

The Papers of Charles Hamlin (mss24661)

366_05_001-	Hamlin, Charles S., Scrap Book – Volume 231, FRBoard Members
-------------	--------------------------------------------------------------

205.001 - Hamlin Charles S
Scrap Book - Volume 231
FRBoard Members

Box 366 Folder 5

TRANSFER
CONFIDENTIAL (F.R.)

RETURN TO
FILES SECTION
DO NOT REMOVE ANY
PAPERS FROM THIS FILE

CONFIDENTIAL (F.R.)

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 6, 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 231 of Mr. Hamlin's scrap book and placed in the Board's files:

VOLUME 231

Pages 2 & 3

Letter from President Hoover to Governor Meyer re results of a survey conducted by the banking and industrial commission and reply thereto.

Page 4

Letter to Mr. Hamlin from Senator Glass re Emergency Relief Bill.

Page 5

Letter to all Governors and F.R. Agents re preliminary classification of loans and investments of member banks as of June 30, 1932.

Page 15

Proposed letter to Chairman Case re reduction of salaries of employees in bank--from Chester Morrill.

Page 19

(X-7215-a) Discounts for Individuals, Partnerships and Corporations.

Page 23

(X-7218) Tax on Checks and Other Taxes Imposed by the Rev. Act. of 1932.

Page 47

(X-7224) Loans to Veterans on Adjusted Service Certificates.

Page 87

Memo to Mr. Hamlin from Mr. McClelland re Comptroller of Currency's inquiries with regard to national bank note circulation.

Page 136

Earnings & Expenses of F.R. Banks, August 1932.

Page 143

Effect of depreciation of sterling exchange on British prices.
Memo from Mr. Gardner to Governor Meyer.

THE WHITE HOUSE
Washington

July 23, 1932.

Honorable Eugene Meyer,
Federal Reserve Board,
Washington, D. C.

My dear Governor Meyer:

I am in receipt of your letter of July 22nd enclosing the results of a survey conducted by the banking and industrial commission of the 4th Federal Reserve District. This statement is a complete indictment of the banking situation because its conclusions are that loans have been refused through the district and probably others of the type subject to rediscount by the Federal Reserve System, and that the result of these restrictions has been to increase unemployment and to stifle business activity in the country.

The conviction I get from this document is that the Federal Reserve System should at once instruct the Federal reserve banks to undertake direct rediscount under authorities provided in the Relief Bill. We cannot stand by and see the American people suffering as they are today and to the extent that may imperil the very stability of the Government because of the unwillingness of the banks to take advantage of the facilities provided by the Government. I deem it necessary to call the attention of the Board to the fact that an emergency of the character denominated in Section 210 of the "Emergency Relief and Construction Act of 1932" has now arisen.

I should be glad if you would bring this directly to the attention of the Board.

Yours faithfully,

(Signed) Herbert Hoover.

VOLUME 231
PAGE 2

Lucas B.

July 26, 1932.

The President,

The White House.

Dear Mr. President:

I have your letter of July 23 and have brought it to the attention of the other members of the Federal Reserve Board.

You will recall that the exact scope of the amendment to section 13 of the Federal Reserve Act which was contained in the emergency relief and construction bill was not determined until the conference report was submitted, that the bill itself was not passed by Congress until July 16, and that it did not become law until last Thursday, July 21. Nevertheless, while the amendment was still pending and although Congress made material changes in it afterward, its provisions were discussed with the Governors of the Federal Reserve Banks during the meeting of the Open Market Policy Conference with the Federal Reserve Board at Washington on Thursday and Friday, July 14 and 15. A tentative draft of a circular governing discounts under this amendment was sent to the Chairmen and Governors of all Federal Reserve Banks on July 16 (before the conference report was adopted by Congress) in order that the important questions of policy

63

and law involved might be developed and covered properly. In this connection, I may say that there were a number of difficult questions which required careful study and upon which there were differing ideas. The replies were obtained as rapidly as possible, in nearly every instance by wire, and were carefully analyzed, and the circular was revised without delay. Its contents and the views of the Federal Reserve Banks were studied by members of the Board over the week end and today its final form was prescribed and approved by the Board. It was wired at once to all Federal Reserve Banks, with the advice that it will be given to the press on Saturday, for release on Monday, August 1, when it will become effective. It will be held confidential in the meantime. In this circular, the Board, recognizing the unusual and exigent circumstances which now exist, authorizes all Federal Reserve Banks, for a period of six months beginning August 1, to discount paper for individuals, partnerships and corporations as contemplated by the amendment.

It may be added that there were no forms in existence which could be utilized for the purpose of handling applications under this new authority, but in order to expedite matters suggested forms have been drafted by the Board's staff and sent to the Federal Reserve Banks with the understanding that they may be adopted by each bank as soon as they are approved by its counsel.

As you know, this amendment to the Federal Reserve Act enlarges in a fundamental way the scope of the activities of the Federal Reserve Banks to include a type of business which they were not organized to handle. Naturally, in such circumstances, time is required for the determination of questions of law, policy and procedure, but when it is recalled that the law did not become effective until July 21 and that the Board's instructions are being issued within five days thereafter, it is apparent that the matter has been handled very expeditiously.

In addition to the other steps which the Board has taken, I may say, for your confidential information, that on July 19 a letter was sent to the Chairman of each Federal Reserve Bank stating that the Board desired that the bank, in cooperation with the Banking and Industrial Committee in its district and such other agencies as it might select, ascertain the extent to which there may be demands for loans which are not being met by other banking institutions and which properly might be granted by the Federal Reserve Bank under the provisions of the amendment, with the view of taking steps to meet the need for loans of this character.

Respectfully yours,

Governor.

P3

WESLEY L. JONES, WASH., CHAIRMAN
REED SMOOT, UTAH
FREDERICK HALE, ME.
HENRY W. KEYES, N. H.
HIRAM BINGHAM, CONN.
TASKER L. ODDIE, NEV.
GERALD P. NYE, N. DAK.
OTIS GLENN, ILL.
FREDERICK STEIWER, OREG.
WILLIAM J. HARRIS, GA.
CARTER GLASS, VA.
KENNETH MCKELLAR, TENN.
EDWIN S. BROUSSARD, LA.
JOHN E. KENDRICK, WYO.
ROYAL S. COPELAND, N. Y.
CARL HAYDEN, ARIZ.
SAM G. BRATTON, N. MEX.
CAMERON MORRISON, N. C.

KENNEDY F. REA, CLERK
JAMES H. DAVIS, ASST. CLERK

United States Senate

COMMITTEE ON APPROPRIATIONS

Lynchburg, Virginia.

July 25, 1932.

My dear Mr. Hamlin:

Thank you and Mrs. Hamlin for your kind invitation to Mrs. Glass and me to visit your home in Massachusetts. However, I am afraid, owing to Mrs. Glass' illness, we shall be unable to avail ourselves of your persistent hospitality.

I am gratified to know that the Federal Reserve Board is not disposed to regard as a dead letter the to section 13 of the act which we put in the recent relief measure. It is, in fact, the only sound and orthodox provision of the entire bill. Judiciously administered it will prove both useful and profitable to the Federal reserve system and to the business of the country.

Doubtless you have noted that I made the provision permanent. While the President, Mills and Balentine and even Eugene Meyer were having a nightmare over the provision, Senator Watson and others induced me to make it temporary. This I did with the fixed purpose to make it permanent later. Meanwhile, the various officials named appeared to recover their equilibrium and I changed the bill in conference.

I expect to be in Washington the latter part of this week and hope to see you.

Sincerely yours,

Carter Glass.
H

The Honorable C. S. Hamlin,
Federal Reserve Board,
Washington, D. C.

VOLUME 231
PAGE 4

Q 4

See 124

FEDERAL RESERVE BOARD

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

July 28, 1932.
B-831.

SUBJECT: Preliminary classification of loans
and investments of member banks as
of June 30, 1932.

Dear Sir:

There is enclosed for your information and confidential use, a copy of a memorandum and statement prepared for the Board with respect to changes in the loans and investments of member banks during the first half of 1932 and the last two years, as disclosed by the June 30 condition reports. Figures for the June 1932 call are based on the preliminary data furnished by the Federal reserve agents and will be published in the forthcoming August issue of the Federal Reserve Bulletin.

Very truly yours,

E. L. Smead, Chief,
Division of Bank Operations.

P 5

Enclosure.

July 27, 1932.
B-831a.

TO: Federal Reserve Board

SUBJECT: Loans and investments of

FROM: Mr. Smead

member banks on June 30, 1932.

CONFIDENTIAL

Attached hereto is a classification of loans and investments of all member banks on June 30, 1932, based on preliminary data furnished by the Federal reserve agents pending the completion of the Board's consolidated call report.

CHANGES DURING THE FIRST HALF OF 1932. Total loans and investments of all member banks declined \$2,645,000,000 during the first half of 1932. Loans to customers (other than banks) declined \$2,341,000,000, of which \$895,000,000 represents a reduction in security loans to non-broker customers and \$1,200,000,000 in "other" loans (largely commercial). Loans to banks decreased \$114,000,000 at banks in New York City and \$218,000,000 at all member banks. Open-market loans show a net reduction of \$155,000,000, largely as a result of a decrease of \$298,000,000 in security loans to New York brokers and an increase of \$167,000,000 in holdings of acceptances of other domestic banks. Investments in United States Government securities increased \$308,000,000, while holdings of other securities decreased \$239,000,000.

CHANGES SINCE JUNE 1931. As compared with June 1931, total loans and investments of all member banks show a net reduction of approximately \$6,000,000,000. Loans to customers (other than banks) declined \$4,028,000,000 during the year, of which about \$1,600,000,000 was in security loans to non-broker customers, \$229,000,000 in loans to brokers outside New York City, \$321,000,000 in real estate loans, and \$1,880,000,000 in "other" loans (largely commercial). Total open-market loans declined \$1,357,000,000 during the year ending in June 1932, as a result

of decreases of \$940,000,000 in loans to New York brokers, \$262,000,000 in commercial paper, \$79,000,000 in acceptances payable abroad, and \$76,000,000 in acceptances of other domestic banks. Holdings of United States Government securities on June 30 last were \$284,000,000 higher than a year earlier, while investments in other bonds, stocks and securities show a reduction for the year of over \$1,000,000,000.

The following table shows the amount and percentage of reduction in total loans and investments, during the first half of 1932 and during the year ending June 30, 1932, by classes of banks:

	Decrease during first half of 1932		Decrease during year ending June 30, 1932	
	Amount	Percentage	Amount	Percentage
<u>Total, all member banks</u>	\$2,645,000,000	8.7	\$5,993,000,000	17.7
Central reserve city banks:				
New York City	746,000,000	10.0	1,573,000,000	19.0
Chicago	258,000,000	17.0	495,000,000	28.2
Reserve city banks	881,000,000	8.3	2,097,000,000	17.8
Country banks	757,000,000	6.9	1,826,000,000	15.1

Member banks that suspended during the first half of the year, less member banks reopened, had loans and investments of about \$200,000,000, while member banks that suspended during the year ending in June 1932, less member banks reopened, had loans and investments of about \$900,000,000. The decline in loans and investments due to bank suspensions is partly offset by changes affecting membership, including the absorption of nonmember banks, etc., which added around \$150,000,000 to the loans and investments of member banks during the year ending on June 30, 1932, also by the gradual depositing with member banks of funds released through the liquidation of the assets of suspended banks.

CONFIDENTIAL

ALL MEMBER BANKS -- PRELIMINARY CLASSIFICATION OF LOANS AND INVESTMENTS ON JUNE 30, 1932, COMPARED WITH PRECEDING CALL DATES
(Amounts in millions of dollars)

B-831

Date	Total loans and invest- ments	Loans to banks		Loans to customers, exclusive of banks						Open market loans					Investments		
		On secur- ities	All other	Total	On securities		On real estate		Other loans to cus- tomers	Total	Accept- ances payable in U.S.	Accept- ances payable abroad	Com- mercial paper	Security loans to New York brokers	Total	U. S. Government securities	Other securi- ties
					To brokers outside New York	To other custo- mers	Farm land	Other real es- tate									
TOTAL-ALL MEMBER BANKS																	
1930, June 30	35,656	230	305	21,565	819	7,242	386	2,769	10,349	3,113	170	71	507	2,365	10,442	4,061	6,380
1931, June 30	33,923	229	228	19,257	515	6,602	388	2,830	8,922	2,103	389	113	384	1,217	12,106	5,343	6,763
Dec. 31	30,575	455	334	17,570	391	5,899	359	2,678	8,242	901	146	41	140	575	11,314	5,319	5,996
1932, June 30	27,930	345	226	15,229	286	5,004	345	2,552	7,042	746	313	34	122	277	11,384	5,627	5,757
NEW YORK CITY**																	
1930, June 30	8,798	78	118	4,309	68	1,954	-	157	2,129	2,091	144	29	35	1,883	2,203	1,147	1,056
1931, June 30	8,287	66	84	3,839	127	1,770	-	160	1,782	1,497	296	44	94	1,063	2,801	1,656	1,145
Dec. 31	7,460	204	170	3,694	87	1,641	-	153	1,813	695	107	17	29	542	2,697	1,768	928
1932, June 30	6,714	155	105	2,856	65	1,279	-	159	1,352	565	262	21	23	258	3,033	2,009	1,023
CHICAGO**																	
1930, June 30	1,849	43	7	1,257	229	487	2	18	521	176	2	19	56	99	366	160	205
1931, June 30	1,754	58	12	1,004	133	435	2	17	417	117	3	42	21	51	563	346	217
Dec. 31	1,517	74	13	926	124	407	1	22	372	24	2	10	9	3	480	288	191
1932, June 30	1,259	68	10	776	93	353	1	25	305	21	5	5	11	1	383	234	149
RESERVE CITY BANKS																	
1930, June 30	11,852	99	128	7,771	431	2,663	110	1,394	3,172	534	17	19	245	253	3,319	1,525	1,794
1931, June 30	11,814	89	88	7,096	208	2,413	126	1,476	2,873	354	87	26	168	73	4,186	2,062	2,125
Dec. 31	10,598	154	106	6,481	152	2,123	120	1,395	2,691	111	33	12	53	14	3,746	1,844	1,902
1932, June 30	9,717	108	69	5,707	109	1,838	104	1,282	2,375	97	33	7	50	7	3,736	1,952	1,785
COUNTRY BANKS																	
1930, June 30	13,157	11	52	8,228	90	2,137	274	1,201	4,527	312	8	4	171	129	4,554	1,229	3,326
1931, June 30	12,068	16	44	7,318	47	1,984	260	1,177	3,849	135	2	2	101	30	4,555	1,279	3,276
Dec. 31	10,999	24	45	6,469	28	1,728	237	1,109	3,367	71	4	2	48	16	4,392	1,418	2,974
1932, June 30	10,242	14	42	5,890	20	1,535	238	1,086	3,011	63	13	1	37	11	4,232	1,432	2,800

FEDERAL RESERVE BOARD

DIVISION OF BANK OPERATIONS

JULY 26, 1932.

**Central reserve city banks only.

(Proposed Letter)

CRM.

See Bk
July 28, 1932.

Mr. J. H. Case, Chairman,
Federal Reserve Bank of New York,
New York, New York.

Dear Mr. Case:

The Federal Reserve Board has received and noted with interest your letter of July 22, 1932, wherein you advise that, at an executive meeting held on July 21, 1932, your Board of Directors voted, subject to the approval of the Federal Reserve Board, to take certain action which in effect amounts to a reduction in the compensation of all of the employees of the bank, other than officers, in an amount equivalent to 8-1/3% of their present salaries, and a reduction in the compensation of all officers (which it is assumed includes directors) in an amount equivalent to 10% of their present compensation.

The only reason for this action stated in your letter is that the program was "formulated in the light of present employment and salary conditions throughout the country"; and the letter and the inclosed copy of the report of the Committee of the Directors on the Welfare of the Staff contain no discussion of this or any other reason for the action and no reference to the existing situation respecting the earnings and expenses of the Federal Reserve Bank of New York or the possible effect of the proposed action on the welfare, morale or efficiency of the bank's staff.

It appears from previous correspondence and negotiations with the bank regarding proposed increases in the salaries of its officers and employees, and from conversations between Governor

P15

Harrison and members of the Board's staff, that the compensation of the bank's officers and employees has never been at as high a rate as that of persons holding corresponding positions in the larger commercial banks in New York City and is not now as great as the compensation of those employees, even after the reductions which have been made in the compensation of the latter.

It also appears that, since January 1, 1932 the Bank has earned an amount which is not only sufficient to pay all of its expenses, depreciation charges and dividends at the rate of 6% per annum, but also to provide for some addition to its surplus. In this connection, the Board is advised that the bank has book profits resulting from the appreciation of Government securities held by it in an amount exceeding the depreciation charged against its surplus at the end of the calendar year 1931 for the purpose of creating a reserve for depreciation in its bond account, so that the bank's bond account probably will show a net profit and this will result in a further addition to its surplus.

The plan formulated by the Directors for the reduction of the compensation of the bank's officers and employees bears a striking similarity to the provisions for the reduction of the compensation of officers and employees of the United States

Government contained in the Act of June 30, 1932, making appropriations for the Legislative Branch of the Government for the fiscal year ending June 30, 1933; and this has given rise to the question whether the action of the Directors was influenced to some extent by the policy adopted by Congress regarding officers and employees of the Government for the purpose of balancing the Government's budget and, if so, whether the directors were cognizant of the fact that the Legislative Appropriation Act expressly exempts the members of the Federal Reserve Board and its officers and employees, along with all other persons whose compensation is paid from assessments on banks, from the provisions discontinuing leaves of absence with pay and requiring compulsory furloughs without pay, as well as from the provisions regarding reductions in salaries. Also, the question has been raised whether this similarity of action might not add to the erroneous impression that now exists to some extent that Federal reserve banks are government institutions and that their officers and employees are in the general category of officers and employees of the Government. Incidentally, the suggestion has already been made that the Federal reserve banks be required to make detailed reports of their earnings and expenses to the Comptroller General of the United States. In this connection, the Legislative Appropriation Act limits the reduction in compensation of officers and employees of the government definitely to the fiscal year ending June 30, 1933, whereas no definite limitation of time is placed upon the proposed reduction in the compensation of officers and employees of the Federal Reserve Bank of New York.

As to the general question of present employment and salary conditions throughout the country, the Board would appreciate advice as to what consideration was given by the directors of the Federal Reserve Bank of New York to recent developments such as increased factory employment and the upward trend in the general average of wholesale commodity prices which may indicate that the beginning of an improvement in general business conditions is in prospect.

The Board would also like to know whether your Directors have given careful consideration to the possible effect of its proposed action on the public and on general business conditions. Such action might encourage other business concerns which have not yet reduced salaries to do so and encourage those which have already reduced salaries to make further reductions. Also, in view of the superior facilities of the Federal reserve banks for gathering and digesting information regarding business and economic conditions, there is a possibility that the public might interpret such action as an indication that the Federal reserve banks are in possession of information which leads them to fear some impending development which would prolong the unfortunate employment conditions from which the country apparently is about to emerge. Such an impression would be increased if other Federal reserve banks should follow the precedent established by the Federal Reserve Bank of New York and reduce the compensation of their officers and employees; and its effect might be equally as potent in discouraging the public and retarding business and economic recovery as the passage of the Goldsbrough Bill by the House of Representatives, and in this way any general reduction in the salaries of officers and employees of the Federal reserve banks at this time might prove to be distinctly contrary to

the public interest.

You are requested to present this letter to your Board of Directors at its next meeting and to ask that the directors give careful consideration to the questions raised above. If, after careful consideration of these questions, your Directors are still disposed to make a general reduction in the compensation of the bank's officers and employees, you are requested to furnish the Federal Reserve Board for its consideration a full statement of the views of your directors on the subjects discussed above and also the following information:

1. A more detailed and definite statement of the reasons prompting such action.

2. The reasons for effecting the proposed reduction in compensation through the furlough system.

3. Whether such proposed action is based upon any operating or financial condition connected with the Federal Reserve Bank of New York as distinguished from general economic conditions.

4. How the present compensation of the officers and employees of the Federal Reserve Bank of New York compares with that now being paid to officers and employees of large commercial banks in the City of New York, after the reductions which have been made in the compensation of the latter.

5. Whether the compensation of the officers and employees of the Federal Reserve Bank of New York was proportionately increased during the time that the large commercial banks in New York were increasing the compensation of their officers and employees and frequently

paying them bonuses at the end of each year.

6. Whether the directors have adopted a new policy which contemplates that increases as well as decreases in the compensation of officers and employees of large commercial banks in New York will hereafter be met by corresponding changes in the compensation of the officers and employees of the Federal Reserve Bank.

7. Whether the proposed reduction in the compensation of officers and employees of the bank is intended to continue indefinitely or is intended to be limited to a definite period.

8. Whether the general economic conditions which in the opinion of your Directors justify a reduction in the compensation of the officers and employees of your bank would also justify a reduction in the dividends paid by your bank, even though the law provides for cumulative dividends.

9. Whether the Federal reserve bank has instituted any special survey of the possibilities of effecting economies in other respects, such as in operating methods, elimination of unnecessary expenses, the reduction or elimination of free services, etc., and, if so, what specific results have been achieved.

Very truly yours,

Chester Morrill
Secretary

615

AUG 1 1932

MORNING PAPERS

X-7215-a

July 26, 1932.

SUBJECT: DISCOUNTS FOR INDIVIDUALS, PARTNERSHIPS AND CORPORATIONS.

TO ALL FEDERAL RESERVE BANKS:

The third paragraph of Section 13 of the Federal Reserve Act, as amended by the Act of July 21, 1932, provides as follows:

"In unusual and exigent circumstances, the Federal Reserve Board, by the affirmative vote of not less than five members, may authorize any Federal reserve bank, during such periods as the said board may determine, at rates established in accordance with the provisions of section 14, subdivision (d), of this Act, to discount for any individual, partnership, or corporation, notes, drafts, and bills of exchange of the kinds and maturities made eligible for discount for member banks under other provisions of this Act when such notes, drafts, and bills of exchange are indorsed and otherwise secured to the satisfaction of the Federal reserve bank: Provided, That before discounting any such note, draft, or bill of exchange for an individual or a partnership or corporation the Federal reserve bank shall obtain evidence that such individual, partnership, or corporation is unable to secure adequate credit accommodations from other banking institutions. All such discounts for individuals, partnerships, or corporations shall be subject to such limitations, restrictions, and regulations as the Federal Reserve Board may prescribe."

In view of the fact that the power conferred by this provision can be exercised only in "unusual and exigent circumstances", the Federal Reserve Board has not prescribed any formal regulations governing the exercise of this power; but the requirements of the law and the procedure which the Federal Reserve Board will expect to be followed are outlined below for the information of the Federal reserve banks and any individuals, partnerships or corporations that may contemplate applying to them for discounts.

VOLUME 231

PAGE 19

- 2 -

I. LEGAL REQUIREMENTS.

It will be observed that, by the express terms of the law:

1. The power conferred upon the Federal Reserve Board to authorize Federal reserve banks to discount eligible paper for individuals, partnerships or corporations may be exercised only:

- (a) In unusual and exigent circumstances,
- (b) By the affirmative vote of not less than five members of the Federal Reserve Board, and
- (c) For such periods as the Federal Reserve Board may determine.

2. When so authorized, a Federal Reserve Bank may discount for individuals, partnerships or corporations only notes, drafts and bills of exchange of the kinds and maturities made eligible for discount for member banks, under other provisions (Sections 13 and 13a) of the Federal Reserve Act. (Such paper must, therefore, comply with the applicable requirements of Regulation A of the Federal Reserve Board).

3. Paper discounted for individuals, partnerships or corporations must be both (a) indorsed and (b) otherwise secured to the satisfaction of the Federal reserve bank.

4. Before discounting paper for any individual, partnership or corporation, a Federal reserve bank must obtain evidence that such individual, partnership or corporation is unable to secure adequate credit accommodations from other banking institutions.

5. Such discounts may be made only at rates established by the Federal reserve banks, subject to review and determination by the Federal Reserve Board.

- 3 -

6. All discounts for individuals, partnerships or corporations are subject to such limitations, restrictions, and regulations as the Federal Reserve Board may prescribe.

II. AUTHORIZATION BY THE FEDERAL RESERVE BOARD.

The Federal Reserve Board, pursuant to the power conferred upon it by the amendment hereinbefore quoted, hereby authorizes all Federal reserve banks, for a period of six months beginning August 1, 1932, to discount eligible notes, drafts and bills of exchange for individuals, partnerships and corporations, subject to the provisions of the law, the Board's regulations, and this circular.

III. FOR WHOM PAPER MAY BE DISCOUNTED.

A Federal reserve bank may discount for individuals, partnerships or corporations notes, drafts or bills of exchange, which are the obligations of other parties actually owned by such individuals, partnerships or corporations and indorsed by them, or the promissory notes of such individuals, partnerships, or corporations indorsed by other parties whose indorsements are satisfactory to the Federal reserve bank.

Within the meaning of this circular, the term "corporations" does not include banks.

IV. APPLICATIONS FOR DISCOUNT.

Each application of an individual, partnership or corporation for the discount of eligible paper by the Federal reserve bank must be addressed to the Federal Reserve Bank of the District in which the principal place of business of the applicant is located, must be made in writing on a form furnished for that purpose by the Federal reserve bank and must contain, or be accompanied by, the following:

1. A statement of the circumstances giving rise to the application and of the purposes for which the proceeds of the discount are to be used;
2. Evidence sufficient to satisfy the Federal reserve bank as to (a) the legal eligibility of the paper offered for discount under Section 13 or Section 13(a) of the Federal Reserve Act and Regulation A of the Federal Reserve Board and (b) its acceptability from a credit standpoint;
3. A statement of the efforts made by the applicant to obtain adequate credit accommodations from other banking institutions, including the names and addresses of all other banking institutions to which applications for such credit accommodations were made, the dates upon which such applications were made, whether such applications were definitely refused and the reasons, if any, given for such refusal;
4. A list showing each bank with which the applicant has had banking relations, either as a depositor or as a borrower, during the preceding year, with the approximate date upon which such banking relations commenced and, if such banking relations have been terminated, the approximate date of their termination;

5. Complete credit data regarding the financial condition of the principal obligors and indorsers on the paper offered for discount;

6. A list and description of the collateral or other security offered by the applicant;

7. A waiver by the applicant of demand, notice and protest as to applicant's obligation on all paper discounted by the Federal reserve bank or held by the Federal reserve bank as security; and

8. An agreement by the applicant, in form satisfactory to the Federal reserve bank, (a) to furnish additional credit information to the Federal reserve bank, when requested, (b) to submit to audits, credit investigations or examinations by representatives of the Federal reserve bank at the expense of the applicant, whenever requested by the Federal reserve bank, and (c) to furnish additional security whenever requested to do so by the Federal Reserve Bank.

V. GRANT OR REFUSAL OF APPLICATION.

Before discounting notes, drafts, or bills of exchange for any individual, partnership or corporation, the Federal reserve bank shall ascertain to its satisfaction by such means as it may deem appropriate:

1. That the financial condition and credit standing of the applicant justify the granting of such credit accommodations;

2. That the paper offered for discount is acceptable from a credit standpoint and eligible from a legal standpoint;

3. That the security offered is adequate to protect the Federal reserve bank against loss;

4. That there is a reasonable need for such credit accommodations; and

- 6 -

5. That the applicant is unable to obtain adequate credit accommodations from other banking institutions.

A special effort should be made to determine whether the banking institution with which the applicant ordinarily transacts his banking business or any other banking institution to which the applicant ordinarily would have access is willing to grant such credit accommodations.

A Federal reserve bank should not discount such paper unless it appears that the proceeds of such discounts will be used to finance current business operations and not for speculative purposes, for permanent or fixed investments, or for any other capital purposes. Except with the permission of the Federal Reserve Board, no such paper should be discounted if it appears that the proceeds will be used for the purpose of paying off existing indebtedness to other banking institutions.

In discounting paper for individuals, partnerships or corporations, a Federal reserve bank should not make any commitment to renew or extend such paper or to grant further or additional discounts.

VI. LIMITATIONS.

Except with the permission of the Federal Reserve Board, no Federal reserve bank shall discount for any one individual, partnership or corporation paper amounting in the aggregate to more than one per cent of the paid-in capital stock and surplus of such Federal reserve bank.

VII. ADDITIONAL REQUIREMENTS.

Any Federal reserve bank may prescribe such additional requirements and procedure respecting discounts hereunder as it may deem necessary or advisable; provided that such requirements and procedure are consistent

with the provisions of the law, the Board's regulations and the terms of this circular.

By order of the Federal Reserve Board.

Chester Morrill,
Secretary.

Q19

See M

FEDERAL RESERVE BOARD

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

X-7218

SUBJECT: Tax on Checks and Other Taxes
Imposed by the Revenue Act of
1932.

Dear Sir:

Inclosed are five copies of a letter received today from the Secretary of the Treasury, which contains rulings on the questions presented in our letter of July 16, 1932 on the above subject, copies of which were forwarded to you under date of July 25, 1932.

Very truly yours,

Chester Morrill,
Secretary.

Inclosures.

TO CHAIRMEN AND GOVERNORS OF ALL F. R. BANKS.

VOLUME 231
PAGE 23

023

Honorable Eugene Meyer,
Governor, Federal Reserve Board,
Washington, D. C.

My dear Governor:

In your letter of July 16, 1932, request is made for rulings upon a number of stated questions arising under the Revenue Act of 1932 out of transactions incident to the operations of the Federal Reserve system. These questions appear to fall generally into two classes, those relating to the application of a number of the excise taxes to the Federal reserve banks themselves (Part I) and those relating to the application of the tax on checks, etc., provided in Section 751 of the Act, to a great variety of transactions involving the transfer of funds and the settlement of accounts between banks in the course of the operations of the Federal Reserve system (Parts II to VIII).

The questions stated in Part I, involving the extent to which the Federal reserve banks themselves are subject to the various excise taxes, are governed in a large part by Section 7 of the Federal Reserve Act (Section 531, Title 12, U.S.C.), which provides:

" * * * 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."

Under these provisions no excise tax may be collected in respect of a transaction to which a Federal reserve bank is a party in its own right, if, under the taxing Act, the tax as such would be payable by the reserve bank. The tax on checks, etc., under Section 751, is imposed upon the maker or drawer of the instrument. The taxes on telephone, telegraph, etc., facilities, provided in Section 701, and on electrical energy, provided in Section 616, are imposed in each case upon the person who makes payment for the facility

- 2 -

to the company which furnished it. The taxes on sales of miscellaneous articles (other than electrical energy), provided in Title IV of the Act, are imposed in each case upon the person selling the article.

Questions in Part I of your letter are accordingly answered as follows:

I. TAXABILITY OF FEDERAL RESERVE BANKS.

1. Q. Does the tax imposed by Section 751(a) apply to checks drawn on Federal reserve banks by their own officers acting in their official capacities?

A. No.

2. Q. Does the tax imposed by Section 701(a) (2) apply to leased telephone and telegraph service contracted for, used, and paid for by the Federal reserve banks?

A. No.

3. Q. Does the tax imposed by Section 701(a) (1) apply to telegraph, telephone, cable, and radio messages sent by the reserve banks or sent to them collect, which are paid for by the reserve banks and for which no reimbursement is received by them?

A. No.

4. Q. Does the tax imposed by Section 701(a) (1) apply to messages paid for by the reserve banks but for which they are later reimbursed by other banks, such as messages sent by the reserve banks in performing services for other banks?

A. Yes.

- 3 -

5. Q. Is electrical energy furnished to Federal reserve banks for their own use subject to the tax imposed by Section 616(a)?

A. No.

6. Q. Do the taxes on fuel oil and other articles of merchandise imposed in Article IV of the Revenue Act of 1932 apply when such articles are purchased by the reserve banks for their own use?

A. Yes. The taxes as such are payable by the seller.

The questions which are stated in Parts II to VIII of your letter are intended to cover the more common forms of transactions by which transfers of funds or settlements of balances are effected between banks. It would seem desirable to set forth a general statement of the basis for the rulings on these questions, so that the scope of the rulings will be understood when applied to cases where there may be some local variations in the form of a given transaction. To give a separate explanation of the basis of the ruling on each question in your letter is believed to be unnecessary, since it is apparent that a great many of the transactions covered by your letter, although falling into different classes and grouped separately, have certain elements in common, so far as the application of the tax is concerned. A general statement as to the character and form of the instruments which are subject to the tax will serve to explain the rulings on a majority of the questions stated, and will permit more or less categorical answers to be made to the specific questions, except in those cases where an additional statement as to the basis of the ruling may be necessary.

- 4 -

The tax under Section 751 is imposed upon certain "instruments presented for payment", namely, "checks, drafts, or orders for the payment of money" drawn upon a bank, banker, or trust company. "Checks" and "drafts" are terms which have a well-established meaning. "Orders for the payment of money", intended to be taxed under this section, are such as have some similarity to "checks" and "drafts", at least to the extent that they must be capable of being characterized as "instruments" and of being "presented for payment." The phrase "presented for payment" implies that the instrument must be capable of having a holder, that is, a person who by reason of his possession of the instrument is entitled to receive payment of the sum of money specified therein. Moreover, the instrument must according to its terms or effect call for the payment of money; an order or authorization merely to charge a book account does not constitute such an order as is subject to the tax. Of course, if the instrument is in fact an order for the payment of money, it is none the less taxable because the payment of money may, in a particular case or even in a number of cases, be accomplished through a book entry.

A great number of the transfers of funds or settlements mentioned in your letter are accomplished through written orders or authorizations, usually on standard forms, by which the addressee is directed or authorized to charge the account of the person giving such order or authorization or to make an offset against a balance standing to the credit of such person. In some instances the writing does not in express terms contain such an order or authorization but merely states the substance of the transaction, and the order or direction to the addressee is implied from the course of dealing between the parties or has been separately provided for by prior agreement. Some of the orders or authorizations call for the delivery or shipment of currency or coin to the person giving such order or authorization. Orders, authorizations, or instructions of the nature mentioned, whether oral or written, are not subject to the tax.

Some of the transactions referred to in your letter involve transfers of funds belonging to or due to the United States. If the

- 5 -

transfer is effected by or through an instrument which is of such character and form as to be subject to tax, the tax must be collected, as no exemption attaches by reason of the fact that funds of the United States are involved.

The detailed questions stated in your letter, with such changes in phraseology as are necessitated by omitting references to exhibits, and the answers thereto are as follows:

II. VARIOUS FORMS OF REMITTANCES OR
SETTLEMENTS FOR CHECKS AND
COLLECTION ITEMS.

Pursuant to the provisions of Sections 13 and 16 of the Federal Reserve Act and Regulation J of the Federal Reserve Board, the Federal reserve banks act as clearing houses and collect checks for their member banks, which maintain deposit balances with the Federal reserve banks as their legal reserves, and for non-member banks which establish deposit balances with the Federal reserve banks for the purpose. The Board's regulations on this subject are supplemented by circulars issued by the Federal reserve banks. Each Federal reserve bank receives each day numerous checks drawn upon banks in its district and forwards them to the drawee banks for payment. The usual procedure is to send all the checks received during each day drawn on a particular bank to that bank, with one covering letter. The covering letter is known as a "cash letter". The total amount of the checks thus transmitted is accounted for to the Reserve bank in any one of several ways, the principal ones being, (a) by authorizing the Federal reserve bank to debit the amount to the deposit balance of the remitting bank on the books of the Federal reserve bank, and (b) by sending the Federal reserve bank a check or draft drawn upon the remitting bank's deposit with the Federal reserve bank or a correspondent bank. The reply to the cash letter will also state the amount, if any, of the items which are returned to the reserve bank (because not collected or for some other reason), and this amount is accordingly deducted from the total stated in the cash letter.

The Federal reserve banks also collect for their member banks promissory notes, bills of exchange and other similar items and the procedure in forwarding and accounting for such items is similar, so far as the questions here presented are concerned, to that followed in connection with the collection of checks, except for differences in detail which are indicated in Questions 8 to 11 below. For convenience, such items are commonly referred to as "non-cash items", in order to distinguish them from checks and similar items payable on demand at banks, which are commonly referred to as "cash items".

- 6 -

1. Q. Is a tax payable in the event that a member bank, in response to the cash letter, authorizes the Federal reserve bank to debit the amount to its deposit balance with the Federal reserve bank, (a) by a specific authorization in the form used for that purpose; or (b) by returning to the Federal reserve bank a memorandum slip merely stamped "debit" or "paid", which has by custom the effect of such authorization?

A. (a) No. (b) No.

2. Q. In some cases the reserve bank is given a continuing authorization to charge the account of the member bank with the net amount of each "cash letter" sent to that bank. Is such authorization taxable? If so, is it taxable once, or each time an entry is made?

A. Neither the continuing authorization nor the separate entries made pursuant thereto are taxable.

3. Q. Is the tax payable in the event that the bank makes remittance of the amount called for by its reply to the cash letter, by means of a draft or check, (a) drawn against its deposit balance with the Federal reserve bank, or (b) drawn against a deposit in a correspondent bank?

A. The check or draft, whether drawn against a deposit with a Federal reserve bank or against a deposit in a correspondent bank, is taxable.

4. Q. In one instance the cash letter has a detachable portion which is in the form of a draft and which is marked "Settlement draft". This "Settlement draft" is in the usual form of a draft; it is drawn by the remitting bank on, and payable to the order of, the Federal reserve bank. It is not dealt with as an ordinary draft in that it is never returned to the drawer, but is held by the reserve bank as a part of its records. Is such a "Settlement draft" taxable?

A. Yes. The "Settlement draft" is clearly of a character and form which make it subject to tax; and the fact that after payment it is not returned to the drawer does not affect the taxability of the instrument.

5. Q. In the event that any of the transactions described in the preceding questions is taxable, is only one tax imposed, or is the tax payable with regard to each separate item inclosed with the cash letter, when a single settlement is made for the total amount of such items?

- 7 -

A. The taxability of the instruments mentioned in the preceding questions which are held to be taxable is not affected by the fact that such instruments are given in settlement of a great many separate items, each of which may likewise be subject to the tax; only one tax is payable in respect of each instrument.

6. Q. It sometimes occurs that, in its response to a cash letter, the member bank will incorrectly state the amount chargeable against its reserve account, usually because it has failed for some reason to return and deduct an item which should have been returned and deducted because uncollectible or for some other reason. In that event, it communicates again with the reserve bank advising it of the correcting book entry to be made. Is such a transaction taxable?

A. No.

7. Q. In certain reserve districts, in order to achieve greater promptness in settlement, where drafts are sent in settlement of cash letters, the drafts are required to be on certain member banks which have previously agreed that such drafts may be immediately charged against their accounts by the reserve bank, without waiting for the draft to be sent to the drawee bank. After such a charge is made, the reserve bank notifies the bank upon which the draft is drawn so that it may keep its books in order and forwards the draft to it. Is such notification taxable?

A. No.

8. Q. In connection with non-cash items, a printed slip is often attached to each item when it is forwarded for collection by the Federal reserve bank, such slip taking the place of a letter of transmittal. Acknowledgment of receipt of the item, acknowledgment that payment has been received, and authorization to the reserve bank to charge its account is made by the bank receiving it, by returning a carbon copy of the slip stamped "paid" or "debit". Is this transaction, or the returned slip, taxable?

A. No.

9. Q. Is the result different if the collecting bank merely advises the reserve bank that it has credited the latter's account, which is an implied authorization to the latter to make a corresponding entry on its books?

A. No.

- 8 -

10. Q. Promissory notes, bills of exchange and other non-cash collection items which are payable by persons located in the same city as the Federal reserve bank or its branch are sometimes presented by the Federal reserve bank directly to the persons by whom they are payable, and such persons give the Federal reserve banks in payment for such items checks drawn on member banks in the same city. In such cases the Reserve bank immediately presents such checks by messenger to the banks on which they are drawn and the drawee banks give the Federal reserve bank drafts against their deposit balances with the Federal reserve bank. Are such drafts subject to the tax?

A. Yes.

11. Q. In the circumstances described in the preceding question, the bank, instead of sending a draft, sometimes authorizes the reserve bank to charge its account. Is this transaction taxable?

A. No.

III. CLEARING HOUSE TRANSACTIONS.

The questions under this heading involve the settlement of balances resulting from exchange of checks between banks. The settlement of balances resulting from the exchange of checks through the Newark Clearing House Association, Newark, New Jersey, will illustrate this type of transaction. Each business day each bank in the Clearing House Association takes to the office of the association checks deposited with such bank drawn on other banks in the association, and messengers representing the respective banks in the association call for and receive the checks drawn on their banks. Each bank is credited with the amount of the checks drawn on the other banks which it brings to the clearing house and is debited with the amount of the checks drawn on it which other banks bring. There is a net credit or debit balance in favor of or against each bank as a result of the day's exchanges, and the aggregate of the net credit balance must, of course, be exactly equal to the aggregate of the net debit balances. The amounts of the net credit and debit balances to all banks are written on the clearing house statement for that day and this statement, signed by an officer of the Clearing House Association, is sent by messenger to the Federal Reserve Bank of New York, and the balances as shown on the statement are settled on the books of the Federal reserve bank by credits and debits to accounts of member banks. The balances in favor of or against banks which are members of the Federal Reserve Bank are credited or

- 9 -

debited to the accounts of such banks on the books of the Federal reserve bank. The balances for or against other banks, i.e., banks which are not members of, and therefore have no account with, the Federal reserve bank are, by arrangement between the banks concerned, credited or debited to the accounts of designated banks in New York City which are members of the Federal reserve bank. These credits and debits are made by the Federal reserve bank pursuant to continuing letters of authorization on file with it signed by the various banks.

The questions asked in this connection are:

1. Q. Are any of the above-described transactions which consist merely in book entries, taxable?

A. No.

2. Q. Is the clearing house statement above referred to subject to the tax?

A. No.

3. Q. Are the letters of authorization subject to tax? If so, are they taxable once, or each time an entry is made, or as to each item covered by each entry?

A. Such letters of authorization are not subject to tax.

4. Q. In some instances the clearing house issues certificates showing the net balances. Such a certificate is issued to a creditor bank calling upon a debtor bank to pay the creditor bank the amount stated therein. No accounts are carried in any of the clearing house banks in the name of the manager for the purpose of effecting settlement pursuant to the certificates, and these certificates are issued by the clearing house manager merely as memoranda to facilitate the settlement of balance between the members of the clearing house association. The Federal reserve bank participates in the clearings and certificates issued in its favor against member banks are charged against their deposit balances on the books of the Federal reserve bank pursuant to standing authorizations. Are such certificates subject to the tax?

A. No.

5. Q. In some instances (particularly where banks are so located as not to be in communication by messenger with the Federal reserve bank) a group of banks adopt, by agreement, the procedure of forwarding each day to each member of the group all of the items they receive that are payable by or

- 10 -

through that member of the group, forwarding to the reserve bank a form on which are listed the names of all the other members of the group together with the amount of the items that it has forwarded to each. When received by the reserve bank, this form is used as an authorization to make the appropriate entries in the accounts of the banks in the group. In practice, however, instead of making several entries, the reserve bank strikes the balance from the advices sent by all the members of the group and makes each day only one entry in each of their accounts, representing the net balance for the particular bank. Is the use of these forms in the manner above described taxable?

A. No.

6. Q. Are the resultant book entries made by the reserve bank taxable?

A. No.

7. Q. In certain instances, the Federal reserve bank itself acts as a clearing house, receiving the checks from the various banks, striking the balance and making the appropriate entries in the accounts of the various banks. Are these transactions taxable?

A. No.

8. Q. In certain instances the Federal reserve bank performs these services even for banks which have no account with it (i. e., banks not members of the Federal Reserve System). Where such banks are located in the same city as the reserve bank, the method adopted is for the drawee bank to send a messenger to the reserve bank to get the checks drawn on it which have been forwarded to the reserve bank for collection. The checks are immediately charged to the account of a member bank which has authorized the reserve bank to do so, and credited to the bank which forwarded them. In the event that the check is later dishonored, the book entries are reversed. Are such authorizations taxable?

A. No.

IV. MEMBER BANKS OBTAINING CURRENCY FROM RESERVE BANKS.

A member bank desiring currency usually obtains it from the Federal reserve bank, and the amount usually is debited on the books of the Federal reserve bank to the deposit balance maintained by the member bank with the Federal reserve bank as the legal reserve of the member bank. Such requests for currency and the authorizations to debit the reserve balances assume a variety of forms and give rise to the following questions:

- 11 -

1. Q. Is such a request by a member bank for the shipment of currency to it taxable when made by telephone and not confirmed in writing?

A. No.

2. Q. If such a request is made by telephone but confirmed in writing after the shipment of the currency, is it taxable?

A. No.

3. Q. If a messenger sent to the Federal reserve bank delivers merely a receipt for the currency and receives the currency, is the transaction taxable?

A. No.

4. Q. If the messenger in such a case delivers a check or draft drawn on the Federal reserve bank for the amount of the currency, is the transaction taxable?

A. The check or draft is taxable.

5. Q. If a written request for currency is accompanied by a check or draft, are both the check and the request taxable?

A. Only the check or draft and not the written request is taxable.

6. Q. When the transaction is completed, the reserve bank frequently sends a confirmation on a printed form to the member bank. Is this document taxable, whether or not any other part of the transaction is taxable?

A. The confirmation is not taxable, whether or not any other part of the transaction is taxable.

V. TRANSACTIONS INCIDENT TO REDISCOUNTS AND ADVANCES
BY FEDERAL RESERVE BANKS.

1. Q. Federal reserve banks extend credit accommodations to their member banks: (a) By rediscounting, on the indorsement of their member banks, the commercial, industrial and agricultural paper acquired by them from their customers; and (b) by making advances to

their member banks on their promissory notes secured in the manner prescribed by law. In either event, the proceeds usually are made available to the member bank by crediting the amount to the deposit balance of the member bank on the books of the Federal reserve bank. Are such credit entries taxable?

A. No.

2. Q. At the maturity of the rediscounted paper or the promissory notes of the member banks, the Federal reserve banks, pursuant to agreements or regulations previously made, return the rediscounted paper or promissory notes to the member banks and debit the amounts due thereon to the deposit balances of the member banks on the books of the Federal reserve banks. Are these transactions taxable?

A. No.

3. Q. The member bank frequently desires to have its promissory notes or rediscounted paper returned to it prior to the time when it would be returned in due course as described above. Its reason for so desiring may be, for instance, that the maker of the instrument desires to pay it before maturity, or it may be that the member bank desires to decrease the total amount of the paper rediscounted for it by the reserve bank. In such case the member bank communicates with the Reserve Bank by letter or by telegram, requesting that the item be returned to it, and, either impliedly or actually in words, authorizing the reserve bank to debit its deposit balance on the books of the reserve bank with the amount due thereon. Are these transactions (i.e., the book entries, the transmission of the instruments, or the communications requesting the return of the instruments and authorizing the book entries) taxable?

A. Neither the book entries, the transmission of the instruments, nor the communications requesting the return of the instruments and authorizing the book entries are taxable.

VI. INTER-BANK TRANSFERS OF FUNDS.

One of the important functions of the Federal Reserve System is to facilitate the transfer of funds between banks. This function is performed (with unimportant exceptions) free of charge for members of the System. It is done as far as possible without resorting to shipments of currency.

Transfers between member banks in the same Federal Reserve District are made merely by means of entries on the books of the Reserve bank. The steps involved in such transaction are: (1) A member

bank requests the reserve bank to transfer an amount on its books from the reserve account of the requesting bank to the account of another bank, (2) the reserve bank makes the transfer on its books, and (3) the bank to whose account the transfer is made is notified. If the bank to which the transfer is made is located in another District, the second step must consist in (a) a transfer from the account of the requesting bank to the account of the reserve bank for the District in which is located the bank to which the transfer is made, and (b) a transfer by that reserve bank to the account of the latter. If the latter has no account with the reserve bank, the reserve bank transfers to the account of a bank which has and which is a correspondent of the bank to which the transfer is made. For the purpose of effecting transfers between two Federal reserve banks (where the transfer is from one District to another), the Gold Settlement Fund is maintained in Washington. This fund was created by a deposit of gold by each Federal reserve bank with the Treasurer of the United States to the credit of the Federal Reserve Board, which maintains books showing the amount due to each Federal reserve bank. The Federal reserve banks each own an undivided interest in this fund and advise the Federal Reserve Board each day of the transfers made to each other. The Board makes appropriate book entries transferring interests in the Fund equivalent to the transfers of funds made between the Federal reserve banks.

Member banks make their requests for transfers in many ways:- by letter, telegram, telautograph, and telephone. After the transfer has been made, the Federal reserve bank sends a memorandum of the transaction to the member bank, and executes appropriate vouchers, and makes appropriate entries on its books.

(1) Q. Are such transfers of funds by one Federal reserve bank to another at the request of a member bank, made by means of a telegram or letter sent by one Federal reserve bank to another, taxable?

A. No.

(2) Q. Is a request for such a transfer, made by the member bank, taxable if made by telephone and not confirmed in writing?

A. No.

(3) Q. Is such a request taxable if made by telephone and confirmed in writing after the transfer has been made?

A. No.

(4) Q. If made by telautograph or telegram and not confirmed in writing?

A. No.

(5) Q. If made by telautograph or telegram and subsequently confirmed in writing?

A. No.

(6) Q. If made by letter?

A. No.

(7) Q. If such requests are taxable if made by telephone, then when a number of such requests are made in the course of one day and the Federal reserve bank makes only one book entry for the total amount at the conclusion of the day, is one tax only imposed or is each separate request taxable?

A. Neither the separate requests nor the covering book entry is taxable.

(8) Q. In the event that a request for transfer of funds made by letter is taxable, is a letter containing a request for several transfers subject to taxation once, or several times depending upon the number of transfers requested in the letter? (In this connection it has been suggested that, if taxable at all, such requests are subject to only one tax since they are contained in one letter or memorandum.)

A. Such a request is not taxable.

(9) Q. Requests for such transfers are sometimes accompanied by a draft for the amount to be transferred. Is such draft taxable?

A. Yes.

(10) Q. If so, is the letter transmitting the draft and making the request also taxable?

A. No.

(11) Q. Is a receipt or acknowledgment on a printed form sent by the reserve bank to the member bank in response to a letter such as is described in the preceding question also taxable?

A. No.

(12) Q. When a bank located in one Federal Reserve District requests that a transfer be made to a bank located in another District, the steps incident to completing the transaction include a transfer by the Federal reserve bank of the District in which the requesting bank is located to the Federal reserve bank of the District in which the transferee bank is located and a transfer from the latter reserve bank to the transferee bank, both transfers being accomplished by means of book entries in the accounts of the respective banks. Is the latter transfer taxable?

A. No.

(13) Q. Transfers are also made by Federal reserve banks between two member banks located in its district. Requests for such transfers take the same forms as the transfers described above, but such transfers are accomplished merely by means of book entries in the reserve accounts of the two banks involved. Are such transfers taxable when the requests are made in any of the different ways described above (including messenger, telephone, written memorandum, etc.)?

A. No.

VII. TRANSFERS TO 5% REDEMPTION FUND, WAR LOAN DEPOSIT
ACCOUNT AND RECONSTRUCTION FINANCE CORPORATION.

National banks issuing national bank notes are required by statute to maintain with the Treasurer of the United States a Redemption Fund equal to 5% of their notes in circulation. When necessary, a national bank will in most instances make additions to its 5% Redemption Fund by requesting the Federal Reserve Bank of its district to transfer the required amount to the account of the Treasurer of the United States. Such requests are made substantially in the following form: "Please charge our account \$_____ and credit the Treasurer of the United States for the account of our 5% Redemption Fund". The reserve banks prepare "debit tickets" covering the necessary book entries and send copies, or similar slips, to the member banks for their records.

1. Q. Is such a request taxable?

A. No.

2. Q. Sometimes such a request is accompanied by a draft. Is the draft or the written request taxable?

It has been contended by some of the reserve banks that such transfers to officers of the United States are not taxable in any event.

A. The draft is taxable.

3. Q. Similar questions are also raised with regard to transfers from the reserve account of a member bank to the Treasurer of the United States as payments on the War Loan deposit of the bank giving the direction (representing its subscription to United States securities).

A. Requests to charge the reserve account of a bank to cover subscriptions to United States securities are not taxable, but drafts drawn for this purpose are taxable.

4. Q. From time to time borrowing institutions repay on advances made by the Reconstruction Finance Corporation, doing so (a) by means of instructions to the Reserve bank to charge the borrowing bank's account and to credit the Treasurer of the United States for account of the Reconstruction Finance Corporation, and (b) by means of drafts. Debit tickets are prepared by the reserve bank and similar slips are forwarded to the requesting bank for its records. Are either the instructions, the debit tickets and slips, or the drafts taxable?

A. Neither the instructions nor the debit tickets or slips are taxable, but the drafts are taxable.

VIII. MISCELLANEOUS TRANSACTIONS.

(a) Purchase of Securities by Reserve Banks on Behalf of Member Banks.

Member banks frequently request reserve banks to purchase Government or other securities, or bankers' acceptances for them, authorizing the reserve bank, either impliedly or specifically, to charge their reserve account with the cost. Such requests are made in a variety of ways.

1. Q. Is such request taxable if made by telephone and not confirmed in writing?

A. No.

2. Q. If made by telephone and subsequently confirmed in writing?

A. No.

3. Q. If made by letter not specifically authorizing the reserve bank to charge the account of the requesting member bank?

A. No.

4. Q. If the request described in the preceding question contains a specific authorization to charge the member bank's account?

A. No.

5. Q. If the reserve bank, when the transaction is completed, sends to the member bank a memorandum confirming the transaction and stating the amount of the charge, is such confirmation taxable?

A. No.

(b) Incidental Expenses, Telephone Calls, etc.

6. Q. In connection with transactions of this type as well as numerous others, the reserve banks have occasion to charge the accounts of member banks, without specific authorization, with expenses incurred in connection with telephone, telegraph, shipping charges on securities, etc. The member bank is notified by sending to it a copy of the "debit ticket" made out by the operating department which incurred the expense, or else a list of the expenses which have been charged to its account is sent to the member bank at the end of the month. Are such "debit tickets", book entries or memoranda taxable?

A. No.

7. Q. Are telephone calls and telegrams subject to a tax when they pertain to Fiscal Agency or Reconstruction Finance Corporation business when the cost falls directly on the Treasury Department or the Reconstruction Finance Corporation?

A. As already pointed out, a Federal reserve bank is exempt from tax in cases where the charges for such messages sent on its own account are payable by it. Where, however, the charge for the telephone or telegraph message is paid by a member bank, the tax must be collected, notwithstanding the message may have related to matters involving the Treasury Department or the Reconstruction Finance Corporation. Where the charges for such messages are paid by the Treasury Department or the Reconstruction Finance Corporation, no tax is due; the Treasury Department is exempt by reason of section 701(b) of the Revenue Act, and the Reconstruction Finance Corporation is exempt by reason of section 10 of the act creating it (Act of January 22, 1932, Public No. 2, - 72d Congress), which has provisions almost identical with those of Section 7 of the Federal Reserve Act.

(c) Member Bank Subscriptions to Stock of Federal Reserve Banks.

8. Q. All banks which are members of the Federal Reserve System are required to subscribe to the capital stock of the Federal reserve bank in an amount equal to 6% of their own unimpaired capital and surplus. As a member bank's capital and surplus accounts are increased it is necessary to subscribe for a proportionate increase in its holdings of Federal reserve bank stock. Infrequently, drafts are drawn in favor of the Federal reserve bank for these payments. Usually when subscribing for this additional stock the member bank authorizes a charge to its account. In the latter case, is the transaction taxable?

A. The authorization to charge the reserve account of the member bank is not taxable, but the draft is taxable.

- 18 -

(d) Correction Entries.

9. Q. Member and nonmember banks make deposits of coin or currency with the reserve bank, receiving immediate credit subject to verification. Occasionally in process of verification the Reserve Bank finds counterfeits and shortages for which a debit is prepared and charged to the depositing bank's account. Are such entries taxable?

A. No.

10. Q. A similar question is raised with regard to maturing coupons deposited with the reserve bank. When mutilated or unmatured coupons are discovered, the coupons are returned to the depositing bank and charge made to its account. Are such transactions taxable?

A. No.

(e) Penalty for Insufficient Reserves.

Q. At periodic intervals an analysis is made of each member bank's reserve account to determine whether adequate reserves have been carried during the period, as required by the Federal Reserve Act. If the reserves have not been properly maintained, a penalty is assessed pursuant to the Federal Reserve Act and the regulations of the Federal Reserve Board. The penalty is charged to the reserve account of the member bank by the Reserve bank itself. Is such a charge taxable?

A. No.

Very truly yours,

(Signed) Ogden L. Mills,
Secretary of the Treasury.

P 23

2m Na

FEDERAL RESERVE BOARD

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

X-7224

August 4, 1932.

SUBJECT: Loans to Veterans on Adjusted
Service Certificates.

Dear Sir:

There is inclosed herewith, for your information, a copy of Public Act No. 303, 72nd Congress, approved July 21, 1932, together with four copies of an extract of revised regulations of the Veterans' Administration with regard to loans by banks on veterans' adjusted service certificates under section 502 of the World War Adjusted Compensation Act as amended by the Act of July 21, 1932.

The changes made by this Act affecting the rediscount of notes representing such loans are, (1) a loan may be made at any time after the date of the adjusted service certificate instead of only after two years from the date thereof, and (2) except as to interest accrued prior to July 21, 1932, the rate of interest on such loans shall not exceed $3\frac{1}{2}\%$ per annum, compounded annually. You will note that the Veterans' Administration, in its revised regulations, has interpreted this latter provision of the Act of July 21, 1932, to mean that the

VOLUME 231
PAGE 47

847

- 2 -

limitation of the rate of interest such a loan may bear to 3 1/2% per annum compounded annually, is applicable only to loans or extensions of loans made on or after July 21, 1932.

Should you desire additional copies of the extract of regulations of the Veterans' Administration, the Board will be glad to forward them to you.

Very truly yours,

E. M. McClelland,
Assistant Secretary.

Inclosures.

TO GOVERNORS OF ALL F. R. BANKS.

B47

Office Correspondence

FEDERAL RESERVE
BOARD

Sec. Bn

Date August 18, 1932.To Mr. Hamlin

Subject: _____

From Mr. McClelland

GPO 2-8495

There is attached hereto copy of a form letter which is used by the Comptroller of the Currency in answering inquiries with regard to national bank note circulation under the amendment contained in the Federal Home Loan Bank Act. I understand that copies of this letter have been forwarded by the Comptroller direct to the Governors of the Federal reserve banks.

VOLUME 231
PAGE 87

P 87



TREASURY DEPARTMENT

OFFICE OF COMPTROLLER OF THE CURRENCY

WASHINGTON

Address reply to
COMPTROLLER OF THE CURRENCY

Section 29 of the Federal Home Loan Bank Act, approved July 22, 1932, provides as follows:

"That notwithstanding any provisions of law prohibiting bonds of the United States from bearing the circulation privilege, for a period of three years from the date of enactment of this Act all outstanding bonds of the United States heretofore issued or issued during such period, bearing interest at a rate not exceeding 3-3/8 per centum per annum, shall be receivable by the Treasurer of the United States as security for the issuance of circulating notes to national banking associations, and upon the deposit with the Treasurer of the United States by a national banking association of any such bonds, such association shall be entitled to receive circulating notes in the same manner and to the same extent and subject to the same conditions and limitations now provided by law in the case of 2 per centum gold bonds of the United States bearing the circulation privilege; except that the limitation contained in section 9 of the Act of July 12, 1882, as amended, with respect to the amount of lawful money which may be deposited with the Treasurer of the United States by national banking associations for the purpose of withdrawing bonds held as security for their circulating notes, shall not apply to the bonds of the United States to which the circulation privilege is extended by this section and which are held as security for such notes. Nothing contained in this section shall be construed to modify, amend, or repeal any law relating to bonds of the United States which now bear the circulation privilege. As used in this section, the word "bonds" shall not include notes, certificates, or bills issued by the United States. There are hereby authorized to be appropriated such sums as may be necessary to carry out the provisions of this section."

You are informed that if the bank is not already a bank of issue but intends to avail itself of the circulation privilege, it will be necessary that it order a plate bearing the signature of the president and the cashier, to be used in printing its currency. A form upon which to furnish the required signatures is enclosed. Three autograph signatures of each officer whose name is to appear upon the bank's circulating notes must be furnished and each signature must in its entirety be confined to the spaces provided in the form by impressed lines.

It will require from fifteen to thirty days to prepare the plate and print the notes. If a bank does not have a plate an order for currency can not be acted upon until a draft in payment of the cost of the plate is received. The cost of

the original plate is \$46.00 and your draft for that sum should accompany your application. If a bank already has a plate and wishes to increase its circulation, an order for currency will be given upon receipt of additional bonds or receipt of advice of the amount of new bonds to be deposited. No Special blanks upon which to announce an intention to deposit bonds are either required or furnished by this office. A letter addressed to the Comptroller explaining the plans will be all that is necessary.

National bank notes are printed in denominations of \$5, \$10, \$20, \$50, and \$100, but since all surface printing is done with the same plate only one plate is necessary for each bank. Bonds to be deposited as security for circulation should be assigned to the Treasurer of the United States in trust for the bank and sent to the Comptroller of the Currency. Only the following bonds, all obligations of the United States, are now eligible as security for national bank note circulation:

2% Consols 1930	3% Treasury Bonds of 1951-55
2% Panama Canal Loan of 1916-36	3 1/8% " " " 1946-49
2% " " " " 1918-38	3 3/8% " " " 1943-47
2 1/2% Postal Savings Bonds	3 3/8% " " " 1940-43
3% Panama Canal Loan of 1961	3 3/8% " " " 1941-43
3% Conversion Bonds of 1946-47	

Should additional bonds bearing interest at 3-3/8% or less per annum be issued by the United States prior to July 22, 1935, they in addition to those listed above will also be eligible as security for circulating notes. Until July 22, 1935, any bonds, including 2% Panamas and the 2% Consols, deposited as security for circulation may be withdrawn if a bank desires and in their place any bonds eligible as security at the moment of withdrawal may be substituted.

Registered bonds of the descriptions eligible as security for circulation may be forwarded to the Comptroller of the Currency, properly assigned to the Treasurer of the United States in trust for the depositing bank. Coupon bonds should be forwarded with proper instructions to the Division of Loans and Currency of the Treasury Department, where they will be reissued in registered form, payable to the Treasurer of the United States in trust for the depositing bank. After having been reissued in registered form the bonds will be delivered by the Division of Loans and Currency to the Comptroller of the Currency, who will then deposit them with the Treasurer of the United States.

The Comptroller is frequently asked as to his policy with reference to requiring additional security should the market price of bonds deposited to secure circulation decline below par. It has never been the policy of the Comptroller's office to require additional security in such cases and no change is anticipated. It will be recognized, however, that no binding statement as to future policy is possible. In any emergency that might arise, consideration would, no doubt, be given to the additional security afforded by the 5% redemption funds maintained by issuing banks and to the further fact that to reimburse it for amounts expended in paying their circulating notes the United States under Section 5230 U.S.R.S. has a paramount lien upon the assets of the issuing banks.

An "original issue" is an issue of currency against a new deposit of bonds. Such an issue when shipped is sent by mail direct to the issuing bank with postage, registration and insurance prepaid. A bill for the charges is forwarded at the end of each month. In those cases where the amount of bonds deposited is so large that all the currency to be issued against them cannot be promptly printed and shipped at one time, various shipments are made as the currency is printed. Each shipment is an original issue and a separate bill for each is forwarded at the end of the month.

New notes for replacement of unfit notes redeemed and destroyed as well as notes fit for circulation redeemed and not destroyed, are also forwarded by registered mail direct to the issuing banks with postage, registration and insurance prepaid. The amount expended for postage, registration and insurance on such notes is not billed to the banks at the end of each month but is included in the annual assessments for expenses incident to redemptions made by the Treasurer of the United States upon all national banks of issue at the close of each fiscal year. No new currency, constituting either an original issue or that replacing notes destroyed, and no redeemed notes fit for circulation, will be delivered to agents of issuing banks.

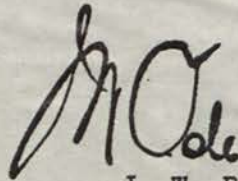
The law requires that a bank shall verify annually the bonds held by the Treasurer of the United States to secure payments of its notes but the bank may appoint an agent to verify them. The law requires also that the bank designate an agent to witness the destruction of its unfit notes.

Circulation issued against all United States bonds, including those bearing a rate of interest higher than 2% will be subject to a semi-annual tax of 1/4 of 1 per cent. The Attorney General has also rendered an opinion, the substance of which is contained in the following paragraph:

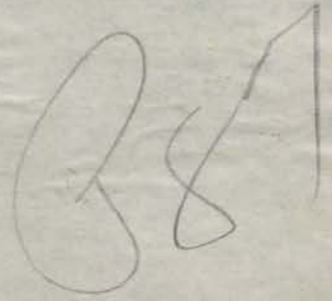
"Reading the provisions of Section 29 in an effort to carry out the intent of Congress as disclosed by the legislative history of the measure, it is my opinion that the three-year period prescribed by Section 29 means that the bonds referred to in said section lose the circulation privilege at the end of the three-year period and the notes issued upon the deposit of such bonds must be retired in an appropriate manner."

All national banks issuing circulation are required to keep a complete and generally uniform record of their transactions with this bureau and of their transactions with the office of the Treasurer of the United States relating to their circulating notes and to their 5% redemption funds. Accordingly there is enclosed a copy of a form showing in detail the several items that enter into these accounts. You are requested to install these forms as a part of your records immediately after you receive new notes from this bureau. The form is particularly desirable for banks taking out circulation for the first time as it enables them to record every transaction from the date of receipt of an original issue of circulating notes. The difficulty of tracing notes reported as missing is greatly increased when such a record is not kept by the bank. This office has no supply of this form for distribution.

Immediately after new notes have been received from this bureau, the contents of the package should be counted and any discrepancy in the amount, or hiatus in the bank numbers of the notes, should be reported at once to this office. The bank numbers are printed on the lower left-hand and upper right-hand corners of the notes and it is essential that a complete record be kept of these numbers.

A handwritten signature in dark ink, appearing to read "J. W. Pole". The signature is stylized with a large, looped initial "J" and a cursive "Pole".

J. W. POLE,
Comptroller.

A large, handwritten mark or signature in the bottom right corner of the page, possibly reading "B81" or similar. It consists of a large, open loop followed by the numbers "81".

EARNINGS AND EXPENSES OF FEDERAL RESERVE BANKS, AUGUST 1932

Federal Reserve Bank	Month of August 1932					1932				Jan. - Aug. 1932		
	Earnings from -					Current expenses		Current net earnings		Current net earnings		
	Dis-counted bills	Pur-chased bills	U. S. secur-ities	Other sources	Total	Exclusive of cost of F.R. currency	Total	Total	Ratio to paid-in capital	Total	Ratio to paid-in capital	Less accrued dividends and net charges (current) to profit and loss
									Per cent		Per cent	
Boston	\$60,028	\$9,097	\$154,618	\$4,601	\$228,344	\$152,220	\$167,504	\$60,840	6.6	\$766,811	10.0	\$304,201
New York	208,439	45,343	1,130,955	27,893	1,412,630	519,150	527,258	885,372	17.7	6,675,075	16.8	4,382,143
Philadelphia	194,613	12,057	211,358	16,004	434,032	162,021	180,464	253,568	18.5	2,205,875	20.3	1,589,921
Cleveland	106,462	11,706	268,679	16,833	403,680	203,181	229,824	173,856	14.4	2,035,335	21.3	1,426,989
Richmond	82,701	7,159	70,954	23,128	183,942	114,721	124,651	59,291	13.5	402,356	11.4	190,910
Atlanta	102,747	4,499	70,707	5,990	183,943	96,185	101,005	82,938	20.1	613,059	18.6	414,082
Chicago	76,945	16,131	321,883	38,287	453,246	282,320	359,599	93,647	6.5	1,784,445	15.3	1,892,023
St. Louis	36,781	3,881	100,906	5,879	147,447	107,671	116,307	31,140	8.2	193,877	6.5	1,508
Minneapolis	40,890	2,512	94,050	2,787	140,239	79,002	86,132	54,107	21.9	322,290	16.5	202,332
Kansas City	63,679	3,395	86,375	21,080	174,529	134,392	142,003	32,526	9.4	337,459	12.3	166,345
Las Vegas	50,539	3,305	57,162	2,906	113,912	92,817	92,984	20,928	6.3	140,738	5.3	-25,099
San Francisco	260,220	10,779	186,015	33,767	490,781	190,127	212,578	278,203	31.1	2,284,113	31.3	1,821,986
TOTAL												
Aug. 1932	1,284,044	129,854	2,753,662	199,155	4,366,725	2,133,807	2,340,309	2,026,416	15.6			
July 1932	1,487,405	153,833	2,669,287	190,907	4,501,432	2,193,458	2,243,703	2,257,729	17.3			
Aug. 1931	470,998	446,986	907,818	181,935	2,007,737	2,107,296	2,176,928	-169,191	--			
Jan.-Aug. 1932	14,222,600	2,297,544	16,860,376	1,872,502	35,253,022	16,702,374	17,491,589	17,761,433	17.1	17,761,433	17.1	12,367,341
1931	3,602,254	1,850,663	8,325,186	1,264,529	15,042,632	17,010,213	18,072,414	-3,029,782	--	-3,029,782	--	-8,472,690

FEDERAL RESERVE BOARD
DIVISION OF BANK OPERATIONS
SEPTEMBER 13, 1932.

VOLUME 231
PAGE 136

Q 136

See No.

FEDERAL RESERVE BOARD

Date: August 23, 1932

MEMORANDUM

To: Governor Meyer
From: Mr. Gardner

Subject: Effect of the Depreciation
of Sterling Exchange on British
Prices.

British prices are now lower than when England suspended the gold standard on September 21, 1931. The suspension allowed sterling to go to a discount on the exchanges, and this in turn tended to raise sterling prices of international goods on the British market relative to the prices of these goods in gold standard countries. Many factors, however -- particularly tariffs, quotas, and exchange restrictions -- interfered with this tendency; and since "gold" prices continued to fall, even the relative rise meant no permanent heightening of the British price structure. Through June -- the latest date for which detailed figures are available -- prices in England rose steadily with relation to prices in the United States; yet they were lower in June than they were at the time of the gold suspension, for they had risen on a falling base.

As for the prices of strictly British -- i.e., domestic -- commodities, no considerable stimulus through trade expansion or credit expansion was set in motion by England's departure from gold, and in the course of this memorandum they have been touched upon but lightly. It is the effects upon the relative prices of international commodities that are especially subjected to examination.

Effect on prices of goods traded internationally. - The suspension of the gold standard was followed by a depreciation of sterling relative to gold standard currencies. The same factors which forced the gold suspension

3
B-4

VOLUME 231
PAGE 143

forced the depreciation. The discount on sterling in turn compelled those who sold to England to raise sterling prices by a corresponding amount if they were to obtain the same gold prices as before; and it enabled English exporters to charge correspondingly higher sterling prices without altering the gold prices at which they were selling in world markets. The indicated adjustment did not, of course, have to work out through a rise in sterling prices; it might equally be effected through a fall in gold prices, and indeed there is reason to believe that the difficulties of selling to depreciated-paper countries and the keener competition from these countries on world markets have exerted a depressive effect on gold prices generally. But whether sterling prices of international commodities moved up or gold prices down, one would expect a rise of the former relative to the latter equivalent to the full discount on sterling exchange. That is, one would expect it under conditions of perfect competition. Actually, however, we are further from such conditions today than at any time since the war.

In part the barriers to international trade are inevitable. It costs something to ship goods from market to market, and these costs vary according to the country. Furthermore the organization of markets, the existence of established selling connections, and the persistent habits of consumers, prevent large shifts overnight in the channels of international trade. Under these circumstances differentials among gold prices for substantially the same commodity in various markets of the world are unavoidable.

To inevitable factors of difference of this sort, however, have been added influences deliberately imposed by governments in the form of tariffs and quota systems. The increasingly severe application of these barriers to trade has been characteristic of the whole period of the depression; but it has been particularly in evidence since England's departure from the gold standard. Furthermore with the actual or threatened breakdown of currencies has come a further impediment to international transactions in the form of government monopolies of dealings in exchange. The purpose of these monopolies is to maintain a country's currency internationally at a level which could never be maintained in a free market. This is achieved by rationing the volume of funds which can be transferred abroad. Whether or not an importer can obtain funds to pay his foreign creditor is wholly a matter of the discretion of the central bank or exchange commission which administers the monopoly. This situation may result in absolute prohibition of certain classes of imports and the serious embarrassment of all importing transactions so that what otherwise might be profitable trades are never consummated. Even where exchange markets are left free, the risk of fluctuating currencies must be faced unless there is a well-developed forward business. And always there is the chance that under present conditions individual credit may not prove good -- particularly when it is a question of developing new business abroad.

This complex of factors has led to a considerable degree of isolation

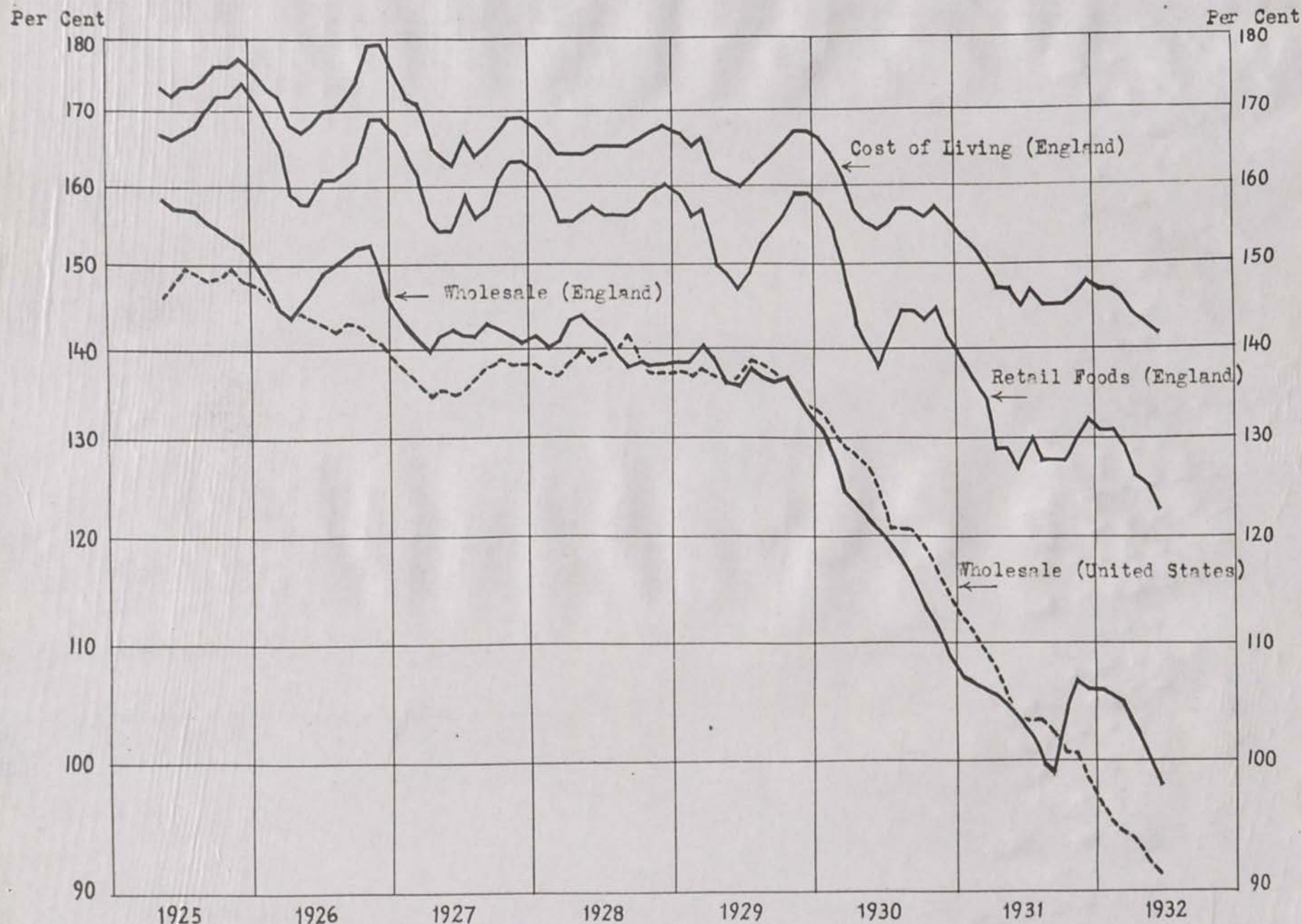
of markets. Within broad limits price movements in coal, butter, or meat may occur in the United States quite without relation to price movements in the same commodities in England. Where this is the case, there is no reason to expect the discount on sterling to be reflected at all closely even in the prices of international commodities. Yet it is in the markets for such commodities that the whole initial effect of the departure from the gold standard must be sought.

Evidence of the charts. - Notwithstanding the considerable degree of isolation which exists between markets of the world today, prices in England and the United States (to use the United States as a representative gold standard country) reflect relative exchange rates fairly closely. Chart 1 is designed to show in perspective the movement of the three major types of British prices -- wholesale, retail, and cost-of-living; but by way of comparison the wholesale index for the United States is also shown. The American wholesale index is more heavily weighted with manufactured products than the English and in other respects it is not entirely comparable. Yet the broad relationship is clear. The story on the surface of it looks somewhat as follows.

When England returned to the gold standard in April, 1925, British prices were on a higher level, relative to the pre-war base, than those in the United States. They continued to fall, until early in 1926 they drew even. Then came the great coal strike in England and prices mounted; but following the settlement they fell, the gap finally closing again in

CHART I

PRICES IN ENGLAND AND THE UNITED STATES 1925 to 1932



Base periods: cost of living and retail foods indexes, July, 1914 = 100; wholesale prices, 1913 = 100.
 Sources: England, cost of living and retail foods indexes, Ministry of Labour; and wholesale prices, Board of Trade; United States, wholesale prices, Bureau of Labor Statistics

1928. In 1930 the English index, composed mainly of raw materials, dropped somewhat more steeply than the American. Our new tariff may have been an influence in this situation. The similarity of movement persisted, however, until in September, 1931, England left the gold standard and a discount of from 20 to 30 per cent on sterling developed. The British index immediately jumped above the American -- though not by the full amount of the sterling premium on the dollar -- and then, as the American index continued to decline, English prices followed.

The apparent relationship here pictured is a close one. It would seem that, notwithstanding considerable dissimilarity in the commodities compared and the obstacles to international competition that have existed throughout the period, the exchange ratio between sterling and the dollar has dominated the relationship between the two indexes.

As one passes from wholesale commodities, representing in the English index mainly international goods, to retail commodities which reflect domestic labor, transportation, and distributing costs, the movement of prices becomes more sluggish. In a general way the prices of retail foods in England have followed wholesale prices. There has, however, been a marked seasonal rise in the fall of each year; and it is noteworthy that the rise in 1931 -- the one that followed the departure from the gold standard -- was certainly no more marked than those of other years. In fact it was rather less marked. And the same is true of the yet more sluggish cost-of-living index. So far as the

consumer in England is concerned there has been almost no reflection of the momentous shift in England's monetary standard last September.

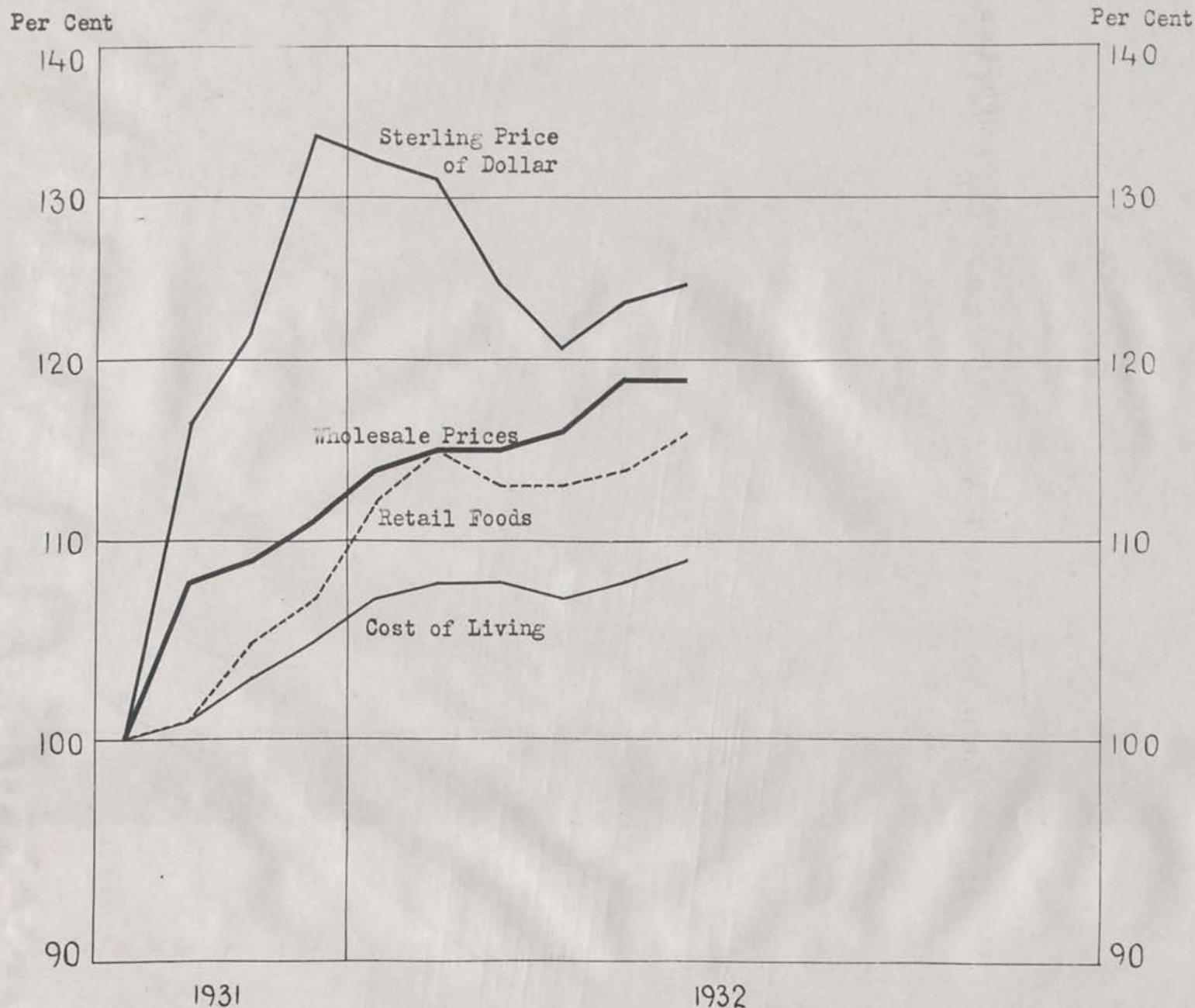
This is true even though, as shown in Chart 2, both retail foods and cost of living in England have risen in price relative to similar groups in the United States. Particularly is this noticeable in the case of retail foods; but there is no direct connection between retail prices in England and the United States, nor between cost of living in the two countries. The link is indirect and works out through those international markets which are common to the two countries. The really significant comparison shown on Chart 2 is that between the relative rise of wholesale prices in England and the sterling price of the dollar.

For the purposes of Chart 2 a special index of American wholesale prices has been used. This index is composed, so far as possible, of the same types of price quotations as compose the British wholesale index. It is not entirely comparable. No index can be made so and still represent conditions in the American market. But it is far more comparable than the Bureau-of-Labor-Statistics index of 784 price series, the official index for this country, which was used in Chart 1.

The line on Chart 2 showing wholesale prices represents the ratio of the English index to the comparable American index. It is evident from the rising line that since the departure of England from the gold standard sterling prices have risen relative to dollar prices but not

CHART II

RATIO OF ENGLISH TO AMERICAN PRICES (Sept. 1931 = 100)



Wholesale Prices = Board of Trade index (150 prices) for England ÷ Federal Reserve Board special index (150 prices) for United States.
 Retail Foods = Ministry of Labour index for England ÷ Bureau of Labor Statistics index for United States.
 Cost of Living = Ministry of Labour index for England ÷ National Industrial Conference Board index for United States.

by as much as the sterling price of the dollar itself. At first the gap was wide; but as sterling developed strength in 1932 and the price of the dollar fell, while relative sterling prices continued to rise, the gap closed. By spring the adjustment between (a) relative whole-sale prices in the two countries and (b) exchange rates, had been worked out to a considerable degree. The lines would indicate that the price relationship of the two countries on the average reflected the exchange rates of their currencies, notwithstanding the often widely diverse fluctuations of prices of the same commodity in England and the United States.

One technical point with regard to Chart 2 should be noted. All the lines on this chart are based on the month of September, 1931, as 100. During most of September England was on the gold standard and it was not until October that there was an important upward movement of prices. Exchange, however, reacted immediately to the gold suspension, and the sterling price of the dollar for September on a daily average basis was 7 per cent above par. By measuring the exchange level in subsequent months relative to the level in September, this 7 per cent premium is lost; and the line showing the sterling price of the dollar is lower throughout its course than it would have been had the first three weeks of September been taken as a base. Since it was not feasible to do this with commodity prices, the entire month of September

was used as a base for all lines. The chart as it stands, therefore, overstates somewhat the closeness of the adjustment of prices to exchange.

Evidence of individual commodity prices. - That the prices of different commodities -- bacon, coffee, cotton cloth -- should not move in unison with one another is quite to be expected. Even if markets were free and competition close, one would look for considerable variation in the movement of individual prices. This variation is the very essence of the process whereby supply and demand are in some measure kept in balance in the face of shifts in climatic conditions, available natural resources, technical knowledge, or consumer preferences. The major adjustments of our economic life as at present organized are predicated upon the diversity of movement of individual prices. Hence if any dominant influence were making for an upward movement, one would not expect it to be reflected uniformly through the entire range of prices. As a whole, the price structure might be raised, say, by 20 per cent; but meanwhile the price of a given commodity might rise by 60 per cent, while that of another might fall by 10 per cent. There would be nothing surprising in this; and it is not the sort of problem we are dealing with in comparing British with American prices.

The problem we are dealing with in making this comparison is that

of the different movement of prices of the same commodity in two markets. If competition between the two markets were free and unhampered, the prices of different commodities might move in different directions, but the prices of the same commodity in both markets would move together except for the variations in the rate of exchange between the two currencies concerned. If the sterling price of the dollar rose 25 per cent, one would expect the sterling price of cotton to rise 25 per cent with relation to the dollar price of cotton -- and throughout the entire range of individual commodities one would expect to find the same differential even though prices of some were moving up and prices of others down. All assuming close and unhampered competition -- such as definitely does not exist in the world today. As a matter of fact the available evidence shows that there is enormous variation in the differentials which have developed since September in the sterling and dollar prices of approximately the same commodities.

Data are not available to enable us to compare all the individual commodities of the English wholesale price index with corresponding commodities of the American index. In the table following, however, the comparison is made for a considerable list of individual commodities or groups of closely similar commodities. About four-fifths of all the price quotations in the respective indexes are represented.

PRICES OF INDIVIDUAL COMMODITIES IN
ENGLAND AND THE UNITED STATES

(September, 1931 = 100)

Commodities	Weight relative to 150	June, 1932		
		English index	American index*	English index relative to American
All commodities	150	98.9	83.2	119
Bacon	2	107.5	59.0	182
Corn	2	128.5	71.5	180
Cheese	2	117.3	69.2	170
Butter	3	83.6	54.2	154
Hemp	1	106.4	69.4	153
Leather: hides	4	71.8	47.8	150
Cocoa	1	109.8	74.1	148
Wool: raw	1	94.2	68.4	138
Wheat	3	123.1	90.0	137
Zinc	1	101.8	78.0	131
Lead	1	90.1	69.0	131
Rubber	1	69.0	52.9	130
Tin	1	100.3	79.0	127
Jute	1	86.2	69.2	125
Cotton: cloth	9	96.3	77.9	124
Cotton: yarns	5	100.7	81.9	123
Woodpulp: chemical sulphite.	2	87.6	73.3	120
Cotton: raw	2	97.7	82.0	119
Flour	3	115.5	98.0	118
Beef	6	99.3	84.1	118
Sugar	2	97.3	82.2	118
Copper	4	85.3	73.2	117
Linen: yarns	2	115.8	100.0	116
Wool: yarns	8	95.4	82.9	115
Tea	1	79.2	72.4	109
Iron and steel	24	101.1	97.0	104
Timber	4	89.1	86.1	103
Sulphuric acid	1	100.0	100.0	100
Coal	10	96.0	97.5	98
Sodium carbonate	1	100.0	102.2	98
Barley	5	70.6	74.3	95
Mutton	2	85.7	95.7	90
Glass	1	106.3	117.8	90
Lamb	1	79.4	101.4	78
Coffee	1	96.5	127.5	76

* Federal Reserve Board special index.

The table shows a range from a relative rise in bacon of 82 per cent to a relative fall in coffee of 24 per cent. Were the commodities really identical and were there no barriers to competition, they would all show a uniform rise of 24 per cent, the amount by which the sterling price of the dollar increased during the period. In considerable measure it is possible to account for the divergences.

The American tariff is at the root of most of the cases in which the ratio of English to American prices has risen by more than the discount on sterling. Take, for instance, the first commodity on the list -- bacon. By June the price of bacon in New York had fallen 41 per cent from its September level. In England the price had risen. Allowance must be made in the English price for the depreciation of sterling during the period; but even on a gold basis the decline was far more drastic in this country. Had prices in the two countries been competitive in September, a relative drop of such severity here in subsequent months would have been impossible since it would have led to exports of bacon and consequent equalization of markets. But costs of transportation and the American tariff isolated our bacon industry, permitting prices here to stand in September well above those prevailing abroad. From this high protected level it was possible for American prices to drop steeply without placing the American producer in position to take advantage of markets abroad where the price decline had been more moderate.

A similar story of tariff-isolated markets with independent price

movements could be told of the next three commodities on the list -- corn, cheese, and butter. To some extent the preferences and habits of the British consumer play into the situation. He prefers Danish butter and bacon, and he is used to Argentine corn. The direction of international trade is not easily changed. But the chief difficulty has been that in each of these cases the severe decline in American prices has been from a high protected level and has left the American producer still unable to compete abroad.

Much the same analysis can be made of those metals which stand high on the list. It is true that the relative rise in the English price of zinc and lead (largely the result of falling prices here) was much less in June than in May. In June prices of both these metals fell in England, while zinc recovered sharply here, and lead held its own. There can now be no question of exporting either metal to England. But even in May this opportunity did not exist; for at that time a decline of 34 per cent from the high tariff-protected price in the United States in September still left zinc producers unable to dispose of their product in London, although the sterling price had risen 10 per cent. On a more moderate scale this situation was repeated in the case of lead.

On the other hand tin, which comes largely from British Malaya

and to which no tariffs apply either here or in England, has behaved as a competitive commodity should. Both in September and June it was selling at nearly the same gold price in England and the United States, which means that the sterling price almost exactly reflected the discount on sterling. Broadly speaking, this was also true of copper in the month of May before we applied a tariff. The case is not quite as clear as that of tin because we produce most of our own copper while an increasing proportion of the English supply is being drawn from sources outside the United States. Nevertheless until our tariff went into effect in June, forcing South American, African, and Canadian supplies directly upon foreign markets (including London), the sterling price differential corresponded in considerable degree to the discount on sterling.

Among the textiles the same close competitive situation exists with respect to jute, on which there is no tariff. Raw cotton shows a somewhat smaller differential; but that is on account of the inclusion of an Egyptian quotation in the English index. The price of American cotton alone in the two markets reflects the full discount on sterling. Rubber, also, which is free of tariff, shows a differential not much greater than the altered exchange rate of the currencies, the actual prices on a dollar basis in London and New York for ribbed sheets being much the same.

Indeed it may in general be said that where identical commo-

dities are being compared and no tariff is in effect to isolate the markets, the British price relative to the American substantially reflects the discount on sterling. This is particularly true when the commodity in question is imported by both countries from a common source. When this is the case, even the tariff, providing it is unchanged, makes little difference.

Just how widely, however, commodities may differ though designated by the same general name, is shown in the case of coffee. Coffee in England means the more expensive Central American types. Coffee here is chiefly the common Brazilian. Since England left the gold standard the sterling price of coffee has actually fallen in the face of a substantial recovery in the price of the Brazilian product in New York. Brazilian coffee still remains, however, by far the cheaper product and there is no incentive for Americans to change.

The tea which finds its mass consumption in England comes from India and Ceylon, whereas it is Formosan tea which figures in the American index. The British barley quotation is for malting barley; ours for feeding barley in Chicago. Even in a common raw material like hemp, what are in effect two commodities may be created by the practices of the respective markets. Almost of necessity the English use a low-grade hemp, for their machinery is adjusted to it. The higher grades preferred by Americans may drop

relatively in price, but the English go on consuming low-grade hemp.

The familiar mutton of the Englishman is a high quality product representing the slaughter of comparatively young sheep. The American mutton, a product of older sheep reared chiefly for wool, is destined in the main for stews. Under such circumstances the English product is so far above the American in price that even a sharp decline fails to interest Americans -- quite aside from the prohibitive tariff, which, in this case, is irrelevant. In the case of lamb the tariff may have had some effect, though the fact that Americans are not accustomed to frozen lamb would probably have been sufficient to keep out the New Zealand product consumed in England, even after it had fallen in terms of gold somewhat below the price for fresh lamb here.

The tariff certainly has had some effect on the situation in wheat and beef; but there again the difference in types compared, subject as they are to different seasonal movements, has played a considerable part in permitting relative price changes greater or less than the discount on sterling.

The same differences in types compared, as well as heavy transportation costs, underlie the failure of two important British export groups -- coal, and iron and steel -- to reflect the discount on sterling. It is probable, however, that another

factor is at work in the case of exports -- namely, the efforts of British producers to expand their foreign markets by undercutting prevailing prices. Particularly in a commodity like coal where leading customers such as France and Germany have raised obstacles to the purchase of the British product, the necessity of an inducement in the way of price concessions is apparent. Incidentally it may be noted that coal prices in Germany have fallen considerably more than in the United States, which is a difficult market for English coal exporters to reach.

Other British exports have done rather better, especially cotton cloth. Not only have prices of cotton cloth risen by the full amount of the discount on sterling, but there has been a notable expansion in the volume exported since the gold standard was abandoned. By far the largest relative increase, however, was to China where the popular embargo on Japanese goods was a more important factor than the exchange differential. Furthermore, although cotton cloth is the highest export commodity in the list given on page 10, its relative price increase no more than matches the rise in the sterling price of the dollar. The British are seeking volume in their export trade rather than high unit prices.

Note on British trade. - The effect of the depreciation of sterling on the volume of British trade is somewhat aside from the main purpose of this memorandum, except in so far as trade

recovery would in itself lead to a rise in prices. In general it may be said that several British industries -- textiles, iron and steel, and even coal -- have stood up better than those of competitors abroad. But world markets have been deteriorating so rapidly that such relative advantages as have developed still leave England in the midst of depression. Even had general recovery set in, it would probably have been signalized, at least in its initial stages, more by an expanded volume of production and the absorption of the unemployed than by a rise of prices. The ultimate effects would depend upon whether the recovery of business in England spread to the rest of the world.

Actually the depreciation of sterling has not brought anything approaching full-fledged industrial recovery in England. Together with the tariff it undoubtedly is responsible for the better balance of merchandise trade enjoyed by the country since the gold standard was suspended. This particular difficulty of the British situation is by way of being cured. But at the outset the effect has been to add to the complications faced by other countries; and, taken alone, the improved international trading position of England has been quite inadequate to cure a depression which is due to a multitude of factors the world over.

Conclusion. - It is apparent that the only immediately effective price-raising influence of the departure from the gold standard

in England has been the spread introduced between sterling and gold prices in the markets for international commodities. Even with regard to international commodities the evidence points to the great variety of spread -- sometimes actually of a reverse character -- which has followed the depreciation of sterling. A study of individual commodities leaves one with the impression that the barriers to international trade in the world today are so numerous and important that markets are in considerable measure isolated -- particularly where heavy tariffs are in effect. Certainly there is wide room for divergence; and the effect of the sterling discount has been far from uniform.

It would be easy to underestimate, however, the forces of competition that are still at work throughout the field. In a large number of cases the apparently unrelated movement of the sterling and dollar prices of a given commodity is attributable to the fact that really two different commodities are being compared. Were comparison made between identical commodities in countries in which they are habitually traded, the movement of relative sterling prices would in general be found to reflect the movement of the exchange rate of sterling with the currencies concerned. Even where the American tariff is the factor which permits a divergent movement of sterling and dollar prices, it is still generally true that the

price in England relative to the price in the country from which England has imported the commodity reflects the discount on sterling. Furthermore few of the obstacles to international trade are absolute. The isolation of markets is only a matter of degree.

The nexus of competitive relationship, therefore, between England and the rest of the world is real, if somewhat loose. And directly and indirectly that nexus extends to the United States. Hence notwithstanding the diversity of situations surrounding individual commodities, the general relative position of British wholesale prices reflects to a large extent the discount on sterling relative to the dollar.

As was noted at the beginning of this memorandum, however, the increase in sterling prices has been only relative. They have continued to fluctuate as much as prices in the United States and other gold standard countries; and after a substantial initial rise they have fallen till today they are lower than when the gold standard was suspended in September, 1931.

6143