ALEXANDER WALL
1503 PHILADELPHIA NATIONAL BANK BUILDING
PHILADELPHIA, PA.

October 29, 1941

My dear Marriner:

The second letter in this cover is too long for you to read before it has been analyzed by someone for you. Please get some generous soul to look it over.

I quote one sentence I would like you to read because it is written just as I feel and is about you.

> "If I could be assured of your own longevity and continued willingness to serve there would be no fear. But neither of these can be made certain and I do fear the creation of a practice, to become a custom, in the hands of a less skilled person."

That expresses a frank and honest opinion. If I could be helpful to you I would like to be so.

Very truly yours,

Wall

Mr. Marriner S. Eccles
Board of Governors of the Federal Reserve System
Washington, D. C.

C.

Encl.

ALEXANDER WALL
1503 PHILADELPHIA NATIONAL BANK BUILDING
PHILADELPHIA, PA.

October 29, 1941

Mr. Marriner S. Eccles,
Board of Governors of
the Federal Reserve System,
Washington, D. C.

My dear Marriner:

You have been so generous of your time that it is with great hesitation that I am writing to you now, although in an attempt to present a viewpoint which might be adapted to general, sound administrative advantage. This idea or thought, which I give to you, may suggest something which will fit into the plan to adjust reserve requirements both to stimulate sound banking and limit unsound inflation. If you get an idea from it then it is yours to use in your discretion.

One method attempting to control too great an advance of credit by banks against speculatively held securities was the horizontal advance of the rediscount interest rate. The attempt "to shake out the sheet" by a flat horizontal raise in the rediscount rate did not limit the restraint in credit extension to banks fostering speculation. The rate advance went flatly against all banks, some of which might be in no wise at fault. I believe that it may be quite proper for a bank to support the capital market by having a part of its loanable funds lent on stock market security. Without any exact data it has been assumed that this might be twenty or twenty-five percent of its available loanable funds. I would not hold U. S. Governments as part of this percentage. If the Federal Reserve System should set say three percent as a base rediscount rate such a rate should apply only to rediscounts from banks within this base. For every one percent above the allowable base tolerance the rediscount might well have a differential of say one-eighth or one-quarter of one percent increase as a minimum in the rediscount rate. The Federal Reserve System could then raise the differential or have it go up by an increasing scale and effect control over speculatively designed lending. The base rate should be raised only in extremis as those banks which fulfilled their proper functions should not be penalized to control banking speculation.

It seems to me that you could conceive of a similar shifting reserve. Loanable funds could be used for commercial lending, preparedness financing, government bond holding and speculative lending. Could not a reserve differential be worked out for classified types of banking based on commercial lending banks, having modest investments in their own plant assets. It might be possible to compute reserves not entirely on the amount of deposits but in some way on the disposal of the deposits.

The original fundamental reason for reserves was to have a marginal protection for depositors, in the nature of an assurance that funds will be available, directly or by conversion to pay depositor withdrawals. Now the reserve requirement seems to be becoming a fiscal tool to control interest rates. This objective, if so, seems to me to be dangerous although in the present emergency a control of the rate structure may be desirable in relation to public financing. It is dangerous because of the uncertainty of administrative efficiency. If I could be assured of your own longevity and continued willingness to serve there would be no fear. But neither of these can be made certain and I do fear the creation of a practice, to become a custom, in the hands of a less skilled person. Therefore it is my hope that you will evolve a standard of practice which will rest reasonably safe in any hands. I suggest a modest approach.

1. A bank can or should be allowed to lend its own net worth in any risk it may choose.

2. The expenditure of depositor funds in the purchase of government bonds should make a reserve against such deposits practically unnecessary. Any reserve would be only lip service to tradition.

3. Any deposits developed by preparedness loans of an amortized nature, especially if participation loans connected in any way with the Government or its subsidiaries with taxing power sureties against loss, should require small reserves.

4. Time deposits, as already recognized, require smaller reserves.

5. Reciprocated bank deposits have offsets and only the net difference should require reserves.

6. Perhaps insured deposits require no reserves or a lesser reserve.

There may be other types of deposit with similar or like reserve differentials. It might be good practice to start with total deposits and deduct all directly offset items, a percentage varying with the degree of offset of other items and arrive at a net free and virtually unprotected deposit total against which varying reserves might be required. In this way a proper elasticity might be preserved to support industry. It expresses a viewpoint which when coupled with the rediscount rate might as I outlined it give us a plastic control.

The length of this letter appalls me and I apologize again. In fact I am sending it to you with a carrying letter so that you may have someone read it and throw it away at the time he reaches this point of it if it is too crazy.

Very truly yours,

C.

November 29, 1941.

Mr. Alexander Wall,
1503 Philadelphia National
Bank Building,
Philadelphia, Pennsylvania.

Dear Alex:

This will acknowledge yours of October 29 in which you discuss certain phases of the present monetary and fiscal situation. In your letter you state:

> "Now the reserve requirements seems to be becoming a fiscal tool to control interest rates. This objective, if so, seems to me to be dangerous although in the present emergency a control of the rate structure may be desirable in relation to public financing. It is dangerous because of the uncertainty of administrative efficiency. If I could be assured of your own longevity and continued willingness to serve there would be no fear. But neither of these can be made certain and I do fear the creation of a practice, to become a custom, in the hands of a less skilled person."

Apparently you feel that as a general proposition the fixing of reserve requirements should not take into account the interest of the Treasury in its borrowing operations. In other words, you would probably feel that the interest rate should be determined by the so-called natural forces in the money market and that the Treasury should pay whatever that "natural" rate is. While you are willing to see the interest rate influenced by considerations of fiscal policy during the present emergency, you think that this is a dangerous precedent because of the "uncertainty of administrative efficiency".

If it were the inflexible policy of the Treasury to obtain borrowed money at the lowest possible rate, I would feel that you were entitled to your concern. On the contrary, the best interests of the Government are furthered by the economic productivity and stability of the country and this, in turn, may not necessarily coincide with the lowest possible interest rate.

At the present time, for instance, considerations of the inflationary dangers inherent in the enormous defense program make it highly desirable that the declining interest rates be halted, even though the Treasury might thereby pay more annual service on the Government debt than would be true under a continuation of the decline in interest rates. Under inflationary conditions the Government would stand to lose billions through rising prices of the vast quantities of materials and armaments that it must purchase, whereas there are relatively few millions involved in a slightly higher interest rate on its securities. The reverse situation might well obtain during a period of impending or actual deflation. Under such conditions a lower interest rate might well be the sound policy for the fiscal and monetary authorities to pursue, since this would create a climate favorable to an expansion of debt and unfavorable to the accumulation of savings.

From these observations it must be apparent that it is not only eminently proper for the monetary authorities to consider the Government's fiscal policy, but that they could scarcely act in the public interest without considering it. And, after all, there is no "natural" rate of interest. That is a classical doctrine, never as well founded as its apostles believe, that certainly has no basis in fact under modern conditions. A consideration of the various factors underlying our present surplus of bank reserves must convince any student that the so-called natural forces are practically nonexistent or, at least, that they are now by far the unimportant part of the picture.

The problem of regulating bank reserves is so extensive and so many mechanisms have been proposed that I think it would be helpful to you to read through a reprint of an article which was prepared by some of our staff members here, but not published. While this is not confidential, it is not for publication and has thus far been distributed to the Federal Reserve Banks and to a few people particularly interested in the problem of bank reserves.

Sincerely yours,

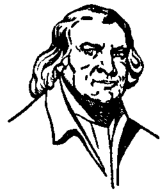
M. S. Eccles,
Chairman.

enclosure

LC:b

ROBERT MORRIS ASSOCIATES

A National Association of Financial Credit Men



CENTRAL OFFICE
1417 SANSOM STREET
PHILADELPHIA, PA.

December 3rd, 1941

Mr. Marriner S. Eccles,
Board of Governors,
Federal Reserve System,
Washington, D.C.

My dear Marriner:-

This simply acknowledges receipt of your letter this morning about bank reserves.

I am on my way to the doctor who is performing a minor operation on Mrs. Wall and whether I will get back today or tomorrow to look over the text completely I do not know. I will do the best I can with it.

Yours very truly,

Secretary

AW:HLB