Form F. R. 511

TO Mr. Morrill

FROM Mr. Thurston

REMARKS: 12/8/47

Would you feel disposed to acknowledge this one for the Chairman's signature? I certainly do not like his alternative and, incidentally, his memory is at fault.

E.T.

CHAIRMAN'S OFFICE

THE PEOPLES SAVINGS BANK

CEDAR RAPIDS, IOWA

December Second
of
The Peoples Savings'
Forty-Eighth Year
1947

Mr M S Eccles, Chairman
Board of Governors
Federal Reserve System
Washington D C

Dear Mr Eccles:

I have for acknowledgment your letter of November 28 and wish to advise that I have read over your statement twice. Upon referring to the financial statement of this bank, I find that on December 31, 1941 our deposits were $5,800,000.00 and our loans were $3,050,000.00. Our statement of October 6, 1947 shows deposits of $18,570,000.00 and loans of all kinds totaled $3,604,000.00.

1941 ?

The merchants National Bank of this city as of December 31, 1947 had deposits of $45,800,000.00 and total loans of $11,152,000.00. On October 6, 1947, their total deposits were $89,900,000.00 and their total loans were $11,450,000.00. Our two banks represent more than 85% of the total banking resources of Cedar Rapids and I don't think any fair minded person could be heard to say that we have unduly expanded bank loans in Cedar Rapids. I agree with you that many banks have materially expanded their loans and discounts since December, 1941, but I wonder if your plan is the best available one.

If you don't now have authority to pay interest on bank deposits lodged in the Federal Reserve System, why don't you ask Congress for that authority. Would it not be possible for the System to attract sufficient funds and thereby immediately curtail general market credits while at the sametime place funds in the hands of your open market committee, so as to permit them to handle the government security market in an orderly way. I agree that under such a procedure, it might not be possible for you to pay 6% dividends to your stockholders, but my memory tells me there were some years in the past when the "Fed" was not able to do this.

Very respectfully

FRANK C WELCH
President

fcw;hkl

December 16, 1947.

Mr. Frank C. Welch, President,
The Peoples Savings Bank,
Cedar Rapids, Iowa.

Dear Mr. Welch:

I am glad to learn from your letter of December 2, 1947, that you have read my statement to the Joint Committee on the Economic Report on November 25, 1947. In view of your evident interest, I am sending you herewith a copy of my second statement to that committee which I made on December 10, 1947, with special reference to the reserve proposal.

We realize that some banks may not have individually expanded their loans and investments, and also that from the point of view of the consideration of each particular loan or investment there may have been no reason apparent to the banker why he should question its soundness. So long as there was no over-all restriction upon the amount of funds that could be used for the purpose of making loans and investments, each banker would naturally be guided by his credit judgment. Yet in the aggregate the loans of all banks might expand, as they have been doing in fact, and the inflationary possibilities of bank loans would then become apparent. The purpose of the proposal for a special reserve requirement is to exert a strong restraining influence on bank credit expansion as a whole. Individual bankers would then need to guide their loan policies with an eye to the restricted amount of funds remaining available, just as they would if there were to be an increase in the existing reserve requirement. The difference, however, between an increase in an existing reserve requirement and the proposed special reserve is that the former would completely immobilize a certain amount of funds of each member bank in the Reserve Bank, whereas the proposed special reserve requirement could be met by investments in short-term Government securities which would yield a reasonable income to the bank.

Your suggestion that authority be obtained to pay interest on reserve deposits is one that has come up from time to time in the history of the Reserve System. Aside from the fact that, if interest were offered merely for the purpose of attracting deposits to the Reserve Banks on a voluntary basis, it would not accomplish its purpose unless the rate were so high as to more than equal the return that

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could be obtained from loans and investments, it is apparent that the suggestion is based upon an important misconception of the function of reserve deposits at Federal Reserve Banks. They are not needed by the Reserve Banks in order to place funds in the hands of the Open Market Committee, since the adequacy of the power of that committee and of the Reserve Banks to carry out the open market policy of the System does not depend upon having the use of the funds to be derived from an increase in the reserve deposits of member banks. The fundamental purpose of reserve requirements is to influence the volume of credit extended by member banks, because the ability of member banks to expand credit is dependent upon the amount of reserves which they are required to maintain.

Moreover, it should be borne in mind that, under the express terms of the law by which the Reserve Banks were chartered, any surplus funds of the Reserve Banks, after providing for their expenses and the retirement of their capital at par together with accrued dividends at 6 per cent, will belong to the Government in case of liquidation of the Reserve Banks. They have in the past paid franchise taxes and they are currently paying interest to the Treasury on their Federal Reserve notes in an amount equal to 90 per cent of their net earnings after providing for these obligations. Since there would be no offsetting increase in income, the payment of interest on their deposits would be equivalent to a gift from the Government because it would curtail by that amount the payments to the Treasury.

Incidentally, I should like to comment on what appears from your letter to be a misunderstanding. Member banks have received the full amount of dividends due them at the rate of 6 per cent per annum for the entire period of their ownership of stock in the Reserve Banks. You may have in mind that for a short period after the Reserve Banks were organized, while they were getting under way, they did not have sufficient earnings, but at an early date they had paid all arrears and have continued ever since to make the payments currently as required by law.

May I say in conclusion that the proposed special reserve requirement is regarded as only a part of any effective anti-inflationary program and that the need for action of this kind would be reduced to the extent that other more important actions were taken. If such actions were taken and if voluntary action on the part of bankers were sufficiently effective to avoid further over-all expansion of bank credit, the purpose of the special reserve plan would be met. We do not regard it as a self-sufficient panacea. We simply have not been able to formulate any better or more reasonable plan to accomplish the purpose.

Sincerely yours,

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M. S. Eccles,
Chairman.

Enclosure
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