The First National Bank
of Lincoln

LINCOLN, NEBRASKA

February 13, 1951

Mr. Marriner S. Eccles, Governor
Federal Reserve System
Washington, D. C.

Dear Mr. Eccles:

Probably you can answer my inquiry without taking too much of your time.

In your recent discussion of the "Special Reserve Plan", and also in the recommendations of your Board for such a plan two or three years ago, it was suggested that this special reserve should consist of <u>short term</u> governments.

It has not been quite clear to me the necessity for these government holdings being limited to short term governments. Would it not serve practically the same purpose if banks were permitted to include any government issues? This of course would eliminate the necessity of any rearrangement of any bank's existing holdings, and probably few if any banks would need to go into the market for additional bonds.

At the present time there are of course only a limited amount of bank eligibles beyond the five or six year callable range. Possibly you may be thinking of the fact that within a reasonable short period a substantial number of longer bonds will become eligible, and you might prefer that these would not drift into the special reserve. Personally, I do not see even that this would be particularly disturbing. We know that the passage of time is working steadily, and it will not be very long before existing issues become intermediate and short maturities.

Inasmuch as all references I have seen regarding this plan suggest that it be composed of short maturities, there is undoubtedly some reason for this qualification.

M. S. E.
2-13-51

Would you also be willing to give me some idea as to what might be meant by short bonds? Do you have in mind one or two year maturities or up to five years?

For several years I have leaned quite strongly towards something similar to this suggested plan, and it would be of interest to me if you could briefly give me your ideas on the two questions I raise.

Thanks, and best wishes.

Sincerely,

P R Easterby

Investment Counsel

PRE:lb

February 21, 1951.

Mr. P. R. Easterday,
Investment Counsel,
The First National Bank,
Lincoln, Nebraska.

Dear Mr. Easterday:

This is in reply to your inquiry of February 13 regarding the special reserve plan. I appreciate your intelligent interest in this plan. I would like to point out, however, that in the present situation this plan should not be considered as an alternative to a restrictive open market policy. As long as banks hold large armounts of securities in excess of requirements and with other investors selling securities to the Federal Reserve to expand loans, the effectiveness of the special reserve plan is limited unless accompanied by a flexible open market policy.

The reason for limiting the plan to short-term Government securities was to encourage banks to hold this type of security. At the time the plan was originally proposed, you will recall, there was a very wide spread in interest rates between short-term and long-term securities. Banks were selling short-term securities to the Federal Reserve ~~to expand loans, the effectiveness of the special reserve plan is limited unless accompanied by a flexible open market~~ and buying longer-term ones. In this way, additional reserves were being created and multiple credit expansion made possible. The aim of the proposal at that time was to prevent this shifting without the necessity of permitting short-term interest rates to rise, because the Treasury was so strongly opposed to higher short-term rates.

Another reason for limiting the requirement to short-term securities is that the larger the amount of securities that are eligible to be counted as reserves the higher the reserve requirement must be. If banks hold large amounts of Government securities in excess of the requirement, then the requirement does not restrict them in expanding loans. For the plan to be really restrictive, it would be necessary for the eligible securities outstanding and available to banks to be limited in amount.

The plan as proposed earlier would have included as eligible securities Treasury bills, certificates, and notes with original maturities of not over two years. The purpose of limiting it to these particular issues was to prevent erratic changes in the amount of eligible securities that would result from the approach to maturity and the retirement of longer term issues.

Enclosed is a copy of a description of the proposal as presented to Congress in December 1947.

Sincerely yours,

M. S. Eccles.

Enclosure

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Investment Counsel,
The First National Bank,
Lincoln, Nebraska.

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