October 23, 1935

Chairman Eccles

Mr. Goldenweiser

Following is a brief **statement** of the arguments for and against action by the System at this time to offset increases in excess reserves; also some arguments for doing it through raising reserve requirements and for doing it through the sale or run-off of securities:

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ARGUMENTS FOR ACTION

1. Easier to act now, when it would cause no restraint on trade, than later.

Reply: why act at all when there is no apparent reason? Ammunition now used will not be available for later use.

2. The System is out of touch with market.

Reply: will continue to be so, unless action is terribly drastic.

3. Impress public with System's readiness to fight inflation.

Reply: no evidence of inflation.

4. It may reassure investors and transfer short money into long money.

Reply: raising short money rates would counteract that; and would they be reassured?

5. Would be easier to ask for more authority from Congress, if existing authority will have been used.

Reply: little difference so long as a large part of power remains unused.

6. Now is a good time - to offset war-scared gold.

Reply: good argument as to promptness of action, but does not touch on question of desirability of action.

7. Government's can now be sold without harm to Government bond market.

Reply: they can always be allowed to run off without much harm to market.

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8. A good time to experiment with new device.

Reply: not a real experiment, if conditions do not warrant it.

ARGUMENTS AGAINST ACTION

1. Psychologically important to have action always signify policy.

Reply: Statement of reasons would overcome that.

2. Reasons for action should be perfectly clear and not sophisticated.

Reply: Absorption of excessive reserves is simple and clear enough

3. Ammunition, which is limited, should be used when it will be most effective and in impressive amounts.

Reply: such action would be hard to get and might prove too deflationary.

4. Action taken now might deter recovery.

Reply: it should be clearly explained as not a reversal of policy but as absorption of fortuitous additions to excess reserves.

OPEN-MARKET SALES OR ADVANCES IN RESERVES?

Arguments for reserve advance:

1. It does not deplete our earning assets.
2. It reaches directly more banks.
3. It is new and interesting.
4. It does not directly affect Government security markets.
5. It accustoms banks to use of this device at a time when its use will not impose a burden.
6. It has only become possible since Banking Act of 1935.

Arguments for sale of securities:

1. System should some time reduce United States holdings; this is a good time.
2. It is a familiar device that will not scare bankers.
3. It can be so used as to increase earnings by partial replacement with long-term obligations.
4. Reserve changes should be used only as an exceptional thing for long-time readjustments. Their frequent use makes banking too uncertain.

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Points to consider if reserves are to be raised:

If action is decided upon and is to take the form of advance in reserve requirements, the following should be taken into account:

1. It appears that it would be better to have the action apply to all cities and not to reserve cities alone. The argument for exempting country banks is only political in a broad sense, because as a matter of fact these banks have more excess reserves than the city banks and in addition have large balances due from city banks which they can withdraw. While it is true that the gold lands in New York, the disbursements by the Government scatter the proceeds all over the country. The city banks have bought more Government issues, while the country banks have kept idle balances with their city correspondents. There is no reason at this time for the discrimination in favor of country banks.

2. The action should be moderate - not to exceed 25 percent.

3. There should be a clear statement made about the reasons for the action and the method adopted.

4. Banks should be advised that, if they have no excess reserves, the Reserve banks will stand ready to take over from them the necessary amount of Government obligations (the System can then allow an equivalent amount in its portfolio to run off). If a bank has no Government securities and no excess reserves and no balances with a correspondent,and if the increase in reserve requirements will cause it to borrow from a Reserve bank, it should be given a preferential rate - perhaps something like the open market

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rate.

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5. Before action is taken it would be desirable to have all the Reserve banks report about how many banks in their districts would not have sufficient excess reserves to meet the advances, and also for such banks find out whether they have adequate balances with other banks or sufficient holdings of Government securities.

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