BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date November 2, 1954

To Chairman Martin

Subject:

From Woodlief Thomas

Following my discussion of reserve requirement proposals at a Board meeting, you suggested that the Board would like to have a memorandum covering the material that I presented. Attached is a copy of a memorandum which I have prepared.

The principal purpose of this memorandum is to serve as a basis for discussion at the meeting of the System Committee on Reserve Requirements. It should be emphasized that although the material presented is based in part upon deliberations and studies of the Committee, the selection of material and the views expressed are mine and may not represent the views of other members of the Committee or of the Board's staff. Following the scheduled meeting on November 10, the Committee may wish to present to the Board a progress report of a different sort. } ok

3 yrs 7 mths

W. T.

1953-1/1
54-1/1
22

17058
12,852
4206

Attachment

9 mths
12/22

R.E.S. 100
Brown 750
Smith 200
C.C.B 500
Canady 1,000
2,550

November 1, 1954.

REVIEW OF RESERVE REQUIREMENT PROPOSALS AND STUDIES

(Draft for Committee Consideration)

For twenty-five years or more, the Federal Reserve System has given frequent consideration to the desirability of altering the system of computing reserve requirements for member banks. It has come to be recognized that the major function of bank reserves and reserve requirements from the standpoint of Federal Reserve policy is to limit the capacity of the commercial banking system to expand credit and create money. Hence reserve requirements provide an important mechanism for the Federal Reserve authorities to use in their policy actions designed to influence the volume of bank credit and the supply and use of money. Nevertheless, any particular system or structure of reserve requirements that contains variations with respect to types of deposits or locations of banks affects individual banks differently in accordance with the nature and place of their business. Such variations should have a defensible reason and should be devised so as to not be inequitable with respect to individual member banks.

There are two primary sets of reasons for various proposals that have been made for reform of the reserve requirements structure:

1. The inadequacy of the existing system as a means of exerting effective control over the volume of bank credit and the supply and use of money has been the major reason for some proposals, which are designed primarily to affect the level of reserve requirements.

2. Questions of equity as among individual banks and of efficient administration of reserve requirements have occasioned other proposals, which are concerned primarily with the structure of reserve requirements rather than the level of reserves.

Plans Designed to Improve Control Function of Reserve Requirements

Several plans have been considered in the past twenty-five years for the purpose of improving the function of reserve requirements in exerting control over the level of reserves and hence over the supply of credit and money. None of such proposals has been actually adopted, except authority to the Board to raise and lower the reserve percentages within designated limits on the basis of the existing structure. Stricter regulation with respect to the definition of time deposits may also have affected slightly the level of requirements by removing a potential loophole. Among the proposals, the more important were as follows:

1. Velocity reserve proposal. This plan, suggested in the early 1930s after a careful and comprehensive study of the function of reserve requirements by a System committee, was in part designed to improve the structure of requirements. It also aimed to enhance the control powers, particularly to correct weaknesses indicated by the use of credit--bank and nonbank--in the stock market speculation of the 1920s. Another aim was to close a loophole that appeared in the 1920s owing to the lower requirements against time deposits.

The proposal would base requirements in part on the volume of deposits with no distinction as to type of deposits and in part on the rate of turnover of deposits as measured by the volume of checks drawn against or withdrawals of deposits. Thus reserve requirements would reflect the rate of use of money as well as the volume of money. This proposal was given considerable study in the 1930s and was recommended to Congress by the Board. It was never pushed vigorously, partly because during that period of small credit use and large excess reserves it would not have been particularly effective, nor was it needed. Certain difficulties of administration also raised some opposition to the plan. The problem of time deposits was largely corrected by new legislation and regulation in the 1930s and granting of discretionary authority to raise requirements offered a more effective means of absorbing redundant reserves when the occasion arose.

2. Ceiling reserve proposals. Various proposals have been suggested to impose higher reserve requirements on increases in deposits beyond some basic level or ceiling than on deposits below that level. The first such proposal was designed to absorb some of the excess reserves caused by the continued gold inflow of the 1930s. These reserves threatened to go beyond the capacity of the System to absorb them under its then existing powers and resources. The ceiling proposals were considered again in the 1940s as a possible means of absorbing reserves created by the System policy of supporting Government security prices.

3. Special or security reserve plans. Proposals were made in the 1940s for requiring banks to hold supplementary reserves in the form of short-term Government securities. These were designed to deal with the problem of Government security price supports.

4. Asset reserve proposals. Proposals have been made from time to time that bank reserve requirements should be based upon types of assets rather than upon deposits. These in essence would impose a sort of qualitative credit control over banks by imposing larger reserve requirements on certain types of assets than on others.

Present status. Although proposals for reserve requirement systems designed primarily to provide for changes in the total volume of requirements have been justified at times in the past, it is questionable whether at present any additional authority of this sort is needed. With the System open-market

24-22-20 22 24
20 19 18 19 20
13 12 13 14
6 5 6 6

portfolio as large as it now is and with freedom to use it, it is likely that existing reserve requirements are higher than necessary to give the Federal Reserve authorities adequate means of restraining credit growth. During the past two years, requirements have been reduced and, with continued growth in the economy and in monetary needs, further additions to reserves or releases of existing reserves will be needed by the banking system. These could be supplied through Federal Reserve purchases of Government securities, but it appears likely that the System portfolio is already more than adequate and need not be further enlarged. Hence reductions in reserve requirements from time to time may be an appropriate means of making available additional reserves needed. Such action would also make possible a further increase in earning assets of commercial banks and therefore facilitate the raising of additional capital which may be desirable on other grounds. Consequently, it would appear that any alterations in the method of computing reserve requirements would need to be justified on the basis of equity and administrative considerations rather than to give any additional authority for increases in the level of required reserves.

Revisions in Structure for Equity and Administrative Reasons

Among defects to be found in the existing structure of reserve requirements from the standpoint of equity as among individual banks and of efficient administration, the following are the more important:

1. Vault cash. Exclusion of vault cash from eligible reserves is both inequitable and irrational. Cash held by the banks in their vaults, although for working purposes, in effect serves the function of reserves in that it places some limitation on the capacity of those banks to expand credit. Moreover, vault cash can be obtained by banks only by giving up reserves to the Federal Reserve Banks. In turn, currency can be supplied by the Federal Reserve

Banks through the issuance of currency, which is a Federal Reserve liability similar in nature to member bank reserve balances. The amounts of vault cash that must be held, moreover, vary considerably from bank to bank according to type of business and proximity to the Reserve Bank or branch. This means that some banks must have larger cash holdings than other banks, and thus have less to lend or invest. These differences are illusrated in Table I.

TABLE I

Selected Ratios of Vault Cash to Net Demand Deposits
June 30, 1953
(Per Cent)

	Central Reserve City Banks		Reserve City Banks	Country Member Banks	
	New York	Chicago		Total	With inter-bank demand deposits of $3 million or more
Average ratio	.6	.6	1.8	3.8	3.0
Highest ratio	2.7	3.8	17.8	*	5.7
Lowest ratio	1/	.4	.3	*	.9
Middle 90 per cent:					
High	2.6	2.8	6.0	*	4.9
Low	.1	.4	.8	*	1.5

1/ Less than .05 per cent.

* Not computed.

2. <u>Classification of banks.</u> The existing classification of banks according to groups of cities creates a number of inequities. This classification has derived from the system of reserve depositories that was established under the National Bank Act, before the Federal Reserve System came into existence. The basis of classification was originally the holding of interbank deposits, but the higher and lower requirements apply not to interbank deposits alone but to all demand deposits held by the banks. Since the inauguration of the Federal Reserve System, the location, the amounts, and the extent of use of interbank deposits have changed considerably. A number of banks in lower classifications hold relatively larger amounts of interbank deposits than most banks with higher classifications. Some banks in the higher classifications hold relatively little or no interbank deposits.

The task of designating reserve cities and the determination of exceptions for individual outlying banks present difficult administrative and judicial problems for the Federal Reserve Board. It is clear that there are glaring inequities among individual banks with respect to classification but under the existing law it is not possible to correct these inequities without creating new ones.

3. <u>Allowance for balances due from banks.</u> Another aspect of interbank balances which has not heretofore been given much consideration is that for banks owning the deposits which are carried with correspondents these balances serve in effect the same function as reserves in that they limit the capacity of the owning bank to extend credit on the basis of a given volume of deposits. The depositing banks in effect pass on a part of their cash reserves to the banks receiving the deposits, yet the former obtain only a small reserve credit through permission to deduct amounts due from banks from their deposits in computing reserve requirements and thus cannot extend credit on the basis

of these reserves. While city banks must hold larger reserves against these balances, they obtain from them additional funds to lend or invest. Since the carrying of interbank balances seems to be an ingrained and perhaps an essential feature of our structure of small unit banks, the country banks must in practice hold more of their cash in this form than do banks in the central money markets. Any system of reserve requirements should make allowance for this practice.

To a considerable extent under the existing system, inequities resulting from the exclusion of vault cash and the inadequate reserve allowance for balances due from banks are compensated for by the differentials in reserve requirements against deposits for the three classes of banks. This compensation, however, is more or less haphazard and does not work equally for individual banks.

4. Member vs. nonmember bank requirements. Under the existing structure of reserve requirements the position of member banks of the Federal Reserve System is less favorable than that of most nonmember State banks. If it should become essential for the Board to raise requirements for member banks, these inequities would be increased and the effectiveness of restrictive credit policies lessened. Positions of member banks relative to nonmember banks would be improved if member bank reserve requirements were lowered nearer to a level below which State banking authorities would be willing to reduce nonmember requirements. Any lowering of member bank requirements would present an opportunity to make alterations in the structure of reserve requirements in a way that would remove some of the inequities among the individual member banks.

Uniform Reserve Plan

Various plans have been considered for removing inequities in and improving administration of the system of reserve requirements. One of these was the velocity reserve proposal, which has already been discussed. The most comprehensive recent suggestion for changing the structure of reserve requirements was the so-called uniform reserve plan, first suggested in 1948. This plan was worked out by a staff group within the Federal Reserve System and was based in part upon ideas that had been evolved principally in the Board's Division of Bank Operations. It was presented informally as an illustration of the nature of the problem to the Board and the Reserve Banks, to the Federal Advisory Council, and to a subcommittee of the Congressional Joint Committee on the Economic Report. The essential features of this plan were as follows:

1. Classification of banks by cities would be eliminated.

2. Higher reserve requirements would be placed on interbank deposits than on other demand deposits. Requirements against time deposits would continue at a lower level than those against demand deposits.

3. Banks would be given a reserve credit for balances due from other banks equal to the required reserves that the depository banks were required to hold against these balances.

4. Vault cash would be included as reserves.

5. The Federal Open Market Committee would be given authority to change percentages of requirements within limits to be fixed by statute.

The principal objections raised against this proposal were that it would substantially raise requirements, either absolutely or relative to other banks, for banks, particularly country banks, having a large proportion of deposits in balances due to other banks. At the same time, it would lower requirements for some city banks with relatively small amounts of interbank balances. There was also some objection on the part of banks to doing away with the reserve city classification. Putting the plan into effect would involve substantial transitional adjustments, particularly if it were done at a time when it was undesirable to lower total requirements. Since this was the case most of the time from the end of the war until 1953, adoption of the proposal was not given serious consideration during that period, although from time to time studies of it were made with a view to its possible adoption as a means of raising requirements.

Modified Uniform Reserve Proposals

In the summer of 1953 some modifications of the uniform reserve proposals were presented by the Board's staff for consideration by the Board and were sent to the Reserve Banks for comments. The modifications in the 1948 plan were designed to ease the transition from the existing to the new system and also to retain classification of banks and make more adequate allowance for correspondent banking.

There were two modified plans. Both of them were similar to the 1948 plan in that they would count vault cash as reserves; would give a reserve credit for balances due from banks; would have uniform reserve requirements against demand deposits (other than interbank) for the different classes, as well as similar requirements for time deposits; and would have authority in the Board to change requirements within limits. The modified plans differed from the 1948 plan in that they would establish two classes of banks—reserve depository banks and other banks, with different requirements for interbank balances. Banks would be permitted to choose the classification in which they wanted to be.

Modified Plan A would set higher requirements against interbank deposits than against other demand deposits, but these applied only at the reserve depository banks. The depositing banks would be given reserve credit equal to this higher requirement for such balances. Requirements against other demand deposits would be uniform. Plan B would set uniform requirements against all demand deposits—interbank and other at both classes of banks—but would authorize a higher reserve credit for depositing banks for balances carried with reserve depository banks. The latter proposal would give greater recognition to the role of correspondent banking; but it was subject to the objection that it would allow some pyramiding of reserves and thus would restrict Federal Reserve control over the supply of reserves. Because under each plan the higher reserve credit would be allowed only for balances with reserve depository banks, any banks wanting to attract correspondent bank balances would probably have to choose to be in the reserve depository class.

More Moderate Proposals

As an alternative to proposals for fundamental revision of the reserve structure, suggestions have been made from time to time for revisions which would correct only more glaring defects in the existing system without changing its essential nature. These proposals would call for legislation permitting vault cash to count as reserves and authorizing the Board either to classify individual banks rather than cities or to grant more exceptions for individual banks within reserve and central reserve cities. These proposals would generally involve no change in the existing statutory limits as to percentages of reserve requirements or in the existing authority to change them, although in putting them into operation the Board would make some changes in requirements within those limits to bring about a nearer approach to uniformity.

Proponents of these suggestions expressed the view that, with the minimum revisions suggested, the Board could make adjustments which would remove most of the important inequities in the existing structure. The Board could use a variety of criteria in classifying banks. Specific criteria might be indicated in the legislation or the Board might be given authority to set up its own criteria.

Putting such proposals into effect would result in substantial reductions in reserve requirements for most banks if increasing those for some banks is to be avoided. The effect of any such total additions to reserves could be offset by Open Market Committee sales of short-term Government securities without unduly depleting the System's portfolio.

Comments on the Modified Proposals

Comments received from the Federal Reserve Banks in 1953 with respect to these recent proposals indicated a majority opinion that some change in the reserve requirement structure is desirable, although a few questioned the need for any change. Each particular proposal, however, was opposed by a majority of the Reserve Banks. There was considerable objection to the elective classification of banks suggested in the modified plans, but the nature of some of the objections indicated that perhaps the implications of the idea were not fully recognized by some of those objecting to it.

The more moderate or minimum approach was generally viewed in 1953 as inadequate by most of the Reserve Banks, many of whom thought it would not be advisable to request that vault cash be permitted to count as reserves without accompanying this modification with a more fundamental revision in the reserve requirement structure. More recently there have been a number of expressions of interest in the minimum approach as a means for quick action in case the situation called for substantial modification in reserve requirements.

Although the uniform reserve proposal in its 1948 form has not been again presented for consideration, voluntary and incidental comments by many of the Reserve Banks last year indicated considerable feeling in favor of the plan. The principle of requirements based on type of deposits rather than on location of bank is viewed with favor by a large number of persons, both in and out of the System.

Further Study of Problem by Staff Committee

Study of the reserve requirement problem has been continued by the Board. It was felt that the Board should be prepared to present some plan in case one were requested by Congress or considered by the Board to be desirable, or at any rate should be in a position to pass judgment upon any plans that might be proposed from other sources. Accordingly, the Board set up a committee composed of Federal Reserve Bank staff members to work with members of the Board's staff in studying the problem. The committee is to give further study to the problem of reserves and the possible impact of various proposals upon individual banks. On the basis of these studies it might be possible to prepare a suitable plan that the Board might propose in case some such proposal seemed desirable.

This committee has had one meeting to explore the problem. At this meeting some members were impressed with the desirability of early action on a minimum attainable basis. Others felt that before recommending action there is need for study of the basic questions of the purposes and functions of reserve requirements and of the effect of particular changes. Although there was general agreement upon some important points, the members of the committee held rather wide differences of views as to the particular details of possible changes in reserve requirements. The committee decided to proceed with studies of many aspects of the problem and assignments were made to various individuals to carry out these studies. A list of the studies now in process is as follows:

1. Role of reserve requirements
2. Optimum level of reserve requirements
3. Shortcomings of existing system of reserve requirements
4. Problems in bank classification
5. Central reserve cities
6. Branch bank classification
7. Interbank balances
8. Deposit activity
9. Reserve differentials - a concluding study

Preliminary drafts have been received for six of the eight basic studies under preparation.[1/] These manuscripts indicate that a searching attempt has been made to achieve a better understanding of the purposes and functions of reserve requirements, the operations and shortcomings of the existing reserve requirements mechanism, and the difficulties in trying to develop a better system of requirements. At the same time, the manuscripts reveal substantial differences in views among the various members of the Committee on some basic issues and bring to light a number of areas in which further study would be desirable before definite conclusions could be adequately supported.

Points of Agreement

It might be said that there is general agreement upon the following points:

1. The major function of legal reserve requirements is to establish a framework for controlling the supply of credit and money, i.e., to serve as a tool of monetary policy.

2. The existing system of requirements is workable for the purpose of regulating the money supply.

3. Authority to raise or lower the level of reserve requirements is needed but it would appear that existing limits would provide an adequate range for most foreseeable circumstances. Although

1/ These manuscripts have been reviewed in a staff memorandum on "Current Issues in the Reserve Requirement Study" that has been given to members of the Committee on Reserve Requirements.

the present level of reserve requirements is probably higher than necessary, the statutory powers for reduction are adequate. Also, in view of the possible growth of the economy and barring extremely large gold movements or return flow of currency, it is likely that the existing power to increase requirements will be more than adequate for the future.

4. As between the broad classes of member banks, the inequities in the existing structure of requirements may not be as great as has been commonly believed when allowance is made for the additional working balances in the form of vault cash and deposits with correspondents that banks with the lower legal requirements apparently find it necessary to carry. These working balances serve the function of reserves for the banks owning them. The question of whether this is an appropriate standard of equitableness may be subject to some debate and require further study.

5. For individual banks within classes, however, there are inequities of a fairly serious nature and there are also administrative difficulties in classifying banks. The more important changes needed to correct these defects include the following:

(a) Permit vault cash to be counted as reserves.

(b) Discontinue the reserve classification of banks, making reserve requirements vary only with respect to types of deposits, or base classification on individual banks rather than cities, or at least permit more exceptions of individual banks in reserve cities.

Questions for Further Consideration

There remain many unsettled questions regarding various aspects of the problem. These include some matters of principle regarding the purposes of reserve requirements, various details with respect to an appropriate structure of requirements, and the need for more information as to the effect of particular changes that might be considered. Some of the more important of these questions are as follows:

1. Should there be further analysis of the basic function of reserve requirements, with view to evolving new criteria, or should the principle that the function is to regulate the money supply be accepted as basic premise?

2. What criteria should govern the general level of requirements and what provisions should be retained for changing the requirement percentages as a means of varying the level?

3. What is an appropriate reserve requirement base?

   (a) Types of deposits?

      Should there be higher requirements for interbank balances?

      How high, if any, for time deposits? Should there be a distinction between savings and other time deposits?

      Should other classifications of deposits be considered, such as foreign, large, business deposits?

   (b) Types of assets - should reserve requirements be used as a form of qualitative credit control?

   (c) Deposit turnover - velocity?

   (d) Growth in deposits?

4. What should be done about classification of banks or cities?

   (a) Should classification of banks be completely abandoned, with requirements based entirely on type of deposit?

   (b) Should classification of cities continue on the basis of some specific criteria, with exemptions for individual banks?

   (c) If classification of individual banks is employed, what should be the criteria of classification-- total deposits due to banks, net amounts due to bank less amounts due from bank, total volume of deposits, turnover of deposits? How specific should the law be with respect to these criteria?

Analysis of Classification of Banks[1/]

Some study has been made as to variations in holdings of interbank deposits by individual banks in different classes. This study was undertaken in

1/ This section presents some of the preliminary results of studies in process on a particularly significant aspect of the problem. These results are tentative and further studies may be needed before final conclusions are accepted.

part to inquire into the feasibility of classifying banks for reserve purposes according to their holdings of interbank deposits. Tests were made according to amounts of balances due to banks and also according to the net difference between balances due to banks and those due from banks. Some of the differences are illustrated in Table II.

It appears from this analysis that any classification of banks based on holdings of interbank deposits would involve substantial shifts from existing classification. Also the number of shifts and the particular banks affected might vary substantially according to the criteria used. For example,

Of 35 central reserve city banks from 15 to 23 should have lower classifications, and 4 to 10 of them might be country banks.

Of 315 reserve city banks, 10 or more should be central reserve city banks and 100 to 165 should be country banks.

Of 209 country banks with balances due to other banks of over $1 million, anywhere from 30 to all, depending on the criteria adopted, should be reserve city banks.

Before suggesting that banks be classified on any such basis, further study is needed of magnitude of effects and of other possible criteria.

Basis for Differentials by Classes of Banks.1/

Many inquiries into the reserve requirement structure and its problems have come forth with the conclusion that it would be desirable to abolish classification of banks and to adopt a system of uniform reserve requirements by type of deposits. Adoption of any such proposal, however, has run into the difficulty that requirements of country banks would be raised relative to those of city banks. This would seriously disturb established relationships among banks and groups of banks and create difficult transitional problems. Permitting vault

1/ This section presents some of the preliminary results of studies in process on a particularly significant aspect of the problem. These results are tentative and further studies may be neeced before final conclusions are accepted.

TABLE II

VARIOUS CLASSIFICATIONS OF MEMBER BANKS
BASED ON INTERBANK DEPOSITS 1/
June 30, 1953

	New Classification	Present Classification: Central Reserve City	Reserve City	Country
Total	559	35	315	209
Basis No. 1 - Gross "due to" of				
C.R.C. - Over $100 million	22	12	10	0
R.C. - $6 to $100 million	208	13	155	40
Country - Under $6 million	329	10	150	169
Basis No. 2 - Net "due to" of				
C.R.C. - Over $100 million	20	12	8	0
R.C. - $4 to $100 million	168	14	142	12
Country - Under $4 million	371	9	165	197
Basis No. 3 - Mixed				
C.R.C. - Gross of over $100 million	22	12	10	0
R.C. - Gross of under $100 million with gross over $10 million or net over $1 million	216	17	169	30
Country - Gross of under $11 million and net of $1 million or less	321	6	136	179
Basis No. 4 - Mixed				
C.R.C. - Net of over $25 million	70	21	49	0
R.C. - Net of under $25 million and gross of $1 million or more	393	10	174	209
Country - Gross under $1 million	96	4	92	0

1/ All central reserve and reserve city banks and those country banks that have balances due to banks of $1,000,000 or over.

cash to count as reserves would diminish the effect of this change for some banks but by no means remove it as compared with the present levels of requirements.

It might be said, however, that the existing lower requirements for country banks or higher ones for city banks have no rational basis and should be removed by adopting a set of requirements that would be uniform for all banks. This might be done without actually raising requirements for country banks by lowering those for city banks and absorbing the reserves released, as may be desired, by Federal Reserve open market operations. Analysis of the over-all cash holdings of banks, however, reveals that the existing differentials in required reserves are in practice fully compensated for by holdings of other cash, including cash in vault, balances due from other banks, cash items in process of collection, and excess reserve balances at Federal Reserve Banks. This analysis shows (1) that ratios of the total of these cash items (excluding required reserves) to gross demand deposits for any particular broad group of banks has been remarkably uniform throughout the postwar period; (2) that when required reserves against demand deposits are added to these cash items the ratio of that total to gross demand deposits for each class of bank is closely similar to corresponding ratios for other classes of banks at any given time; but (3) that there are persistent differences by districts and presumably by individual banks in these ratios. Such ratios are shown in Tables III and IV.

It appears that banks on the average tend to maintain for working purposes certain rather fixed amounts of cash in addition to required reserves and that these holdings broadly compensate for differences in required reserves among the different classes of banks. Thus if bank classifications were abolished and uniform reserve requirements were imposed on all demand deposits, interbank and

TABLE III

Ratio of Cash Assets Less Required Reserves to Gross
Demand Deposits and Applicable Reserve Requirement Ratio,
by Class of Bank, Selected Periods 1947 - 1954

Period a/	Central Reserve City Banks			Reserve City Banks		Country Banks		All Member Banks	
	Res. Req. Dem. Deps.	Cash Asset Ratio		Res. Req. Dem. Deps.	Cash Asset Ratio	Res. Req. Dem. Deps.	Cash Asset Ratio	Res. Req. Time Deps.	Cash Asset Ratio
		New York	Chicago						
1947 March	20	6.5	10.8	20	15.2	14	20.5	6	14.5
1948 March	22	7.8	10.1		15.7		19.8		14.8
June	24 b/	8.5	10.7		16.1		19.5		15.0
Sept.		7.6	9.7		15.9		20.3		15.0
Dec.	26	8.9	10.1	22	15.4	16	19.3	7-1/2	14.9
1949 June	24	8.7	10.0	21	15.1	15	19.1	7	14.6
Sept.	22	7.7	9.3	18	14.9	12	21.4	5	15.0
1951 March	24	9.7	10.7	20	15.6	14	18.8	6	15.0
1953 Sept.	22	9.1	10.0	19	15.5	13	19.1		15.1
1954 Sept.	20	9.9	10.3	18	15.2	12	20.7	5	15.8

a/ Averages of daily figures for first half of March, June, September, or December, except vault cash which is a single date figure for the end of the preceding month. Periods have been selected during or following each change in reserve requirements since 1947.

b/ Change in reserve requirement ratio during period.

TABLE IV

Ratio of Cash Assets Less Required Reserves to Gross Demand Deposits
by Class of Bank and by District, 1948 and 1954

	Boston	New York	Phila.	Clev.	Rich.	Atlanta	Chicago	St. Louis	Minn.	Kas. City	Dallas	San Fran.	All Districts
Reserve City Banks by District													
First half of: June 1948	11.2	15.5	13.1	14.5	16.2	18.1	17.9	17.3	19.0	20.6	21.4	13.7	16.1
March 1954	10.0	14.0	13.9	14.2	16.3	18.4	16.0	16.0	17.2	19.0	19.8	13.9	15.5
June	10.5	14.5	14.2	14.6	16.8	18.2	15.9	17.1	19.2	19.0	20.3	14.3	15.9
Sept.	9.6	14.0	13.4	13.3	16.1	17.7	15.2	16.2	17.3	18.4	20.5	13.7	15.2
Country Banks by District													
First half of: June 1948	17.8	17.7	19.1	20.0	22.3	20.8	20.0	17.5	19.0	20.0	22.3	17.0	19.5
March 1954	17.0	15.9	18.3	17.6	22.1	22.9	18.9	19.1	18.0	20.0	23.8	18.9	19.2
June	17.1	16.1	18.8	17.6	22.4	20.8	19.5	18.4	19.3	22.2	23.4	18.8	19.3
Sept.	17.6	16.7	19.9	19.9	24.3	21.6	20.6	20.8	22.2	22.8	25.8	19.5	20.7

other, country banks and to a degree reserve city banks would in effect be deprived of the lower reserve requirements which now compensate them for having to carry balances with other banks. They would either have to reduce their balances with correspondents or would maintain much larger total cash holdings relative to demand deposits than banks that find it possible to operate with relatively small balances with other banks, particularly New York City banks. It should be noted that all cash balances serve the function of reserves for the banks owning them in that they limit possible extensions of credit by these banks. It might be argued that banks obtain some advantages from carrying balances with correspondents and hence do not deserve the compensation of lower reserve requirements; yet to shift to a different system without some allowance for established practices would create serious transitional difficulties and might be of questionable equity.

This difficulty might be reduced and less drastic changes from existing broad relationships result if larger reserves were required against interbank deposits than against other demand deposits, while abolishing differentials between classes of banks. In this event, however, banks with a greater than average proportion of interbank to total deposits would have relatively larger requirements than other banks and would also have a bigger increase from existing levels than other banks in the same reserve class. Nor would this measure directly compensate for differences in holdings of balances due from banks. Banks holding substantial amounts of both balances due to and balances due from other banks would be particularly penalized in terms of total cash holdings relative to other banks.

A more effective correction would be accomplished by permitting banks to count as reserves a somewhat larger portion of their balances due from banks than is now permitted, at the same time requiring reserves against interbank deposits as high as the reserve credit allowed. Identity of these two figures would prevent pyramiding or creation of reserves without Federal Reserve action. Such an arrangement would permit abolishing differentials by classes of banks and provide a closer approach to uniformity among banks in total cash holdings relative to demand deposits.

This reasoning leads to the uniform reserve plan with relatively high requirements against deposits due to banks and equally as large reserve credits for balances due from banks. It also furnishes a rationale for higher requirements against interbank deposits, in addition to, and perhaps better grounded than, the reasons, heretofore used, of volatility, velocity, and expediency. It does not, however, conflict with those reasons. It recognizes the necessary existence of correspondent banking in our banking structure and fits it more effectively into the reserve structure without sacrificing Federal Reserve control.

An Example

It may be possible to work out a structure of reserve requirements in accordance with this rationale that would provide reasonable equity among banks, involve little change in existing broad relationships, and furnish administratively feasible and simple procedures. Following is one possible scheme that is presented for illustrative purposes*

Uniform requirements of 30 per cent against interbank deposits
15 per cent against other demand deposits
5 per cent against time deposits.

With reserve credit of 30 per cent for balances due from banks and cash items in process of collection
100 per cent for cash in vault.

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* The Committee will wish to consider whether it wants to recommend any particular plan at this time or even wishes to present one for illustrative purposes.

On the basis of the existing structure of deposits, this scheme, as shown in Table V, would bring about a reduction of about $3.7 billion, or 21 per cent, in total required balances at Federal Reserve Banks. Percentage decreases for each of the broad classes of banks would be closely similar. The resulting level of requirements at this time would be approximately the same as would be obtained under the present method of computations (with no allowance for vault cash) if requirements were as follows: Against net demand deposits - 16 per cent at central reserve city banks, 14 per cent at reserve city banks, and 9 per cent at country banks; and against time deposits - 5 per cent at all member banks.

There would be greater variations from existing levels for individual banks and probably also for different dates, but the results would probably be more reasonable and equitable than the present ones. Some device for a ceiling or maximum might be necessary to avoid increases in requirements for a few individual banks, such as permitting them to carry either the amount required by the new method or that required for reserve city banks under the present method.

Legislation to permit such a change should include authority for the Board to raise and lower the percentages within some specified limits -- perhaps 20 to 40 per cent for interbank deposits, 10 to 20 per cent for other demand deposits, and 3 to 6 per cent for time deposits.

This scheme is presented at this time as an example, not as a recommendation. Further study of the effect of this and possibly other combinations would be needed before determining whether to sponsor this scheme and if so what figures to propose.

TABLE V

MEMBER BANK REQUIRED RESERVES ON PRESENT BASIS AND UNDER A MODIFIED UNIFORM RESERVE PLAN1/

(Average of daily figures, first half of September 1954. In millions of dollars)

	All member banks	Central reserve city banks		Reserve city banks	Country banks
		New York	Chicago		
Basic data and present required reserves					
Interbank demand deposits	13,237	3,971	1,309	6,657	1,299
Other demand deposits	95,753	18,426	4,733	35,788	36,806
Net demand deposits	94,653	20,344	5,452	36,720	32,137
Time deposits	39,041	3,671	1,274	15,374	18,721
Cash items in process of collection	7,432	2,015	481	3,708	1,228
Due from banks	6,906	38	109	2,017	4,742
Vault cash (Aug. 25)	2,057	140	31	627	1,259
Reserve balances with F.R.Banks	18,366	4,274	1,159	7,481	5,453
Present required reserves	17,577	4,252	1,154	7,378	4,792
30-15-5 Modified Plan					
30% of interbank	3,971	1,191	393	1,997	390
15% of other demand deposits	14,363	2,764	710	5,368	5,521
5% of time deposits	1,953	184	64	769	936
Total	20,287	4,139	1,167	8,134	6,847
Less 30% of due from banks and cash items in process of collection	4,302	616	177	1,718	1,791
Less vault cash	2,057	140	31	627	1,259
Required reserves with F.R.Banks	13,928	3,383	959	5,789	3,797
Decrease from present requirements: Amount	3,649	869	195	1,589	995
Per cent	-20.8	-20.4	-16.9	-21.5	-20.8
Ratios: Cash assets (excluding required reserves against time deposits) to gross demand deposits.					
Present basis	30.1	28.1	28.4	30.8	30.8
Under modified plan2/	26.8	24.2	25.2	27.0	28.2

1/ In this modified plan, exchanges for clearing house, items with Federal Reserve Banks in process of collection, and all other reported cash items would be treated the same as due from banks.

2/ Assumes that banks would continue to hold same amounts of cash assets other than required reserves as they now hold.