RESERVE REQUIREMENTS

Proposal

Every insured bank and every other bank which receives demand deposits and does business in interstate commerce shall maintain reserves of ___ per cent against demand deposits and reserves of ___ per cent against time and savings deposits, such reserves to consist of cash in vault and a balance with the Federal Reserve bank of its district.

The Board shall have the power to increase or reduce these reserve requirements for banks and bankers located (a) in New York City, (b) in other cities in which Federal Reserve banks or branches are located, (c) in places where no Federal Reserve bank or branch is located or for any combination of these groups; but the reserve requirement shall not be reduced below the percentages specified above and no increase in reserve requirements shall reduce the aggregate amount of excess reserves held by all banks subject to these reserve requirements to less than $1,000,000,000.

The Board shall have authority to require special reserves (not subject to the above limitations) against all deposits of foreign funds with American banks and bankers.

Discussion

The proposal is that banks be permitted to count as reserves the cash in their vaults as well as deposits with the Federal Reserve banks. There is no logic and no advantage in having vault cash excluded from reserves; it merely gives a fortuitous advantage to banks that are located near a Federal Reserve bank or branch.

In suggesting the minimum reserve requirements stated above, it was the Board's intention to make no change in the present reserve position of any group of banks but to provide that such changes as may occur, if they were not in the public interest, could be corrected by action in raising requirements in the money center, that is New York, or in other large cities where Federal Reserve banks or branches are located, or in banks outside of these financial centers. The provision for having the banks grouped this way will result in greater flexibility of the Board's control over reserves, since there are times when reserves accumulate in the financial centers and other times when tightness in the money market may result in handicapping the capital market, while at the same time conditions outside of the money market may be such as not to require an increase in the idle funds at the disposal of banks.

The proposed power of the Board to raise reserve requirements for the purpose of preventing injurious credit expansion is an extension of the principle recognized in the Banking Act of 1935 and foreshadowed in the emergency banking legislation of 1933. It will enable the Federal Reserve System to maintain its position close enough to the market to

make it possible to regulate it through the use of its portfolio of U.S. securities. At the same time it will not make it possible to use reserve requirements as a means of causing banks to go in debt to the Federal Reserve banks or to be obliged to liquidate loans or investments.

In view of the enormous inflow of gold amounting to $8,000,000,000 in the past five years and the still continuing inflow of gold, as well as of silver purchases by the Treasury, the Federal Reserve System would not be in a position to discharge its responsibility for working toward economic stability unless it had instruments of control available in case an inflationary development should get under way.

The proposed plan is based on the opinion that reserve requirements should be adjusted from time to time to the country's aggregate reserve position but should not be used as current instruments of credit regulation. Such current influence on the money market as may be necessary from time to time will continue to be exerted through the instruments originally prescribed by the Federal Reserve Act, namely, open-market operations and discount rates, which are much more flexible and more easily adjusted to constantly changing conditions.

The power to require special reserves against foreign deposits is an added protection against the influence on American business and credit conditions of the erratic movements of foreign funds in and out of the market. Under this provision an inflow of foreign funds, so long as it is in the most liquid form of bank deposits, would not have any effect on bank reserves, and an outflow of such funds would not cause tightness or liquidation.