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FEDERAL RESERVE BANK
OF NEW YORK

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May 14, 1935.

Dear Governor Eccles:

In all the discussions of the Patman Bonus Bill there has been little, if any, mention of the fact that the enforced issue of somewhat over $2 billions of United States notes, apart from everything else, would result in an immediate increase in excess reserves of an equivalent amount. Those excess reserves would not be reduced by any corresponding decline in the volume of other kinds of currency outstanding. The passage of this law would, therefore, very materially increase the problem which would face the Federal Reserve System in the event that it becomes necessary to control the expansion of credit based on the huge volume of excess reserves. I mention this now only because I gathered from the press reports (probably incomplete) of your testimony before the Senate Banking and Currency Committee last Friday that you felt that the passage of this bill would have little inflationary effect other than that which would arise from the "psychology of fear."

While I personally cannot feel that the enactment of this law and the consequent increase in excess reserves would immediately have a substantial inflationary effect apart from fears that might result from the issue of non-interest bearing notes of the government, there are other features in the bill which I believe should seriously concern us in the Federal Reserve

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System. I refer particularly to Section 3, sub-paragraphs (a) and (b) which, instead of providing a means for the retirement of the United States notes issued to pay the bonus, attempt to set up a plan to check inflation by the restriction or termination of the issue of other kinds of currency, including Federal Reserve notes, in the event that the price level should exceed the average of prices from 1921 to 1929. You are probably familiar with the extraordinary character of these provisions. It suffices to say that in the event of an increase in the price level to the figure fixed, the Reserve System and the member banks might be seriously embarrassed in the future conversion of reserve deposits into necessary currency, and the Reserve System would in any event find itself operating under the orders of the Secretary of the Treasury on matters of currency issue. Furthermore, the whole section is built upon the predicate that price levels can be and should be controlled by currency expansion and contraction, a theory with which I know you disagree. It does not deal with the real problem, which is control of the volume of bank reserves.

You probably have these aspects of the bill in mind. I am referring to them now only because they seem to us so important in relation to the Administration's approach to the whole bill.

Faithfully yours,

George L. Harrison,
Governor.

Hon. Marriner S. Eccles,
Governor, Federal Reserve Board,
Washington, D. C.

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