The Papers of Charles Hamlin (mss24661)

363_07_001-	Hamlin, Charles S., Scrap Book – Volume 205, FRBoard Members

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 1, 1941

To The Files

Subject:

From Mr. Coe

MPC.

After correspondence with Mrs. Hamlin (see letters of May 25 and June 4, 1941) the items attached hereto and listed below, because of their possible confidential character, were taken from Volume 205 of Mr. Hamlin's scrap book and placed in the Board's files:

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Page 21
Preliminary memo for the Executive Committee of the Open Market Policy Conference.

Page 26
Memo - A More Equitable Distribution of The Earnings of The Federal Reserve Bank.

Page 37
Memo to Board from Mr. Wingfield re Summary of Provisions of the Bill S-4723 in troduced by Senator Glass.

Page 61
(X-6641) Effect of Consolidation on Clayton Act Permits.

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Memo to Mr. Hamlin from Mr. Wingfield re Provisions of Sections 6 and 11 of Bill S. 4723 introduced by Senator Glass.

Page 63
Memo to Board from Mr. Wyatt re Senator Glass' resolution re State Department's alleged interference with F.R. System.

Page 71
Letter to Mr. Hamlin from F.R.Bk. of Dallas re Bill H.R. 10211.

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(X-6649) Bill to Amend Federal Reserve Act and National Bank Act.

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Correspondence between F.R.Bk. of N.Y. and Board re reasons which have prompted directors to advocate continued further purchases of government securities.

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Earnings & Expenses of F.R. Banks, June 1930.

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Memo to Mr. Hamlin from Mr. Smead re First signs of recession of business in 1929.

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Memo to Mr. Hamlin from Mr. Smead re Effect of payment of Gold Certificates by Federal Reserve Banks instead of Federal Reserve notes.

Page 151
Letter to Gov. Harrison from Chairman Curtiss re increased purchases of Government securities by the System.

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Sec Bd

June 20, 1930.

PRELIMINARY MEMORANDUM FOR THE EXECUTIVE COMMITTEE OF THE OPEN MARKET POLICY CONFERENCE

During the past two weeks the purchase of $50,000,000 of U. S. Government securities for the System account, approved by a majority of the members of the Open Market Investment Committee, has been completed. As in the case of previous security purchases, the principal effect has been to accelerate the tendency toward easier money conditions, by facilitating the retirement of indebtedness of member banks and reducing the dependence of the acceptance market on the System.

The following tabulation shows changes in the various forms of Reserve Bank credit from the date of the last meeting of the Conference to June 3, just preceding the recent purchase of Government securities, when the total demand for Reserve Bank credit still showed some enlargement in connection with the May month-end, and from June 3 to June 18, when the purchase of Government securities had been completed and the temporary Treasury overdraft eliminated.

(In millions of dollars)

	May 21	June 3	June 18
Discounts	210	276	207
Bills bought	187	199	133
U. S. Securities	528	527	598
Other Securities	6	6	5
Total	932	1,008	943

This shows that since June 3 the purchase of $50,000,000 of U. S. Securities, together with the liquidation of Reserve Bank credit called into use temporarily over the May month-end, has resulted in a reduction in member bank indebtedness to an amount slightly smaller even than around the middle of May, notwithstanding the reduction of over $50,000,000 in the bill holdings of the System. The reduction in System bill portfolio reflects larger holding of bills by member banks, which gives them a cushion against recurring periods of firm money.

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Accompanying these changes in the form of Federal Reserve credit in use, there has been a definite, but orderly, decline in money rates. Treasury tax period operations did not result in any large surplus of funds in the New York money market, even temporarily, such as caused the rapid fluctuation in money rates during the March tax period. The following table shows the change in rates both before and after the change in the discount rate of the Federal Reserve Bank of New York effective June 20.

	May 21	June 3	June 19	June 20
Call money	3	3	2 1/2	2 1/2
Time money, 90 days,	3 1/4-1/2	3 1/4	2 3/4	2 1/2-3/4
Bills, 90 day, unendorsed	2 3/8	2 3/8	2 1/8	2
Commercial paper	3 3/4	3 1/2-3/4	3 1/2-3/4	3 1/4-3/4
U. S. Certificates				
Sept. 1930 - yield	2.21	1.98	1.65	1.60
Dec. 1930 - yield	2.63	2.41	1.95	1.92

BUSINESS CONDITIONS

During the month since the last meeting of the Open Market Policy Conference in May, business conditions have shown no material change - if anything, the tendency has been toward a further decline, rather than toward definite improvement. In the largest industries, such as the steel, automobile, and building industries, the recent changes have apparently been chiefly of a seasonal nature, and factory employment also has shown a decline of about the usual proportions for the time of year, but substantial curtailment has occurred in the cotton goods industry. The Federal Reserve Board's seasonally adjusted index of industrial production for recent months and a year ago is shown below. From such information as is now available it appears that a further decline in June is more likely than an increase.

	1930				
May 1929	Jan.	Feb.	Mar.	Apr.	May
124	104	107	104	106	104p

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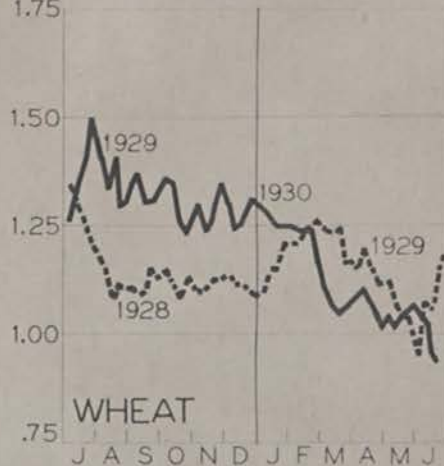

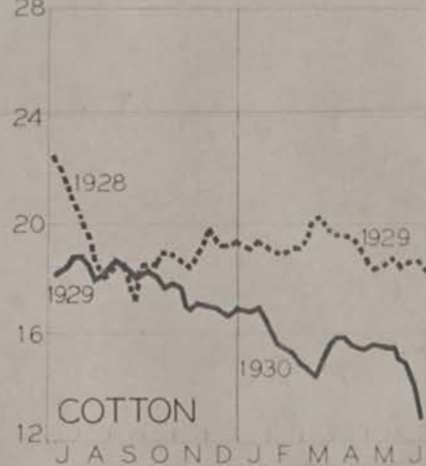

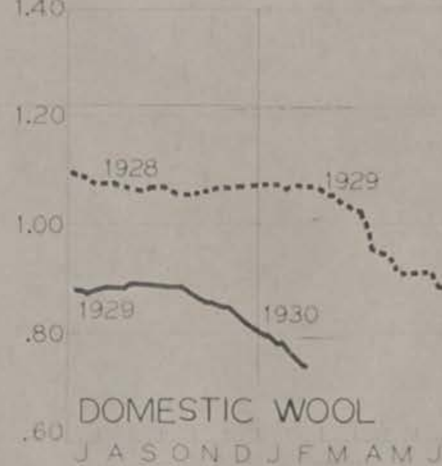

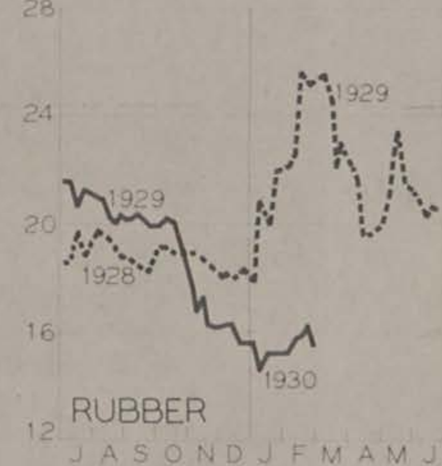

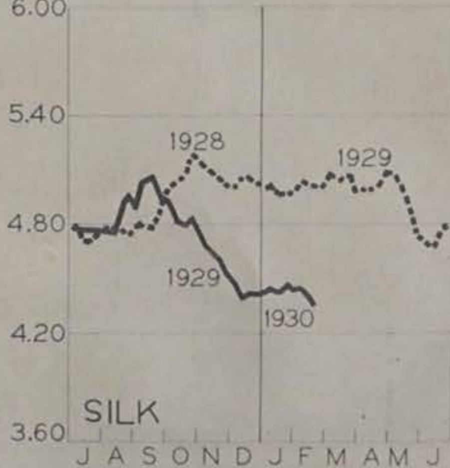

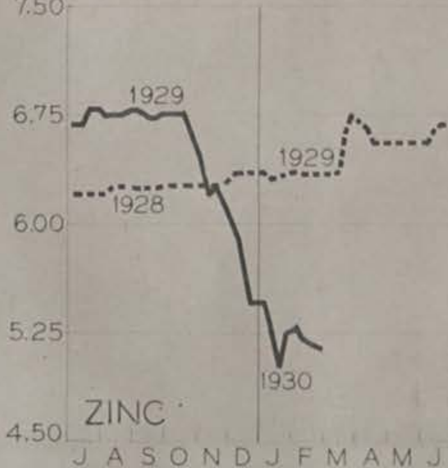

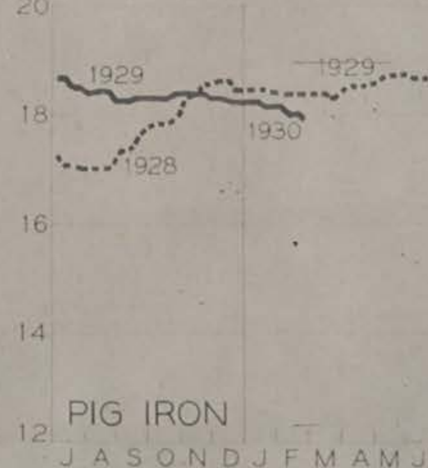

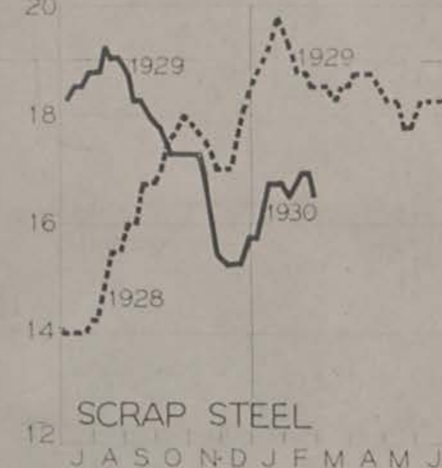

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It is now apparent that the current recession in business bears greater similarity to that of 1921 than to the recessions of 1924 and 1927. As in 1921, the decline in this country has been accompanied by a world-wide business depression, and a world-wide decline in commodity prices. The last weekly commodity index of the Federal Reserve Board, for June 13, showed the largest decline for any week this year. During the past week wheat and cotton have declined substantially, as shown in the accompanying diagrams, wheat reaching a new low point since before the War, and cotton the lowest since 1926-1927, when the price was depressed by an unusually large crop.

BUSINESS DEMAND FOR FUNDS

The commercial loans of weekly reporting banks have continued the unseasonable decline noted at the last meeting of the Committee, so that the total reduction in these loans since last autumn is now by far the largest that has occurred since 1921. This does not mean, however, that there is no business demand for funds; the demand is for capital rather than short-term credit, and the demand has been so great as to exceed at times the gradually increasing supply of funds seeking employment in investment securities, and the bond market is not yet really strong and easily becomes congested.

Evidence of this large demand for capital funds is contained in the following table, which shows new bond issues during the first five months of 1930 compared with the corresponding period in 1928 and 1929:

(In millions of dollars; refunding issues excluded)

	1928	1929	1930
Domestic corporate	1,054	1,083	1,654
Municipal and state	629	512	599
Foreign	672	237	552
Total	2,355	1,832	2,805

The total amount this year has been approximately 50 per cent larger than in the first five months of last year, and considerably larger also than in the similar period in 1928. This large increase in new issues apparently is in response to an unsatisfied demand for capital which accumulated during the high

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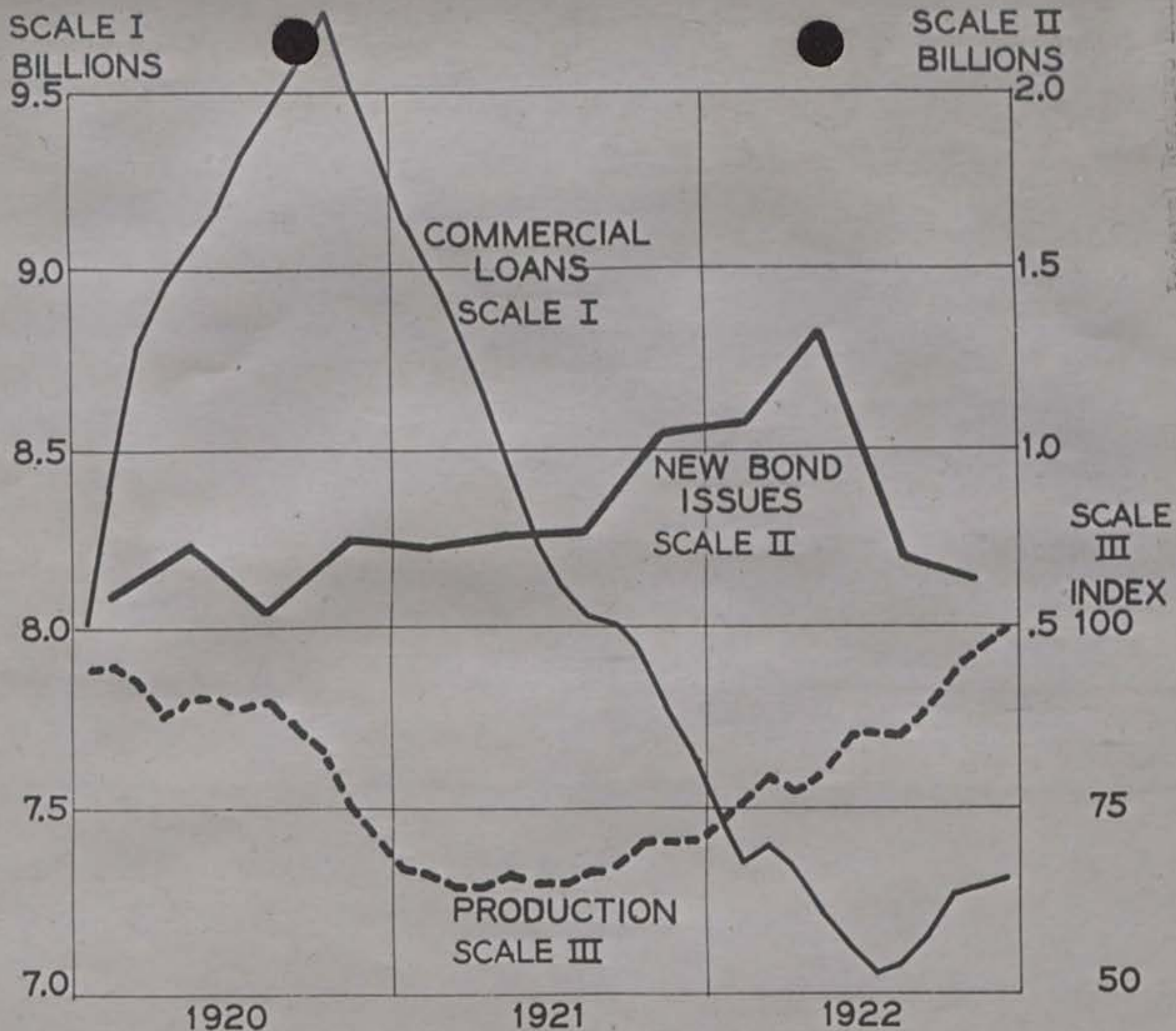

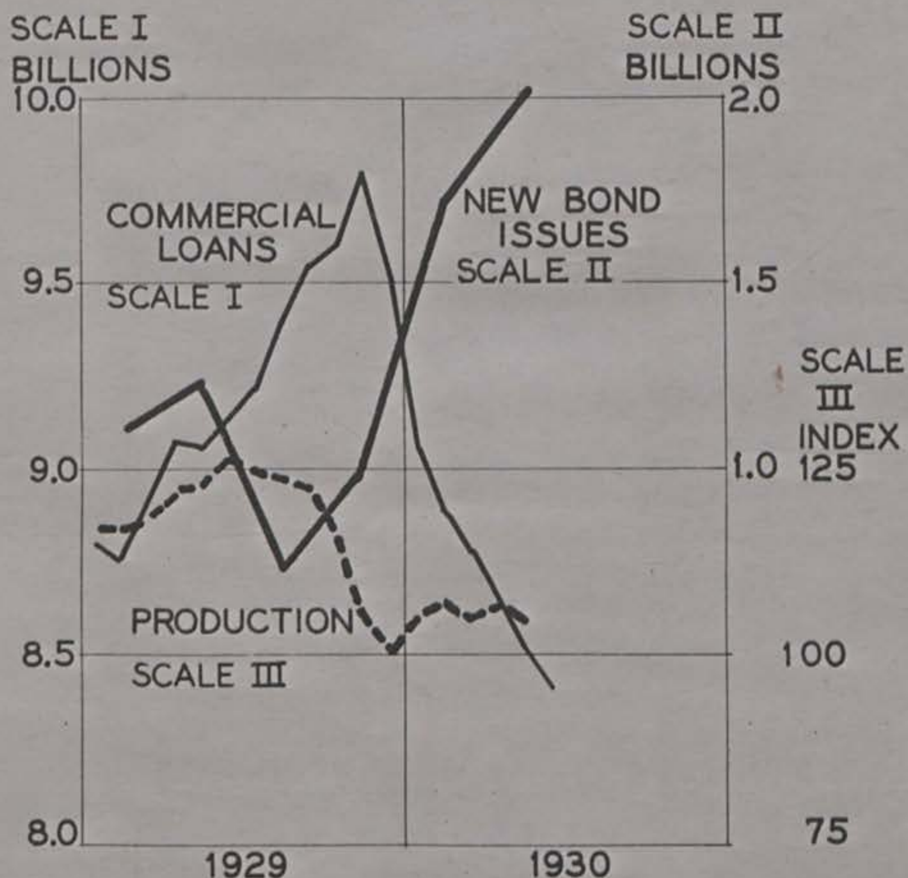

Demand for Capital and for Short Commercial Loans Compared with

Industrial Activity

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interest rate period of the past year and a half. During that period foreign borrowing in this market was largely suspended; municipal borrowing through the bond market was held back; and the amount of new capital obtained by domestic producing and distributing corporations, notwithstanding the extraordinarily large volume of corporation securities which were sold, was not unusually large. A large proportion of the stock issues in 1929 represented funds obtained by investment trusts and financial trading corporations, new securities issued in exchange for old securities in cases of mergers, and stock issues sold for the purpose of retiring bonds or bank loans. Consequently, this year there has been no evidence that domestic corporations are oversupplied with capital, but rather there has been an increase in the demand for capital, especially from railroad and public utility corporations, and the bond market has not been strong enough to furnish all the funds which could be used.

The accompanying diagram shows that in 1921-1922 there was a similar tendency for an enlarged demand for capital through the bond market to precede business recovery, whereas the demand for short loans tended to follow, rather than to precede, business recovery. In the less severe recessions of 1924 and 1927, also, a large volume of new capital issues preceded business recovery, while expansion of commercial loans awaited increased business activity.

MEMBER BANK CREDIT

In view of this tendency for a demand for capital funds to precede a business demand for short-term credit after periods of business recession, it is not surprising to find that there appears to be a corresponding tendency for expansion in member bank credit to occur first in the forms of credit related to the capital market, rather than in short-term commercial credit. The following diagrams indicate that in each period of business recession in recent years member bank investments and loans on securities have increased before commercial loans. Tendencies in bank credit during recent months, shown in the last diagram, appear to have been somewhat similar to those of corresponding periods in previous years.

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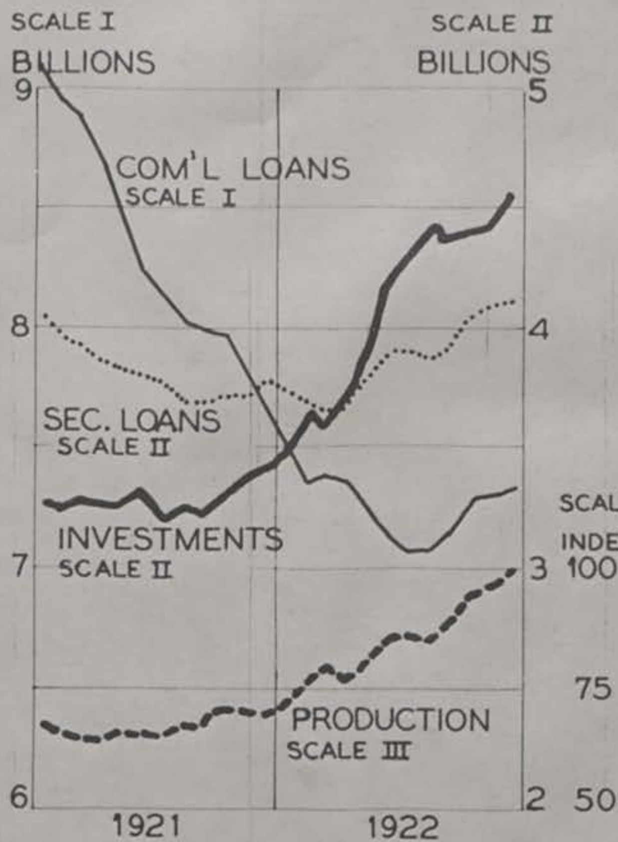

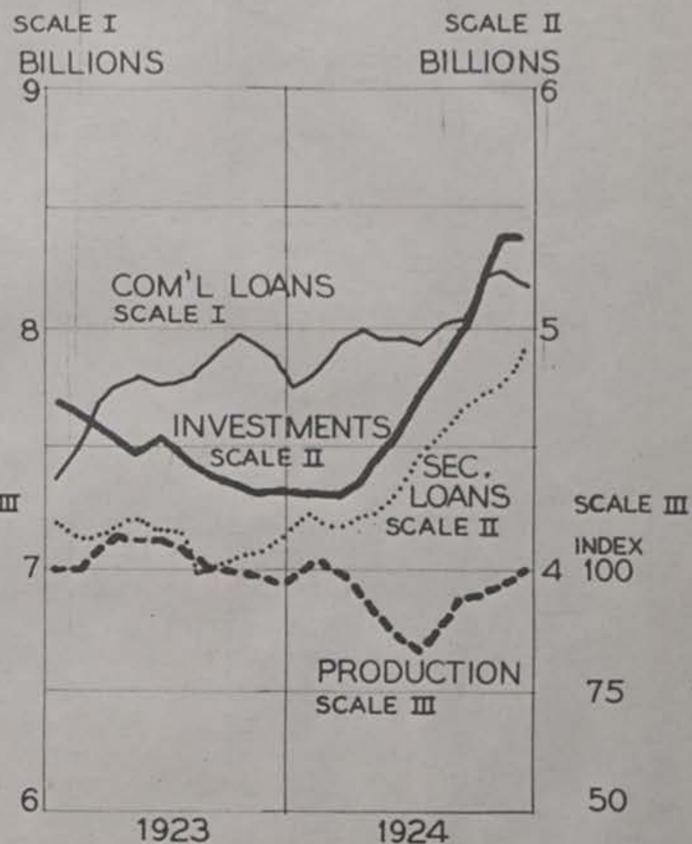

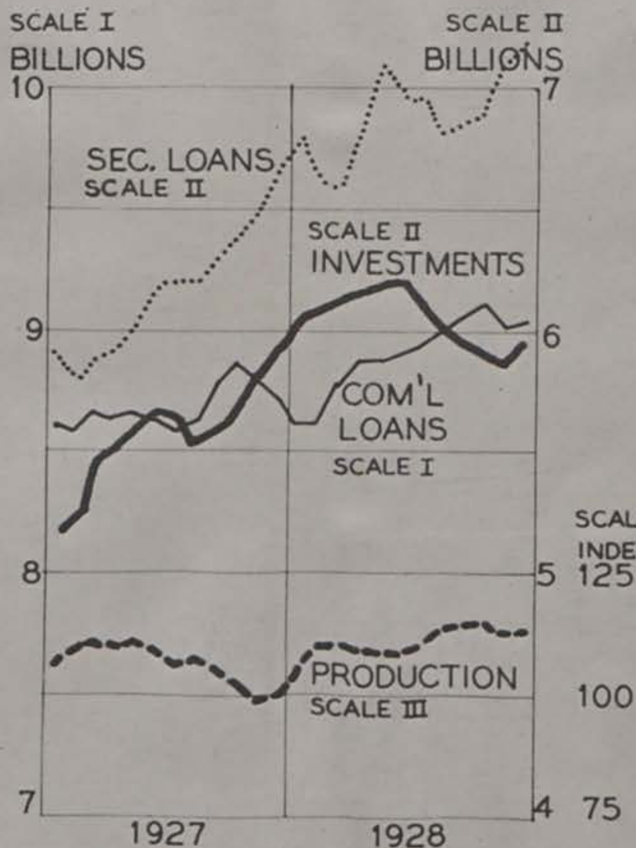

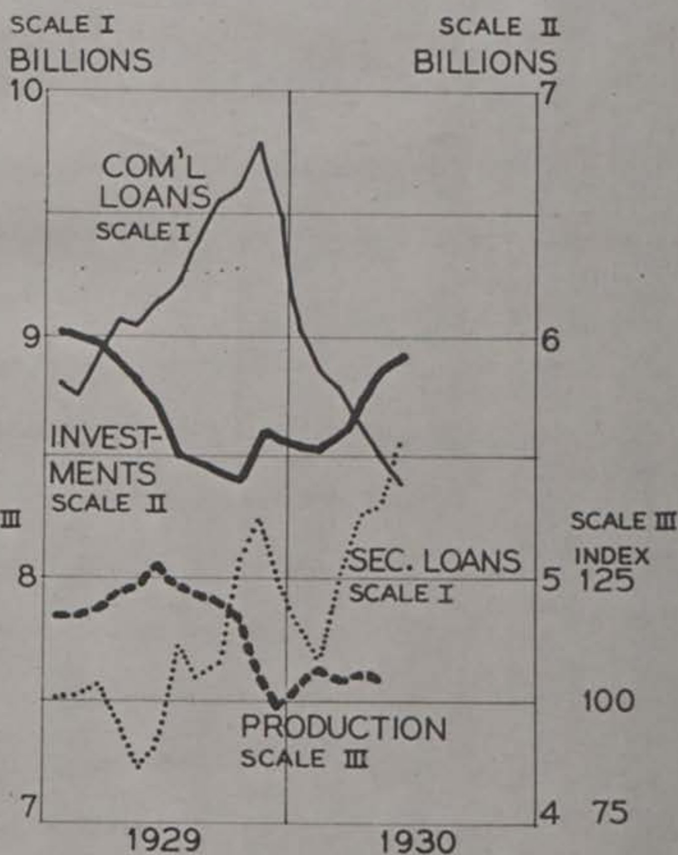

Member Bank Credit and Industrial Production

An analysis of security loans indicates that, notwithstanding the high level of security loans in reporting banks, the total of currently reported security loans, including loans of corporations and others to brokers, has shown a reduction of nearly $4,000,000,000 since last autumn. The following figures summarize the changes since the high point of last October:

(In millions of dollars)

	Oct. 2, 1929	June 11, 1930
Loans to brokers:		
By weekly reporting banks	2,318	3,112
By other banks and customers	1,396	354
By other lenders*	5,379	1,755
Total brokers loans	9,093	5,221
Loans of reporting banks to customers other than brokers	5,508	5,453
Total	14,601	10,674

* Includes borrowings of Stock Exchange Members' borrowings from private bankers, foreign lenders, and others.

From the high point of last September to June 11, the Standard Statistics Company index of the prices of 405 stocks showed a net decline of 28 per cent. The figures above show a decline of 27 per cent in the total of currently reported security loans during the corresponding period. In view of the fact that bank loans on securities undoubtedly include a certain proportion of business loans and do not represent exclusively loans for the purpose of carrying securities on margin, and include also loans on bonds, it is clear that the amount of loans used purely for security trading purposes has declined more than security prices, and that a larger proportion of stocks at the present time are held outright than was the case last autumn. Another factor in the volume of security loans has been the large amount of new securities which have been offered for public subscription during recent months, some part of which, no doubt, have been carried on borrowed funds, pending distribution.

The increase in security loans of reporting banks since last October has

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been entirely in loans to brokers - presumably the most liquid type of security loans - and has represented simply a partial replacement of the large volume of loans called by corporations and other non-banking lenders.

MEMBER BANK INVESTMENTS AND FEDERAL RESERVE SECURITY PURCHASES

The increase in bank investment holdings during recent months has proceeded rather slowly. No doubt this has been due to some extent to the decline in bond prices last year, which has made banks reluctant to increase their investment portfolios. Investments of weekly reporting member banks now constitute a smaller proportion of their total loans and investments than was the case three years ago. Compared with the growth in the proportion of time deposits to total time and demand deposits in these banks, the increase in the proportion of investments has lagged decidedly, as the following table indicates:

	Percentage of investments to total loans and investments	Percentage of time deposits to total time and demand deposits
June 1921	22%	22%
June 1927	28%	32%
June 1930	26%	34%

The diagram on the following page indicates quite clearly that purchases of Government securities by the Reserve Banks at several times during recent years have expedited the purchase of investment securities by commercial banks. As in earlier periods, the increase in the System's holdings of Government securities since last autumn has been followed by an increase in the investment holdings of reporting member banks. Up to the present time, however, this increase in bank investments has been considerably smaller than that of 1922 or 1924, although to produce an equal effect, a much larger increase would be required at the present time; that is to say, the growth in the business of the country since 1921 has probably amounted to around 45 per cent, so that the capital requirements of business have been greatly enlarged. The increase in investment holdings, moreover, has not yet been sufficient to replace the decrease last year.

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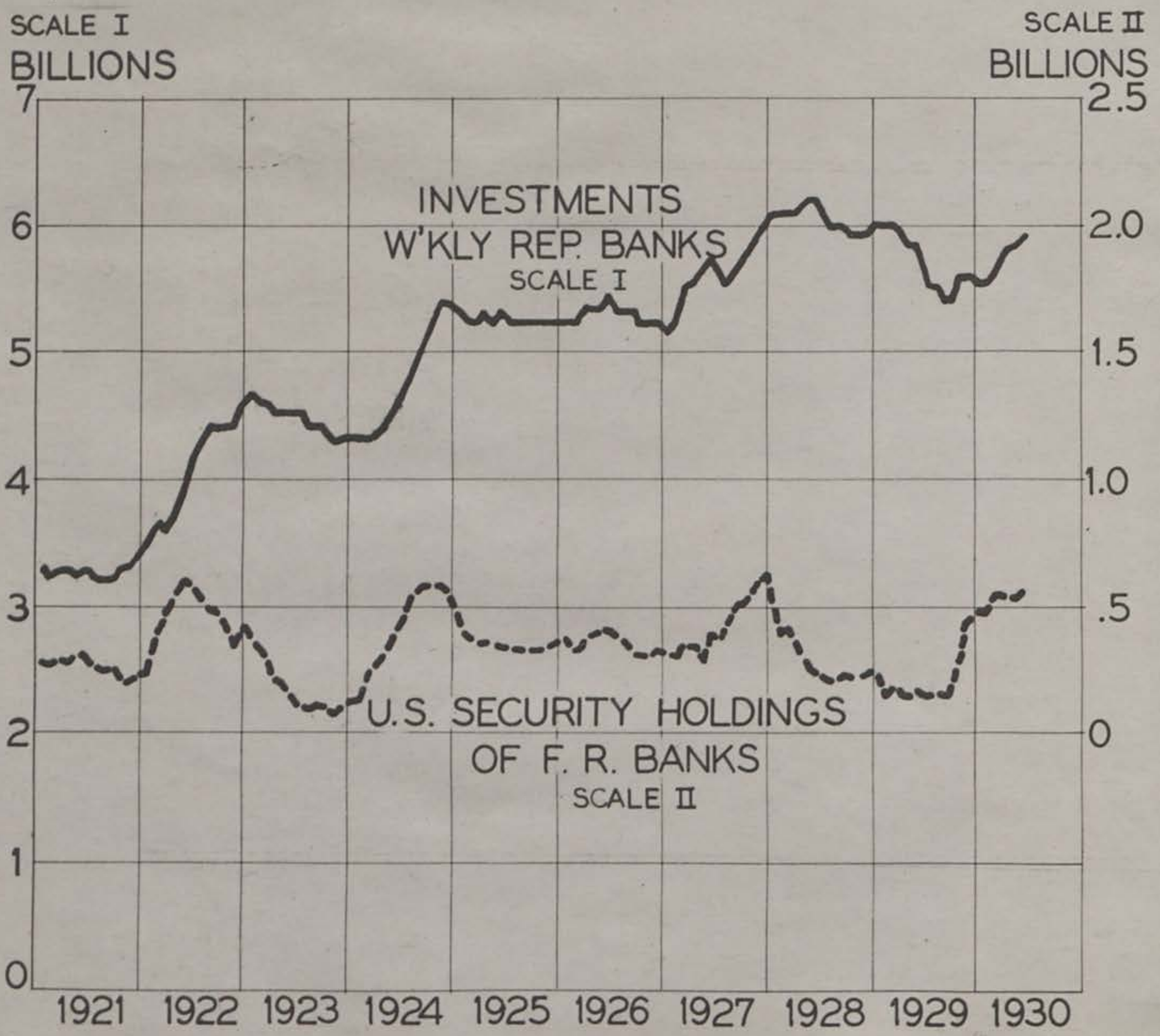

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The effect of Reserve Bank purchases of Government securities on the position of member banks, with respect to their ability to increase their investments, was supplemented in 1921-1922 and in 1924 by heavy imports of gold. This year also there has been an inflow of gold, but it has been small in comparison with the movements in the earlier periods.

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A MORE EQUITABLE DISTRIBUTION OF THE EARNINGS OF THE FEDERAL RESERVE BANK.

In the lengthy and nation-wide debate which raged uncessingly for a number of years preceding the organization of the Federal Reserve System in 1914, and more especially in the seven-year period following the panic of 1907 when our banking machinery broke down in a period of prosperity because it could not sustain the load, the combined thought of the nation was concentrated with great intensity and thoroughness upon the construction of a new banking and currency system that would embody the soundest principles gained by the experience of all the ages throughout the world. Not only the best banking brains of the nation and all the nations had free play in this discussion, but all of our foremost economists, business, agricultural, and political leaders were heard from exhaustively in the effort to formulate a system which would not only be based upon an impregnably strong position, but which would at the same time be responsive to and entirely fulfilling all the needs of this particular nation, and which would be politically expedient, since this particular nation had pre-conceived and deep-rooted habits of thought following the abolition of the first and second Banks of the United States, hostile to the creation of a centralized government bank, corresponding to the central banks of the other great nations. It is not necessary here to dwell upon the reasons for this, and reference is only here made to this preliminary history to place emphasis upon the fact that a very intense and searching X-ray was focused over a long period of time upon everything related to the subject, comprising the whole history of economics and banking.

It will be recalled that the United States Government in the first place created and sent abroad a very able monetary commission headed by a very able man, Senator Nelson W. Aldrich of New Jersey, to make a close and

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intimate study on the ground, and with the benefit of extensive discussions with the most able authorities in Europe, of the banking systems of the other great nations. This committee returned to the United States with probably the most comprehensive data ever assembled together on this subject. On this data was finally evolved a bill in Congress sponsored by Senator Aldrich for the creation of the National Reserve Association. Although this bill was endorsed by the American Bankers Association Convention in New Orleans in October, 1911, it met with much opposition in Congress, and failed to pass. However, it provided the skeleton and ground-work for the Federal Reserve Act, which in theory and general structure very closely resembled it.

A comparison of the text of the National Reserve Association and the Federal Reserve Association bills very clearly establishes the important fact that however much the respective bills may have differed in any other respects, they were absolutely identical in one respect of the greatest fundamental importance; namely, that under no circumstances should these reserve banks be operated for profit, and provisions were written into both laws designed to forever obviate that possibility, by limiting the return to the stockholders to a moderate rate of interest, and the further provision in both acts, that in case of liquidation, only the par value of the stock would be returned to the stockholders, and any surplus or earnings would revert to the Treasury of the United States. It is interesting to note that the National Reserve Act provided, first; for a contingent fund to be maintained to an amount equal to 1% on the paid-in capital, and not to exceed $2,000,000, as a protection against any possible losses (this also to revert to the United States Treasury in case of liquidation); second; a 4% cumulative dividend to be paid to the stockholders; third; one-half of additional earnings to go to surplus until the latter amounted to 20% of the paid-in capital, one fourth to the Government as a franchise tax, and one-fourth to shareholders until the dividends to the latter

equalled 5%, and in no case more than 5% per annum. After that point had been reached, one-half of excess earnings to go to surplus, and one-half to the Government as franchise tax, provided that after 20% surplus had been reached, the entire amount of the excess earnings should go to the Government as a franchise tax.

A study of this subject makes the conclusion very plain that the governing and fundamental thought and intention of these provisions was centered upon the primary necessity of insuring beyond all peradventure the impregnable soundness of these institutions for reserve purposes by removing any possibility that they might themselves become over-extended and in the same position as any other banks, and impotent by reason thereof in times of stress and crisis to lend their powerful aid to save the situation, fulfilling the functions for which they were created. The seriousness of concentrating the reserves of the nation to these institutions was fully recognized, for it was apparent that this radical experiment and adventure carried with it tremendous responsibilities, and that if these reserve institutions should ever collapse, everything else would fall down with them. The one supremely important basic principle of the Federal Reserve System centered in insuring and forever maintaining the impregnable strength of these reserve institutions.

I do not consider that the basic thought in turning the excess earnings over to the Government as a franchise tax was motivated by any conception that the Government is entitled to appropriate all the surplus earnings of these privately owned institutions in return for the charter rights granted them, but rather that this sort of a distribution of the earnings would be most effective in insuring that the stockholders would be limited to a 6% return, insuring the proper and sound administration of the banks, and removing the urge to operate them for profit rather than for safety. The absolute unanimity relative to this is very striking and impressive, when it is considered that this unanimity

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was arrived at after a period of the most concentrated thought, exhaustive discussion, the assemblage of all history and experience and the free interplay of all thought of the recognized authorities here and abroad.

I am presenting these facts to your attention as a prelude to what I am further going to say, because to me the combination of investigation, wisdom, experience, intellectual comprehension, and sound and considered judgment, resulting in this unanimity of conclusion, seems very high and convincing authority indeed, and I cannot but feel that the deliberate and considered judgment of so high a tribunal upon this fundamental factor of supreme importance should not be reversed except upon the authority of combined judgment of the same importance, and entitled to the same profound respect.

When the Federal Reserve Law was under discussion before its passage, some of our soundest bankers and best thinkers saw two very dangerous possibilities in it in particular, and many of our best bankers opposed it because of this. The first danger was of clumsy and ignorant tinkering with the Law because of popular clamor and political influence, which might result in converting a scientifically adjusted and effective piece of machinery into an engine of destruction and ruin. The second was the possibility and probability of credit expansion under this system to an unwholesome and dangerous extent - to an extent that would among other things be sure to put to a very severe test the strength and stability of the reserve banks. And also it was clearly apprehended that the proper conduct of these reserve banks, involving the safety of the whole banking and business structure of the nation, would call for a very high order of economic comprehension, ability, steadfastness, and courage in the personnel of the Federal Reserve Board and the personnel of the banks, and that in this respect the System was vulnerable to political influence, as well as the uncertainty of the calibre and qualifications of in-

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cumbents placed in their positions by voting majorities. I am glad to say that from its first inception the System has been signally fortunate in the first place, in having its policies and destines shaped by so great a banker as Mr. Paul M. Warburg, who, in my estimation, has hardly a peer in broad comprehension and sound constructive ability, and in having associated with him gentlemen of high character and ability, and that the personnel of management throughout has been with few exceptions well-qualified and of high character. Nevertheless, the Federal Reserve System, having no counterpart in the world, was an experiment, which has been and will continue to be in a constant state of evolution.

Looking back over its history, we can see mistakes have been made, and penalties have been paid for them - but with constant gain in experience, it is constantly working to higher levels of efficiency and correct adjustment. On the whole it has been invaluable, and though we have lessons yet to learn in perfecting it, we would not be without it. Above everything else, all the experience we have gained emphasizes constantly the imperative need and the solemn duty to forever perserve and defend the strength, liquidity and soundness of these reserve institutions. We have recently witnessed the culmination of extraordinary credit inflation, resulting finally in the greatest stock market collapse in history, and in a business recession which is becoming prolonged. I am not going to discuss this at all today, except to call your attention to the fact that during this period the amount of bank credit created under the operation of the Federal Reserve System, and for the protection of which the Federal Reserve System constituted the reserve safeguard, expanded in volume to more than ten times the amount of the entire resources of the Federal Reserve System, and on that volume of outstanding credit, the gold reserve declined to approximately 6½%, as was clearly shown in the National City Bank Bulletin analysis of October 1928. In that month I was in

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Washington, and was told by members of the Federal Reserve Board that the volume of outstanding bank credit was approximately $55,000,000,000, of which approximately 55% was employed in carrying stocks and bonds, approximately 10% in real estate operations, and the remaining 35% in conducting the other business of the country.

It is very pertinent here to lay emphasis and stress upon the fact that the Federal Reserve Law, originally designed to function so that the volume of currency and credit created by the System would automatically expand and contract with the movements of commerce - thus getting away in the first instance from the rigid, unresponsive volume of bond-secured currency which had caused us so much trouble in our preceding system - afterwards had to be altered to enable the System to furnish the tremendous volume of credit necessary to carry on the War, for which reason the Law was amended to permit banks to borrow against Government bonds - the huge volume of which, both then and now, created the means of enormous credit expansion - without at the same time providing any means of automatic contraction with the movements of commerce, or any means of contraction except such as might be brought about by open market operations only partially effective. That is the law today, and I am free to confess it would be difficult, if not impossible, to change back under present conditions except possibly by gradually imposing restrictions. If to the difficulties we have so recently witnessed of controlling this huge and inelastic volume of credit, mounting up to a figure where the percentage of actual gold reserve supporting it constantly dwindles, and might conceivably drop much lower then 6½%; this situation should be further aggravated and made still more precarious by the dangers of the Federal Reserve Banks themselves, further expanding the volume of credit by going into the market and purchasing earning securities in large volume in order to make large earnings for the benefit of their stockholders, the consequences might be too tragical for the

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imagination to grasp.

Do not lose sight of the fact that the operations of this sort of the Federal Reserve Banks mean something very different from those of ordinary member banks. When the Federal Reserve Bank goes into the market to purchase securities, it has the effect of immediately creating an inelastic volume of bank credit of ten to fifteen times that much, so that if the combined Federal Reserve Banks should purchase, for illustration, $500,000,000 of securities for earning assets, it would create something like at least $5,000,000,000 expansion of bank credit. It can be readily seen that huge volumes of bank credit would thus be created, unrelated to legitimate business needs, which would naturally seek employment in speculation. Last year's stock market experiences warn us of the great dangers in this. There could very well come a time when confidence would be lost. That very same confidence which we now have in the banking structure of the country might be lost, and if that should ever be lost, we are all lost. Anybody having a balance in a bank created by bank credit extended by bankers can call for the currency. The currency is all redeemable in gold. You must admit that it will require very wise, sound and safe management on the part of the Federal Reserve Board and the Federal Reserve Banks to protect this volume of credit and guarantee the redemption of our currency in gold, and even more so it is imperatively demanded that any provisions written into the Law itself shall be of the safest and soundest character. We have no positive assurance in fact, that Federal Reserve management will never get into inexperienced or incompetent hands. Long periods of business depression, unemployment, declining prosperity, failures, and what we call bad times happen along in cycles, and at such times dissatisfaction and public clamor are rampant, and foolish laws and remedies gain many followers among the unthinking, uninformed, and ignorant. Federal Reserve laws will not permit of any crude and clumsy tinkering without destructive results,

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and Federal Reserve management must ever be strong, brave, sound and conservative, unresponsive to popular clamor or politics, to successfully navigate the ship through stormy and dangerous waters.

Therefore, the question before the house today presents considerations of the most serious character. We have debated this question in our previous sessions. There can be no question that many of the banks of the country, especially those that are not particularly prospering, are looking with dissatisfaction at turning over practically all of the excess earnings to the Government as a franchise tax. One very definite evidence of this is seen in the five bills now pending in Congress (possibly there may be others), which have so far, I think, had no hearings or made any progress, namely:

H.R. 10472, Mr. Wingo, introduced March 4, 1930.

Providing that the surplus earnings at the end of each calendar year shall be distributed to the stockholders on a pro rata basis according to their stock holdings of the Federal Reserve, and their average reserve balance maintained with the Federal Reserve Bank during the year; such distribution to be in accordance with the rules and regulations to be prescribed by the Federal Reserve Board.

H.R. 10211, Mr. Steagall, introduced February 24, 1930.

Providing that 10% of excess earnings to surplus, the remaining 90% divided between the United States and stockholders as follows: Federal Reserve Board shall determine as nearly as possible what proportion of net earnings was derived from the issuance of Federal Reserve notes, which amount shall be paid over to the United States as a franchise tax, the remainder distributed among the stockholders in proportion to their stockholdings.

H.R. 7966, Mr. McFadden, introduced January 6, 1930.

Providing that excess earnings be distributed pro rata by the Federal Reserve Bank to each member bank in proportion to their respective reserves, such dis-

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tribution however limited to those members whose maximum reserve at any time during the year does not exceed $500,000.

Senate Bill 3564, Mr. Fletcher, introduced February 15, 1930.

Providing for 10% to surplus, and 90% distributed among stockholders pro rata at the end of each calendar year under rules and regulations prescribed by the Federal Reserve Board.

Senate Bill 5723, Hon. Carter Glass, introduced February 4, 1930.

Providing that after regular 6% dividends have been paid, one-half shall be paid to the member banks as an extra dividend, one-fourth paid to the Government as a franchise tax, and the remaining one-fourth dividend as follows: first, by addition to surplus of the bank until such surplus reaches 100% of subscribed capital, or 200% of paid-in capital, and the balance as an additional franchise tax to the Government.

Under all of these bills, in case of dissolution or liquidation, the stockholders would receive back the par value of their stock, any surplus or other earnings to revert to the Government. I apprehend that the consideration of the proposed legislation will narrow down to the McFadden and Glass bills, because of the prominence and authority of the authors as members of the House and Senate Banking and Currency Committees, respectively. I also apprehend that because of member bank pressure, some sort of legislation will be enacted that will have the effect at any rate of reducing the amount paid to the Government as a franchise tax, and in some way giving some benefit of the remainder to the stockholders, to measurably satisfy the latter. The same sort of pressure that brings this about is not unlikely to be hereafter exerted in the direction of expanding the operations of the Reserve Banks to make more money and bring in more dividends, especially for the reasons which I shall hereafter endeavor to show.

Behind all of this, and strongly prompting it, is the feeling that

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the Federal Reserve System is losing members and popularity because of the feeling that the relationship is unprofitable, to counteract which means are being sought to make the relations more profitable and satisfactory, and to attract new members. I sincerely believe there is much misconception and fallacy in the expectation that any possible distribution of earnings would change this situation.

It is proper to say here that on May 26th of this year the Economic Policy Commission of the American Bankers Association made public their report, in my opinion a well-considered and thoroughly sound expression, opposing at this time any change in the law to permit a larger distribution of earnings to the member banks. The large calibre of the members of this Commission needs no comment when I name them - R. S. Hecht, Chairman, George E. Roberts Nathan Adams Leonard P. Ayres, Frank W. Blair, Walter W. Head, W. E. Longyear, Walter S. McLucas, Max B. Nahm, Melvin A. Traylor, Paul M. Warburg, O. Howard Wolfe, Gurden Edwards. Time does not permit going into the full text of this able document, which fully recognizes the dangers above referred to, but as illustrative of profits that would be derived by the members offsetting the very dangerous risk of changing the law, may I not quote the following extract from it:

"In this connection it might be well to point out that a proposed increase in dividends would, after all, be a very small financial inducement to present to prospective banks. The Federal Reserve Bank of Richmond has computed, on the basis of the past six years, a theoretical forecast of additional earnings that would be disbursed to member banks during the next six years under two plans introduced in the United States Senate. The Fletcher bill provides that earnings, after present dividends, and completion of 100% surplus, should be distributed to the stockholder banks. If the earnings of each bank were distributed among its own members there would be no extra dividends in the Boston,

New York, Philadelphia, Cleveland, Chicago and San Francisco districts during the next six years, but the other six Federal Reserve banks would pay annual extras at the following rate: Richmond, 6.08%; Atlanta, 4.09%; St. Louis 3.50%; Minneapolis, 9.51%; Kansas City, 5.48%; Dallas 4.83%. If the earnings were pooled and paid out to all members in all districts each member would receive an average annual extra dividend of .78%. Under this plan no franchise tax would be paid.

"Under the Glass bill the average annual extras would be as follows: Boston, 2.51%; New York, .48%; Philadelphia, 2.05%; Cleveland, 2.09%; Richmond, 3.26%; Atlanta, 4.67%; Chicago, 3.20%; St. Louis, 2.02%; Minneapolis, 4.75%; Kansas City, 2.74%; Dallas, 3.31%; San Francisco 1.87%. If these extra funds were pooled the result would be an extra average annual dividend of 1.73% for each member. Under this plan the system would pay an average franchise tax of $1,941,996 each year.

"A member bank having capital and surplus of $200,000, therefore, holding Federal Reserve Bank stock amounting to $6,000 on which it is receiving $360 under the present 6% dividend arrangement, would with the addition of each 1% to the dividend rate receive an additional income of $60 a year. If each member bank will figure out for itself the dollar-and-cents gain it would enjoy, we are confident it will be agreed that the gains are small as against the economic disadvantages which can be pointed out."

I may mention here, though time does not permit to go into it, that all the important central banks in the world are operated pretty much the same in effect with different variations, to pay the bulk of the earnings to the government after a moderate and reasonable return to their stockholders. The banking and economic structure and conditions of different countries naturally differ considerably, as their laws differ considerably in consequence, but the principle is essentially the same. For my own part, I have an open mind on

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the proposition of giving our member banks any possible benefits in the way of increased services or participation in surplus earnings, consistent with the paramount considerations of safety which must be unconditionally and immutably assured before that can be done. The question is how? As I see it, we have not yet gained enough experience or a long enough perspective over any long range of normal years to determine what the average of earnings would be, assuming that the banks are soundly and properly operated, as reserve institutions must be.

Taking the range of earnings back to 1914, any average for instance, including the huge earnings of 1918, 1919, 1920 and 1921 would have to be eliminated because of the abnormally expanded operations of those years incident to War conditions not likely to occur or be justified again. Out of a total of $904,000,000 total gross earnings of the combined banks from 1914 to 1929 inclusive, $474,000,000, or more than half, of the earnings of these fifteen years were made in the four years mentioned. The earnings of these four years also contributed powerfully to building up the surplus quickly.

I have read with much interest the study of possible distribution of earnings made by the able Governor of the Federal Reserve Bank of Richmond, Mr. George J. Seay, referred to in the above report of the Economic Commission. Mr. Seay tabulates all franchise taxes paid the Government up to and including 1929, aggregating roundly $147,000,000, of which amount $124,000,000 was paid for the years 1920 and 1921. For the two following years, 1922 and 1923, the total franchise taxes, $11,000,000, were also abnormally large. The total franchise tax, $135,000,000, paid in those four years represents 92% of $147,000,000, the total amount paid for the years 1917 to 1929 inclusive. These abnormal years should be eliminated from all average calculations. The last seven years have witnessed a phenomenal and unprecedented expansion of building, business, speculation, and volume and activity in the markets, with

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a corresponding expansion of credit volume and Federal Reserve Bank operations. I do not think any average of those years either would be a safe guide in estimating earnings over say the next ten years. It is still a very uncertain question what the earnings will be in the long reach ahead, and it is entirely possible that through shrinkage of operations and possible losses, years will be encountered of inability to earn expenses. In any such years there will be the urge to expand operations, when every sound consideration would demand contraction, in order to make unwarranted dividends for the stockholders. I emphasize - this must never be permitted.

But even averaging the abnormal profits of abnormal years as above shown, the returns to the stockholders would be very small indeed. Notwithstanding this, however, I would not oppose reducing the franchise tax paid to the Government to whatever percentage would be reasonable and justified by the charter privileges granted, taking into full consideration on the one hand the following provision of Section 7 - "Federal Reserve Banks, including the capital stock and surplus therein, and the income derived therefrom, shall be exempt from Federal, State, and Local taxation, except taxes upon real estate"; and on the other hand, that although it has been stated the banks make a large profit on circulation under certain conditions, and under others not, the Government technically imposing no tax on circulation, I have a memorandum from Governor Talley, which if I understand it correctly, indicates that the Act provides that the Federal Reserve Bank shall pay such rate of interest as may be established by the Federal Reserve Board on only that amount of Federal Reserve notes which equals the total amount of outstanding notes, less the amount of gold and gold certificates held by Federal Reserve Agents as collateral security. Without further time or access to records, I cannot distinguish the material difference, and I pass over that. The Federal Reserve Banks are owned by the stockholders, who take all the risks and all the losses and pay all of their own expenses, serving the Government unstintedly with all their facilities. I

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think we should pay the Government, of course, anything that may be determined as just and equitable. The Government also has a duty and an obligation to the public to maintain a sound banking and currency system, not alone for the benefit of the member banks, but for the whole public, and should not unreasonably appropriate the earnings of the banks, carrying out the mandate of the Government law.

After establishing the ratio of this franchise tax, I would not be opposed to paying the remaining excess into some sort of a Contingent Fund to be held intact for the benefit of the stockholders over a period of say ten years, or any number of years, more or less, that would enable a longer perspective to be had of the operations, needs, and future conditions of the System, until it can be determined in the light of experience and mature consideration what disposition could be properly made of them. This fund might be invested in Government bonds.

I believe the member banks would do well to give very serious and sober consideration at this time to the broad and long range perspective imperfectly covered in the foregoing, making further studies of their own. Mr. Warburg has been consistent in his opposition to larger dividends. In my estimation he is an authority without an equal in the profoundness of his knowledge, and in his comprehension and sound judgment on government banking, in theory and practice. His recent two volumes on the Federal Reserve System should be read by every banker.

Let us briefly analyze some of the causes of dissatisfaction with an open mind, to see if they are well-founded. As to loss of interest on balances member banks should take into consideration that under our previous banking system, country banks were required to carry 15% reserves, of which three-fifths could be carried on a 2% basis with city bank reserve agents, and the other two-fifths had to be carried in <u>legal tender money</u> (on occasions very

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difficult to get) in their own vaults. Non-legal tender money which they carried in stock for counter purposes was not reserve, and there was at all times a large volume of it yielding no more income than the balances carried with the Federal Reserve Bank. Under the Federal Reserve System they have to carry very much less cash on hand than formerly because of the stability of conditions and the certainty of getting in all the currency needed immediately. Reserve city banks had to carry 25% reserves, of which 12½% could be carried with central reserve city banks on a 2% basis. Central reserve city banks had to carry a 25% reserve always on hand. As a practical proposition, banks of all three classes carried much more currency on hand than stock reserve requirements in order to be safe and prepared for emergencies.

Under Federal Reserve conditions, the required reserves have been cut in half, to say nothing about the reduction in counter cash carried. The banks, therefore, have the other half released for lending purposes. If a country bank lends the other half at 10%, it would be equivalent to earning 5% of the entire amount of the reserve previously carried, or if they can lend it to average 5%, if you please, that would be equivalent to 2½% of the entire amount of the reserve previously carried; whereas, they could formerly earn 2% on only three-fifths of the reserve previously carried. The same principle applies to the reserves of the city banks.

Personally, I have not been able to convince myself that any distinction ought to be made in disbursements of dividends to two banks, each with the same capital, but one having twice as large deposits, and therefore carrying twice as large reserves. The latter has twice as large liabilities, needs to borrow twice as much money, all things being equal, and would in any case, have to carry correspondingly larger reserves, and would benefit correspondingly in having half of those reserves released. The larger the volume of business, the larger demands they will make on the Federal Reserve Bank for clearing their float, shipping currency, making transfers, and everything

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else. They get more benefit out of it in proportion to their capital than the smaller bank.

In the case of our own individual banks, they have some stockholders who carry larger balances without interest than other stockholders, and they have some stockholders who carry no balances at all. They could not make any discriminations on that account in paying dividends, and should the Federal Reserve Bank make such discriminations, it would be violative of every precedent and usage applying to all other corporations. I do not believe there is any sound basis for the Federal Reserve Banks adventuring into this sort of thing, especially as the reserves of the larger bank are adjusted to its conditions on the same impartial and fair ratio that the smaller banks are adjusted to its conditions. Otherwise, the larger bank could with equal propriety say that as its capital is the same as the smaller bank, it should carry no larger reserves than the smaller bank. The reserves have no reference to capitalization, but to volume of deposits. The bank with a larger volume makes much more earnings in proportion to its capital, carries no more proportionate reserve than the smaller bank, and no more than it should carry to protect its depositors, and I fail to see where it is entitled to any special consideration by virtue of that fact.

Is it not also true that one fundamental cause of dissatisfaction is in the first place that the country banks find it easier to borrow money on all sorts of collateral and under all sorts of arrangements, including personal loans on collateral, without any red tape, loss of time, and hard-boiled regulations, from their city bank correspondents, who additionally allow them 2%, and will willingly do various things the Federal Reserve Bank is not permitted to do. The regulations need no apologies, as they are sound and proper, calculated to progressively improve the standards of banking, the economics of the country, and develop bankers of greater comprehension and ability, in which our

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unit system is by and large lacking. But it is easier and very natural to follow the line of least resistence, lean to the easiest way, the most comfortable way, and string along with the big city banks as before the System started, relying on the latter to do all the borrowing that is necessary from the Federal Reserve Bank to take care of the needs of their customers.

I wonder if the country banks in the agricultural regions, who in recent years have been operating under more or less discouraging conditions, owing to the prolonged depression in agriculture, the hazards of their loans, losses, and slow collections, reduced volume and profits, and because of this, the necessity of employing funds in low rate, secondary reserves instead of 10% loans - the movement of business from small towns to larger towns in this automobile era, the gradual decline of small town business and small town banks because of these conditions - are not, unconsciously perhaps, laying the blame in the wrong place. Three percent of a bank's capital and surplus is very small in proportion to its total assets. It should not be any hardship, or really amount to anything material one way or the other to keep this small percentage safely and continuously invested without risk or the necessity of renewal to yield 6% in Federal Reserve stock.

I have been looking over the changes in membership in the system in the last five years - 1925-29, inclusive. These figures reveal that although the number of members declined from 9,489 to 8,522, a net loss of 967 within that period, a total of 1,241 banks were lost to membership through mergers by the member banks, suspensions, etc., 807 banks joined the System, against 631 withdrawing, which showing is nothing in particular to be unduly agitated over. We have within that period been going through a very necessary and wholesome consolidation of banks, resulting in stronger and more desirable members, and a progressively stronger banking situation - the only sound corrective that can be applied to a generally over-banked country bank situation

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extending practically over the whole country, and especially in the agricultural sections, which has been one of the most difficult problems the country has had to deal with - two or more banks in towns having business enough to support only one properly managed bank. Banks with insufficient capital and incompetent management, dividing the business, leading to excessive competition and unsound practices, all in a precarious position. I think we will all agree that as and when such situations can be corrected as they are now being corrected by consolidation and elimination, resulting in stronger institutions able to command better talent, with capital and volume sufficiently large to be operated properly and profitably, a very constructive and necessary thing has been accomplished.

Any reduction in the number of the members of the System resulting from this as above shown means nothing at all beyond that the System is improving itself. It is not an advantage to the System to have a lot of members of a weak and unprofitable, poorly-managed character that cannot conform to the rules anyhow and are foredoomed to pass out because of their own inherent conditions through no fault of the Federal Reserve System. The situation, in short, is that by consolidations and eliminations, the progress of events is progressively creating gigantic and strong institutions in the big cities, and more wholesome and sturdy institutions in the smaller towns. It is certainly far better for the economics of the country that this process should continue, remedying an unsound banking situation with natural and sound correctives, than to perpetuate it, and the conditions arising from it, by chaining up all these weak links with stronger institutions in large towns, to keep them alive and at the same time to keep alive the over-banked situation and keep alive the excessive competition, by virtue of which none can be operated profitably. The Federal Reserve statement totals do not indicate that the System itself is declining, but getting stronger and better, and the statements, moreover, indi-

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cate at this time an extraordinarily strong, liquid, and healthful condition. As long as this continues, and the Federal Reserve System is serving all the needs of the country fully and acceptably, I don't see anything to be concerned over. The preservation of invulnerable strength, and the highest grade management that can be secured in the Federal Reserve Banks, holding the reserves of the nation, is the thing that counts. The preservation of a banking and currency system on a firm and everlasting foundation is the thing that is indispensable.

Shall we not concentrate our energies, with all the force that is in us, on the attainment of those objectives, and in every possible way discourage any experimentation or tinkering with the Federal Reserve Law, or make any changes in it until we know beyond peradventure where it will land us.

1. Sincerely and conscientiously holding the views above expressed, I would like to see this Convention go on record as endorsing the report of the Economic Policy Commission of the American Bankers Association above referred to, as representing the considered judgment of as able and represantative a Committee as could be named within the Association.

2. Recognizing, however, that there are at this time five bills pending in Congress as heretofore enumerated, and that with the political influences that will be brought to bear, it is not unlikely that some sort of legislation will be enacted, if it becomes necessary to choose an alternative, I would recommend following the form of the Glass Bill, S 5723, reading as follows:

5 "Sec. 7. After all necessary expenses of a Federal
6 reserve bank shall have been paid or provided for, the stock-
7 holders shall be entitled to receive an annual dividend of
8 6 per centum on the paid-in capital stock, which dividend

[illegible] shall be cumulative. After the aforesaid dividend claims

19 have been fully met the net earnings, beginning with the

(Pg 2) 1 earnings for the year ending December 31, 1929, shall be

2 distributed as follows: Twenty-five percentum of such net

3 earnings shall be paid to the United States as a franchise

4 tax; 25 per centum of such net earnings shall be paid into

5 the surplus fund of such bank; Provided, however, That no

6 such payment shall be made into such surplus fund in excess

7 of an amount sufficient to make the entire surplus fund equal

8 to the amount of the subscribed capital stock of such bank,

9 and that any part of such 25 per centum which is not needed

10 to bring such surplus fund up to 100 per centum of such

11 subscribed capital stock shall be paid to the United States

12 as additional franchise tax; and the remaining 50 per centum

13 of such net earnings shall be paid at the end of each cal-

14 endar year to the stockholders on a pro rata distribution to

15 be made in accordance with such rules and regulations as

16 may be prescribed by the Federal Reserve Board."

with their recommendation, however, that same be amended to read as follows (lines 12 to 16, inclusive):

"and the remaining 50 per centum of such net earnings shall be credited on the books of each Federal Reserve Bank to a 'Contingent Fund' for the benefit of the stockholders, out of which no dividends shall be paid to the stockholders exceeding 2% on the paid-in capital of the bank in any one calendar year, and then only subject to the approval of the Federal Reserve Board."

3. I would recommend that the Chairman of this Meeting appoint a special committee of seven to draft a memorializing resolution respectively

to the Banking and Currency Committee of each branch of Congress, with copies to the Directors of the Federal Reserve Bank of Dallas, the Federal Reserve Board, and the Federal Advisory Council, embodying the recommendations of this Convention.

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- Address by Beverly D. Harris, Senior Vice-President of the Second National Bank of Houston, Texas, before the Annual Meeting of the Federal Reserve Stockholders, at Dallas, Texas, June 19, 1930.

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FEDERAL RESERVE
BOARD

OFFICE CORRESPONDENCE Date June 23, 1930

To Federal Reserve Board

From Mr. Wingfield-Assistant Counsel.

Subject: Summary of Provisions of the Bill S-4723, introduced by Senator Glass.

On June 17, 1930, Senator Carter Glass introduced a bill, S.4723, to amend the provisions of the National Bank Act and the Federal Reserve Act in a number of respects. When he introduced this bill Senator Glass stated on the floor of the Senate that it is merely a tentative measure to which he hopes to direct the inquiry into the banking system authorized by the Senate. For the information of the Board, however, I will briefly summarize below the most important changes which Senator Glass' bill would make in the present law.

(1) The first paragraph of the bill, S. 4723, states that the title of the bill is the "Banking Act of 1930."

(2) Section 2 of the bill, S. 4723, would amend the 7th paragraph of Section 5136 of the Revised Statutes which has to do with the powers which a national bank may exercise. In addition to the specific powers of national banks now contained in the law, this bill provides that national banks may generally engage in all forms of business that commercial banks of the State in which the national bank is situated are permitted to transact by the laws of the State, except in so far as national banks are expressly forbidden to undertake such business by the National Bank Act, the Federal Reserve Act, or other laws of the United States.

Under the present provisions of Section 5136 of the Revised Statutes, national banks are authorized to buy and sell investment securities. Section 2 of the bill, S. 4723, would also amend Section 5136 so as to limit this power of national banks to only the buying and selling of investment securities solely upon order and for account of customers, and in no case for its own account, except as specified in Section 24 of the Federal Reserve Act.

(3) Section 5144 of the Revised Statutes now provides that each shareholder of a national bank shall be entitled to one vote on each share of stock held by him. Section 3 of the bill S. 4723 would amend Section 5144 so as to restrict the right of a shareholder to vote only shares of stock actually owned by him as a result of bona fide purchase, gift or inheritance, and the shareholder who becomes such through nominal transfer, or ownership on behalf of another, may not vote stock so acquired. This section of the bill would further amend Section 5144 so as to provide that no corporation, association or partnership and no officer, employee or director of any corporation, association or partnership which is the owner of stock in any national bank shall vote either the stock owned by him individually or the stock owned by the corporation. The present provision of Section 5144 authorizing shareholders to vote by proxy is retained in the bill S. 4723.

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(4) Section 4 of the bill S. 4723, would amend paragraph (c) of Section 5155 of the Revised Statutes so as to authorize a national bank, after the date of the approval of this bill, to establish and operate new branches within the limits of the State in which the national bank is situated rather than merely in the city, town or village in which such national bank is located. The proposed amendment retains the present provision of the law that new branches may only be established and operated if such establishment and operation are permitted to State banks by the law of the State in which the national bank is located.

(5) Under the provisions of Section 5197 as it now reads, a national bank is authorized to charge interest at the rate allowed by the laws of the State, territory or district where the bank is located and when no rate is so fixed by State law a national bank may charge a rate not exceeding 7 per centum. Section 5 of the bill S. 4723 would amend these provisions so as to authorize a national bank to charge the rate allowed by State law or a rate one per centum in excess of the discount rate of the Federal reserve bank in the Federal reserve district where the national bank is located, whichever may be greater, and where no rate is fixed by State law a national bank would be authorized to charge a rate not exceeding 7 per centum or one per centum in excess of the discount rate of the Federal reserve bank in the Federal reserve district where the national bank is located, whichever may be greater.

(6) Section 5200 of the Revised Statutes limits loans by a national bank to any one person to 10 per cent of the capital and surplus of the national bank. This section, however, contains a number of exceptions to the 10 per cent limitation. Section 6 of the bill S. 4723 would amend Section 5200 by adding a provision that no obligation of a broker or of any finance company, securities company, investment trust or other similar institution, or of any affiliate, shall be entitled to the benefits of any of the exceptions contained in Section 5200, but all such obligations shall be subject to the 10 per cent limitation. This section would further amend Section 5200 so as to provide that the total obligations of an affiliate shall not exceed the 10 per cent limitation or the amount of the capital stock of the affiliate actually paid in and unimpaired, whichever may be the smaller. It is further provided that an affiliate shall include a finance company, securities company, investment trust, or any other corporation the control of which is held directly or indirectly through stock ownership, or in any other manner by a national bank or by the shareholders thereof who own or control a majority of the stock of the national bank.

(7) Section 7 of the bill S. 4723 would amend Section 5211 of the Revised Statutes by adding a new paragraph which would require each affiliate of a national bank to furnish to the Comptroller of the Currency not less than three reports each year, setting out in detail the condition of the affiliate. The president of the national bank is required to satisfy himself as to the correctness of each such report transmitted to the Comptroller. This amendment contains detailed requirements with reference to the filing of such reports and the form of such reports and authorizes the Comptroller of the Currency to call for special reports whenever in his judgment it is necessary. An affiliate which fails to furnish the

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reports required of it shall be subject to a penalty of $100 for each day during which such failure continues.

(8) Section 8 of the bill S. 4723 would amend the first paragraph of Section 7 of the Federal Reserve Act so as to provide that after the payment of a 6 per cent dividend to member banks, one-fourth of the remainder of the net earnings of a Federal reserve bank shall be paid to the United States as a franchise tax, one-fourth to the surplus fund of the Federal reserve bank (but after the surplus equals 100 per cent of the subscribed capital the remainder goes to the United States as a franchise tax) and the remaining 50 per cent of the net earnings of a Federal reserve bank shall be paid to the member bank stockholders.

(9) Section 9 of the bill S. 4723 would amend Section 9 of the Federal Reserve Act by adding a new paragraph which would require each affiliate of a member State bank to furnish to the Federal Reserve Board not less than three reports each year, containing detailed information with reference to the condition of the affiliate. This amendment contains detailed requirements with reference to the filing of such reports and the form thereof and requires the president of the member bank to satisfy himself as to the correctness of each such report transmitted to the Federal Reserve Board. Any affiliate which fails to make any report required shall be subject to a penalty of $100 for each day during which such failure continues. This section of the bill contains substantially the same definition of an affiliate as was contained in Section 6 of the bill as above noted.

(10) Section 10(a) of the bill S. 4723 would amend the first paragraph of Section 10 of the Federal Reserve Act so as to eliminate the Secretary of the Treasury from membership on the Federal Reserve Board and to provide for a membership of only seven members including six members appointed by the President of the United States and the Comptroller of the Currency as an ex officio member. Section 10(b) of this bill would amend the second paragraph of Section 10 of the Federal Reserve Act so as to eliminate the Secretary of the Treasury from the provision which now renders the Secretary or Comptroller of the Currency ineligible during the time he is in office and for two years thereafter to hold any office, position or employment in any member bank. Section 10(c) would amend the fourth paragraph of Section 10 of the Federal Reserve Act to eliminate the Secretary of the Treasury as an ex officio chairman of the Federal Reserve Board and to provide that the oaths of office of members of the Federal Reserve Board shall be filed with the Secretary of the Federal Reserve Board rather than be certified to the Secretary of the Treasury as is now required.

(11) Section 11 of the bill S. 4723 would amend the seventh paragraph of Section 13 of the Federal Reserve Act so as to provide that during the life or continuance of advances to a member bank on the 15-day promissory collateral notes of the member bank such member bank shall not increase or enlarge the total loans already made by it either upon collateral security to any borrower or to the members of any organized stock exchange, investment

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house, or dealer in securities, upon any obligation, note, or bill secured or unsecured, except for the purpose of purchasing and carrying obligations of the United States.

(12) Section 12, which is the last section of the bill S. 4723, would amend Section 24 of the Federal Reserve Act so as to require a national bank to invest its time and savings deposits in the amount of real estate loans authorized under the provisions of Section 24 of the Federal Reserve Act or in property and securities of the kinds and amounts required by law of savings banks in the State where the national bank is situated. In case no such State savings bank law exists the savings and time deposits of a national bank shall be invested in property and securities specified by the Comptroller of the Currency. The reserve of 3% of time deposits required by the Federal Reserve Act shall count as a corresponding part of such investments. This section of the bill further provides that in case a national bank becomes insolvent, all the property acquired under this section shall be applied by the receiver thereof in the first place ratably and proportionately to the payment in full of the time and savings deposits of the national bank.

A copy of the bill S. 4723 is attached hereto for the Board's information.

Respectfully,

(S) B. M. Wingfield
Assistant Counsel.

Copy of bill attached.

BMW-sad

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See BH

FEDERAL RESERVE BOARD

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

X-6641

June 25, 1930.

SUBJECT: Effect of Consolidation on Clayton Act Permits.

Dear Sir:

In a ruling published on page 28 of the Federal Reserve Bulletin for January, 1925, the Federal Reserve Board ruled with reference to consolidations of banks covered by Clayton Act permits as follows:

> "The Board holds that in any case where two or more banks consolidate under a statute, either Federal or State, which vests in the consolidated institution all the rights, franchises, or interests of the consolidating banks, the consolidated institution would, as a matter of law, have the right to the service of any director of any of the consolidating banks; in other words, that a director who is serving a bank by the permission of the Federal Reserve Board may, after his bank consolidates with another, continue to serve the consolidated institution if the statute under which the merger was effected gives to this institution all the rights, franchises, and interests of the constituent banks. The Board rules, therefore, that in such cases it will not require the director affected to make application to the Board for a new permit, but the director will be permitted, without any formality, to continue to serve the consolidated institution together with the other banks which he was serving before the consolidation took place."

The Board's ruling further provided, however, that in every such case the Federal Reserve Agent should consider and report to the Board with recommendation whether or not the situation existing as a result of the consolidation of the banks involved has so affected the question of competition between the banks upon which the director was serving as to make advisable the revocation of the permit formerly issued. When this ruling was issued the question whether the Federal Reserve Board should issue a permit

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covering interlocking bank directorates under the provisions of the Clayton Act depended primarily on the question whether the banks involved were in substantial competition. Since this ruling was published, however, the Clayton Act has been amended so as to provide that such a permit may be issued if in the Board's judgment it is not incompatible with the public interest and may be revoked whenever the public interest requires its revocation. In view of this amendment, a Federal reserve agent when reporting to the Board whether or not a permit should be revoked on account of a consolidation, should consider, in addition to the question whether competition between the banks involved has been affected by the consolidation, whether in view of all the circumstances involved, the public interest requires the revocation of a permit. In this connection, particular consideration should be given to whether the consolidation will result in any restriction of credit or stifling of competition between the banks involved.

By Order of the Federal Reserve Board.

Very truly yours,

E. M. McClelland,
Assistant Secretary.

TO ALL FEDERAL RESERVE AGENTS.

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Federal Reserve Bank of St. Louis

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Serah Bd

Date June 25, 1930.

To Mr. Hamlin.

Subject: Provisions of Sections 6 and 11 of Bill S.4723 introduced by Sen. Glass.

From Mr. Wingfield- Asst. Counsel.

2—8495

In connection with paragraph (6) of my analysis (X-6638) of Senator Carter Glass's bill S. 4723, you have inquired whether any of the exceptions contained in Section 5200 of the Revised Statutes are <u>now</u> applicable to obligations of a broker, finance company, securities company, investment trust, or an affiliate of a national bank.

The eighth exception of Section 5200 permits a national bank to lend to any one up to 25 per cent of its capital and surplus on notes secured by bonds or notes of the United States. This exception would, of course, be applicable to notes of the corporations above referred to when secured by obligations of the United States and would permit such corporations to borrow from a national bank an amount equal to 25 per cent of the capital and surplus of the national bank. A broker or other described corporation also might possibly acquire in some instances certain classes of paper defined in several of the other seven exceptions to Section 5200. If the broker or other described corporation then discounted this paper with a national bank these exceptions would be applicable to its obligation to the national bank.

You also requested that I explain in more detail the effect of Section 11 of the bill S.4723.

If Section 13 of the Federal Reserve Act should be amended as is proposed by the provision contained in Section 11 of the bill S. 4723, a member bank which had obtained an advance from a Federal reserve bank on its own 15-day promissory note could not, while such advance continued in existence, make any loan to a member of a stock exchange, an investment house, or a dealer in securities regardless of whether such loan was secured or unsecured. In addition, the member bank, while the advance on its 15-day promissory note continued in existence, could not make a loan to <u>any</u> borrower, <u>if such loan is secured by collateral.</u> It may be noted that these restrictions do not apply when the loan is for the purpose of purchasing and carrying obligations of the United States. The result of this proposed amendment would be to prevent a member bank from doing <u>any</u> collateral loan business (other than loans already made or made for the purpose of purchasing and carrying obligations of the United States) while it holds an advance from the Federal reserve bank on its 15-day collateral note. As a practical matter, this amendment, if enacted, would probably cause most member banks to cease to obtain direct advances from their Federal reserve banks on their 15-day promissory notes.

Respectfully,

B.M.Wingfield

B.M.Wingfield
Assistant Counsel

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Federal Reserve Bank of St. Louis

Sec Bd

June 26,1930

Federal Reserve Board

Mr. Wyatt-General Counsel.

Senator Glass's resolution re State Department's alleged interference with Federal Reserve System.

For the information of the Board there is quoted below the text of a resolution (S. Res. 305) introduced in the Senate yesterday by Senator Glass, which was read, ordered to be printed, and laid on the table, in accordance with his request:

"Whereas the Senate by Resolution 293, passed June 16, 1930, requested the Secretary of State to inform the Senate (1) 'upon what authorization of law, constitutional or statutory, expressed or implied, does the State Department base its right either to approve or disapprove investment securities offered for sale in the money markets of the United States by foreign governments, corporations, or individuals,' and (2) 'by what sanction of law, constitutional or statutory, does the State Department assume the right to direct action of the Federal Reserve Board or banks with respect to their lawful powers concerning the business of banking in foreign countries or the investments of these banks in foreign securities offered in the money markets of the United States'; and

"Whereas the Secretary of State, as of June 20, 1930, responded to clause 1 of said Senate resolution by referring the Senate to Article II of the Constitution of the United States and to section 202 of the Revised Statutes as authority for the exercise of the functions referred to in clause 1 of said Senate resolution; and

"Whereas the Secretary of State, in response to clause 2 of said Senate resolution, asserts that 'the Department of State has not assumed the right to direct the action of the Federal Reserve Board or banks with respect to their lawful powers,' as mentioned in Senate Resolution 293, and in this connection refers the Senate to an official statement of the Secretary of State issued May 16, 1929; and

"Whereas a careful inspection of Article II of the Constitution of the United States and of section 202 of the Revised Statutes discloses no single sentence which, explicitly or implicitly, authorizes the action taken by the Department of State with respect to the flotation of foreign investment loans on the money markets of the United States; and

"Whereas a careful examination of the statement issued by the Secretary of State on May 16, 1929, reveals the exact declaration that the department 'will not permit any officials

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"of the Federal reserve system either to themselves serve or to select American representatives as members of the proposed international bank'; Therefore be it

"Resolved, That it is the sense of the Senate that the Department of State, having no legal sanction for the action mentioned in Senate Resolution 293 with respect to investment securities offered in the money markets of the United States by foreign governments, corporations, or individuals, should desist from the dangerous practice of involving the United States Government in any responsibility of whatever nature, either by approval or disapproval for foreign investment loans floated in this country, and should refrain from assuming authority over the Federal Reserve Board and banks or officials thereof with respect to matters which, by express authority of law, are confided to them and not to the Department of State."

Respectfully,

Walter Wyatt
General Counsel.

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Federal Reserve Bank of St. Louis

Dallas

see Bk

FEDERAL RESERVE BANK
OF DALLAS

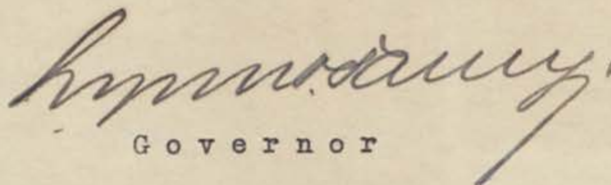
June 27, 1930.

Mr. Charles S. Hamlin,
Federal Reserve Board,
Washington, D. C.

Dear Mr. Hamlin:

As a matter of convenience I am sending you a copy of a letter which I have addressed to Governor Young regarding Bill H. R. 10211, together with copy of Mr. Harris' speech to our Stockholders on June 19, and copy of resolution passed by the Stockholders at the conclusion thereof.

Very truly yours,



Governor

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Federal Reserve Bank of St. Louis

C O P Y

FEDERAL RESERVE BANK

of Dallas

June 26, 1930.

Dear Governor Young:

I have been impressed with the fact that Bill H. R. 10211, introduced by Mr. Steagall and referred to the Banking and Currency Committee of the House of Representatives 71st Congress, Second session, on February 24, 1930, was on June 14 reported out by the Committee without amendment and with favorable recommendation for passage. No doubt you have received a copy of the bill and the report.

The purpose of this bill is to amend Section 7 of the Federal Reserve Act so as to provide for a distribution of earnings of Federal reserve banks among member banks in excess of the dividend of 6% per annum as limited by present law. In view of the fact that a number of bills of similar import have been introduced in the House - according to my information some five in number, and at least two similar bills in the Senate, none identical in their provisions, I am surprised that any one of the bills would be reported out with favorable recommendation for passage without any hearings or consultation with the Federal Reserve Board, so far as I know.

The Steagall Bill, in my judgment, gives the Federal Reserve Board a wider latitude and more discretion as to distribution of Federal reserve bank earnings in excess of the statutory 6% dividend, than any of the other pending bills. It is observed that there is nothing specific in the legislation proposed in this bill and that it does not have the effect of pressure upon the management of the System to earn profits for the purpose of a larger return to member banks upon their investment in Federal Reserve bank stock or their reserve balances. It seems to merely make the provision that such excess earnings may be distributed as, if and when that is possible under such rules and regulations as the Federal Reserve Board may prescribe. As a matter of fact an application of the provisions of the bill to the earnings experienced by the System in the past and the probabilities in the future, would result in such meager distribution as to be almost negligible.

In this connection I am enclosing a copy of an address on this subject delivered by Mr. Beverly D. Harris, Vice President of the Second National Bank, Houston, Texas, before the meeting of the Stockholders' Association of this bank on June 19. I am also sending along with this, copy of resolution which was passed by the Stockholders' meeting at the conclusion of the address by Mr. Harris. I am impressed not only with the sound views expressed by Mr. Harris but also by the conservative action of the Stockholders' meeting. This is all the more remarkable in view of the wide discussion of this subject which has led to an assumption both on the part of the member banks and the public that the Federal reserve banks are exceptionally profitable enterprises, that the franchise tax payments to the government are excessive, and too, the pressure that has been brought by the member banks on their respective Federal reserve banks, the Federal Reserve Board and Congress.

In all of these circumstances I have been deeply interested in the

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subject as well as feeling some concern over the possibility of some amendment being enacted into law that would unwisely exert pressure upon the managements of the individual Federal reserve banks to make earnings and that would result in setting up a sort of competition between the districts along this line that would bring about a result inimical to the public interest.

Very truly yours,

Governor

Mr. R. A. Young, Governor
Federal Reserve Board
Washington, D. C.

P. S. Since the above was written I am in receipt of Board's letter X-6640 of June 24, to which this may be considered as a reply.

L.P.T.

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with the recommendation, however, that same be amended to read as follows: (lines 12 to 16, inclusive):

"and the remaining 50 per centum of such net earnings shall be credited on the books of each Federal reserve bank to a 'Contingent Fund' for the benefit of the stockholders, out of which no dividends shall be paid to the stockholders exceeding 2% on the paid-in capital of the bank in any one calendar year, and then only subject to the approval of the Federal Reserve Board".

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Resolution passed by the Stockholders' Association of the Federal Reserve Bank of Dallas at its annual meeting on June 19, 1930.

RESOLVED, That the form of the Glass Bill, reading as follows, be adopted:

5 "Sec. 7. After all necessary expenses of a Federal
6 reserve bank shall have been paid or provided for, the stock-
7 holders shall be entitled to receive an annual dividend of
8 6 per centum on the paid-in capital stock, which dividend
9 shall be cumulative. After the aforesaid dividend claims
10 have been fully met the net earnings, beginning with the
1 earnings for the year ending December 31, 1929, shall be
2 distributed as follows: Twenty-five per centum of such net
3 earnings shall be paid to the United States as a franchise
4 tax; 25 per centum of such net earnings shall be paid into
5 the surplus fund of such bank; Provided, however, That no
6 such payment shall be made into such surplus fund in excess
7 of an amount sufficient to make the entire surplus fund equal
8 to the amount of the subscribed capital stock of such bank,
9 and that any part of such 25 per centum which is not needed
10 to bring such surplus fund up to 100 per centum of such
11 subscribed capital stock shall be paid to the United States
12 as additional franchise tax; and the remaining 50 per centum
13 of such net earnings shall be paid at the end of each cal-
14 endar year to the stockholders on a pro rata distribution to
15 be made in accordance with such rules and regulations as
16 may be prescribed by the Federal Reserve Board."

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Federal Reserve Bank of St. Louis

Resolution passed by the Stockholders' Association of the Federal Reserve Bank of Dallas at its annual meeting on June 19, 1930.

RESOLVED, That the earnings of the Federal Reserve Bank of Dallas should be more equitably distributed to the member banks, but caution exercised in the perfection of any plan for this purpose so as not to put the Federal reserve banks in competition with the member banks.

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Federal Reserve Bank of St. Louis

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FEDERAL RESERVE BOARD

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

X-6649

July 1, 1930.

SUBJECT: Bill to Amend Federal Reserve Act and National Bank Act.

Dear Sir:

There is enclosed herewith for your information, copy of a memorandum from the Board's Assistant Counsel, summarizing the provisions of S-4723, a bill introduced by Senator Glass to amend various provisions of the National Bank Act and the Federal Reserve Act. As the supply of the printed bill is still limited, only one copy is attached hereto.

Very truly yours,

E. M. McClelland,
Assistant Secretary.

Enclosures.

TO ALL GOVERNORS AND AGENTS.

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Federal Reserve Bank of St. Louis

COPY

FEDERAL RESERVE
BOARD

OFFICE CORRESPONDENCE

Date June 23, 1930

To Federal Reserve Board

From Mr. Wingfield-Assistant Counsel.

Subject: Summary of Provisions of the Bill S-4723, introduced by Senator Glass.

On June 17, 1930, Senator Carter Glass introduced a bill, S.4723, to amend the provisions of the National Bank Act and the Federal Reserve Act in a number of respects. When he introduced this bill Senator Glass stated on the floor of the Senate that it is merely a tentative measure to which he hopes to direct the inquiry into the banking system authorized by the Senate. For the information of the Board, however, I will briefly summarize below the most important changes which Senator Glass' bill would make in the present law.

(1) The first paragraph of the bill, S. 4723, states that the title of the bill is the "Banking Act of 1930."

(2) Section 2 of the bill, S. 4723, would amend the 7th paragraph of Section 5136 of the Revised Statutes which has to do with the powers which a national bank may exercise. In addition to the specific powers of national banks now contained in the law, this bill provides that national banks may generally engage in all forms of business that commercial banks of the State in which the national bank is situated are permitted to transact by the laws of the State, except in so far as national banks are expressly forbidden to undertake such business by the National Bank Act, the Federal Reserve Act, or other laws of the United States.

Under the present provisions of Section 5136 of the Revised Statutes, national banks are authorized to buy and sell investment securities. Section 2 of the bill, S. 4723, would also amend Section 5136 so as to limit this power of national banks to only the buying and selling of investment securities solely upon order and for account of customers, and in no case for its own account, except as specified in Section 24 of the Federal Reserve Act.

(3) Section 5144 of the Revised Statutes now provides that each shareholder of a national bank shall be entitled to one vote on each share of stock held by him. Section 3 of the bill S. 4723 would amend Section 5144 so as to restrict the right of a shareholder to vote only shares of stock actually owned by him as a result of bona fide purchase, gift or inheritance, and the shareholder who becomes such through nominal transfer, or ownership on behalf of another, may not vote stock so acquired. This section of the bill would further amend Section 5144 so as to provide that no corporation, association or partnership and no officer, employee or director of any corporation, association or partnership which is the owner of stock in any national bank shall vote either the stock owned by him individually or the stock owned by the corporation. The present provision of Section 5144 authorizing shareholders to vote by proxy is retained in the bill S. 4723.

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(4) Section 4 of the bill S. 4723, would amend paragraph (c) of Section 5155 of the Revised Statutes so as to authorize a national bank, after the date of the approval of this bill, to establish and operate new branches within the limits of the State in which the national bank is situated rather than merely in the city, town or village in which such national bank is located. The proposed amendment retains the present provision of the law that new branches may only be established and operated if such establishment and operation are permitted to State banks by the law of the State in which the national bank is located.

(5) Under the provisions of Section 5197 as it now reads, a national bank is authorized to charge interest at the rate allowed by the laws of the State, territory or district where the bank is located and when no rate is so fixed by State law a national bank may charge a rate not exceeding 7 per centum. Section 5 of the bill S. 4723 would amend these provisions so as to authorize a national bank to charge the rate allowed by State law or a rate one per centum in excess of the discount rate of the Federal reserve bank in the Federal reserve district where the national bank is located, whichever may be greater, and where no rate is fixed by State law a national bank would be authorized to charge a rate not exceeding 7 per centum or one per centum in excess of the discount rate of the Federal reserve bank in the Federal reserve district where the national bank is located, whichever may be greater.

(6) Section 5200 of the Revised Statutes limits loans by a national bank to any one person to 10 per cent of the capital and surplus of the national bank. This section, however, contains a number of exceptions to the 10 per cent limitation. Section 6 of the bill S. 4723 would amend Section 5200 by adding a provision that no obligation of a broker or of any finance company, securities company, investment trust or other similar institution, or of any affiliate, shall be entitled to the benefits of any of the exceptions contained in Section 5200, but all such obligations shall be subject to the 10 per cent limitation. This section would further amend Section 5200 so as to provide that the total obligations of an affiliate shall not exceed the 10 per cent limitation or the amount of the capital stock of the affiliate actually paid in and unimpaired, whichever may be the smaller. It is further provided that an affiliate shall include a finance company, securities company, investment trust, or any other corporation the control of which is held directly or indirectly through stock ownership, or in any other manner by a national bank or by the shareholders thereof who own or control a majority of the stock of the national bank.

(7) Section 7 of the bill S. 4723 would amend Section 5211 of the Revised Statutes by adding a new paragraph which would require each affiliate of a national bank to furnish to the Comptroller of the Currency not less than three reports each year, setting out in detail the condition of the affiliate. The president of the national bank is required to satisfy himself as to the correctness of each such report transmitted to the Comptroller. This amendment contains detailed requirements with reference to the filing of such reports and the form of such reports and authorizes the Comptroller of the Currency to call for special reports whenever in his judgment it is necessary. An affiliate which fails to furnish the

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reports required of it shall be subject to a penalty of $100 for each day during which such failure continues.

(8) Section 8 of the bill S. 4723 would amend the first paragraph of Section 7 of the Federal Reserve Act so as to provide that after the payment of a 6 per cent dividend to member banks, one-fourth of the remainder of the net earnings of a Federal reserve bank shall be paid to the United States as a franchise tax, one-fourth to the surplus fund of the Federal reserve bank (but after the surplus equals 100 per cent of the subscribed capital the remainder goes to the United States as a franchise tax) and the remaining 50 per cent of the net earnings of a Federal reserve bank shall be paid to the member bank stockholders.

(9) Section 9 of the bill S. 4723 would amend Section 9 of the Federal Reserve Act by adding a new paragraph which would require each affiliate of a member State bank to furnish to the Federal Reserve Board not less than three reports each year, containing detailed information with reference to the condition of the affiliate. This amendment contains detailed requirements with reference to the filing of such reports and the form thereof and requires the president of the member bank to satisfy himself as to the correctness of each such report transmitted to the Federal Reserve Board. Any affiliate which fails to make any report required shall be subject to a penalty of $100 for each day during which such failure continues. This section of the bill contains substantially the same definition of an affiliate as was contained in Section 6 of the bill as above noted.

(10) Section 10(a) of the bill S. 4723 would amend the first paragraph of Section 10 of the Federal Reserve Act so as to eliminate the Secretary of the Treasury from membership on the Federal Reserve Board and to provide for a membership of only seven members including six members appointed by the President of the United States and the Comptroller of the Currency as an ex officio member. Section 10(b) of this bill would amend the second paragraph of Section 10 of the Federal Reserve Act so as to eliminate the Secretary of the Treasury from the provision which now renders the Secretary or Comptroller of the Currency ineligible during the time he is in office and for two years thereafter to hold any office, position or employment in any member bank. Section 10(c) would amend the fourth paragraph of Section 10 of the Federal Reserve Act to eliminate the Secretary of the Treasury as an ex officio chairman of the Federal Reserve Board and to provide that the oaths of office of members of the Federal Reserve Board shall be filed with the Secretary of the Federal Reserve Board rather than be certified to the Secretary of the Treasury as is now required.

(11) Section 11 of the bill S. 4723 would amend the seventh paragraph of Section 13 of the Federal Reserve Act so as to provide that during the life or continuance of advances to a member bank on the 15-day promissory collateral notes of the member bank such member bank shall not increase or enlarge the total loans already made by it either upon collateral security to any borrower or to the members of any organized stock exchange, investment

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house, or dealer in securities, upon any obligation, note, or bill secured or unsecured, except for the purpose of purchasing and carrying obligations of the United States.

(12) Section 12, which is the last section of the bill S. 4723, would amend Section 24 of the Federal Reserve Act so as to require a national bank to invest its time and savings deposits in the amount of real estate loans authorized under the provisions of Section 24 of the Federal Reserve Act or in property and securities of the kinds and amounts required by law of savings banks in the State where the national bank is situated. In case no such State savings bank law exists the savings and time deposits of a national bank shall be invested in property and securities specified by the Comptroller of the Currency. The reserve of 3% of time deposits required by the Federal Reserve Act shall count as a corresponding part of such investments. This section of the bill further provides that in case a national bank becomes insolvent, all the property acquired under this section shall be applied by the receiver thereof in the first place ratably and proportionately to the payment in full of the time and savings deposits of the national bank.

A copy of the bill S. 4723 is attached hereto for the Board's information.

Respectfully,

(S) B. M. Wingfield
Assistant Counsel.

Copy of bill attached.

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Federal Reserve Bank of St. Louis

Form No. 131

Office Correspondence

FEDERAL RESERVE
BOARD

Date July 10, 1930.

To Mr. Hamlin

Subject:

From Mr. Noell

There is attached hereto, for your information, copy of a letter dated July 3rd, addressed by Governor Harrison to Vice-Governor Platt, enclosing copy of a letter which was sent to the Governors of the other Federal reserve banks, giving the reasons which prompted the directors of the Federal Reserve Bank of New York to advocate further purchases of Government securities.

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Federal Reserve Bank of St. Louis

COPY

FEDERAL RESERVE BANK

OF NEW YORK

July 3, 1930.

CONFIDENTIAL.

Dear Mr. Platt:

For the information of the Federal Reserve Board, I am glad to transmit herewith a copy of a letter which we have today dispatched to the governor of each of the Federal reserve banks, briefly summarizing the reasons which have prompted our directors to advocate continued further purchases of government securities.

Very truly yours,

(Signed) George L. Harrison,
Governor.

Hon. C. S. Platt,
c/o Federal Reserve Board,
Washington, D. C.

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Federal Reserve Bank of St. Louis

SENT TO THE GOVERNOR OF EACH FEDERAL RESERVE BANK
AND MR. CURTISS, FEDERAL RESERVE BANK OF BOSTON.

CONFIDENTIAL.

July 3, 1930.

Dear Governor Norris:

We have already forwarded to you a preliminary draft of the minutes of the meeting of the executive committee of the Open Market Policy Conference held in Washington on June 23. As you will have observed from those minutes, a majority of the members of the committee voted that in their opinion it was not desirable at that time for the Federal Reserve System to undertake any further open market purchases of government securities. As a result of this action by the committee no recommendation was submitted to the conference as a whole, and while the views of the committee were reported to the Federal Reserve Board, no recommendation was put before them for consideration.

As I reported at the meeting of the committee in Washington, our directors voted on June 19, after the completion of the purchase of the $50,000,000 previously authorized by the conference, that, in their opinion, further purchases in an amount of about $25,000,000 a week should be continued. I personally favored such purchases during the discussions in Washington, and our directors, at their meeting on June 26, reiterated their views with respect to the importance of a continuance of that program. In fact, they felt so earnestly the need of continuing these purchases of government securities that they have suggested that I write to you outlining some of the reasons why the Federal Reserve Bank of New York has for so many months favored having the Federal Reserve System do everything possible and within its power to facilitate a recovery of business.

They do not feel that low discount rates or further purchases of government securities will of themselves fix commodity prices or restore business activity. There are too many other factors involved in the situation to expect that any such credit operations would, or could, alone accomplish these objectives. They do feel, however, that further purchases of government securities in circumstances such as the present, can do no possible harm and will likely accomplish some good.

As they view the situation it is about this: The United States and most other countries of the world are in the midst of a severe business depression. The decline in business activity has been great as judged by almost every available index. Unemployment is serious. Commodity prices have suffered the most severe and rapid decline since the post-war deflation of 1921, and are now about 12 per cent less than a year ago. The decline has been most pronounced in the last few weeks. Profit margins are seriously cut, purchasing power has been reduced, and many people are facing unemployment and distress.

While it is no doubt true that this depression is, in part at least, the result of causes quite unrelated to monetary conditions and clearly outside the control of the Reserve System, there are nevertheless some aspects of the situation with respect to which the Reserve System has a direct responsibility.

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Overproduction of certain basic commodities, both actual and potential, has no doubt played a large part in developing present conditions. On the other hand, it is also true that underconsumption, due to credit restrictions and high rates during 1928 and 1929, a stoppage of the flow of capital, and an interruption of economic activity in many sections of the world, has also been an important factor in the present depression. But whether the present depression is due more to overproduction or more to underconsumption, it must be agreed that there is a surplus of many basic commodities awaiting distribution, commodities which are wanted and needed in many sections of the world which have not the power to purchase them. This surplus of unsold goods may not, in many cases, be great, but unfortunately the mere existence of an unsold surplus hanging over the market is a dominant factor in the course of the price of any commodity. Anything, therefore, that can be done to stimulate economic activity and thus provide a market for that surplus, however great or however small, will be a steadying influence and a vital factor in the recovery of prices and business.

Our directors have believed, therefore, that whatever steps the Reserve System may take, whether through discount rates or open market operations, to facilitate a more active and stronger bond market through which capital funds may be made available for new enterprise or distributed to those parts of the world where purchasing power is now seriously curtailed, should be taken promptly and courageously. This is especially true, they feel, if in the conditions as they now exist there can be said to be no substantial risk incident to such a course. Stimulating an active and strong bond market will run very little danger of encouraging unnecessary borrowings by those concerns which already have surplus products or ample capacity to produce. On the other hand, such a course will make available necessary capital funds to those who now lack capital and will thus do much to revive normal economic conditions, restore purchasing power and tend to distribute our surplus goods into fields where they are so urgently needed.

During 1928 and 1929 the diversion of world credit into the speculative markets very severely restricted certain types of new financing through the bond market. Money became difficult to obtain for building operations and other new enterprises in many markets. New foreign borrowings in this market were greatly reduced and foreign buying from us is in consequence now reduced. Indeed, current figures relating to our foreign trade indicates a drop in the past four or five months of over 20 per cent as compared with last year. Even if we take into account the decline in commodity prices, the amount of goods being exported from the United States to world markets is now substantially less than last year. All the evidence indicates that we have surplus goods to sell and that there are other parts of the world that are in need of those goods. To stimulate their distribution to the points where needed becomes a matter of the most vital importance if the decline in commodity prices is to be checked and business is to be restored to normal activity.

In previous business depressions recovery has never taken place until there has been a strong bond market through which new enterprise requiring long time capital may be financed. So while there is no considerable demand from business for short time money at the present time, and short time money may be said generally to be plentiful and cheap in many sections of the country and other parts of the world, there is nevertheless a large demand for long time

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capital for new undertakings. The bond market has in the past several months been able to absorb a very considerable volume of these new issues but it is not yet vigorous nor is it able to supply all of the funds which legitimate business, both at home and abroad, so much demands.

This appears to our directors to be a situation in which the Reserve System has some responsibility. As indicated in the attached chart, whenever the Federal Reserve System embarks upon a program of purchasing government securities, the bond market has become more active and stronger. When the System buys securities, short time money becomes more plentiful and cheaper. It also becomes less profitable in comparison with long time money, and it has been demonstrated in the past that in such circumstances, through a further increase in the reserves of member banks money will be made available for the bond market or shifted to the bond market from the short time market or from other investments less profitable than bonds.

Purchases of securities which have been made thus far have aided in relieving the member banks from the pressure of indebtedness at the Reserve Banks and in a measure have provided the market with surplus funds available for use in the bond and mortgage market. But to a large extent these purchases which have been made thus far have been offset by declines in rediscounts and in the bill portfolios of the Federal reserve banks so that the total of Federal reserve credit has shown a net decline, even making allowance for gold imports. It has been our belief, therefore, that purchases of government securities should be continued to the extent necessary to keep some supply of surplus funds in the money market as a stimulus to the bond market, at least until such time as there may be some evidence of a recovery in business. This may not involve any very large amount of further purchases, but our directors feel that additional purchases at the present time are not only desirable but necessary if the System is to do its utmost for the accommodation of business and trade.

Even since the meeting of the committee on June 23 there has been a further seasonal tendency for the bill holdings of the System to diminish and some tendency for discounts to increase, though this movement was interrupted by the unusual demand for funds incident to the end of the month and holiday currency requirements which led to increases of both bills and discounts and brought the total of reserve bank credit outstanding to $1,060,000,000. The events of this period have illustrated the extreme sensitiveness of the banks at present to any indebtedness at the Reserve banks. Even the relatively small amount of additional borrowing which New York City banks found necessary was accompanied by an increase of one per cent in the call loan rate. It is thus evident that an even small amount of borrowing under present conditions is as effective a restraint as substantially a greater amount was a year ago. This is normally a season when the bill holdings of the System diminish and when the extra demand for funds for crop moving begins to be felt. It is, therefore, a time when there is need for us to be particularly alert to avoid increases of rediscounts, even apart from a more general policy of operating positively in supplying the market with surplus funds.

So while there may be no definite assurance that open market operations in government securities will of themselves promote any immediate recovery, we cannot foresee any appreciable harm that can result from such a policy and believe that the seriousness of the present depression is so great as to justify taking every possible step to facilitate improvement.

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This letter is being written largely because our directors feel that it is fair to them and to the policies which they have pursued so earnestly in the past several months, to give you some idea of the reasons which have prompted not only our rate reductions but our advocacy of further purchases of government securities. I hope you will please accept it in that spirit, and with the understanding that our directors feel keenly the need for a continued and frank exchange of views among the Federal reserve banks and the Board, especially at such a critical time as the present. I hope you will please feel free to show this letter to your officers or to your directors and to write us equally frankly what may be your own views in the hope that we may thus facilitate a common approach to our present problem. I am taking the liberty of sending a similar letter to the governor of each other Federal reserve bank and a copy to the Federal Reserve Board.

Very truly yours,

(Signed) George L. Harrison,
Governor.

Mr. George W. Norris,
Governor, Federal Reserve Bank of Philadelphia,
Philadelphia, Pa.

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Federal Reserve Bank
of New York
Reports Department
July 3, 1930.

PRICE INDEX

BILLIONS OF DOLLARS

INVESTMENTS W'KLY REP. B'KS.

BOND PRICES

F. R. SECURITIES

SERIES REVISED

BUYING

BUYING

BUYING

BUYING

BUYING

SELLING

SELLING

SELLING

SELLING

105
100
95
90
85
80
75

$ 1.000
5 .750
4 .500
3 .250
2 0

1919 1920 1921 1922 1923 1924 1925 1926 1927 1928 1929 1930

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EARNINGS AND EXPENSES OF FEDERAL RESERVE BANKS, JUNE 1930

Federal Reserve Bank	Month of June 1930									January - June 1930		
	Earnings from -					Current expenses		Current net earnings		Current net earnings	Dividends accrued	Available for reserves, surplus and franchise tax*
	Discounted bills	Purchased bills	U. S. securities	Other sources	Total	Exclusive of cost of F.R.Currency	Total	Amount	Ratio to paid-in capital			
									Per cent			
Boston	$50,565	$34,477	$112,539	$25,684	$223,265	$152,305	$154,608	$68,657	7.1	$235,176	$350,399	(a)$115,896
New York	138,197	78,070	454,664	171,511	842,442	530,780	540,722	301,720	5.6	3,102,946	2,036,373	1,738,773
Philadelphia	93,218	7,052	130,031	28,058	258,359	149,692	152,142	106,217	7.7	790,788	499,318	298,261
Cleveland	73,638	21,141	143,770	37,380	275,929	205,403	209,902	66,027	5.1	718,259	475,716	191,808
Richmond	64,967	14,133	37,550	13,559	130,209	118,680	119,348	10,861	2.3	91,514	179,197	(a)112,216
Atlanta	102,523	23,683	25,846	19,640	171,692	105,839	106,772	64,920	14.7	417,956	162,537	253,593
Chicago	59,902	33,543	212,241	64,233	369,919	291,634	323,809	46,110	2.8	645,996	606,806	10,758
St. Louis	60,040	12,282	64,749	10,798	147,869	105,496	106,212	41,657	9.6	279,456	158,845	118,204
Minneapolis	13,302	14,732	70,118	6,264	104,416	78,509	78,924	25,492	10.1	141,253	92,623	56,086
Kansas City	48,166	10,972	52,429	29,609	141,176	144,744	145,344	(a)4,168	-	(a)84,908	129,708	(a)216,342
Dallas	34,594	8,191	75,355	8,219	126,359	106,962	108,066	18,293	5.1	174,216	131,903	24,130
[illegible] Francisco	35,262	42,236	98,876	20,365	196,739	190,941	197,527	(a)788	-	56,280	341,552	(a)393,873
TOTAL												
June 1930	774,374	300,512	1,478,168	435,320	2,988,374	2,180,985	2,243,376	744,998	5.3			
May 1930	798,589	456,189	1,499,567	125,913	2,880,258	2,188,253	2,610,570	269,688	1.8			
June 1929	4,005,777	448,306	598,237	428,294	5,480,614	2,239,670	2,637,482	2,843,132	21.9			
Jan.-June 1930	6,729,131	4,241,485	8,913,207	1,260,046	21,143,869	13,215,123	14,574,937	6,568,932	7.7	6,568,932	5,164,977	1,853,286
1929	23,179,159	6,196,911	3,637,205	1,269,046	34,282,321	13,226,365	15,297,034	18,985,287	25.0	18,985,287	4,601,393	13,761,594

(a) Deficit.

*After adjustment for current profit and loss entries, purchases of furniture and equipment, etc.

FEDERAL RESERVE BOARD
DIVISION OF BANK OPERATIONS
JULY 11, 1930

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Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date July 14, 1930

To Mr. Hamlin

Subject: First signs of recession of business in 1929

From Mr. Smead

2—8495

This will acknowledge receipt of your letter of July 11 asking for a report showing when the first signs arose of a recession of business in 1929 and any references to it by the Board.

One of the principal indexes which might be expected to reflect the first signs of a business recession is that of industrial production. This index was increasing month by month last year until June when it reached 127 (adjusted for seasonal variation). From that point on it declined each month until December when it stood at 99. The first public reference to this decline by the Board was, I believe, in the National Summary of Business Conditions issued on or about September 1, when the production figures for July became available. The decrease in industrial production, however, was not marked in July though there was an abrupt turn in the index number, which had been on the increase for several months. The National Summary of Business Conditions issued about October 1 also called attention to a somewhat further reduction in industrial production.

Activity in the building industry, another business indicator, was commented on as follows in the monthly review published in the May 1929 Bulletin, page 313: "Activity in the building industry has been declining continuously since November of 1928, and in the first quarter of 1929 the value of building contracts awarded was more than 15 per cent lower than in the first quarter of 1928." In April, however, there was a sharp increase in the volume of building contracts awarded, the index number (adjusted) for this month reaching 135 compared with 104 in March. This was followed by declines to 130 in May and 122 in June, but in the month of July the index number reached a peak of 156. From that time on the decline in contracts awarded was very marked, the index for August being 107 and for December 85.

Factory employment and payrolls held up much better, no appreciable decline in either of these being shown until November. Freight car loadings began to decline in October, but the figures for this month were not available, of course, until the month following. Wholesale prices also began to decline in October.

The monthly index of prices of 90 common stocks reached a peak of 253.5 on September 7 and then declined to 239.5 on September 30 and to 224.5 on October 22, from which point it declined every day except one until October 28 when the first substantial break occurred. As you will note from page 350 of the June 1930 Federal Reserve Bulletin, the index for railroad and public utility stocks as well as for about half of the principal groups of industrial issues reached their peaks in September.

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Federal Reserve Bank of St. Louis

A number of the industrial groups, however, had begun to decline substantially from peaks reached earlier, for example, automobiles, textiles, and copper and brass.

That there appeared to be little, if any, evidence of over-expansion by June first, may be noted from the following extract quoted from the review appearing in the June 1929 Federal Reserve Bulletin, beginning at the bottom of page 361.

"High money rates, which thus had a restraining effect on the growth of bank credit, have not, however, been reflected in a general slowing down of business activity. Industrial production was larger in volume during the first quarter of 1929 than in any previous three-month period, and factory pay rolls were also at a high level in the spring of this year. There is no evidence, however, of overexpansion, except possibly in a few industries. The absence of overexpansion during a period of record activity may be ascribed in part to the restraining influence of high money rates. The principal line of activity in which there has been a recession due in part to the influence of high money rates has been the building industry. Dear money has affected the construction industry chiefly through its unfavorable influence on the bond market, which has been inactive for a number of months."

The National Summary of Business Conditions appearing in the July and August Bulletins stated that production continued at a high rate in May and June while the September Summary, as indicated above, called attention to the downward turn in July of the production index.

While it was clear, therefore, from the statistics which became available about the first of September that business had begun to drop off somewhat in July, the recession was not sufficiently marked until after the collapse in the security prices in October and November to indicate that the country was about to face a sharp recession in business.

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Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date July 17, 1930

To Mr. Hamlin

From Mr. Smead

Subject: Effect of payment of Gold Certificates by Federal reserve banks instead of Federal reserve notes

I have your letter of July 9 with reference to an article on gold inflation by Mr. C. R. Noyes in the June number of the American Economic Review.

As stated in your letter, Mr. Noyes seems to think that the reasons prompting the payment of gold certificates into circulation by the Federal reserve banks were (1) that the gold would not be available for primary expansion of bank credit, (2) that it would not appear as an addition to Federal reserve bank reserves and therefore would not be available for secondary expansion of bank credit, and (3) that since no credit would be built up on such gold it would constitute a sort of tertiary reserve which could be drawn on later for gold exports without disturbing our credit structure.

In the summer of 1922 the amount of gold certificates in circulation was down to around $172,000,000, whereas prior to the war it had been considerably over $1,000,000,000. At the same time the gold reserve of the Federal reserve banks was over $3,000,000,000 and Undersecretary Gilbert of the Treasury felt that it should be the policy of the Treasury to increase the amount of gold certificates in circulation quite substantially. There also was some discussion on the part of Federal reserve officials as to whether it might not be a good idea to pay out say $500,000,000 of gold certificates in order to reduce somewhat the System's reserve percentage with the object of minimizing as much as practicable any inflationary tendency arising from an unusually high reserve ratio. The records show that the System decided against this policy, but gold certificates were paid into circulation at the request if not at the insistence of the Treasury Department. In this connection may be cited the Board's letters X-3353 and X-3354 of March 9, 1922, and X-3363 of March 18, 1922, to the Federal reserve banks, particularly the latter which enclosed a copy of the following press statement of the Secretary of the Treasury:

> "The Secretary of the Treasury announces that the Treasury has now resumed payments of gold certificates in ordinary course of business without demand, and that the Federal Reserve Banks throughout the country will be guided by a similar policy in making current payments for Government account. This action removes the last artificial restriction upon gold payments in this country, though gold has at all times during and since the war been freely paid out by the Treasury and the Federal Reserve Banks whenever demanded in payment of gold obligations."

I do not believe that the question as to whether gold certificates would or would not be available as the ultimate basis of an expansion of bank credit played any important part in the decision to pay them out, as everyone connected with the System at that time knew that they could be recalled promptly in case of need and would thereby become available as the basis of any further bank credit expansion that might be needed.

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In August of 1922, when the policy of paying gold certificates into circulation started, total bill and security holdings of the Federal reserve banks had come down from a high at the end of 1920 of about $3,350,000,000 to slightly over $1,000,000,000 and the reserve ratio had risen to nearly 80 per cent. It is obvious, therefore, that gold imported during 1921 and in the early part of 1922 was used to reduce the indebtedness of member banks to the Federal reserve banks, not as the basis of expansion of member bank credit. The gold that came in during the latter part of 1922 was used largely to take care of the increased credit requirements of member banks during the crop-moving and holiday periods.

During 1923 we received about $294,000,000 of net gold imports, and most of this gold went into circulation, total money in circulation in 1923 averaging about $300,000,000 higher than in 1922. In 1924 the incoming gold, which amounted to about $258,000,000, was used largely to increase member bank reserve balances. In both 1923 and 1924, therefore, the gold that came in had about the same effect on the credit situation as gold imports would have had before the System was inaugurated, i.e., the gold was used to increase money in circulation in 1923 and as an addition to legal reserves, and therefore as a basis for expansion of member bank credit in 1924.

It was during the three and one half year period from the middle of 1922 to the end of 1925 that gold certificates were paid into circulation. During this period the amount of gold certificates in circulation increased by $940,000,000 while the total amount of money in circulation increased by $640,000,000, the amount of Federal reserve notes in circulation declining by about $325,000,000. Our monetary gold stock increased from about $3,000,000,000 at the beginning of 1921 to $4,500,000,000 at the end of 1924 and following a decline in 1925 has been substantially below the 1924 level except in 1927 and since May of the current year.

Mr. Noyes says that, judging from published statements, the payment of gold certificates into circulation was done for three reasons: First, in the belief that gold so handled would not be available as a basis for primary expansion of bank credit, since gold or gold certificates in vault do not count as reserves. So far as expansion of member bank credit is concerned, the payment of gold certificates into circulation had no different effect than would the payment of an equal amount of Federal reserve notes, inasmuch as no part of the member banks' vault cash -- Federal reserve notes, gold certificates or any other cash -- can be counted as reserve. The only difference was that by paying out gold certificates the reserve ratio of the Federal Reserve System was somewhat less than it would have been if Federal reserve notes had been paid out instead. This fact was well known in 1922 as indicated by the following extract from Governor Strong's letter to the Board of March 24, 1922:

> "And finally if the object of paying out gold is to reduce reserves and thereby prevent inflation, the object again cannot be accomplished by that method because we will suffer all the inflation which new imports of gold are capable of producing, whether the gold is in our hands or not, and the only present power which the reserve banks can exercise to prevent that inflation would be to let all of their investments run off and by forcing repayment of discounts."

Mr. Noyes says, second, that gold was paid out in order that it would not appear as an addition to the Federal reserve bank reserves and would, therefore, not be avail-

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able for secondary expansion of bank credit. As stated above, the System did not pay out gold in order not to have it appear as an addition to Federal reserve bank reserves. The System as a matter of fact was opposed to paying out any large amount of gold but did so at the strong request of the Secretary of the Treasury.

Third, he states that since no credit would be built on such gold it would constitute a sort of tertiary reserve which could be drawn on later for gold exports without disturbing our credit structure. It, of course, was well understood by both the System and the Treasury that gold paid out could be promptly recalled by substituting Federal reserve notes therefor, any time the gold was needed for export, without disturbing our credit structure. The important fact that must be recognized is that when the borrowings of member banks from the reserve banks do not exceed two to four hundred millions, the indebtedness of member banks is so low that it cannot absorb any substantial amount of gold imports, and necessarily the surplus gold will support a marked expansion in member bank credit. The payment of this gold into circulation, however, in substitution of Federal reserve notes will not minimize the inflation which may result from such imports.

You are correct in the assumption that the same result would have been obtained, so far as Federal reserve credit is concerned, by paying out gold coin as by paying out gold certificates. You are also correct in your statement that by paying out gold certificates the System did not intend to sterilize gold. I do not believe, however, that your statement that we intended merely to protect our own gold reserves against demands for cash is quite right. Gold was paid into circulation as a result of Treasury and not Federal reserve policy, and I think that the payment of gold certificates into circulation instead of Federal reserve notes merely had the effect of reducing the System's reserve ratio somewhat below what it would have been had Federal reserve notes been paid out, i.e., it did not have any material effect upon the expansion of member and nonmember bank credit which took place during 1921-1929, the period covered by Mr. Noyes.

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Federal Reserve Bank of St. Louis

Sec Bd

July 9, 1930

CONFIDENTIAL

Mr. George L. Harrison, Governor,
Federal Reserve Bank,
New York, N. Y.

Dear Governor Harrison:

I had expected to see you in New York on Thursday and to have had the opportunity of discussing with you in person the general policy outlined in your letter of July 3, but owing to the unexpected call which Mr. Paddock our Deputy Governor, has received which will necessitate his leaving for the West at once owing to serious illness in his family, I find it will be impossible for me to leave home.

I have read with the greatest care and interest the arguments which you set forth in your letter concerning the attitude of the directors of the New York bank and the reasons for the policies which they have pursued during the past several months. It is needless for me to say that I am thoroughly in sympathy with the aims and purposes of those policies, but, on the other hand, I am not yet convinced that the increased purchases of Government securities by the system will bring about the desired ends, and may not only frustrate those ends but may do actual harm.

In your letter you state that you are asking for a frank expression of views from each Federal Reserve Bank, and I feel that what I shall say not only will voice my own views but those of the other members of the Board of this bank. In your letter you enclosed a chart showing the sequence of bond prices from 1921 to 1927 in relation to the holding of securities of the Federal Reserve System. During that period there was a very large and continuous increase in deposits by the banks in the country, and in the case of the member banks largely through the increase in time or savings deposits which I am led to believe did not represent strict savings deposits. During that period there was little, if any, increase in commercial borrowings, new financing and transportation enabling commercial houses to run on small inventories and to finance themselves without the aid of commercial banks. This brought about an accumulation of funds in the hands of these banks that were invested either in collateral loans or in bonds and stocks. In other words, a large proportion of the long term bonds and notes that were issued during that period were either carried on collateral loans or went into the portfolios of commercial banks and not into the hands of the ultimate investor. Through most of that period there was also a large increase in the gold stock in the country, or at least until the summer of 1927, and I am led to believe that these factors had quite as much influence on the bond market as the Federal reserve securities shown on your chart.

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As I look back on that period, the average investor turned stock-minded, investing either all or a large proportion of his actual savings in stock equities instead of bonds and was not attracted by foreign bonds. In 1928 and 1929 we had, if I may use the term, an over-production of bonds, both domestic and foreign, and this situation was aggravated by the large increased issue of common stocks. The bond market, which had been supported up to that time largely by the commercial banks, was affected by the fluctuating and somewhat downward trend of the total deposits of banks, that latter, no doubt, affected by the export of gold during that period, and also affedted by the ordinary investor's inability to relieve the situation because of the large issuance of common stocks in companies in which he was already interested or to which he has been accustomed to turn. This over-production of capital issues in 1928 and 1929, both in bonds and in stocks, not only affected the stock market but also the bond market, so that even at the present time a large majority of banks, at least in this district, will show considerable depreciation in their bond accounts.

Since the crash in the stock market of last fall, there has been an accumulation of investment money in the hands of the commercial banks, and it has been our thought that in reducing the discount rate of this bank it would encourage the member banks to reduce the rate of interest allowed on such balances (and such has been the case); that this reduction would bring pressure on the investor to withdraw his balance and invest his funds.

We are in accord with the opinion that the desired aim of the reserve bank policy is to help business and that business probably might be helped by a better bond market, especially in connection with foreign issues, but we do not want to see the bond market largely dependent on the purchases of the commercial banks. In fact, our commercial banks would appear to have a sufficient amount of their assets tied up in bonds at the present time, especially so if their deposits are going to decline through the withdrawals of this investment money, so the real problem is to get this volume of money awaiting investments into the bond market and not into the stock market.

During the past week I have made a point of interviewing the partners of several of our prominent banking houses and they have confirmed my views that the investors are still stock-minded, and that the only thing that would change the investor's point of view is a continued experience of finding stocks unattractive through a falling stock market, or the appreciation that even at present prices from the point of yield stocks are not attractive.

The release of credit through purchases by the Federal reserve banks of Government securities goes largely to member banks, and they in turn unless they buy bonds will probably take that money and loan it in the stock market, and this increase of credit would tend to aid the stock speculator thereby increasing stock market prices, and the psychological effect on the investor would be to invest his money in stocks. The buying of Governments by reserve banks also weakens to some extent the ability of the reserve banks to aid member banks, if an unusual situation develops. I should like to see the volume of credit kept as near statu quo as possible, and therefore, of course, I would favor the purchase of Governments to offset any export of gold which

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might affect the volume of credit in the domestic market.

I think it is up to the banking houses to create the bond market with the assistance of the commercial banks in encouraging investment in bonds among their customers and carrying new issues on collateral loans pending distribution, and for the reserve banks to simply keep in a position to aid the member banks in that policy or in adjusting their reserves. There is a strong feeling, I find, among the directing powers of our large city banks against the operations of the reserve banks in connection with the purchase and sale of Government securities, and I think that same feeling exists not only in Boston but in the other large centers. Our directors, more especially the Class B directors, have been consistent in their feeling that the reduction of discount rate, and a continuance of a low discount rate, would probably help business, and do little or no harm, but on the other hand, they feel that the release of additional credit with the present ease of money in the outside market, should be handled by the member banks. Whether they have been influenced by this general opinion which exists among the officials of the large city banks, I cannot say.

When I compare the yields of certain of the socalled investment stocks with the yields on bonds, I cannot help but reach the conclusion that stock prices are still inflated, and as I look back over the Dow, Jones Index and see that stock prices were considerably higher than they were in 1928, in which year the prices were considerably higher than they had been in the previous decade, and with the general outlook of future business, I feel that my conclusions may in most cases be justified. It seems to me that during the period covered by your chart - a period covering steadily increasing deposits, and a period which I look back on as one when many banking houses had a demand for bonds which they had difficulty in meeting - many bonds doubtless were put out at that time of a character and at prices that would not be justified today. New issues that have come out recently and that have been put out at satisfactory rates have evidently sold readily. I think that is the case of the last Pennsylvania issue, with the telephone issues, and certain others. On the other hand, I am very much disappointed at the reaction of the so-called Reparation bonds. These were placed apparently unusually well, in fact, I had supposed that the entire issue had been placed on investors' orders, and I think I am right in saying that some of the banking houses did not get their full allotment, and yet, as soon as the syndicate was dissolved these bonds sagged back to one or two points under the issuing price, - a fact that I can not understand, and I feel that that reaction has affected adversely the bond market, although I am led to believe that since the first of July the general bond market has been improving, and without any additional assistance from the Federal Reserve System.

It is my impression that there is still hanging over the market quite a volume of undigested bonds, bonds which may have been issued on terms unsatisfactory to the general investor, and until these are cleaned up, and a rather intensive effort is made to change the attitude of the investor from stocks to

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bonds, nothing that the Federal Reserve System can do through the purchase of Governments will be helpful, and, as I said before, may be harmful and delay just the readjustment which we believe desirable. I am not so sure but what many of the members of the bond houses themselves are leaning toward stocks rather than bonds, for I know of several investment trusts or blind pools in common stocks that are either handled by investment houses or by certain representatives of those houses. I do not believe that any of us can quite estimate the enormous amount of investment funds that have gone into investment trusts or been handled by investment managers or in these so called blind pools. A large majority of that money has gone into stocks rather than bonds, and I do not know how that feature of investment business can be changed, or whether it is desirable to have it changed, but I do believe that it is a factor in our general credit situation which should be more carefully considered by our banking houses, and efforts made to issue a class of security which would be attractive to either that class of investment money or to the average investor. This, of course, would mean fewer bonds and more stocks, or bonds issued in some way to compete with the attractiveness of stocks.

I trust that you will pardon the length of this letter, but I have been led to give my views rather fully, as I agree with you that the present situation is a very critical one, and one which we should all study and try to solve with an open mind.

I am

Very sincerely yours,

S/ FREDERIC H. CURTISS
Chairman.

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