November 28, 1947.

Honorable Jesse P. Wolcott, Chairman,
Committee on Banking and Currency,
House of Representatives,
Washington, D. C.

My dear Mr. Chairman:

In connection with any consideration which your Committee may give to the current problem of inflationary bank credit expansion, I am enclosing herewith a draft of a bill which the Board of Governors suggests for dealing with this problem. You may wish to have it introduced in the House of Representatives.

Sincerely yours,

M. S. Eccles,
Chairman.

Enclosure

THIS COPY FOR CHAIRMAN ECCLES

GBV:lim
11/25/47

November 28, 1947.

Honorable Charles W. Tobey, Chairman,
Committee on Banking and Currency,
United States Senate,
Washington, D. C.

My dear Mr. Chairman:

In connection with any consideration which your Committee may give to the current problem of inflationary bank credit expansion, I am enclosing herewith a draft of a bill which the Board of Governors suggests for dealing with this problem. You may wish to have it introduced in the Senate.

Sincerely yours,

M. S. Eccles,
Chairman.

Enclosure

THIS COPY FOR CHAIRMAN ECCLES

GBV:lim
11/25/47

(11/25/47)

A B I L L

To provide for special reserves to be held by banks, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Federal Reserve Act is hereby amended by inserting therein immediately following section 19 thereof a new section reading as follows:

"Sec. 19A. (a) Effective Date and Time Limit. - This section shall become effective on the first day of the third calendar month following the month in which it is enacted (except that percentages and other regulations hereunder may be prescribed in advance of the effective date to take effect on or after such date) and shall expire at the end of three years after its effective date.

"(b) Purposes. - As a result of necessary war financing, the banks of the country own large amounts of short-term Government securities. Substantial amounts of such securities have already been converted into bank reserves and large additional amounts can be converted into such reserves with resulting multiple increases in bank credit and in deposits that serve as money. Such monetary and credit expansion, at a time when total effective demand for goods and services is in excess of the supply which can be produced by the nation's productive capacity and labor force, would further aggravate inflationary pressures on prices and thus produce burdens upon and dislocations in interstate and foreign commerce and the nation's monetary, banking and credit structure. Efforts to avoid such consequences through the use of methods of credit control available under existing law are seriously handicapped because, with the present large volume of the public debt, they would tend to produce such declines in the prices of Government securities (and securities in general) as to cause disturbances to the Government credit, interstate and foreign commerce, and the nation's monetary, banking and credit structure.

"The purposes of this section, in the light of which its provisions shall be construed and applied, are to require banks to hold short-term Government securities or other specified liquid assets in such amounts as may be necessary to protect interstate and foreign commerce and the nation's monetary, banking and credit structure from the above-mentioned burdens, disturbances and dislocations.

"(c) Holding of 'Special Reserve Assets'. - (1) Every bank shall own 'special reserve assets', as described in subsection (d) hereof, in an amount equal to the sum of such percentage of its demand deposits and such percentage of its time deposits as the Federal Open Market Committee (created by section 12A of this Act and hereinafter called the 'Committee') may by regulation prescribe from time to time as necessary to accomplish the purposes of this section, but in no event shall the percentage so prescribed with respect to demand deposits exceed 25 per centum or the percentage so prescribed with respect to time deposits exceed 10 per centum.

"(2) The Committee shall not initially prescribe a percentage in excess of 10 per centum with respect to demand deposits or in excess of 4 per centum with respect to time deposits and shall not thereafter at any one time increase such percentages by more than 5 percentage points in the case of demand deposits or by more than 2 percentage points in the case of time deposits. No initial percentage or subsequent increase thereof shall become effective until the expiration of a period of at least 60 days after notice thereof shall have been published in the Federal Register; but no other notice or procedure shall be required in connection with the prescribing of any percentage under this subsection notwithstanding any other provision of law.

"(3) In prescribing any percentages under this subsection, the Committee shall consider among other factors (A) the volume and ownership of securities and other assets eligible for holding as special reserve assets or readily convertible into such special reserve assets, (B) gold movements, currency fluctuations, and other factors affecting the available supply of bank reserves, (C) conditions in the Government securities market, and (D) the general credit situation of the country.

"(d) Description of 'Special Reserve Assets'. - 'Special reserve assets' shall consist of any one or more of the following assets:

"(1) Obligations of the United States in the form of Treasury bills, certificates of indebtedness, and notes having a maturity not exceeding two years at the time of issue.

"(2) The aggregate amount of the following assets which a bank owns in excess of the sum of 20 per centum of its demand deposits and 6 per centum of its time deposits: (A) Coin and currency in its vault or on hand, (B) demand deposits due from other banks to the extent that they exceed demand deposits due to other banks, (C) deposits with a Federal Reserve Bank (and the Reserve Banks are authorized to receive such deposits from any bank), and (D) cash items received in the ordinary course of business which are in process of collection and are payable immediately upon presentation in the United States.

"(e) Computations. - For the purpose of determining the amounts and percentages specified in subsections (c) and (d) of this section, each bank shall compute all such amounts on an average daily basis covering monthly computation periods or such other computation periods, not shorter than weekly periods, as the Committee may prescribe; and the Committee may prescribe different computation periods for different classes of banks, classified according to size or location or other reasonable basis. The amount by which the average daily amount of special reserve assets owned by a bank in any computation period falls below the amount required by this section or regulations pursuant thereto shall be considered a 'deficiency' for such computation period.

"(f) Penalty for Deficiencies. - Any bank having in any computation period a 'deficiency' as defined in subsection (e) of this section shall pay to the United States a penalty at the rate of one-half of one per centum per month upon the amount of such deficiency for such period. If such penalty is not paid to the Treasurer of the United States by the end of the month succeeding that in which such computation period ended, such penalty, together with interest thereon at the rate of six per centum per annum from the end of such succeeding month until paid, may be sued for and recovered by the United States in a suit to be brought by the United States District Attorney in the District Court of the United States of the judicial district in which the principal place of business of such bank in the United States is located, and the District Courts of the United States shall have jurisdiction of such suits. If and when the Committee shall so request, it shall be the duty of the several District Attorneys in their respective districts, under the supervision of the Attorney General, to institute proceedings to collect such penalties including interest. In unusual cases, when a bank has a deficiency which results from excusable error made in good faith, a certificate may be issued in the discretion of the Committee excusing such bank from payment of a penalty on account of such deficiency.

"(g) Reports. - The Committee may require banks to furnish from time to time such reports and other information as it may prescribe, but no such reports or information shall be required except such as the Committee may find to be necessary to obtain information as to compliance with this section or otherwise to enable it to carry out its functions under this section. Any person who shall knowingly make any false statement or report or give any false information or wilfully fail to furnish any report or information required under this subsection shall be guilty of a misdemeanor, and upon conviction shall be fined not more than $5,000, or imprisoned not more than one year or both; and the expiration of the provisions of this section shall not prevent prosecution for any such offense committed prior to such expiration.

"(h) Regulations and Administration. - The Committee may from time to time prescribe, amend or revoke regulations to effectuate the provisions of this section or to prevent evasion or circumvention of its purposes either by abnormal accumulations of deposits due to or from other banks or by other devices; and such regulations may, among other things, include definitions of the terms used in this section not inconsistent with the definitions contained herein or with the purposes of this section. Any function of the Committee under this section other than the prescribing of regulations and the determination of matters of general policy may be performed by such member, officer, or representative of the Committee as it may designate for the purpose; and in the administration of this section, the Committee may utilize the services of the Federal Reserve Banks and any other agencies, Federal or State, which are available and appropriate.

"(i) Definitions. - When used in this section, unless otherwise required by the context --

"(1) 'Person' means any individual, partnership, corporation, business trust, association, or other similar organization.

"(2) 'Bank' means any person having a place of business in any State or in the District of Columbia which is (A) a national bank, or (B) a person engaged in the business of receiving demand deposits and subject to supervision or examination by the State authority having supervision over banks (or by the Comptroller of the Currency in the case of the District of Columbia); but the Committee may by regulation exclude from such term persons which it deems not to be substantially engaged in the performance of functions customarily performed by banking institutions receiving demand deposits and also not to be within the scope of the purposes of this section.

"(3) The amount of any obligation of the United States in the form of a Treasury bill, certificate of indebtedness, or note means the amount of the book value thereof as determined in accordance with regulations of the Committee.

"(4) 'Demand deposit' and 'time deposit' have the meanings given such terms by regulations prescribed from time to time by the Board of Governors of the Federal Reserve System pursuant to section 19 of this Act.

"(5) 'Month' and 'monthly' refer to calendar month."

C O P Y

SUMMARY OF PROPOSED BILL TO PROVIDE
SPECIAL RESERVE REQUIREMENTS FOR BANKS

The attached bill proposes that, for a temporary period of three years, an authority be provided under which all commercial banks could be required, as an anti-inflationary measure, to hold a so-called special reserve in addition to existing requirements. This special reserve could be held in the form either of cash, cash items, interbank balances and deposits with Federal Reserve Banks or in short-term Government securities, that is, bills, certificates and notes. It is proposed that the Federal Open Market Committee of the Federal Reserve System administer the authority within the limitation that the special reserve would not exceed 25 per cent of demand deposits and 10 per cent of time deposits.

Under existing conditions there are no effective limitations upon the ready availability of reserves, which the banking system obtains from three principal sources. First, when the banks sell some of their large holdings of Government securities in the open market and those securities are purchased by Federal Reserve Banks, reserves are thereby created on which the lending power of the banking system is increased by a ratio of about six to one. That is, for each dollar of reserves about six additional dollars of deposits can be created. Second, gold acquisitions automatically increase the reserves and deposits of the banking system. Third, when nonbank investors sell Government securities which are purchased by the Federal Reserve Banks, this likewise creates additional bank reserves.

The broad purpose of this legislation is to provide under present and prospective conditions some restraint on the creation of bank credit beyond what is essential for the maintenance of full production. Proponents of this measure state that it should be closely integrated with Government fiscal policy and should be flexible in order to meet changing conditions.

The principal features of the proposed legislation are as follows:

Temporary Period. - The law would be effective for a period of three years only.

Banks Affected. - The requirement would apply to all banks receiving demand deposits, including member banks of the Federal Reserve System and nonmember banks -- insured and noninsured. It would not apply, however, to banks that do exclusively a savings business.

Special Reserve Requirement. - A special reserve would be required against both demand and time deposits. The percentage of such special reserve could be varied from time to time by the Federal Open Market Committee (which consists of the members of the Board of Governors of the Federal Reserve System and Presidents of five Federal Reserve Banks) but would be subject to a maximum limit of 25 per cent with respect to demand deposits and 10 per cent with respect to time deposits.

Special Reserve Assets. - Special reserve assets which all banks may be required to maintain, in the percentage fixed by the Open Market Committee, would include (a) obligations of the United States in the form of Treasury bills, certificates and notes with original maturities of two years or less, and (b) the excess of specified cash assets over an allowance for existing reserve requirements and for customary operating funds of the banks. This allowance would be fixed by statute at 20 per cent of demand deposits and 6 per cent of time deposits; and the specified cash assets which would be eligible for use in meeting the special reserve requirement would consist of the following assets to the extent that they exceed the amount of this allowance: Balances with Federal Reserve Banks, the net amount of interbank deposits, coin and currency on hand, and cash items in process of collection.

Fixing of Percentages. - In prescribing the percentages of special reserve assets required, the Committee must consider certain economic factors specified in the bill. Percentages initially fixed could not be greater than 10 per cent with respect to demand deposits or 4 per cent with respect to time deposits and could not thereafter be increased at any one time by more than 5 points as to demand deposits or 2 points as to time deposits. Sixty days' notice would be required before any increase could become effective.

Computations and Deficiencies. - The amount of its required special reserve would be computed by each bank over a monthly period (or such shorter period as might be fixed by the Open Market Committee) and any deficiency in the amount of its special reserve during any month would be subject to a penalty of one-half of one per cent. The penalty would be payable to the United States and if not paid could be recovered in a suit brought by the United States District Attorneys upon request of the Committee. The Committee could waive the payment of penalties where the deficiency results from excusable error made in good faith.

Reports. - Banks would be required to furnish to the Open Market Committee such reports as the Committee deems necessary to obtain information as to compliance with the law and otherwise to enable it to carry out its functions. False reports would be subject to criminal penalties.

Regulations. - The Open Market Committee would be given power to prescribe regulations to effectuate the law and prevent evasions, as well as authority to define terms. Administrative functions could be performed by officers or representatives of the Committee; and the Federal Reserve Banks and other Federal or State agencies which are available could be used in the administration of the law.

GBV:lim
11/28/47