FEDERAL RESERVE BANK OF PHILADELPHIA
PHILADELPHIA, PENNSYLVANIA 19101

OFFICE OF THE
PRESIDENT

October 5, 1973

TO: Chief Executive Officers of all Banks in
Third District portion of Pennsylvania

Recently Secretary Dellmuth sent you a copy of a letter addressed to Senator Scott setting forth his position on uniform reserve requirements. For your information, I am enclosing my reply to Secretary Dellmuth's letter.

Sincerely,

David P. Eastburn

David P. Eastburn

FEDERAL RESERVE BANK OF PHILADELPHIA

PHILADELPHIA, PENNSYLVANIA 19101

OFFICE OF THE
PRESIDENT

September 27, 1973

The Honorable Carl K. Dellmuth
Secretary of Banking
Commonwealth of Pennsylvania
Harrisburg, Pennsylvania 17120

Dear Carl:

I regret the position you took opposing uniform reserve requirements in your September 11 letter to Senator Scott. Adoption of uniform reserve requirements by the Congress would be both in the public interest, because it would make monetary policy more effective, and in the interest of banking because it would introduce equity into what is now a most unfair situation.

The United States, like every modern nation, needs an effective central bank if it is to provide jobs, control inflation, and compete in world markets. At the heart of monetary policy is the Federal Reserve's ability to control bank reserves. As the share of bank deposits governed by state reserve regulations has increased in recent years, the Fed's precision in controlling the money supply has decreased. Unless uniform reserve requirements are adopted nationally, this trend will likely accelerate because of the unfair competitive advantage afforded nonmember banks in states like Pennsylvania.

The Fed's ability to control the nation's money supply is weakened by the existence of state regulation of reserves for two reasons. First, some states allow different types of assets to be counted as reserves. In Pennsylvania, for example, whereas member banks must hold their reserves in non-interest-bearing deposits with the Fed or in cash, nonmember banks are permitted to keep a large portion of their reserves in correspondent balances and earning assets, such as government bonds. Counting correspondent balances results in a pyramiding of reserves which loosens the link between reserves and deposits. (Incidentally, one of the reasons Congress established the Federal Reserve in 1913 was to avoid recurrence of the frequent monetary panics of the late 1800's and early 1900's which were intensified by the pyramiding of bank reserves.) Counting government bonds as reserves complicates the conduct of monetary policy because the Fed does not control the availability of these bonds. Second, the level of reserve requirements varies from state to state and these separate sets of regulations further cloud the relationship between reserves and the money supply.

Monetary policy is clearly a national responsibility; it is not something that can be divided into 50 slices and still be effective. I find it distressing, therefore, that you oppose uniform reserve requirements on grounds of weakening the dual banking system. The dual banking system is not the issue; the issue is an effective monetary policy and a healthy economy in the years ahead.

Let me hasten to add, however, that in a state like Pennsylvania the dual banking system would actually be strengthened if uniform reserve requirements were adopted. We can't have a viable dual banking system in Pennsylvania if reserve requirements continue to favor state nonmember banks so unfairly. Banks should be free to choose between national and state charters, and between membership and nonmembership in the Fed. Nothing in the uniform reserve requirements proposal affects this freedom of choice. What the proposal does is to make the choice a fair one and not loaded in favor of one side or the other.

Sincerely,

David P. Eastburn
President

DPE/a