PERSONAL AND
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August 5, 1948.

Dear Senator Tobey:

Mr. Eccles asked me to send you by special messenger the attached three memoranda. One is a commentary on the House bill proposal covering member bank reserve requirements; the second deals with the gold reserve requirements of Federal Reserve Banks; and the third lists some of the already existing discriminations under which member banks labor.

Mr. Eccles particularly asked me to say that he is not altogether satisfied with these memoranda as they do not make as vigorous a case as might be made, but he was so pressed for time that he did not have an opportunity to do more.

Sincerely yours,

Elliott Thurston,
Assistant to the Board.

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

Enclosures 3

ET:b

(Comment on bill's proposal for increasing gold reserve requirements of Fed. Res. Banks) 8/5/48

Restoration of the previous ratio of required gold certificate reserves held by Federal Reserve Banks of 40 per cent against Federal Reserve notes and 35 per cent against Federal Reserve Bank deposits would make no contribution whatever to the fight against inflation. It would not sterilize new acquisitions of gold nor would it give the Federal Reserve System any additional powers to curb inflationary expansion of bank credit. Furthermore, it would handicap the System's ability to maintain stability of the Government securities market by support of that market.

If Reserve Banks were to be prevented by this device from issuing currency and member banks were thus unable to supply currency to their customers, it would precipitate the kind of money panic which the Federal Reserve System was created to prevent. Likewise, if the Federal Reserve System, because of an artificial limitation, were unable to support the Government bond market, the results could well be demoralizing in the economy as a whole.

Although the Reserve System as a whole has gold certificate reserves in excess of the proposed higher requirement, there is considerable variation among individual Federal Reserve Banks. If the higher requirement were restored, some Federal Reserve Banks would have a deficiency, others would be close to the necessary operating margin, while still others would have a large excess. The reserve position of the individual Federal Reserve Banks is constantly changing with seasonal and other movements of funds in the economy.

Expansion or contraction of Reserve Bank credit should be determined by the needs of the economy and not by the amount of gold certificates which Reserve Banks happen to have, which in turn is contingent upon international movements of gold.

It is already within the System's power to invoke drastic credit control measures. The System has rejected such a course because of the possible disastrous effects on the entire financial situation of the country.

RAY:rj
8/5/48

Comment on the Proposed Federal Reserve Authority
to Increase Temporarily the Reserve Requirements
of Member Banks

Additional Federal Reserve authority to increase reserve requirements of commercial banks proposed in the House version of S. J. Res. 157 is limited to 3 per cent of demand deposits and 1 per cent of time deposits for member banks. Furthermore, the authority to raise member bank reserve requirements by these percentages would expire on March 31, 1949. Any change made in reserve requirements under the authority would cease to be effective on this date.

As an anti-inflation measure, this provision of the House bill is a deceit on the public. Considering the volume of Government securities held by the banks, which may be sold by them to the Reserve System at will to obtain additional bank reserves, even an authority to raise requirements by 10 per cent of demand deposits and 4 per cent of time deposits might not be enough to check excessive bank credit expansion. Government security holdings of member banks now amount to 54 billion dollars. An authority to raise member bank requirements to 10 per cent and 4 per cent respectively would only enable the Reserve System to sterilize bank sales of Government securities in the amount of 9 billion dollars. If the System had to sterilize purchases of Government securities from nonbank investors to this amount, a not inconceivable contingency, there would be no capacity available to offset sales of Government securities by banks. Under the House proposal, the System would only have authority to sterilize temporaril less than one-third of the 9 billions under the original 10 and 4 per cent proposal.

The House bill provision is objectionable also from the standpoint of its exclusion of nonmember banks from coverage under the reserve requirement authority. This exclusion not only restricts the anti-inflationary potency of the provision, weak as it already is at a 3 and 1 per cent maximum authority, but in addition introduces a further discrimination against membership in the Reserve System. Legislative discriminations against Federal Reserve membership are already numerous, and reserve requirements are one of the most important of them. Exercise by the System of this alleged anti-inflationary authority, if enacted, would be effectively blocked by inevitable adverse effects upon System membership. This provision of the House bill appears to be more a deliberate measure to weaken the Federal Reserve System than a measure to strengthen its ability to restrain further inflationary expansion of bank credit.

Some of the More Important Handicaps upon Members of the Federal Reserve System as Compared with Nonmembers.

1. Reserve requirements are more onerous for member banks than for nonmember banks. Member banks are required to carry certain percentages of their demand and time deposits respectively in non-interest bearing balances with the Federal Reserve Banks. Apart from these required reserve balances, member banks have to carry vault cash to meet deposit withdrawals and some balances with correspondent banks, none of which can be counted in fulfillment of statutory reserve requirements. Nonmember bank reserve requirements not only may be lower in amount but may usually consist of vault cash and balances carried with city correspondents, who may render services that are not available at the Federal Reserve Banks. In some instances and to some extent reserves of nonmember banks may be invested in United States Government and other specified securities. To a considerable extent, therefore, nonmember banks receive direct or indirect compensation for a substantial part of the reserves which they are required to carry under State law.

2. Nonmember banks may receive immediate credit for checks cleared through their correspondent banks, whereas credit to member banks for checks cleared through Federal Reserve Banks may be deferred from 1 to 3 days for out-of-town items.

3. Member banks are prohibited from charging exchange on checks received from Federal Reserve Banks for collection and therefore are deprived of revenue which might otherwise be obtained from this source. Many States permit such charges to be made and there are at least 2,000 State banks that make such charges regularly. Member banks are at a competitive disadvantage particularly as compared with some nonmember banks in their dealings with country bank correspondents because nonmember banks may follow a practice of absorbing exchange charges for their customers, whereas member banks are not permitted to do so.

4. In most States, those having a population of a million or more, a national or State member bank must have a minimum capital of $500,000 in order to maintain a branch outside the city in which it is located. This is not required of nonmember banks. Even where branches are not involved minimum requirements for capital are frequently less for nonmember banks than for member banks.

5. There are much greater Federal restrictions on investments and loans of national and State member banks than in the case of nonmember banks.

6. There are certain Federal restrictions on holding companies and interlocking directorates which are not applicable where only nonmember banks are involved.

7. Any State nonmember bank~~s~~ is free to choose whether its deposits shall be insured by the Federal Deposit Insurance Corporation and therefore can save the substantial cost of the assessments for such insurance but member banks have no such choice.

PERSONAL AND
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August 17, 1948.

My dear Senator:

In accordance with our telephone conversation, I am enclosing additional copies of the three memoranda you desire to have; one on the House bill's proposal covering member bank reserves; the second on that bill's proposal for increasing gold reserve requirements of Federal Reserve Banks; and the third enumerating some of the discriminations which already handicap member banks of the Reserve System.

May I take this occasion to say again how much I appreciate your expressions of friendship and confidence and to reiterate my earnest hope that you will carry on in the extremely important place you now occupy. Likewise I appreciate, of course, your reference to my own position. You will not think it presumptuous on my part, I trust, if I say that in case you see fit to mention the subject as you suggested, you make clear that the suggestion originated with you and not with me. You will understand, I am sure, that I would not wish to seem to be in the position of seeking any preferment for myself.

Sincerely yours,

M. S. Eccles.

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

Enclosures 3

ET:b