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Form F. R. 131

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 12, 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 255 of Mr. Hamlin's scrap book and placed in the Board's files:

VOLUME 255

Page 6
Memo to Mr. Hamlin from Mr. Parry re Excess Reserves in Canada and England.

Page 47
Memo to Board from Mr. Van Fossen re Loans, investments, and deposits on June 30, 1934.

Page 58
Copy of letter to Secretary Morgenthau accepting offer to sell F.R. Board lots on Constitution Avenue for building.

Page 60
Memo to Mr. Hamlin from Mr. Goldenweiser re inflation in Germany.

Page 66
Earnings and Expenses of F.R. Banks, July 1934.

Page 77
Memo to Mr. Hamlin from Mr. Goldenweiser re German inflation.

Page 91
Memo to Board from Mr. Smead re Condition of Licensed Member Banks.

Page 103
Memo to Gov. Black from Mr. Smead re value of F.R. note franchise to the F.R. Banks.

Page 117
Memo to Mr. Hamlin from Mr. Smead re value of F.R. note franchise to F.R. Banks.

Page 119
Memo to Mr. Hamlin from Mr. Goldenweiser re Purchasing power parities.

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date July 19, 1934

To Mr. Hamlin

Subject: Excess reserves in Canada and England

From Mr. Parry

ere 16—852

LEP

In answer to your question of a few days ago, it is substantially true to say that commercial banks in Canada and England "are holding no excess reserves at the present time." For Canada the ratio of cash reserves to deposits, while not so low as it was earlier in the depression, is still below that which prevailed prior to October 1929. The English clearing banks are now holding reserves of slightly less than 12 percent -- which compares with 10 1/2 percent in the spring of 1932 and indicates that the reserve position of the English banks, while "comfortable" or even "easy", is nowhere near so easy as that of the member banks of the Federal Reserve System.

I should be glad to talk with you at your convenience about the implications of this contrast together with the conditions that have produced it. A point to be considered is that while some might not consider the System's credit policy in the early days of the depression sufficiently liberal, this policy comprised very large open-market operations and very prompt reductions in discount rates.

VOLUME 255
PAGE 6

Sec'y Franklin

August 2, 1934

TO: Federal Reserve Board

From: Mr. Van Fossen

SUBJECT: Loans, investments, and deposits on June 30, 1934.

At the Board's request the Federal Reserve agents have compiled preliminary figures of loans, investments and deposits of licensed member banks from the June 30, 1934 condition reports.

These compilations, which have been summarized in the attached statement, show a net increase of $555,000,000 in total loans and investments since March 5, 1934, as a result of increases of $458,000,000 in holdings of United States Government securities and of $320,000,000 in other securities and a decrease of $222,000,000 in loans.

Total deposits increased $1,697,000,000 during the four-month period, United States Government and postal savings deposits declined $307,000,000 and all other classes of deposits increased by the following amounts:

Demand	$1,070,000,000
Time	505,000,000
State, county and municipal	199,000,000
Deposits of other banks, certified and officers' checks and cash letters of credit and travelers' checks	229,000,000

Between June 1933 and June 1934 member bank holdings of United States Government securities increased $2,238,000,000 and of other securities $454,000,000, while loans declined $374,000,000, resulting in a net increase in total loans and investments of $2,317,000,000. Total deposits of member banks increased during the year by $4,413,000,000, of which $1,492,000,000

was in demand, $960,000,000 in time, $542,000,000 in state, county and municipal, $644,000,000 in United States Government and postal savings, and $775,000,000 in other deposits (deposits of banks, certified and officers' checks, etc.). A substantial part of the increases during the year were a result, of course, of accessions to membership, the organization of new national banks (mostly to succeed nonmember banks or unlicensed member banks), and the licensing of member banks that had not been licensed by the end of June of last year. It is estimated that State banks admitted to membership and/or licensed during the year had deposits of about $400,000,000 and national banks organized and/or licensed during the year had deposits of between $600,000,000 and $700,000,000.

Confidential

PRELIMINARY FIGURES OF LOANS, INVESTMENTS, AND DEPOSITS OF LICENSED MEMBER BANKS ON JUNE 30, 1934, COMPARED WITH MARCH 5, 1934 AND JUNE 30, 1933

(In thousands of dollars)

B-1008

Date	Loans and investments					Deposits					
	Total	Loans (including overdrafts)	U.S.Government securities	Securities guaranteed by U. S. Government	Other securities	Total	Demand	Time	Public funds of states, counties and municipalities	U.S.Government and postal savings	Deposits of other banks, certified and officers checks, and cash letters of credit
TOTAL-ALL MEMBER BANKS											
1933, June 30	24,786,371	12,858,099	6,887,123	5,041,149		26,563,927	11,830,246	7,802,627	1,386,988	1,594,789	3,949,277
1934, March 5	26,548,211	12,705,759	8,667,064	208,692	4,966,696	29,280,158	12,251,863	8,257,608	1,729,657	2,544,996	4,496,034
June 30	27,103,511	12,483,664	9,124,628	515,522	4,979,697	30,976,834	13,322,172	8,762,957	1,928,680	2,238,366	4,724,659
NEW YORK CITY*											
1933, June 30	7,133,362	3,423,941	2,551,429	1,157,992		7,756,123	4,676,192	671,153	100,381	441,558	1,866,839
1934, March 5	7,350,572	3,418,898	2,767,604	107,028	1,057,042	8,023,140	4,422,089	599,956	121,979	948,093	1,931,023
June 30	7,621,708	3,379,631	3,041,422	198,254	1,002,401	8,445,740	4,869,366	646,386	176,814	865,491	1,887,683
CHICAGO*											
1933, June 30	1,287,123	676,951	384,479	225,693		1,644,793	869,657	357,848	88,091	51,447	277,750
1934, March 5	1,439,696	587,455	563,926	75,041	213,274	1,790,402	865,207	363,593	133,413	73,887	354,302
June 30**	1,444,166	556,701	584,289	77,250	225,926	1,937,296	944,224	361,003	174,070	48,014	409,985
OTHER RESERVE CITIES											
1933, June 30	8,492,468	4,481,773	2,482,571	1,528,124		9,404,443	3,707,983	2,941,030	557,676	700,540	1,497,214
1934, March 5	9,376,471	4,465,896	3,389,864	11,596	1,509,115	10,655,474	3,957,897	3,130,915	685,686	1,040,845	1,840,131
June 30**	9,591,214	4,388,392	3,517,896	115,128	1,569,798	11,410,638	4,363,106	3,369,224	760,873	893,684	2,023,751
COUNTRY BANKS											
1933, June 30	7,873,418	4,275,434	1,468,644	2,129,340		7,758,568	2,576,414	3,832,596	640,840	401,244	307,474
1934, March 5	8,381,472	4,233,510	1,945,670	15,027	2,187,265	8,811,142	3,006,670	4,163,144	788,579	482,171	370,578
June 30	8,446,423	4,158,940	1,981,021	124,890	2,181,572	9,183,160	3,145,476	4,386,344	816,923	431,177	403,240

FEDERAL RESERVE BOARD
DIVISION OF BANK OPERATIONS
AUGUST 1, 1934.

*Central reserve city banks only. **The June 30 figures for Chicago exclude and those for "Other reserve cities" include former "central reserve city" banks in Chicago, with deposits of about $60,000,000, which between March 5 and June 30, 1934, were authorized to carry the same reserve on deposits as reserve city banks.

Sec Bn

August 14, 1934.

Honorable Henry Morgenthau, Jr.,
Secretary of the Treasury,
Washington, D. C.

My dear Mr. Secretary:

I beg to advise that I have presented to the Federal Reserve Board your offer to sell to the Federal Reserve Board for its new building in Washington Squares E-87 and E-88 facing Constitution Avenue, between 20th and 21st Streets, Northwest, for a sum equal to the purchase price paid by the Government for the property sold plus interest on the same at the average rate paid each year by the Treasury on its outstanding obligations, for the period from the date of the acquisition of the property by the Government to the date of its acquisition by the Board, and that your offer was accepted. Upon delivery of deed conveying good title the consideration will be paid.

The descriptions contained in this acceptance are descriptions furnished us by Mr. Delano, Chairman of the National Capital Park and Planning Commission.

I am requested by the Board to express its appreciation of your cooperation in the matter.

With my warm regards, I am

Sincerely yours,

Governor.

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

See BK

Date August 14, 1934

To Mr. Hamlin

Subject:

From Mr. Goldenweiser

GPO 16—852

The inflation in Germany, in its final stages, was so precipitous that we need go back only to the middle of August 1923 to cut the rise in prices down to the magnitude you have in mind.

Should wages in the United States rise to about the same extent as did German wages during the period 1914--August 1923, a laborer now getting $4 a day would receive a wage of $1,300,000. The corresponding prices for some of the necessities of life are given in the table below:

COST OF CERTAIN ITEMS IN A LABORER'S BUDGET ASSUMING INFLATION SIMILAR TO THAT IN GERMANY DURING THE PERIOD 1914--AUGUST 1923.

Item	Approximate present cost	Cost computed on basis of rise in German retail prices
	Cents	Thousands of dollars
Bread - (loaf)	8	40
Butter - (lb)	30	150
Milk - (qt)	11	55
Beef chuck roast (lb)	17	85
Potatoes - (lb)	3	15
Cabbage - (lb)	3	15
Street car fare	8	40
Taxi fare	20	100

BV

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See Bk

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B-811

EARNINGS AND EXPENSES OF FEDERAL RESERVE BANKS, JULY 1934

Federal Reserve Bank	Month of July 1934									January - July 1934		
	Earnings from					Current expenses		Current net earnings		Current net earnings		
	Dis-counted bills	Pur-chased bills	U. S. Govt. securi-ties	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	$579	$98	$251,215	$5,077	$256,969	$172,238	$173,588	$83,381	9.1	$586,657	9.4	$256,685
New York	28,774	540	1,302,510	9,447	1,341,271	598,305	621,300	719,971	14.1	5,340,542	15.5	3,662,506
Philadelphia	15,122	141	269,244	3,127	287,634	189,226	193,271	94,363	7.2	859,386	9.5	372,244
Cleveland	2,383	122	338,443	5,806	346,754	237,634	239,344	107,410	9.8	726,314	9.9	310,398
Richmond	3,824	50	164,579	2,440	170,893	139,517	140,836	30,057	7.1	157,041	5.4	-4,732
Atlanta	577	46	147,526	45,441	193,590	98,276	99,206	94,384	25.1	277,629	10.8	138,119
Chicago	444	171	680,189	25,669	706,473	289,275	293,440	413,033	38.5	2,609,243	35.4	2,533,991
St. Louis	473	14	149,109	4,291	153,887	118,947	120,555	33,332	9.7	231,556	10.0	102,547
Minneapolis	1,021	10	115,082	3,106	119,219	97,408	97,852	21,367	8.2	149,246	8.7	58,053
Kansas City	471	37	150,190	14,668	165,366	149,310	150,129	15,237	4.3	107,737	4.5	-19,837
Dallas	1,088	37	125,551	5,992	132,668	91,934	92,157	40,511	11.9	203,125	8.9	127,546
San Francisco	3,025	93	264,260	8,403	275,781	205,931	208,764	67,017	7.3	427,852	6.9	89,110
TOTAL												
July 1934	57,781	1,359	3,957,898	133,467	4,150,505	2,388,001	2,430,442	1,720,063	13.8			
June 1934	97,806	1,389	3,794,390	99,822	3,993,407	2,383,616	2,432,843	1,560,564	12.9			
July 1933	373,638	32,851	3,349,183	96,255	3,851,927	2,198,620	2,291,962	1,559,965	12.6			
Jan.-July 1934	1,023,992	122,062	27,036,568	744,086	28,926,708	16,646,675	17,250,380	11,676,328	13.8	11,676,328	13.8	7,626,630
1933	7,216,439	1,130,114	20,220,660	925,853	29,493,066	15,646,085	17,280,424	12,212,642	14.1	12,212,642	14.1	6,898,757

FEDERAL RESERVE BOARD
DIVISION OF BANK OPERATIONS
AUGUST 17, 1934.

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Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Sec. Bk

Date August 11, 1934

To Mr. Hamlin

Subject:

From Mr. Goldenweiser

ero 16—852

At the time of German stabilization one gold reichsmark was equivalent to 1,000,000,000,000 paper marks. Wholesale prices in Germany had also risen to about 1,000,000,000,000 times their 1913 level. The rise in retail prices and wages was slower, the rise in retail prices being about three-fourths, and the rise in wages about one-half, that of wholesale prices.

Should the United States undergo an inflation corresponding in magnitude to the German inflation the dollar price of gold and wholesale prices would increase 1,000,000,000,000 times; and wages of unskilled workers, which are now about 45 cents an hour, would become hundreds of billions of dollars an hour. If they rose as much as the dollar price of gold, they would be $450,000,000,000 an hour. If they lagged behind to the same extent as German wages, they would be $225,000,000,000. A laborer, therefore, might receive nearly $2,000,000,000,000 a day, but he would have to pay about $80,000,000,000 for a quart of milk; $25,000,000,000 for a pound of potatoes, and $150,000,000,000 for a ride in a taxicab from the Treasury to the Capitol. The prices for these and some of the other necessities of life are given in a table on the following page.

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Mr. Hamlin - #2

COST OF CERTAIN ITEMS IN A LABORER'S
BUDGET ASSUMING INFLATION SIMILAR TO THAT IN
GERMANY DURING THE PERIOD 1914--1923

Item	Approximate present cost	Computed costs	
		On basis of rise in mark price of gold	On basis of rise in German retail prices
	Cents	Billions of dollars	
Bread - (loaf)	8	80	60
Butter - (lb)	30	300	225
Milk - (qt)	11	110	83
Beef chuck roast (lb)	17	170	128
Potatoes - (lb)	3	30	23
Cabbage - (lb)	3	30	23
Street car fare	8	80	60
Taxi fare	20	200	150

Mr. Hamlin

Sec Bk

August 18, 1934

Federal Reserve Board

Mr. Smead

Under date of August 2 we sent the Board preliminary figures, compiled by the Federal Reserve agents, of loans, investments and deposits of licensed member banks on June 30, 1934. There is now attached a statement giving a classification of all assets and liabilities of member banks on June 30, 1934 in comparison with corresponding figures for the preceding call and for June of last year. This statement is based on data furnished us by the Comptroller of the Currency and on compilations made by this Division from condition reports rendered by State bank members.

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(Preliminary figures)

CONDITION OF LICENSED MEMBER BANKS
(Amounts in thousands of dollars)

B-1010

ASSETS	Condition on - June 30, 1934	Condition on - Mar. 5, 1934	Condition on - June 30, 1933	Change since - Mar. 5, 1934	Change since - June 30, 1933
Loans (including overdrafts)	12,522,980	12,705,759	12,858,099	-182,779	-335,119
U.S. Govt. securities	9,136,684	8,667,064	6,887,123	+469,620	+2,249,561
Secur. guaranteed by US Gov't	508,643	208,692	--	+299,951	+508,643
Other securities	5,006,532	4,966,696	5,041,149	+ 39,836	- 34,617
TOTAL LOANS AND INVESTMENTS	27,174,839	26,548,211	24,786,371	+626,628	+2,388,468
Customers' liab. on accept's	252,916	395,503	424,263	-142,587	-171,347
Banking house, furniture, and fixtures	997,817	982,606	982,036	+ 15,211	+15,781
Other real estate owned	286,348	290,329	227,074	-3,981	+59,274
Cash in vault	472,643	486,086	404,502	-13,443	+68,141
Reserve with F. R. banks	3,819,410	3,148,124	2,235,179	+671,286	+1,584,231
Items with F.R. banks in process of collection	473,810	413,397	423,163	+60,413	+50,647
Due from banks in U.S.	2,666,277	2,303,449	2,008,218	+362,828	+658,059
Due from banks in foreign countries	232,606	209,335	214,111	+23,271	+18,495
Exchanges for C.H. and other checks on local banks	518,239	702,682	1,008,400	-184,443	-490,161
Outside checks and other cash items	64,730	42,916	53,780	+21,814	+10,950
Redemption fund and due from U. S. Treasurer	36,249	40,674	37,261	-4,425	-1,012
Acceptances of other banks and bills sold with endorsement	1,920	24,741	7,948	-22,821	-6,028
Securities borrowed	2,524	6,099	6,654	-3,575	-4,130
Other assets	384,483	331,132	227,820	+53,351	+156,663
Total assets	37,384,811	35,925,284	33,046,780	+1,459,527	+4,338,031
LIABILITIES					
Demand deposits	14,963,215	13,692,248	12,927,778	+1,270,967	+2,035,437
Time deposits	9,811,153	9,416,145	8,980,860	+395,008	+830,293
United States deposits	1,657,793	1,790,401	806,297	-132,608	+851,496
Due to F. R. banks	41,563	39,305	34,004	+2,258	+7,559
Due to other banks in U.S.	4,054,101	3,660,352	3,047,327	+393,749	+1,006,774
Due to banks in foreign countries	154,437	217,128	168,276	-62,691	-13,839
Certified and officers' checks outstanding	317,389	499,636	609,484	-182,247	-292,095
Cash letters of credit and travelers' checks	12,716	9,610	13,430	+3,106	-714
TOTAL DEPOSITS	31,012,367	29,324,825	26,587,456	+1,687,542	+4,424,911
National bank notes	694,790	786,514	727,110	-91,724	-32,320
Agreements to repurchase securities sold	5,314	10,193	14,244	-4,879	-8,930
Bills payable and rediscounts:					
With F. R. banks-Bills pay.	15,997	39,025	64,121	-23,028	-48,124
Rediscounts	3,071	7,218	35,105	-4,147	-32,034
All other - Bills payable	15,755	44,390	91,285	-28,635	-75,530
Rediscounts	17	308	717	-291	-700
Acceptances of other banks and bills sold with endorsement	1,920	24,741	7,948	-22,821	-6,028
Accept's exec'd for customers	266,646	413,794	434,997	-147,148	-168,351
Acceptances executed by other banks for reporting banks	11,352	10,441	7,302	+911	+4,050
Securities borrowed	2,524	6,099	6,654	-3,575	-4,130
Expenses accrued and unpaid	70,759	88,330	67,111	-17,571	+3,648
Other liabilities	179,375	163,544	165,648	+15,831	+13,727
Capital notes and debentures(1)	154,839	125,673	--	+29,166	+154,839
Capital stock(see memo. below)	2,497,343	2,378,117	2,220,330	+119,226	+277,013
Surplus	1,690,560	1,724,409	1,847,462	-33,849	-156,902
Undivided profits - net	387,228	376,282	373,258	+10,946	+13,970
Reserves for contingencies	374,954	401,381	396,032	-26,427	-21,078
Total liabilities	37,384,811	35,925,284	33,046,780	+1,459,527	+4,338,031
MEMORANDUM-- Par value of capital stock:					
First preferred	(2)459,047	266,278	--	+192,769	+459,047
Second preferred	(2) 15,758	6,885	--	+8,873	+15,758
Common	2,025,022	2,106,621	2,220,330	-81,599	-195,308
Total	2,499,827	2,379,784	2,220,330	+120,043	+279,497
Number of banks	6,375	6,206	5,606	+169	+769

(1) $151,629,000 sold to the Reconstruction Finance Corporation and $3,210,000 sold to others by state bank members.

(2) Retirable value exceeds par value in the case of State bank members as follows: First preferred stock, by $2,849,000; second preferred, by $677,000.

July 13, 1934

Governor Black

Mr. Smead

Since talking with you the other day, and the receipt of your note of July 10, we have prepared the attached short memorandum relating to the value of the Federal Reserve note franchise to the Federal Reserve banks.

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PAGE 103

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THE FEDERAL RESERVE NOTE FRANCHISE

AND THE EARNING POWER OF THE RESERVE BANKS

The Federal Reserve note franchise gave to the Federal Reserve banks the means of mobilizing the monetary gold stock of the country through the paying out of Federal Reserve notes in exchange for gold and gold certificates, and this power was exercised to the utmost during the World War when the monetary gold stock was less than half what it is now and the Reserve banks had need to build up their gold reserves. During the post war period the policy of withdrawing gold from circulation was reversed in a measure and for a period of years the amount of gold certificates in circulation was maintained at about $1,000,000,000.

The Federal Reserve note franchise also gave the Reserve banks the potential ability to issue currency in an amount equal to two and one-half times the amount of their gold holdings not required as reserves against deposits. It was, of course, through this power that the Reserve banks were able to meet the demand for currency during the World War and the early post war period. During this period Federal Reserve note circulation was expanded to a point not greatly below the maximum possible, at that time, as is evidenced by the low reserve ratios that then prevailed. This issuance of Federal Reserve notes to meet demands for additional currency, in contrast to a mere substitution of Federal Reserve notes for gold and gold certificates, necessarily resulted in a corresponding increase in the earning assets of the Reserve banks. Since this period was also one of relatively high interest rates, earnings of the Reserve banks were correspondingly high; for example, net earnings of the Reserve banks totaled $52,700,000 in 1918, $78,400,000 in 1919, $149,300,000 in 1920, and $82,100,000 in 1921.

By 1922 the monetary gold stock had increased, largely because of gold imports, to such an extent that the Reserve banks could have paid out gold certificates in retirement of all, or substantially all, of their Federal Reserve note circulation without incurring a deficiency in their required reserves. In other words, the Federal Reserve notes had become for all practical purposes gold certificates since gold reserves of the Reserve banks, after setting aside the required gold and lawful money reserve of 35 percent against deposits, were equal to around 100 percent of Federal Reserve note circulation.

That the note issuing power does not and can not be expected to contribute anything to the earning power of the Reserve banks with our present monetary gold stock (increased by about $2,800,000,000 by a reduction in the gold content of the dollar) is indicated by the fact that at the present time gold reserves available against Federal Reserve notes are $450,000,000 in excess of Federal Reserve note circulation, while at the same time the Treasury holds something over $2,600,000,000 of free gold. The silver purchase policy by increasing the circulation of silver certificates will, of course, tend to bring about a reduction in Federal Reserve note circulation and consequently to make even more improbable any likelihood that the Reserve banks may hereafter find the note issuing function anything other than a source of expense to them.

The situation may perhaps be best indicated by reference to the fact that at the present time (June 30 figures) the monetary stock, exclusive of Federal Reserve notes and Federal Reserve bank notes, amounts to $9,967,000,000 compared with $5,374,000,000 of money in circulation. As the Treasury needs but a small working cash balance in excess of the $156,000,000 gold reserve against United States notes and the Reserve banks less than $1,500,000,000 as a reserve against deposits, it is evident that all Federal Reserve notes and Federal Reserve bank notes could be retired and the amount of money in circulation

increased to something like $8,300,000,000, or more than $700,000,000 in excess of the amount of money in circulation when it reached the highest level in history during March, 1933, and approximately $3,000,000,000 in excess of that now in circulation and that too without making any further use of the power of the Treasury to issue silver certificates and, of course, without any use being made of the authority existing to issue $3,000,000,000 additional of United States notes. It is apparent, therefore, that our stock of money, exclusive of Federal Reserve currency is adequate to take care of all probable requirements.

Even though the Federal Reserve System should lose its right to issue Federal Reserve Currency, the elasticity of our currency would not necessarily be affected since any excess currency not required for circulation purposes would flow into the Federal Reserve banks, which are the central reservoirs of our banking system, and when there was a demand for currency it would flow out of those central reservoirs to the points where it was needed. This, of course, would mean that fluctuations of the reserve ratio would be more pronounced than under present circumstances, because the amount of money paid out or the amount of money received by the Federal Reserve banks would have a 100 percent effect upon their reserves.

The stock of money in the United States on June 30, 1934, exclusive of Federal Reserve currency and of the various types of paper currency the issuance of which does not increase the monetary stock (gold certificates, silver certificates, Treasury notes of 1890 and in part United States notes) was as follows:

Gold	$7,856,000,000
Silver	837,000,000
Minor coin	128,000,000
United States notes*	191,000,000
National bank notes	955,000,000
Total	$9,967,000,000

*Exclusive of $156,000,000 of such notes against which the Treasury holds a gold reserve of that amount.

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Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

See Bk

Date August 27, 1934

To Mr. Hamlin

Subject:

From Mr. Smead

ers 16—852

With reference to your telephone request for certain additional information in connection with my memorandum to Governor Black, dated July 13, regarding the value of the Federal Reserve note franchise to the Federal Reserve banks, as I told you over the telephone it is difficult if not impossible to determine exactly what proportion of the earnings of the Federal Reserve banks has in the past resulted from the issuance of Federal Reserve notes.

Taking the year 1920 for an example, however, the year in which the earnings of the Federal Reserve banks reached a peak of $181,000,000, I find that the average circulation of Federal Reserve notes that year was $3,146,000,000. Cash reserves the same year amounted to $2,119,000,000. Of the latter amount $605,000,000 was required as a reserve (35%) against deposits of $1,728,000,000. By deducting the $605,000,000 required reserve against deposits from total reserves, $2,119,000,000, we obtain $1,514,000,000, which may be assumed to represent the amount of gold the Federal Reserve banks received in exchange for Federal Reserve notes. The Federal Reserve banks, of course, receive no income on that portion of their note issue which results from an exchange of Federal Reserve notes for gold. Since the average circulation of Federal Reserve notes was $3,146,000,000, the difference between that amount and the $1,514,000,000 of notes assumed to be exchanged for gold, or $1,632,000,000, may be taken as the amount of Federal Reserve notes which member banks obtained by either borrowing from, or selling securities to, Federal Reserve banks. The average rate of earnings of the Federal Reserve banks on all earning assets in 1920 was 5½% and that rate applied to the $1,632,000,000 of credit extended for currency purposes would give earnings of $90,000,000. From this figure should be deducted the cost of issuing such currency, about $6,000,000, which would leave earnings resulting from Federal Reserve note issues at around $84,000,000. This, of course, is only approximate and I should

not want it to be taken as too close an estimate of earnings resulting from note issues during that year.

At the present time the Federal Reserve banks have sufficient reserve so that they could, if they were allowed to pay with gold certificates, retire all their note issues without in any way affecting their earning assets. It is clear, therefore, that the Federal Reserve banks not only are not now receiving any income from their Federal Reserve note circulation but are having to pay the expense of printing, issuing and redeeming a large part of the paper currency now in circulation.

With regard to your other question, the stock of money in the United States, exclusive of Federal Reserve currency and of the various other types of currency the issuance of which does not increase the monetary stock, is now approximately $10,000,000,000. After withdrawing all Federal Reserve notes from circulation the Federal Reserve banks would have more than enough cash to cover their required reserves against deposits, and the existing stock of money would be sufficient to permit of an increase in the amount of money in circulation to over $8,000,000,000, or about 60% in excess of the amount of money, $5,300,000,000, now in circulation.

If the Federal Reserve note franchise were taken away from the Federal Reserve banks and at some time in the future gold exports or the demands for currency or both should become extraordinarily heavy, it is possible that we would find the amount of existing currency somewhat short of requirements. If the Federal Reserve note franchise were taken away from the Federal Reserve banks, therefore, some means should be provided whereby the Federal Reserve banks could, in case of necessity, obtain additional currency from the United States Treasury, for example, in about the same way that they now obtain currency from the Federal Reserve Agents. On this currency they should pay interest at an agreed upon rate which, for instance, might be the same as the lowest rate of interest currently paid on 90 day borrowings by the

Treasury. This rate of interest, whatever it might be, which Federal Reserve banks would pay the Treasury for such currency, should not in any way interfere with the credit policies of the Federal Reserve System nor should it deter member banks from borrowing from the Federal Reserve banks such funds as might be necessary to enable them to take care of the requirements of their customers. Presumably such a demand for currency would not come except at times of credit expansion, in which case the discount rates of Federal Reserve banks might be expected to be materially above the rate the Treasury is paying on short time borrowings and this would give the Federal Reserve banks a sufficient profit to enable them to cover all expenses in connection with obtaining currency from the Treasury and issuing it to member banks.

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date August 27, 1934

To Mr. Hamlin

From Mr. Goldenweiser

Subject: Purchasing power parities

16—852

As I understand it, you said that Professor Cassel in a recent article stated that exchange stabilization can be accomplished and is a desirable thing only when the exchanges are at or near their purchasing power parities.

This rather forbidding term has a very simple meaning. It means that exchange rates are approximately adjusted to relative price levels. In other words, that a dollar, which will buy a given amount of commodities in this country, would when exchanged into sterling buy the same amount of commodities in England and when exchanged into francs would buy the same amount of commodities in France. Such an adjustment can be achieved either through changes in the exchange value of a currency or through changes in commodity prices.

There is no quarrel with this doctrine in a general way. Like so many economic theories, it would be accurate "if it were not for the friction." Friction in this case is represented by several elements. (1) Commodities that cannot easily be transported from one country to another and, therefore, do not necessarily compete or cost the same amount in different countries. Such commodities as street car fares, dental services, fresh milk and vegetables cannot easily be sent from one country to the other, and their prices consequently can remain at different levels for a long time. There is a protracted lag between adjustments of prices of commodities that enter into the world market

and of prices of other commodities. (2) The commodity to which the foregoing applies most emphatically is labor. Labor costs differ in different countries, and, therefore, exert an influence towards differences in prices, especially of the kind of commodities mentioned under (1). (3) At all times, and particularly at the present time, there are numerous restrictions to the free movement of commodities and funds that interfere with international adjustment. Principal among these are embargoes, quotas, tariffs and exchange controls.

In view of these considerations, Cassel's statement means no more than that you can't have stabilization until you have stabilization. The argument on the other side would be that stabilization of exchanges by international agreement, at least on a temporary adjustable basis, may be a factor in bringing about better adjustments in other respects and in removing some of the obstacles to the free flow of funds and goods that are now working against stable international relations.