TO..

FROM..

REMARKS:

This letter was recalled after having been left with the Secretary.

12/18/36

CHAIRMAN'S OFFICE

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

OFFICE OF THE CHAIRMAN

December 15, 1936

My dear Mr. Secretary:

In accordance with your request, I have discussed with all members of the Board the plan for sterilizing future acquisitions of gold, which you were good enough to refer to us for comment.

In our opinion, the proposed plan will be effective in preventing additions to our gold supply from influencing the volume of member bank reserves. In fact, the only effect of the operation of the plan, aside from increasing the public debt, would be to prevent a further growth of the reserves of member banks from that source. It would have no effect on existing excess reserves, or on the growth of bank deposits through gold imports. Neither would it do anything to remove the principal causes of excess reserves which are the inflow of capital from abroad and silver purchases.

The problem of excess reserves of member banks, with one phase of which the Treasury proposal would deal, was considered by Congress at the time of the adoption of the Banking Act of 1935, and the Board of Governors of the Federal Reserve System was at that time given the power to deal with the problem by increasing member bank reserve requirements within certain limits for the purpose of preventing an injurious credit expansion.

Last August the Board of Governors increased reserve requirements of member banks by 50 percent and thereby absorbed a billion and a half of excess reserves and used up one-half of its power over the requirements. It was prompted to do so by the growth of reserves resulting from an inflow of gold from abroad. As you know, it is the Board's intention in the early weeks of next year to consider the desirability of using all or a part of its remaining power of raising reserve requirements.

Action with respect to excess reserves by the Treasury at this time would introduce a new factor and a new agency into the situation. The question would arise why it was deemed desirable to deal with the excess reserve position by using the facilities of the Treasury at public expense when a decision about the desirability and efficacy of using the remaining powers of the Federal Reserve System in this matter has not yet been reached. Furthermore, there is no immediate urgency in the situation, since the current movement of gold is small.

For these reasons the members of the Board feel that they would prefer to have the decision in this matter deferred until the Board of Governors and the Open Market Committee have had an opportunity to determine what action for the purpose of diminishing excess reserves, either by further increasing reserve requirements or by decreasing the Federal Reserve System's holdings of Government securities, shall be undertaken. This decision, as you know, will be made in January or February of the coming year. If at that time the Board's powers to absorb excess reserves by raising reserve requirements shall have been exhausted, the Board would welcome the suggested action by the Treasury. In this event, it would be the hope of the Board that the operations of the Treasury would be automatic and continuous in the sense of offsetting all gold imports and newly-mined gold from that time on and all exports of gold acquired under the plan, but not exports of gold held at the time the plan goes into effect.

We feel that for final determination this matter should be submitted to Congress. The plan proposed by the Treasury does not offer a final solution of the problem, since it would result on the one hand in a public debt which it may not always be possible to carry at a low cost, and, on the other hand, in a stock of impounded gold, which may at any time be used to retire this debt. If and when that is done the gold will be added to member bank reserves and the problem of dealing with them will once more have to be faced. From a long-range point of view, therefore, it would be in the public interest to have the fundamental question of responsibility for dealing with excess reserves, as well as of adequate authority to employ the methods necessary to this end, determined by Congress.

Sincerely yours,

MSEccles

M. S. Eccles
Chairman

The Honorable
The Secretary of the Treasury
Washington, D. C.