows:

The Committee bases its report upon the assumption that the Federal Reserve Banks are to open in the simplest possible form on the basis of the Sub-Committee's report to the Board, dated October 2, which report was adopted by the Board.

A plan carrying out this program would have to provide for organizations when opening to fulfill the following functions:

1. The receiving and safe-keeping of the about \$200,000,000 or \$300,000,000 of lawful money which will constitute the deposits and the payments on account of capital stock to be received by the Federal Reserve Banks;
2. The rediscount of paper to be received from member banks. The member banks are entitled to pay in 50% of their deposits required by law by rediscount operations (The question whether the Federal Reserve Banks can temporarily stop their rediscount operations at this point or whether they must be prepared to go on rediscounting when once they have begun will be discussed at a later point in this report.) (108)
3. The receiving through the Federal Reserve Board and the issue to member banks of Federal Reserve Notes.
4. The transfer of balances from the account of one member bank of a district to that of another.
5. The transfer of balances between the Federal Reserve Banks. (The question whether or not any of these functions can be dispensed with, tem-

porarily at least at the opening of the banks, will be discussed in a subsequent part of this report).

6. ^{The} ~~a~~ Clear^{ing} national currency (subject to the adoption of the amendment).

What steps will be necessary to perfect organizations of a capacity to cope with these six requirements?

In enumerating these steps, the Committee makes free to suggest at the same time a plan of how to deal with the same.

1st: Constitution of the Boards of Directors. This has been perfected in almost every district. Forms of oath of office have been handed to Class C Directors and in most of the cases the first meeting of the directors ^{has occurred} and the ~~taking of the oath~~ ^{been administered} has taken place, or will have taken place by the 20th of October. In the few cases ~~where~~ where Class C Directors did not find it possible to dispose at once of their holdings of bank stocks (for instance, in San Francisco) it has been suggested that tentative elections take place with the understanding that they will be duly ratified by formal action of the Board as rapidly as possible.

2nd: The Election of Governors. The Federal Reserve Agents have been instructed to proceed with the election of ^{Governors} ~~these officers~~ as rapidly as possible (consulting the Federal Reserve Board where necessary) and to inform the Directors of the Federal Reserve Banks that a conference will be held at Washington on the 20th of October, when it is expected that delegations consisting of not less than three members (including the Governor and the Federal Reserve Agent) from each Federal Reserve Bank will be in attendance. It is, therefore, to be expected that the election of governors will be ^{further} ~~held~~ as much as possible, and it is to be hoped that on the 20th

the governors ~~representing~~ all Federal Reserve Banks will be present.

3rd: Election of Advisory Council. ^{Advisory Council} ~~These~~ members are to be elected by the Directors of each Federal Reserve Bank. A memorandum containing the Board's views concerning the qualifications of such members and the principles to be followed in electing the ~~same~~ ^{me} has been sent to each Federal Reserve Agent for communication to his Board.

4th: ^{By-laws} ~~Adoption of By-Laws~~ by the Federal Reserve Banks must of necessity precede their opening. Under the law (39) these by-laws are to be prepared by each Federal Reserve Bank, but, in order to secure uniformity, tentative by-laws have been prepared and sent by the Federal Reserve Board to all Directors of Federal Reserve Banks. ~~It~~ ^I is planned to appoint on October 20 a small committee (No. 1 on Legal Matters) consisting of governors, Federal Reserve Agents, etc. which will agree on uniform by-laws ~~to be~~ ^{to be} ~~shall be~~ adopted, temporarily at least, by all Federal Reserve Banks. These by-laws are to be simple in form. Their further elaboration can be left to a permanent committee on by-laws. The varying conditions existing in ^{several} the districts which may render necessary some variations of detail should be covered as far as possible by rules to be adopted by each Federal Reserve Bank, but it is to be urged that the by-laws of all Federal Reserve Banks may remain uniform.

5th: Uniform Stock Certificates and Receipts to be adopted by all banks shall be submitted to the meeting and turned over to the same Committee (No. 1). (These are to be prepared by Counsel.)

6th: Uniform Accounting. A set of books and forms necessary for the opening of the banks will be submitted by Mr. Willie to Committee No. 2 for report.

(4)

7th: A simple system for (a) settling balances and making transfers between Federal Reserve Banks and (b) between the member banks of a district is to be submitted to the same committee (No. 2) for report. (133)

8th: Compensation of Directors and Advisory Council. This is to be fixed by the Federal Reserve Banks subject to the approval of the Federal Reserve Board. Committee No. 3, on organization, should report recommendations. (50-91).

Commercial Paper a
9th: Definition of Commercial Paper and Limit for Six Months Paper drawn against Agricultural Products, etc. are to be promulgated by the Federal Reserve Board. A joint committee consisting of two members of the Federal Reserve Board and some prominent Governors and Federal Reserve Agents should discuss this problem and report recommendations. This committee (No. 4, called the Committee on Plan and Scope) might also discuss and report on the general program adopted by the Board for the opening of the banks. (97-98-109).

Buildings Vaults etc
10th: General Questions of Buildings, Vaults, Inner Organization, Staff, Salaries, etc. ought to be discussed and some general principles to be followed by all banks ought to be reported by Committee No. 3.

11th: The form of the weekly statement to be issued by each Federal Reserve Bank and the Consolidated Statement to be issued by the Federal Reserve Board ought to be submitted and discussed. (Mr. Willis to prepare these forms which are to be submitted to the Federal Reserve Board for discussion before the 20th of October). (75) by Committee No. 4.

Credit Bureau
12th: The question of a credit bureau and statements to be made to member banks by customers rediscounting paper ought to be turned over to the Committee on Plan and Scope. This question might profitably be dis-

gussed at a dinner. ~~It would lead too far to take it up formally at the conference.~~ *would lead too far,* It is necessary, however, to explain to the delegates the importance of this phase and the future development.

13th: Duties of Federal Reserve Agents. These have been discussed in a special report which is attached. A special conference ought to be held by ~~a~~ members of the Federal Reserve Board with the Federal Reserve Agents at which their functions will be fully discussed and regulations to be promulgated by the Federal Reserve Board will be agreed upon. These are in course of preparation. (The report of the Sub-Committee on Federal Reserve Agent ought to be carefully analyzed by counsel and regulations ought to be prepared by him on the basis of this report.) (86. Committee No. 5).

14th: Note Issue and Redemption. Federal Reserve Agents should take a prominent part in Committee No. 5, to be appointed to deal with this question. The Comptroller of the Currency, under whose charge the law primarily places this phase of the functions of the banks, ought to prepare forms and regulations covering the issue of the notes to Federal Reserve Agents (81), the issue ~~of the notes~~ by the Federal Reserve Agents to the Federal Reserve Banks, the safe-keeping of these notes, *and the keeping of* the gold 5% redemption fund ~~to be kept~~ in the Treasury in Washington, etc. (122)

Note for Comptroller:

(73) Under the law there is to be organized* a bureau in charge of the Comptroller and under the supervision of the Federal Reserve Board which is to be in charge of the *administration* ~~execution~~ of laws concerning note issues, *et* This is

to be done (if it has not already been done): Some forms have already been prepared by the ^{Preliminary} ~~Public~~ Committee, which, if approved by the Comptroller, could be made the basis of the regulations to be submitted by him to the Board. (It is suggested that Counsel go over the law carefully and point out the various sections of the law that need to be covered.)

Clearing Currency:

15th: Committee to work out plan for Clearing National Currency to
be dealt with by Committee No. 5 (to be prepared by Gov. Hamlin).

16th: ^{This} Auditing ^{from} should be subject of a special report. Federal Reserve Agents should play a prominent part in this report and it is suggested that it be turned over to Committee No. 5. The reason why Federal Reserve Agents should be in particular charge of auditing and why auditors should cooperate with Federal Reserve Agents has been fully discussed in the special report on Federal Reserve Agents.

It is suggested that the Secretary of the Federal Reserve Board telegraph about the 16th of October to all Federal Reserve Agents in order to ascertain what delegates are coming. There will be probably between forty and fifty men and excellent committees can be composed from this material. The personnel should be considered in ample time before the meeting. ~~The~~ ^a plan for the division of the work outlined among the committees is attached (Exhibit I). The committees will require ^{the whole day on} ~~all of~~ the 21st to complete their reports, which could then probably be acted upon on the 22nd, after which the conference would disband with the order to proceed with the greatest

possible dispatch. The delegates, upon reaching their homes, will promptly proceed to engage their staffs and perfect arrangements for quarters, vaults, furniture, books, forms, stationery, etc. To perfect an organization both as to personnel and physical machinery capable of safely handling even in the most temporary way the problems above outlined will require at least from three to four weeks. Men have to be carefully sifted and particularly those to occupy positions of great responsibility cannot be found within a day or two, and, if found, it takes them some little time to free themselves from their present obligations.

~~As to vaults,~~ ^{vaults} the law requires a double set of ~~the same~~, one for the Federal Reserve Agent and one for the general business of the bank. In view of the large sums of cash which will be entrusted to their care, these banks must provide for the greatest possible degree of safety. Of course, it will be necessary to ^{make temporary arrangements} ~~temporarily~~ in the beginning, but, even then, it will no doubt be necessary to strengthen existing ~~available~~ facilities or to reshape them so as to be available for the changed conditions, and it is most important that, in this respect, the facilities ~~will~~ be such as to enable the banks to go on for some time and until permanent arrangements can be made without being obliged to make frequent, costly and dangerous changes while the machinery is ^{in operation,} ~~already going~~. Informal investigation carried on by the Secretary of the Board in his discussions with Federal Reserve Agents bears out this point of view that at least this period of time will be required. Moreover, information so far received would indicate

(8)

that the Federal Reserve Notes will be ready for delivery about November 15 and your Committee is, therefore, inclined to think that this date should be viewed as the earliest possible moment at which the banks could safely be opened. This would presuppose that everybody will proceed at top speed; that the work will be well planned; that duplications of effort and all "red tape" will be avoided. In order to dispatch business, it is suggested that the services of additional counsel be secured for the next few weeks. Legal documents, contracts, regulations, by-laws, etc. will have to be formulated and the assistance of a man of quick grasp and energy would be very helpful. The Federal Reserve Board's Counsel is apparently unable at this time to free himself from duties already on his shoulders. During the conference and the weeks of activity preceding the opening of the banks such additional counsel seems very desirable.

Before the opening of the banks, and, if possible, before the conference, certain regulations and instructions must be agreed upon and formulated. The appended list * shows what remains to be done, but it is urged that the Counsel and the Secretary go through the law carefully and report to the Governor such additions as may be necessary.

It is most important that the preparation of the program for the meeting be taken up promptly and made out carefully in all its details.

*Will follow.

It is suggested that papers be prepared to be given to each delegate stating the paragraphs of the law requiring action, regulation or discussion and the action and regulation proposed, leaving space for amendments as they may develop in the discussion.

While this may be termed the positive side of the program, there is an equally important ^{negative} side which is the negative one. The Sub-Committee reported on October 2 a plan for the opening of the banks which dealt with those ^{topics} ~~things~~ that were to be taken up now and those which should be deferred to be taken up only after the opening of the banks. It is suggested that a clear statement be made to the delegates as to this program, and it is most important that uniformity of views be established concerning those points amongst the members of the Board. During the conferences with the Class C Directors it has been a frequent occurrence that divergent views were expressed by members of the Board on such questions: as ~~to~~ the time of opening, ~~and~~ the advisability of opening the entire system simultaneously or piece-meal, ^{policy in electing} candidates for advisory council, clearings, etc. It is most important that a definite policy be adopted for the discussion of these points and the Committee submits a list of such items as it believes should be taken up by the Board from this point of view.

Exhibit III

The question has been raised whether or not it would be advisable to call immediately for the first payment on account of the capital stock of the Federal Reserve Banks while deferring until a somewhat later date the transfer of the reserve money to the Federal Reserve Banks. It would not appear that much is to be gained by such ^{an} ~~earlier~~ ^{call}. It could not be made immediately because in order to carry ~~the~~ ^{it} ~~into effect~~ it would be necessary to perfect the organization to that point at least ^{where} ~~that~~ Governors, cashiers, accountants, auditors, would have been engaged and the vaults or other facilities ~~would be~~ ^{would be} available to take care of the about eighteen millions of dollars of gold which would constitute the first payment on account of stock capital. ^(would be available) But nothing is to be gained by such payment. The money would lie idle, the banks would take the responsibility for funds for the receipt of which they could hardly be adequately prepared, the completion of the organization would be pushed at the sacrifice of the greater care in selecting the proper men to fill the offices, and, moreover, the withdrawal of eighteen millions of dollars of gold would ^{draw} ~~draw~~ the reserves of the member banks because the reduction of reserve requirements would not go into effect until later on.

It is the opinion of the Committee that the first call for payment on account of the stock capital should be made ^{simultaneously} ~~in conjunction~~ with the announcement of the Secretary of the Treasury that the banks have been organized, so that payment for stock capital and deposit of reserve money could be made simultaneously, or in quick succession.

The Committee has been asked to report upon the question whether it would recommend the opening of the banks piece-meal. It is

clear that a ~~state of~~ condition which would reduce reserves and inaugurate a system of rediscounting in one part of the country, while the very section so opened might draw for gold on other sections in which reserve requirements ^{had} ~~would~~ not yet ~~have~~ been reduced, would easily lead to confusion.

The Committee would recommend that unless there be the most urgent reasons to the contrary, all efforts should be ^{directed to} ~~be made~~ that ^{opening the banks of} the system ~~be opened~~ simultaneously. The only exception might possibly be ^{found in} the San Francisco District where the delay caused by the great distance to be covered by delegates and communications may possibly bring about the necessity of opening a little later than the other Federal Reserve Banks. It is to be hoped that the San Francisco Bank may succeed in keeping pace with the other eleven banks, but in case this should not be possible the Pacific Coast district forms a unit almost by itself and while undesirable, it is very conceivable that this ^{bank} ~~district~~ should open ~~at~~ some weeks later than the other ~~banks~~.

Should the banks open in case the Federal Reserve Notes are not ready for delivery, [?] ~~and~~ ^S should they open for the mere purpose of receiving the deposits from the member banks and such amount of rediscounts as may be ^{opposed} ~~made~~ to complete the balance to be kept with the Federal Reserve Banks prescribed by the law, [?] ~~upon~~ ^{should they open} a plan of suspending any further operations until such time as the Federal Reserve Notes would be ready for delivery?

To receive the deposits of the banks and to continue discount-operations without being able to furnish Federal Reserve Notes would be an unfortunate procedure. Any additional rediscount granted to any member bank would mean a depletion of the gold ^{supply} ~~balance~~ of the

Federal Reserve Banks because instead of issuing Federal Reserve Bank Notes, they would have to pay out lawful money. If, on the other hand, the Federal Reserve Banks stopped taking further discounts the effect would be ~~an~~ equally unfortunate ~~one~~. The Federal Reserve Banks could not permit the member banks to draw against their balances, these would be tied up and the member banks would be reduced to dealing with their cash in vault alone and any further withdrawal of gold would be felt by them ~~only~~ so much more acutely. Moreover, if the member banks in order to produce the required balance with the Federal Reserve Banks ~~would have~~ rediscounted \$250,000, for illustration, maturing in fifteen days, the Federal Reserve Banks would collect this paper after fifteen days without being ^{able to} ~~in a position of~~ rediscounting new paper against the amount that it ^{might} ~~could~~ collect. They would therefore withdraw so much more lawful money from circulation. has

The only advantage to be gained by the opening of the Federal Reserve Banks in this crippled condition would be to bring into effect the reduction of reserve requirements. It does not appear that this reduction is immediately required at this time; quite the contrary, it appears most desirable that all ~~the~~ gold be held together as much as possible until the opening of the Federal Reserve Banks so that the ability of the member banks ^{to} ~~or~~ put ~~the~~ the largest possible amount of gold into these banks should not be lessened. On the one hand the reduction of the reserve requirements might in certain parts of the country have ^{had to produce} ~~the effect of causing~~ expansion without the control later ^{to be} ~~to be~~ exercised by the Federal Reserve Banks; on the other hand, the anxiety existing in the larger centers concerning the effect of the shifting of reserves would be increased. Great headway has been made during these last few weeks in allaying this fear and this has been a very helpful factor

in bringing about willingness on the part of the banks to help liberally in the present situation. This effect is ^{likely} ~~liable~~ to be lost and ~~the~~ criticism will be leveled at the Federal Reserve Board or the Secretary of the Treasury because it would be ~~plainly~~ ^{throughout} advertised ~~all over~~ the country that the only reason for opening the system in so crippled a form would be the inability on the part of those in charge to deliver in time the Federal Reserve Notes.

The Committee is strongly of the opinion that it will be a grave mistake to contemplate the opening of the banks without being able to issue Federal Reserve Notes, which as a matter of fact would be ~~not~~ ^{tantamount to} ~~amount to~~ the opening for one day, ^{and then} closing again "pending repairs." It ^{must be the purpose of} would ~~also~~ ^{leave the prestige of} the system ~~in a state of~~ all over the world.

The Committee suggests that it would have a very unfortunate effect upon those who are to be entrusted with the running of the system if they should feel that ~~in questions of such importance in which the responsibility of the perfection of the organization and for the running of the same rests on them, they would not have been consulted.~~ ^{had not been}

Moreover, the Committee makes free to suggest that in the negotiations with ~~our friends across the water~~ ^{foreigners} we ~~would~~ ^{do} lose a strategic advantage in stating definitely when we expect to open instead of giving them the feeling that our position will depend somewhat on their actions and that the measure of relief which will come to their own markets ~~is~~ ^{as the} ~~result of~~ reflex action from ours will largely depend upon ~~their own actions.~~ ^{them.}

Your Committee furthermore draws your attention to the fact that when before the House Committee members of the Board stated clearly that it would be necessary for the Federal Reserve Board to know

the fate of the pending amendments before being able to establish the policy to be pursued by the Federal Reserve Banks. From this point of view it would be unfortunate at this time to make any definite announcement. In case the amendments should not be secured it would be necessary that the Federal Reserve Board agree on a definite policy as to the interpretation of its power to suspend reserve requirements. If it should be decided to proceed boldly in exercising the powers granted by this clause, and if counsel advises the Board that it has the power necessary to meet the situation, this phase ought to be fully discussed at the coming conference so that the governors and members of the Boards be fully apprised of the policy to be adopted by them.

It would be very helpful to know on how much gold from the Treasury the Federal Reserve Banks could count when opening.

(Signed)

W. P. G. Harding.

Paul M. Warburg.

Committee.

P.M.W.

10-13-14

EXHIBIT I.

No. 1.

Committee on Legal Matters

1. By-laws
2. Stock certificate

No. 3.

Committee on Organization

1. Buildings, Vaults, Staff,
Salaries (room for F.R. Agent)
2. Compensation for Directors and
Advisory Council

No. 2.

Committee on Accounting

1. Books and forms
2. Settling balances and transfers
between member banks
3. Settling balances and transfers
between Federal Reserve Banks.
4. Definition "Net Balances of Deposits"
(166)

No. 4.

Committee on Plan & Scope.

1. Definition Commercial paper
Open market transactions
Bank acceptances
Restriction Agricultural paper
2. Weekly statement
3. Credit bureau
4. Program for development of banks

No. 5.

Federal Reserve Agents

1. Duties of Federal Reserve Agents
2. Note issue and redemption
3. Auditing
4. Clearing National Bank Currency.

FEDERAL RESERVE BANKS
ORGANIZATION
Distribution of Responsibility.

Counsel

Uniform stock certificates and receipts to be adopted by banks.

Duties F. R. Agents. Prepare regulations based on analysis of report of Sub-Committee. 85.

Do our minutes contain the communication of the Comptroller of the Currency to effect that organization certificates have been filed by all F.R.Banks. 22-23

It is urgently required that we get counsel's opinion about the powers of the F.R. Board to suspend reserve requirements having particular reference to the requirement with respect to cash in vault kept as balance with F. R. Bank.

Give opinion concerning last paragraph of 163 and give opinion concerning 177, regarding directors' fees.

Secretary

Are the books, forms, etc. covered by paragraphs 6 and 7 Committee report prepared in sufficient number? Submit for approval to committee preliminary to conference.

Form of weekly statement. Prepare and submit for discussion by Board prior to conference October 30th. 75.

Communicate to each bank the number and distinctive letter assigned to it for note issue

Advise all F. R. Agents to notify as to classification of A B & C Directors. 52.

Comptroller.

Is requested to secure from Mr. Ralph definite statement as to when F. R. Notes will be ready for delivery and in what amounts.

Prepare forms and regulations covering note issue. 122-81-73.

Expense printing notes to be levied and assessed on F. R. Banks. 128.

The law requires that the Comptroller shall appoint examiners and the Federal Reserve Board shall fix salaries upon the recommendation of the Comptroller. Is the future title of these examiners to be "Federal Examiner" and has the Comptroller any plan in mind which he desires to submit?

EXHIBIT III.

Until after the opening of the banks, the following functions shall not be taken up, and it is suggested that, in order to avoid scattering of attention and efforts, this discussion be refrained from by the conference;

1. Opening of branches;
2. Special permit to National Banks to act as trustee, executors, etc.;
3. Open market transactions (including foreign exchange)
4. Purchase and sale of U. S. bonds and revenue bonds, etc.;
5. Appointment of foreign agents;
6. Charges to be collected by member banks from patrons whose checks are cleared through Federal Reserve Banks;
7. Charges to be imposed for service of clearing or collection rendered by Federal Reserve Banks.

Note: It is very important that an understanding be reached upon the question of clearings. There is evidence that there exists a strong tendency on the part of the banks to dump upon the Federal Reserve Banks their entire transit business, which is not a profitable one to many now and will not be a profitable one after the inauguration of the system. The Federal Reserve Banks in taking over the clearing house functions and the collection business of the entire country might easily undertake for the benefit of the banks a burden for which they would receive very insufficient remuneration and which would force them to create an enormous and very expensive organization. It would very heavily increase the responsibility of those in charge of the system and add to its expenses and interfere with the banking and earning power of the Federal Reserve Banks. It is therefore suggested that this subject be approached only after the most careful study and investigation and that no single Federal Reserve Bank be authorized to take this problem up before, as a matter of principle, the entire subject will have been discussed.

There are certain powers given to the Federal Reserve Banks which should be exercised only upon some joint plan of operation. Amongst others are the following:

Dealing in gold coin or bullion at home or abroad, making loans thereon and contracting for loans of gold. (111)

To buy and sell United States bonds and notes (and warrants having to run not to exceed six months, issued by municipalities, etc.) (112)

The opening and maintaining of banking accounts in foreign countries and the establishment of agencies.*

To purchase and sell foreign exchange.

The purchase of bank acceptances.

Exchanging of 2½ Government Bonds into 3½ Bonds and one-year notes.

The Committee recommends that the suggestion be made to the conference that an Executive Council of the Federal Reserve Banks be created to consist of the twelve governors, of which seven shall constitute a quorum. It should also be provided that the banks may delegate a deputy to take the place of the governor and that they might vote by letter, telegram or proxy in case the question to be voted upon will have been previously communicated to the Federal Reserve Banks.

This Executive Council should have power to deal with these and similar questions delegated to it by the Federal Reserve Banks. In case this Council

*The Board ought to be prepared to answer the question: whether "agencies" means foreign branches to be opened by the Federal Reserve Banks. It is suggested that this would be inadvisable for the Federal Reserve banking system and that it would be better to follow the system of the European central banks that employ other existing banks and private firms to act as their agents or agencies.

should decide to carry on operations of this kind for the joint account of all Federal Reserve Banks, they should be apportioned pro rata the stock capital of the Federal Reserve Banks.

The Board will have to discuss with counsel paragraph 163:

"No member bank shall act as the medium or agent of a nonmember bank in applying for or receiving discounts from a Federal Reserve Bank under the provisions of this Act except by permission of the Federal Reserve Board."

Evidently this is not to be interpreted as forbidding the rediscount by member banks of bank paper endorsed to them by non-member banks but it is very difficult to define what is termed "medium or agent" in this case. Member banks are entitled to a ruling inasmuch as the power is vested in the Federal Reserve Board to give same.

Clause 164:

"The reserve carried by a member bank with a Federal Reserve Bank may, under the regulations and subject to such penalties as may be prescribed by the Federal Reserve Board, be checked against and withdrawn by such member bank for the purpose of meeting existing liabilities, etc."

ought to be studied by the Federal Reserve Board or possibly by one of the committees.

The Committee has suggested that the question of how to define "net balances of deposits" be referred to the Committee on Accounting. The Federal Reserve Board will have to decide whether or not it wants to prescribe that each bank state daily at the close of each day to the Federal Reserve Bank the amount of its net balance, stating at the same time the amount of the balance due to the Federal Reserve Bank under the provisions

(3)

of the Act and the actual balance kept for that day. It may be a routine matter for each bank that, at the close of the day, it should send such statement over the signature of its president or cashier. The penalty to be imposed, however, for encroaching upon the required balance should be fairly heavy because that would be conducive to a policy to be adopted by the banks of keeping their balances rather in excess of the minimum required.

Respectfully submitted:

(Signed) Paul M. Warburg

(Signed) W. P. G. Harding.

Committee.

P. M. W.
10-13-14

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The main problem confronting the Federal Reserve Board is the question of whether the Federal Reserve Banks should be opened in the near future or whether their establishment should be indefinitely postponed. I say indefinitely because I believe that if these Federal Reserve Banks are not opened now it may be impossible to open them for a year, or possibly even longer; because with all the emergency currency that will be outstanding within a few months, with our gold supply more badly scattered than ever (in all probability we shall have substantial premium on gold unless we open the Reserve Banks), our position will be so weak when the moratoria in Europe shall have been lifted and the demand for gold in that quarter will be so enormous that the Federal Reserve system if in operation at that time, having no control whatever upon the American market, would be in an extremely precarious situation. To my mind it would be helpless and it would not be long before its own position would become involved. If we want to open, I believe we shall have to open now, and the sooner the better.

But we could not think of opening now unless the law be radically amended in some respects. If the banks opened under the present law they would have a capital paid in of about \$19,000,000 and deposits of about \$250,000,000. Under present circumstances a very large portion of these deposits would be paid in by way of rediscounts, so that one might expect that the actual gold held in the aggregate by the new banks would amount to around \$150,000,000. Against this there is at present a gold obligation due in London of \$80,000,000, and it has been figured that our total indebtedness, though partly covered by the present moratorium, amounts to \$500,000,000. While I am confident that through the shipment of our food supplies this indebtedness will be gradually liquidated, the immediate drain on our gold supply might prove very embarrassing, and

whether or not we might be able to meet the present situation, past and present experience shows conclusively that a gold reserve of \$250,000,000 is not sufficient to safe-guard the immense financial structure of currency and bank credits of the United States.

The United States is rich in gold. Its entire gold holding, including the holdings of all banks, the free Treasury balance, and gold in circulation, is estimated to amount to upwards of \$1,500,000,000. It is apparent how inadequate is a system which assembles only \$250,000,000 of this gold and leaves about \$1,250,000,000 free as an absolutely useless and wasted asset of the nation. It should be the object of the Owen - Glass bill to consolidate as much as possible all gold in the Federal Reserve banks and the Treasury and to get it away from the cash vaults of the National banks, the State banks and the trust companies and out of circulation. From this point of view I believe that the Federal Reserve Act ought to be amended, provided it does not already clearly vest in the Federal Reserve Board the power to do the following things:

To change at its discretion the dates upon which the further instalments of the capital stock of the Federal Reserve Banks are payable and furthermore to postpone the dates when the reserve requirements of the member banks shall go into effect and to modify such requirements to meet the situation by unanimous vote of the Federal Reserve Board. The Federal Reserve Board with such powers vested in it could rule that Federal Reserve bank notes should be counted as reserve of member banks (the Owen-Glass bill itself does not specifically state anything to the contrary) and it could furthermore rule that whether the reserve be held as balance with the Federal Reserve Bank or in their own vaults be optional with the member banks. This would bring about a most desirable change, that is, the transfer of the gold from the member banks to the Federal Reserve

Such member banks as would not cooperate with this could be easily brought in line by the power of the Federal Reserve Bank of refusing them notes or rediscounts. Member banks now hold in their vaults about \$970,000,000 of specie and legal tender notes, and it would be safe to figure that the Federal Reserve Banks could control no less than \$800,000,000 of this amount. It is unnecessary to enlarge upon the effect. If \$80,000,000 be withdrawn in this case the gold cover is only weakened by ten per cent. If \$80,000,000 be withdrawn out of \$150,000,000 the gold cover would be reduced by fifty per cent and the structure would either be dangerously weakened or a contraction would become necessary so great that it might bring about general confusion and panic. There is no reason whatsoever why Federal Reserve bank notes should not be counted as reserves just as much as the notes of the German Reichsbank and the Bank of France are counted as reserves in those countries. There is even more reason for counting them here as reserve money, because the German and French notes are notes of private institutions while the American notes are obligations of the United States. While national banks should certainly not be permitted to count their own obligations as reserve, there is no reason whatever why they should not count the United States obligations as reserves, for which as entirely independent institutions the Federal Reserve banks are primarily responsible. This principle has been recognized by the law when it permits a large part of the reserve to be kept as balance with the Federal Reserve Banks, which as a matter of fact, under the system as it stands now is not different from Federal Reserve bank notes, inasmuch as balance can be converted into notes and notes can be converted into balance. There is only one reason why the member banks should wish not to part with their gold and that is because they have the obligation of redeeming their national bank currency in gold. If, however, they agree to put all their

gold holdings into Federal Reserve Banks, the responsibility of providing the gold for the purpose of redeeming ought to be thrown upon the Federal Reserve Banks and the member banks should be permitted to redeem their national bank currency through the Federal Reserve Banks or by payment in Federal Reserve bank notes. The Federal reserve banknotes must gradually become the circulating medium of the entire country. The gold notes must be withdrawn and assembled in the Federal Reserve Banks, and the national bank currency will be gradually withdrawn.

The Owen-Glass bill should be amended so as to give the Federal Reserve Banks with the approval of the Federal Reserve Board, discretionary power to begin to purchase at a price not to exceed par, the United States Government bonds against which currency has been issued. The Federal Reserve banks ought to be permitted to purchase these bonds at any time (not only after the expiration of two years) and their purchase ought not be limited to \$25,000,000 per year, because it may become very necessary for the Federal Reserve Banks to bring about contraction in order to find effective means of reducing the vast volume of currency which will have been issued. It is a thought well worth considering whether the Federal Reserve Banks should not gradually assume by some method to be further developed the Aldrich-Vreeland circulation. It would give a very much desired revenue to the Federal Reserve Banks and it would put this circulation under the control of the Federal Reserve Banks. While it might reduce to a marked extent the gold cover behind the notes, I believe we are only deceiving ourselves if we leave this circulation outstanding and do not figure against the total circulation the gold reserve which exists to cover all outstanding circulation. Moreover, the obligation is the same if we consider that on the one hand we have all the member banks united as currency associations

and liable for the circulation and on the other we have the same member banks united as Federal Reserve banks responsible for the Federal Reserve notes. The currency associations will have to fall back on the Federal Reserve banks anyhow, for the redemption of their notes, and I believe that we would get a clearer vision and better results by having at least the power to assume this entire circulation. I do not deny that unless the Federal Reserve Board is fully conscious of the terrific responsibility which it would undertake in permitting inflation that the system would be a dangerous one. But past and present experiences has shown that in establishing a system of this kind, we have to see to it that the greatest possible power is vested in a central organ, whatever that may be, and that only in vast power lies safety in critical times, and that for normal times one must rely on the ability and conscientiousness of the man in charge to bring about the necessary contraction. In this case it is, to my mind, a much safer system to corral all the gold and operate the system normally with a gold reserve of 80 or 100 per cent rather than to let the gold be scattered and believe that there is safety in permitting to each bank to needlessly hoard a vast amount of gold and let the gold reserve in the general reservoir consist of 50 or 60 per cent subject to reduction 20, or even 10 per cent in case of emergency. To my mind there cannot be any doubt as to which of the two systems is the safer and more conservative.