

Gov. Eccles-

December 31, 1948

The Members of the Board

Mr. Vardaman

On the 17th instant, the Board approved and delivered to the Chairman for transmittal to the President's Economic Committee and to the President, three statements, with respect to prospective legislation granting additional authority to the Board to increase reserve requirements. These statements were entitled respectively:

(a) "Suggested Paragraph for Inclusion in the President's State of the Union Message";

(b) "Suggested Paragraph for Inclusion in the President's Economic Report"; and

(c) "For the President — Legislation Needed by the Federal Reserve Board".

In suggestion (a), this sentence is used among others: "In order to be equitable, such supplemental reserve requirements must be applicable to all insured banks". The discussion in the Board has been to the effect that unless such supplemental reserve requirements were made applicable to all insured banks, the Board did not want a continuance of the present supplemental requirements, or any additional authority granted for supplemental requirements. In view of this definite opinion of the Board, I feel that this opinion should be made clear to the President and to his Economic Advisory Committee.

In statement (b), the following sentence is used, among others: "It might well authorize the Board in its discretion to permit the Federal Reserve Banks to allow some return on these supplemental balances". I was of the opinion and am informed by two members of the Board and by several members of the staff that they construed the term "some return" to mean payment of interest on reserve balances. One member of the Board advises that he is "neutral" on this question; another states that he did not intend that the Federal Reserve Banks should pay interest; and another member states that he did not intend to define the phrase "some return" at this time, but would like such definition to be made at a later date when the Board would then decide whether "return" should be in the form of interest paid direct by Federal Reserve Banks, or in the form of an interest return on short-term Government securities, authorized to be accepted as reserves.

In statement (c), this phrase is used: "New authority to the

Federal Reserve Board to authorize Federal Reserve Banks to pay interest on reserve balances held to meet these supplemental requirements, and also on any excess balances". This paragraph definitely interprets the phrase "some return" to mean a payment of interest by Federal Reserve Banks on reserve balances -- both required reserves and any excess reserves. It does not mention any limitation on the amount of excess reserves upon which the Board would allow interest.

I was absent from the Board meeting on the 17th on official business, and was not, therefore, present to discuss or vote upon the three subject statements. But I did say to the Board in the meeting on the 23d instant that I was opposed in principle to the payment of interest by Federal Reserve Banks on reserve balances, but that in view of the Board's unanimous action on the 17th, I would not interpose further objection. However, in view of the subsequent discussion and the apparent confusion in the minds of some members of the Board and members of the staff as to what was meant exactly in these three subject statements, and, further, in view of the fact that these statements are definite policy statements released by the Board to another Government agency, I feel that I should make a statement for the record so that my position on this question of interest payment may be clearly recorded.

I am opposed to the payment of interest by the Federal Reserve System on any reserve funds which may be in its hands, whether they be required reserves or excess reserves; and I am opposed to asking for or even suggesting to the Congress or to the President, or to any of the established committees working on these matters, that any such authority be granted to the Board.

I feel that the payment of interest by the Federal Reserve Banks on reserve balances would initiate a policy which is, in effect, another step towards eventual, complete capture by the Federal Reserve System of that function of private commercial banking, which concerns correspondent bank relationship between central reserve and reserve city banks, and so-called country banks.

Such a step, in my opinion, is a drastic and dangerous departure from the traditions of the Federal Reserve System of more than thirty years standing.

Such departure might well lead eventually to an entirely new method of Treasury financing by the simple expedient of having larger and larger commercial banks' funds deposited with the Federal Reserve System at a nominal rate of interest -- the System then using such funds to purchase Treasury obligations at a rate of interest much less than such obligations might have to bear if sold direct to commercial banks and other investors in an open and free market. It will tend to make dangerously

easy, without the restraints of the present system, funds for Treasury financing, in accordance with the political and economic views of the political Administration in power.

Such interest payment policy would be inconsistent with regulations now in force, prohibiting the payment of interest on demand balances by all insured commercial banks. If we ask for authority for the Federal Reserve Banks to pay interest, then we will undoubtedly reopen the entire question, and the commercial banking system in all probability will demand a similar authority.

I would much prefer that we carry on as we are at present, having only one source of Federal obligations; that is, the Treasury -- and in the forms now used by the Treasury; that is, bills, certificates and bonds. I am opposed to injecting this potentially dangerous policy into a Banking System which has proven to be the most successful and universally fair of any nation in the world.

I recognize the problem of earnings that confronts commercial banks when substantial percentages of their deposits are required to be held in cash with the Reserve Banks, but this can be well met by some arrangement similar to the "Special Reserve" plan previously suggested by the Board.

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