The Papers of Eugene Meyer (mss52019)

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EUGENE MEYER

SUBJECT FILE

FEDERAL RESERVE BOARD
OFFICE CORRESPONDENCE
JAN-SEP 1932

Form No. 131

Office Correspondence

FEDERAL RESERVE
BOARD

Date January 4, 1932

To Governor Meyer

Subject: Demand for Currency

From Miss Joy

A.J.

GPO 2—8495

Since Christmas currency has not returned from circulation as rapidly as usual. On December 30 the volume outstanding was only $100,000,000 less than a week earlier, while in the years 1924-1926, when the holiday came at about the same time in the week, the decline averaged over $140,000,000.

This is the third successive week in which there has been an additional non-seasonal demand for cash, and for the three weeks as a whole this extraordinary demand probably exceeds $100,000,000, approximately offsetting the return flow of currency in earlier weeks.

From December 14, when the failure of the Federal National Bank of Boston was announced, to the day before Christmas, the demand for currency increased $210,000,000, more than $75,000,000 in excess of the increase in the years 1924-1926, when the cost of living was 17 per cent higher and business was considerably more active. It is not improbable that the reduction in the dollar volume of holiday purchasing this year reduced the demand for currency considerably in the last ten days before Christmas, so that the added non-seasonal demand for money during this period was considerably more than $75,000,000. Then, in addition, the return flow of cash to the reserve banks and the Treasury was smaller than usual in the week between Christmas and New Year's Day.

Form No. 131

Office Correspondence

FEDERAL RESERVE
BOARD

Date January 5, 1932

To Governor Meyer

Subject: Bank Suspensions, 1931

From Mr. Smead

2—8495

Attached hereto is a preliminary statement on bank suspensions for 1931, which was prepared for Mr. Awalt last night. I understand that Mr. Mills wanted the figures for use in connection with a proposed amendment to the Reconstruction Finance Corporation bill, which is to be reported out by the Senate Committee some time today.

BANK SUSPENSIONS IN 1931

(Preliminary figures)

	All banks		National banks		State bank members		Nonmember banks	
	Number	Deposits	Number	Deposits	Number	Deposits	Number	Deposits
Year 1931 total	2,290	$1,759,000,000	410	$473,000,000	108	$302,000,000	1,772	$984,000,000
Last quarter of 1931	1,049	866,000,000	199	244,000,000	51	155,000,000	799	467,000,000
October 1931	522	478,000,000	100	116,000,000	25	118,000,000	397	244,000,000
November "	174	69,000,000	35	28,000,000	8	4,000,000	131	37,000,000
December "	353	319,000,000	64	100,000,000	18	33,000,000	271	186,000,000

FEDERAL RESERVE BOARD
DIVISION OF BANK OPERATIONS
JANUARY 4, 1932.

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date January 9, 1932

To Mr. Harrison

Subject:

From Mr. Smead

2—8495

Attached hereto are five copies of the letters received from the Federal Reserve Agents in reply to the Board's letter of December 12, asking for an expression of their views in regard to the recommendations contained in the report of the Committee on Member Bank Reserves. There are also attached five copies of a letter, with enclosure, received from Governor Martin of St. Louis. I assume you will give a copy of these letters to each member of the Board.

COPY

FEDERAL RESERVE BANK

OF BOSTON

December 15, 1931

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

SUBJECT: Report of Committee on Bank Reserves.

Dear Governor Meyer:

I am in receipt of your letter of the 12th asking for an expression of my views in regard to each of the recommendations contained in the report of the Committee in Bank Reserves. This report makes four specific recommendations.

1st. Computation of a single reserve based upon net deposits and average daily debits.
2nd Distribution of the required reserve between vault cash and balances in Federal reserve banks.
3rd. Deductions allowed in arriving at net deposits.
4th. Re-classification of reserve cities.

I have no suggestions to make except in connection with the third, namely, deductions. Under the Committee's program, deductions would include float and balances due from other banks. It is my impression that the policy of allowing deductions of balances due from other banks originated from the availability of such balances to meet depositors' demands. If such is the case, I want to suggest to the Committee that they limit this deduction to float and balances due from other banks in Federal Reserve Bank and branch cities. There is evidence that balances are carried by banks in other banks either for the interest returned, which makes it in the nature of a loan, or for some other purpose than an exchange. While I appreciate the Committee's argument in reference to this point as it affects the use of member bank credit for the public, it seems to me that the importance of not weakening the reserve requirement as it affects an individual bank should be given greater consideration.

I am in thorough agreement with the principles underlying the changes recommended by the Committee, and I have no other suggestions than those stated above to present to the Board before it passes on the report.

Yours very truly,
Signed: Frederic H. Curtiss,
Federal Reserve Agent.

FHC/D

COPY

FEDERAL RESERVE BANK OF PHILADELPHIA

January 2, 1932

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

Dear Governor Meyer -

Sometime ago you asked for my views with regard to each of the recommendations contained in the report of the Committee on Bank Reserves.

Having given further consideration to the report and agreeing with the opinion expressed by the Committee that "one of the principal purposes of the reserve is to insure that the Federal reserve banks at all times have resources adequate to their responsibilities", we regard it as absolutely necessary that any plan of reserve requirements should provide for that. From the careful studies the Committee has made, one is satisfied that the proposed requirements will maintain reserve balances about equal to those now maintained, so that the Federal reserve banks will be able to function as at present.

The abandoning of the classification of banks in accordance with their location is approved, as is also that of not separating deposits into two classes in calculating reserves. It seems logical, too, to have the reserves carried bear some relation to the banks' daily turnover. The recommendation, therefore, of requiring reserves of 5% on net deposits plus 50% on the average daily debit charges made to depositors' accounts, is approved.

The proposed "deductions from deposit accounts" is approved.

The carrying of reserve on United States Government deposits is approved.

Limitation of total reserve to 15% of gross deposits is approved.

C O P Y

Federal Reserve Bank of Philadelphia - #2

The "counting of vault cash as reserve"-we always have felt that the amount of vault cash should be allowed as deduction from the amount against which reserve should be held, but did not favor its being counted as actual reserve. At first we were disposed to object to the Committee's recommendation, but we are satisfied with the opinion of the Committee, based on the results of its study, that its proposal will maintain the reserve balances at about the present figure. From some investigations we have made, we are satisfied that only to use the vault cash as a deduction from the amount upon which the reserve is carried, would put, if the other recommendations of the Committee were adopted, too great a burden on the out of town banks. To correct that, would require quite a readjustment of the Committee's other proposals, so we feel we are justified in accepting the Committee's recommendations as made.

Administration and enforcement of reserve requirements - these are approved with the hope that they may be effective. Our experience has been that many banks do not fear penalties forviolations of the law. I would like to recommend that the days of the week closing the periods of computing reserves be made uniform in all Federal reserve districts. If that is not done, banks, by shifting balances from one district to another, can abuse the law and operate with actually less reserve than is required.

Very truly yours,

Signed: R. L. Austin
Chairman

COPY

FEDERAL RESERVE BANK

OF RICHMOND

January 5, 1932

SUBJECT: Report of Committee on Bank Reserves

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

Dear Governor Meyer:

I duly received your letter of December 12 on the subject of the report of the Committee on Bank Reserves. I have delayed replying to it because we here had in mind a conference of all the officers to formulate a joint expression of opinion. Every one here now is, and has for some time been, under such pressure that we have not been able to carry out our purpose, and I am therefore writing you my individual views.

You probably concur with me in the general opinion that this is not an opportune time to press upon the harassed banks in this district a revolutionary reserve requirement and computation. It seems that the new plan would reduce the reserve deposits in this bank from three to five million dollars. That may not seem a large amount to you but it would reduce our lending power in that proportion, and would be a loss of our reserve deposits superimposed upon the losses already unavoidable on account of the failure of so many member banks.

Having made this preliminary statement I wish to say that the report of the Committee on Bank Reserves appears to me entirely sound in theory and entirely feasible in application so far as this district is concerned. The proposal to take into consideration for reserve purposes the velocity of deposits, appears to me a stroke of genius, although I can readily understand how it may meet with stiff resistance on the part of member banks in the large centers.

In that recommendation which specifies the amount of vault cash which may be included in reserves, I think the purpose of the recommendation would be served and that the Federal Reserve Bank would be in a stronger position if the so-called country banks should be required to carry balances with the Reserve bank of at least three-fifths of the total legal requirements for reserves in lieu of the two-fifths set forth in the Committee's report. With the recommendation regarding the administration and enforcement of reserve requirements, I am in agreement. I am particularly glad to subscribe to a recommendation for a change in the law with respect to making new loans when reserves are deficient which will render the law workable and more susceptible to enforcement.

C O P Y   Federal Reserve Bank of Richmond

GOV. MEYER #2

I note with approval the amended manner of treating the subject of reserve deficiencies which the Committee suggests. This matter has had my close scrutiny ever since revised Regulation D came into operation on January 1, 1928. It has for a long time been my personal opinion that no good purpose is served by continuing the progressive penalty rate above 6%. It is my view that admonitory letters, re-enforced by a maximum penalty of 6%, will halt the practice of permitting reserve deficiencies on the part of banks which are not headed for insolvency. On the other hand when a bank persists in running with an impaired reserve in the face of a penalty and admonitory letters, it is almost a sure sign that it is "in extremis" and the higher penalty rate is not likely to cure the situation. Since January 1, 1928 I have found occasion to write (under the requirements of Regulation D) to the individual directors of twenty-nine banks which were persistent offenders. Of these twenty-nine, twenty-four subsequently failed.

Governor Seay has secured the opinions of several of our member banks as to the Committee's report and he will doubtless transmit those opinions to you in his own letter on the subject.

With highest personal regards, I am,

Sincerely yours,

Signed: Wm. W. Hoxton
Chairman and Federal Reserve Agent

C O P Y

FEDERAL RESERVE BANK OF ATLANTA

January 5, 1932

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

Dear Governor Meyer:

I have received your letter of December 12th in which you asked for an expression of my views with regard to the recommendations made in the recent report of the Committee on Bank Reserves with reference to the proposed changes in the computation and maintenance of member bank reserve requirements. This subject was presented at the December meeting of our directors and was held over for further discussion at the meeting on January 8th. I had thought that the conference in Washington would be held later than the 8th in which event I would have been able to give you the views expressed at our January meeting. For that reason only, I have not sooner replied to your letter.

I am in full accord with the recommendations of the Committee to do away with the classification of deposits as to demand and time, and with its statement as to the primary functions of reserves. Permission for member banks to hold a part of their increased reserve requirements as cash in vault would go far toward removing the handicap under which many small country banks now operate because of the distance in their location from a Federal reserve bank or branch. For this, the Sixth Federal reserve district, figures compiled by the Committee for the month of May, 1931, indicate that banks outside reserve bank and branch cities were carrying cash in vault in an amount equal to 43% of required reserves under present requirements, whereas reserve city banks were carrying cash in an amount equal to only 19% of reserve requirements. This, in my opinion, results in an inequality between the "outside" banks and the reserve city banks which the proposal of the Committee will tend to correct. The Committee's recommendation gives relief also to the "outside" banks in providing for the calculation of reserves for all member banks against deposits net of amounts due from banks. It occurs to me that a reduction in the ratios of vault cash holdings to required reserves for both reserve city and "outside" banks would decrease the expected reduction in member bank reserve balances at the Federal reserve banks, and at the same time would still afford the small "outside" banks an appreciable measure of relief. X

The principles that legal reserve requirements should reflect fundamental changes in the demand for credit, and that reserves should reflect the increased use of credit and enable the exercise of restraint over its growth are appealing, and are apparently sound. Activity in deposit accounts is an important factor, I believe, in the use of bank credit, and such activity is best measured by debits to deposit accounts. It seems to me, nevertheless, that however sound the consideration of bank debits may be in the determination of reserve requirements from the standpoint of member banks as a whole, the injustices its blanket application would work in practice on individual member banks make its adoption inadvisable. Although there may come a time when the exercise of restraint on credit expansion is desirable for a member bank, I believe the decision must be made by the officers of each individual bank according to their judgment of conditions in its own territory, and tempered by such considerations as the Federal reserve bank sees fit to give it.

The Committee's proposal that member banks be permitted to hold a part of their required reserves as cash in vault, although of merited aid to the "outside" member banks, throws a sizable burden on the Federal reserve banks. Inasmuch as the majority of the member banks in this district are "outside" Federal reserve bank and branch cities, they would be in a position to utilize practically the full amount of their vault cash as reserves, with a resulting large reduction in the amounts required to be carried as reserve balances with the Federal reserve bank. From a study which has been made from the figures on banks in this district compiled by the Committee for the month of May, 1931, it has been found that the Federal Reserve Bank of Atlanta stands to suffer a reduction of $9,915,000 in its reserve deposits, or 20.7% of required balances under present law, provided the member banks made no change in the amount of vault cash they were holding, and a reduction of $11,210,000, or 23.4%, provided they took full advantage of the vault cash provision permitted under the Committee's recommendation. It is my belief that such a shrinkage in this important source of funds of the reserve bank should be sanctioned only after most careful consideration, especially at the present time when the total of member bank reserve balances is at a low point and when the need for use of these reserves may prove extensive.

The loss of $10,000,000 in reserve deposits of the Sixth District Reserve Bank would have a serious effect on our free gold position at the present time. It would necessitate the sale of $10,000,000 of our $12,900,000 in Government securities now held, thus resulting in the practical elimination of our means of protecting our free gold position. The net result would be that our free gold would fall below the $5,000,000 considered necessary for our normal operations. In the absence of Government securities that could be sold, our only practicable method of improving our gold position would be that of rediscounting, a procedure equally objectionable to ourselves and the other Federal reserve banks, particularly so in the event any of the other reserve banks found themselves in a similar position. Our contracted free gold position would bar us from further participation in open market purchases of Government securities, and this condition might be symtomatic of a curtailment of the System's operations in this account.

From the standpoint of the Federal Reserve Bank of Atlanta, and of other reserve banks similarly situated, I am therefore in favor of the abolition of the distinction between time and demand deposits, and of the provision whereby member banks are permitted to count a part of their vault cash as reserve, but I feel that the vault cash and other recommendations of the Committee should be so adjusted as to enable us to maintain our reserve deposits in large measure intact.

Very truly yours,

(Signed) Oscar Newton
Federal Reserve Agent

COPY

FEDERAL RESERVE BANK OF CHICAGO

December 14, 1931

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

Dear Governor Meyer:

I have yours of the twelfth relative to the report of the Committee on Bank Reserves and shall be glad to go over this matter thoroughly and write you more fully at a later date with any suggestions which I may have.

Very truly yours,

Signed: Eugene M. Stevens
Chairman

EMS HH

COPY

FEDERAL RESERVE BANK
OF
ST. LOUIS

December 24, 1931

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

Dear Governor Meyer:-

I am in receipt of a letter from Mr. O. J. Sullivan, President, National Stock Yards National Bank, National Stock Yards, Ill., transmitting a memorandum covering certain opinions of his concerning the proposed change in the law governing reserves of member banks of the Federal Reserve System. I have read this memorandum with considerable interest, and requested Deputy Governor Attebery to study it carefully and give me his opinion as to the merits of the arguments advanced by Mr. Sullivan. I am enclosing the memorandum of Mr. Sullivan; also the memorandum of Deputy Governor Attebery. I thought you might be interested in reviewing them and might possibly want to submit them to the Committee which now has the subject under consideration.

Wishing you a Merry Christmas, I am

Very truly yours,

Signed: Jno. S. Wood
Chairman of the Board.

JSW:RMS

Enclosures

COPY

THE NATIONAL STOCK YARDS NATIONAL BANK
OF NATIONAL CITY

NATIONAL STOCK YARDS
ILLINOIS

CONTROL OF CREDITS

"It is the function of reserve requirements to restrain such over-expansion by making it necessary for banks to provide for additional reserves before they expand credit."

The present arrangements for reserves gives the Federal Reserve Bank ample control of credit expansion as in the case of practically all banks using the System, an increase in the loans reduces the amount that a member bank deducts from its gross balances and thereby increases the reserve requirements, i.e., a bank located in a Central Reserve City enjoying accounts from other banks (which is true of 90% of banks located in Central Reserve and Reserve Cities) with demand deposits of $5,000,000 having $1,000,000 on deposit with other member banks, when computing reserves, deducts the $1,000,000 leaving $4,000,000 net balances against which it figures 13%, which would be $520,000. The bank then lends $500,000 and draws this amount from its deposits with other banks, leaving at the close of business that night $500,000 on deposit with other banks. It then deducts $500,000 from the $5,000,000, deposits leaving $4,500,000 net deposits against which it reserves 13%, which is $585,000.

On can readily see that the bank, while expanding its credit, increases its reserves.

This example shows that while the member bank was increasing its loans $500,000, increased its reserves $65,000 with the Federal Reserve Bank, and yet the Federal Reserve Bank has not been called upon to advance any funds.

COPY

CONTROL OF CREDIT.

"To perform this function adequately it is essential that reserve requirements reflect both the volume, activity, etc."

Active accounts based on the business requirements of the bank's customers are not so frequently the basis for credit, but are carried for service rendered. If the Federal Reserve System is going to base reserve requirements upon the volume and activity of accounts, each member bank would of necessity analyze the cost of each account, and the analysis then shown to the customer, and after a service charge has been made the active account would no doubt be moved to a non-member bank, leaving only a comparatively small inactive account with the member bank for credit purposes. An inactive account of $100,000 controls a line of credit of $500,000 - a reserve of 5% on this inactive account gives the Federal Reserve Bank a reserve deposit of $5,000.00 from the member bank, yet the Federal Reserve Bank may be called upon, especially when money is tight, to carry this customer's paper up to $500,000 while enjoying a deposit of only $5,000.

In certain specialty lines of business, where the commodity handled is one of comparatively high cost, such as at the numerous Stock Yards, the costs under the proposed change would be exorbitant and prohibitive. The funds used in handling live stock at the numerous Stock Yards banks are handled three times in a day. First the funds are deposited by the packers to cover their purchases, and in payment of these, check out funds and deliver them to a commission firm. The commission firm deposits those funds and immediately draws them out and deposits them with the banks at the Stock Yards for the credit of the country bank, use of the farmer, and the country bank, in turn, checks out that money and deposits it wherever its active account might be.

One can see from this operation that a million dollar a day transaction would result in total debits of three million dollars, and if we had to set up an additional reserve of 50% of the debits we would be reserving $500,000 more than the first transaction.

Numerous commission firms from May to November turn their capital over as high as five times a day, i.e., a commission firm having an investment of $5,000 which is on deposit with us, would in the course of a day, handle as high as $25,000 in transactions, which would be debits against its account, and if we were to set up the additional reserve of 50% of the debits against such firm accounts, we would be reserving each day from May to November $12,500, whereas the account would be only $5,000. These commission firms would be forced to move their balance to a non-member bank

COPY

as the charge that we would make for handling the account would be prohibitive and they could not charge it to the farmer, as under present conditions of agriculture, he could not afford to pay that additional cost, already being burdened with debts and high taxes and receiving ridiculous returns on his products.

There are other lines of business in large cities transacted similar to Stock Yards business, possibly not having the enormous turnover per day, ie., commission merchants at Kansas City, Minneapolis, Chicago and St. Louis selling grain on a commission basis. It is possible for a grain merchant to have debits against his account of $50,000 a day, whereas his average balance may be only $5,000. The same is true of cotton factors at Fort Worth, Galveston, Houston, New Orleans, Atlanta, Richmond and numerous merchants handling similar commodities on a cash basis. The same is true of bond houses located in the large cities where the transactions against their accounts are enormous compared to their average balance. The banks enjoying such accounts would be in the same position as the Stock Yards banks.

We are not thoroughly familiar with the changes that will be brought about in the accounts of security brokers in the large cities, but doubtless clearing houses of settlement will be established so that only net charges will appear as bank debits, and the member banks will adopt other systems for handling certain transactions wherever possible, which will defeat your efforts and further weaken the Federal Reserve System.

All of this could cause removal of numerous accounts from member banks to non-members, which volume all over the country could amount from five hundred million dollars upward, which, of course, would cause a decrease in the deposits of the Federal Reserve System, weakening the system to where it will not have sufficient deposits to help control credit.

OPERATION OF PROPOSED FORMULA IN RECENT YEARS.

"Very few ordinary business accounts turn over more rapidly than once a week."

The analysis of debits as shown in the Committee's report was made from each bank's total debits of a past period. To make a fair analysis of the working of the proposed plan, each individual account should be analyzed; it is quite possible for 20% of the deposits to account for 75% of the debits. In our bank we have a class of deposits aggregating 12% of

COPY

our deposits which account for 35% of our debits. We believe that percentage is true of all Stock Yards banks. The analysis should classify debits so as to find out what individual group causes the greatest activity. It is not fair to discriminate against active accounts unless, of course, that class of business brought on expansion of credits but the Committee's report fails to show this.

We believe that if an exhaustive analysis is made of accounts among country banks, stock yards banks and banks specializing in accounts of merchants handling agricultural products, it would show the activity is caused by the class of business these banks handle. The present analysis is supposed to show that had the proposed reserve requirement been in operation during the years 1928, 1929 and 1930, the Federal Reserve Banks would have checked expansion in security loans. We all know that during this inflation period, prices on agricultural products were constantly declining and farmers were suffering while securities reached dizzy heights. The proposed legislation would have penalized farmers' banks and indirectly the farmer would be asked to control security loans. The country would be better off if the Government could bring about inflation in the prices of agricultural products rather than place an additional burden on them.

We believe the same analysis would show the activity of accounts of other banks is caused by certain accounts which, of course, includes brokers' deposits and deposits of banks placed with city banks for investment purposes, mostly the placing of money on call.

SUMMARY.

Reserve requirements can be raised to help prevent over-expansion of credits during abnormal periods, but the increase in reserve requirements should apply only to a bank rediscounting or borrowing from the Federal Reserve Bank.

The proposed legislation could not have prevented over-expansion in real estate as that class of paper was exploited by non-member banks, bond houses and investment companies affiliated with member banks. National banks already have a restriction as to the amount of real estate paper they can carry.

The proposed legislation would impose a burden on banks specializing in accounts of those handling live stock, cotton, grain and other farm products

C O P Y

and would add additional costs to the farm or to those handling his products.

The proposed legislation will be a discrimination between active and inactive accounts.

The proposed legislation could bring about clearing houses of settlement and other schemes and systems to defeat the purpose for which legislation is asked.

The proposed legislation could weaken the Federal Reserve System which we do not want to happen.

Signed: O.J.Sullivan
President.

COPY

December 23, 1931.

Memorandum for Mr. Wood:

You have asked me to express my views in regard to the statements accompanying the letter dated December 16 from the President of the National Stock Yards National Bank, which statements and letter refer to the report of the Committee on Bank Reserves.

The illustration used to show that under present arrangements a member bank enlarging the credit it extends, at the same time increases its required reserve is true only to a limited extent. For instance, taking the illustration used, after another loan of $500,000 is made there would be no further increase in required reserve as a result of additional loans. The illustration takes for granted that the $1,000,000 on deposit with other banks need not be maintained, and does not give any consideration to the effect its withdrawal would have on the required reserve of the banks from which withdrawn.

It is agreed that credit wisely extended and in proper amounts serves a useful purpose, but unwisely extended and in excessive amounts can do great harm. We have fresh in our minds the excessive use of credit for speculative purposes and the results. If basing a portion of the required reserve of member banks on activity of deposits will curb the excessive use of credit for speculative purposes, all well and good, so far as that phase of the matter is concerned. On the other hand, is it reasonable to curb activity of deposits when such activity is the result of legitimate business? In the case of a stock yards bank the activity of the deposits of packers, commission firms and country banks is high and as Mr. Sullivan has pointed out, the funds are often turned over three times in a day, and a member bank handling this class of business would necessarily be obliged to pass the cost of increased reserve on to its depositors, in this instance the packers, commission firms and country banks and it would eventually be borne by the producers and purchasers of livestock products.

Theoretically if "it is the function of reserve requirements to restrain such over-expansion by making it necessary for banks to provide for additional reserves before they expand credit" it would be well to base a portion of the required reserve on bills payable and rediscounts of member banks, but in practice this would work a hardship on member banks borrowing for seasonal needs or to take care of unforeseen withdrawals resulting from unrest, etc.

I am not impressed with the idea that a reserve based on activity of deposits will cause the removal of many accounts to nonmember banks, but do believe that in cases like the National Stock Yards National Bank where the high activity applies to a limited number of deposits, such as those of the packers and commission firms, it would probably be possible and to their advantage to organize an affiliate nonmember State bank to handle the deposits of such customers.

I think the statement "It is not fair to discriminate against active accounts unless, of course, that class of business brought on expansion of credits but the Committee's report fails to show this" merits careful consideration.

I am of the opinion that the proposed plan places too much reliance

C O P Y

Memorandum for Mr. Wood - #2

on reserves required against activity of deposits and I therefore think it would be better instead of having 56% of the required reserves based on net deposits and 44% against activity of accounts, to have a larger percentage on net deposits and a smaller percentage on activity of deposits.

Signed: O.M.Attebery,
Deputy Governor.

C O P Y

FEDERAL RESERVE BANK OF ST. LOUIS

December 29, 1931.

SUBJECT: Report of Committee on Bank Reserves.

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

Dear Governor Meyer:

In your letter of December 12, you asked for an expression of my views with regard to the recommendations contained in the report of the Federal Reserve System Committee on Bank Reserves. After careful study, I am pleased to submit the following:

For the reasons stated in the report, I concur in the recommendation that a part of the required reserves of member banks be based on "debits to deposit accounts." However, inasmuch as the proposed formula is a distinct departure from any plan previously tried, and as it appears from the figures submitted that it would not have increased the total volume of reserves in the Federal Reserve System, and as many of the member banks would doubtless resort to means of reducing the debit figures, I suggest that consideration be given to the desirability of increasing the required reserves against net deposits and lowering the percentage on debits. While in this district 63% of the proposed reserves of the member banks was based on deposits, page 40 of the report states that for the country as a whole only 56% was based on deposits, the remainder depending on debits. I understand that Governor Martin has forwarded to you a memorandum setting out a number of ways in which the member banks might reduce the debit figures.

The proposed bill omits the provision that member banks in outlying sections of Federal Reserve Bank and Branch cities may, with the permission of the Federal Reserve Board, maintain the same reserves as banks located outside of such cities. From the work sheets showing the present and proposed reserves of each bank in this district, it is noted that the large downtown banks in St. Louis had no excess vault cash on the basis of the new formula, while practically all of the outlying banks in St. Louis did. If these outlying banks must maintain four-fifths of their required reserves in the Federal Reserve Bank and still maintain the vault cash that they have been carrying, it is evident that they will have to maintain proportionately more reserves than the downtown institutions. In addition, they would be at a disadvantage with the banks in the suburbs adjacent to St. Louis, which would have to carry only two-fifths of their required reserves in the Federal Reserve Bank. Of course, this situation might be remedied if the Board would interpret the term "vicinity of a Federal Reserve Bank or Branch thereof" to mean within a certain radius from the Federal Reserve Bank short enough to exclude the outlying banks. A different radius would doubtless have to be determined for each Federal Reserve city, according to conditions there.

C O P Y

FEDERAL RESERVE BANK OF ST. LOUIS - #2

In paragraph (d) it is stated that all balances due from other member banks in the United States may be deducted from gross deposits. In the suggested bill attached to Assistant Secretary Noell's letter of May 24, 1928, it was stated: "A deposit made by one bank in another shall not in any case be considered a 'time certificate of deposit.'" Therefore, so that there may be no misunderstanding as to including as deductions from gross deposits all deposits due from other banks, whether checking accounts, certificates of deposit, or otherwise, and whether demand or time, it is suggested that the word "balance" be changed to "deposits" or defined in detail.

Paragraph (e) of the revised bill provides that debits to deposit accounts shall include checks, etc., charged to all accounts included in gross deposits, "except charges resulting from the payment of certified checks and cashiers', treasurers", or other officers' checks." When the Federal Reserve Board began to gather the weekly debits to individual accounts, the instructions specified that debits in settlement of clearing house balances and corrections should not be included. This is mentioned so that these may be added to the exceptions in the bill, or covered later in the Board's definition. Renewals of certificates of deposit and transfers from one account to another should also be covered.

In paragraph (f) of the revised bill, gold bullion is excluded from the definition of cash. It occurs to me that perhaps some of the large seacoast banks might like to have gold bullion included in thedefinition.

From the work sheets left with us by the Committee, it appears that the proposed plan would result in a decrease in the reserves of the member banks in each State and in each reserve city, except St. Louis. There would be a loss of $4,113,000 in reserves carried in the Federal Reserve Bank of St. Louis. However, on page 40 of the report, it is stated that the proposed formula would have produced, during May, 1931, reserves in vault and in the reserve banks equivalent to 99.7% of the actual required reserves plus vault cash under present requirements, i.e., the total body of reserves would be the same under either formula. We therefore assume that the loss in our district would be made up in other districts.

Trusting that these suggestions may be of some assistance, I am

Yours very truly,

Signed: Jno. S. Wood
Federal Reserve Agent.

COPY

FEDERAL RESERVE BANK OF ST. LOUIS

December 28, 1931.

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

Dear Governor Meyer:

At the last meeting of the Governors' Conference during the discussion of the Report of the Committee on Bank Reserves I raised the question as to the possibility of banks so changing their average daily debits by charges made to deposit accounts that 50% of such amount would not provide sufficient reserve when added to 5% of its net deposits. Our Deputy Governor, Mr. O. M. Attebery, had already given some study to this matter and imemediately on my return I asked him to make a careful survey of the matter after questioning bankers in different parts of the district.

I am sending you memorandum which he has prepared.

It may be that the Committee that has made such a thorough study of this subject is in a better position to come to a conclusion as to whether the suggested methods of beating the provision will really amount to any consequence, but it is something I fear will be hard to tell much definitely about until the plan is actually in operation. I know that every bank naturally will immediately attempt to find ways to decrease the amount of reserve it must carry, and the chances are will be ingenious enough to exceed what we can forecast. I am wondering whether some provision could not be worked into the proposed act giving the Federal Reserve Board the authority by regulation to increase or decrease the 50% of the average daily debits whenever in its discretion the total reserves of the country are decreased below the minimum which the Committee used as a basis for its calculation plus some percentage for the natural growth of the country. The very fact that such discretion was vested in the Board would doubtless have a tendency to keep the banks from making very strenuous efforts to decrease the reserve.

As the National Stock Yards National Bank, National Stock Yards, Ill. was desirous that its protest come to the attention of the Board, it has been sent in by our Federal Reserve Agent, Mr. Wood, together with a memorandum discussing it.

Yours sincerely,

Signed: Wm. McC. Martin
Governor.

C O P Y

December 22, 1931

Memorandum for Governor Martin:

Complying with the request you made upon your return from the last Governors' Conference, I have endeavored to think of ways whereby member banks might reduce the activity of accounts with a resulting lowering of reserve requirements in the event the plan proposed by the Committee on Reserves is adopted.

I have discussed the matter with the other officers here and by correspondence with the officers of our branches. It has also been discussed with a number of officers of member banks. The following have been suggested as possible ways of reducing activity:

(1) Where it is the practice when renewing a loan to charge up the maturing note and credit the proceeds of the new one, instead the new note can replace the maturing note and the only charge against the account of the maker would be for the discount or interest.

(2) Chain stores doing a cash business and making large deposits of cash daily, whose custom is to make frequent transfers of funds to offices located in other cities, could with practically no additional inconvenience purchase exchange on other cities, making payment in cash.

(3) It is the general custom with large concerns to handle payrolls by drawing checks in favor of their employees on their depository banks. Such payments could be made in cash in instances where the bank's customer does a heavy cash business.

(4) During periods of Government financing, large corporations and other owners of maturing securities handle the transactions through commercial banks, the customer receiving credit for the maturing issue and being charged with the cost of the new issue. It would be a simple matter instead for the customer to be credited or charged with the difference between the maturing securities and those purchased.

(5) Duplicating entries might be eliminated between the parent bank and its affiliate engaged in trust or fiduciary powers in large transactions.

(6) By stamping a renewal clause on the back of maturing certificates of deposit, thus eliminating the cancellation of the matured certificate and the issuance of a new one. The renewal clause should indicate that the interest on the certificate has been paid to a certain date and the maturity extended six months to bear further interest from date.

(7) If a stamp tax on checks is adopted it would tend to reduce activity and encourage the use of currency.

(8) Where activity of deposits is extremely high and the high activity applies to a limited number of depositors, such as is the case of stockyards banks, it probably would be to the advantage of the member bank to organize an affiliate nonmember State bank to handle the deposits of such customers.

Memorandum for Governor Martin - #2

It is practically impossible at long range to even hazard a guess as to whether these methods of reducing activity are of any consequence. I am also inclined to think that in actual practice there probably would be many other ways of curtailing activity.

Personally I am of the opinion that until the plan has been tried and proven it would be better not to place so much reliance on reserves required against activity of deposit accounts and that it would therefore be better instead of having 56% of the required reserves based on net deposits and 44% against activity of accounts, to have a larger percentage on net deposits and a smaller percentage on activity of deposits.

O. M. Attebery,
Deputy Governor.

C O P Y

FEDERAL RESERVE BANK OF MINNEAPOLIS

December 21, 1931

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

Dear Governor Meyer:

This is in reply to your letter of December 12, with reference to the report of the Committee on Bank Reserves. After a detailed study, with members of my staff, of the Committee's recommendations and the proposed law and regulation, I should say that I am thoroughly in accord as to the principals involved. In my judgment, the proposed law will serve an important purpose as machinery for automatic credit control.

From a practical point of view, there are a few objections and I am fearful that there will be strenuous objections to the proposed law from many parts of the country, particularly from banks in the large financial centers. There is one point I would like to raise in connection with the proposed law which concerns the unusually large volume of transfers of funds at some member banks arising from such events as dividend disbursements and grain settlements. For example, on May 1 the Grain Statilization Corporation built up a special deposit in the two largest banks in Minneapolis, which was immediately disbursed in payment for grain purchased on May contracts. In effect, the Grain Statilization Corporation merely placed its funds with the First National Bank and the Northwestern National Bank of Minneapolis for transfer. These banks could make no use of the funds and they merely acted as distributing agents. They necessarily maintained the funds either in the form of a deposit due from correspondent banks or in the form of a balance due from the Federal Reserve Bank. In the process of distributing these funds, they were transferred from the original account to the account of the Farmers' National Grain Corporation, thence to the certified check account, and from there to commercial firms and others who again redistributed part of these funds. Through these numerous transfers, the original payment of eighteen million dollars was magnified into bank debits of approximately sixty million dollars. These necessary transactions in handling these funds would require the banks handling the money to maintain reserves for an eight weeks' period of approximately one-half million dollars greater than the normal reserve requirement. Furthermore, the credit policy was not served by enlarging these banks' reserves for that eight weeks' period.

In this district, the working out of the proposed law in actual practice would require the liquid and better managed banks to carry larger reserves and at the same time, the frozen and poorly managed banks would have a reduction in reserve requirements. It is my opinion at the present writing that the reserve requirement of 50 per cent of the amount of average daily debits to deposit accounts is rather large and will be the cause of most of the serious objection to the proposed law. If a plan could be worked out by increasing the percentage of reserve on the net deposits and a reduction of the percentage of the amount of average daily debits to deposit accounts so as to produce practically the same amount of reserves for the country as a whole, for example, 6 per cent of the amount of net deposits plus 30 per cent of the amount of the average daily debits to deposit accounts, I believe the proposed law would not be confronted with so many objections.

Very truly yours,

J. R. Mitchell,
Federal Reserve Agent

JRM:BP

C O P Y

FEDERAL RESERVE BANK OF KANSAS CITY

December 14, 1931

Federal Reserve Board,
Washington, D. C.

Attention Mr. Eugene Meyer,
Governor

Genetlemen:

Replying to your letter of December 12, I am glad to advise that I am in agreement with the principles underlying the changes recommended by the Committee on Bank Reserves, and that each one of the recommendations contained in the Committee's report appears to me to be both sound and workable.

Serious defects have been apparent in the existing reserve requirement, as well as many inequalities in the effects ofits application to individual member banks. It seems to me that although the proposed changes will no doubt appear drastic to a few banks having an unusually high rate of deposit turn-over, the plan will serve to place all member banks on an equitable basis as to the reserve requirement, and will at the same time provide a logical and understandable basis for the reserve requirement.

Very truly yours,

M. L. McClure,
Federal Reserve Agent

M/H

COPY

FEDERAL RESERVE BANK OF DALLAS

December 16, 1931

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

Dear Governor Meyer:

Receipt is acknowledged of your letter of December 12, requesting my views with regard to each of the recommendations contained in the recent report of the System's Committee on Bank Reserves.

Governor McKinney is making a careful study of the Committee's report, and, in this connection, he is calling a meeting of representative member bankers to be held in Dallas next Friday, December 18, for the purpose of obtaining an expression of their views with reference to the proposed revision of reserve requirements. As soon as this meeting is held, I shall confer with Governor McKinney and write you a letter embodying not only my own personal views in regard to the matter, but also any suggestions which the Governor of this bank or the member bankers of this district may wish to have submitted to the Board before it passes on the Committee's report.

Yours very truly,

Signed: C. C. Walsh,
Federal Reserve Agent

Form No. 131.

Office Correspondence

FEDERAL RESERVE BOARD

Date March 2, 1932

To Mr. Harrison

Subject:

From Mr. Magee

2—8495
G P O

This was the original report of Dr. Willis talk which appeared in the Journal of Commerce of January 29, 1932, and was reprinted a month later in the New York Times of March 1, 1932.

Magee

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Author(s):

Article Title: Reserve Weak in Depression, Says Dr. Willis

Journal Title: Journal of Commerce

Volume Number: Issue Number:

Date: January 29, 1932

Page Numbers:

Author(s):

Article Title: Reserve Banking Faulty, He Asserts

Journal Title: New York Times

Volume Number: Issue Number:

Date: March 1, 1932

Page Numbers: Business Records, 42

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date April 16, 1932

To Governor Meyer

Subject: Bank suspensions

From Mr. Smead

GPO 2—8495

The Comptroller's Office called up yesterday and asked for bank suspension figures from February 2 to April 12 and for the same number of days (71) prior to February 2. I understand this information was requested for the use of General Dawes.

The figures given to the Comptroller's Office are as follows:

	Total bank suspensions	National bank suspensions	State bank member suspensions	Nonmember bank suspensions
February 2 to April 12, 1932, both inclusive (71 days):				
Number of banks	182	34	6	142
Deposits*	79,744	27,264	3,517	48,963
November 23, 1931 to February 1, 1932, both inclusive (71 days):				
Number of banks	756	147	35	574
Deposits*	521,467	159,854	42,881	318,732

*In thousands of dollars.

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date April 18, 1932

To Governor Meyer

Subject: Analysis of bills pending in Congress relating to soldiers' adjusted compensation certificates

From Mr. Riefler

WR

GPO 2—8495

In all, forty-two bills, dealing with the bonus, have been introduced this session in the House. Six additional bills have been introduced in the Senate. Of these forty-eight bills, twenty-one have as their prime object present payment in full of the face value of adjusted compensation certificates; while the others in general are directed toward lowering or cancelling interest on loans on these certificates, or toward abolishing the present requirement that veterans cannot borrow on their certificates until two years after the date of issuance.

Immediate payment of face value of certificates

Of the twenty-one bills which provide for immediate payment of the face value of the certificates, nine, including the first bill on the subject introduced by Representative Patman, provide no means of raising funds other than a general authorization; seven provide funds through the sale to the public of long-term bonds; one provides for the delivery of bonds to veterans, and three provide for the sale of bonds to the reserve banks. The second Patman bill is the only one that provides that funds shall be raised by printing currency in the amount needed to pay the face value of the certificates. Many of the bills are identical in form.

Inasmuch as there is no possibility that the funds necessary to cash the bonus could be raised by taxation, there is no essential difference between the bills which provide no financial machinery for raising funds to pay the bonus and those which provide for a public bond issue. If any of these bills were passed, a bond issue for the full amount would be necessary. These bills, therefore, of which Senator Brookhart's S-1799 is typical, are concerned mainly with a question of public policy, namely the advisability of issuing bonds to raise funds for a veterans' bonus at this time. The other bills which provide for raising funds directly or indirectly by tampering with the currency, raise additional problems. Of these, S-4350, introduced by Senator Thomas, is typical of those which provide for the sale of bonds to the Federal reserve banks. H. R. 7726, introduced by Representative Patman, stands alone as the only bill which provides for using the printing press directly to provide funds for payment of the bonus. The Brookhart, Thomas, and Patman bills, discussed in this memorandum, therefore, are typical of the various measures now advocated to provide payment in full of the face value of the bonus.

S-1799--Senator Brookhart

Under the Brookhart bill the Government would be directed to pay now the bonus which is due in 1944 less any loans at present outstanding. The Treasury consequently would be required to raise in the neighborhood of two and one-half billion dollars through the issue of bonds, and turn the proceeds over to the veterans who hold adjusted service certificates. This measure is advocated from the point of view of public policy, first as a relief measure, and second as a means of stimulating industry.

From the point of view of relief the measure is both costly and inequitable. Despite the fact that only a portion of the veterans need relief, and that destitution is quite as widespread among the general population as among the veterans, the amount of funds involved is several times larger than in any of the general relief measures considered by Congress.

From the point of view of stimulating business, it is difficult to prove that a distribution of two billion five hundred million dollars in the manner indicated in this bill would not stimulate some consumption of commodities. It is questionable, however, whether such stimulation would be more than a flash in the pan. The present depression is much more pronounced in the capital than in the consumption industries, and this measure by raising all of its funds in the capital market might tend to withdraw from that market funds which would otherwise be used in the construction of plant, housing, equipment, etc.

From a broad economic point of view the fallacy of the plan is that it would add to the burden of existing indebtedness without creating any tangible productive asset in exchange. The raising of funds through the capital market, either by private or public bodies, is economically sound if the funds are used not to meet current expenditures but to produce needed permanent improvements which will themselves produce the revenue to pay interest and principal on the additional indebtedness created. In the case of the bonus proposal, an already large public debt would be further increased without any compensating increase in the productive assets of the nation to provide payment for the debt.

S-4350--Senator Thomas

The difficulty of raising funds to pay the bonus by selling a bond issue to the public has led to the suggestion of Senator Thomas that bonds be sold to the reserve banks to provide the funds required. Under the Thomas bill, the Secretary of the Treasury would sell two per cent, thirty-year bonds to the Federal reserve banks in the amount needed to provide funds to cash the bonus. The maturity of these bonds could be extended for more than thirty years at the discretion of the Treasury and the interest rate could be fixed at less than two per cent on agreement between the Treasury and the Federal Reserve Board. In order to permit currency to be issued against these bonds the bill makes all the provisions of the Glass-Steagall Bill permanent instead of temporary. The payment of the bonus is to be effected by Federal reserve notes so issued unless the Federal Reserve Board instructs the Administrator of Veterans' Affairs to make payment by check.

This mechanism has been defended as financially sound on the erroneous belief that it parallels the financial mechanism of the Reconstruction Finance Corporation. First, this is not true. The Reconstruction Finance Corporation issues its securities directly or indirectly in the market and does not obtain its funds from the Federal reserve. Second, the Reconstruction Finance Corporation does not increase the total volume of net indebtedness but merely gets under existing indebtedness, i.e. funds borrowed by the Reconstruction Finance Corporation are used to loan on existing liabilities. The financial operation is more similar to refinancing than to new financing. Such refinancing the veterans already have existing in their loans on their certificates.

The economic effect of this bill as compared with the Brookhart bill is the same insofar as it relates to the effect of present payment of the bonus. In addition, however, it would have the following far-reaching effects upon the position of the reserve banks.

(1) It would commit the Federal reserve banks to a two and one-half billion dollar operation in the open market, i.e. the immediate effect would be the same as though we bought this amount of U. S. securities in

the open market. A part of this amount would be used to retire existing reserve bank credit while the remainder would increase reserves of the member banks and create extremely easy money conditions. The volume of excess reserves created would be very much larger than was needed to finance the boom in 1929. It would, therefore, put more reserve bank credit in the market than the country could safely use even if industry were operating at full capacity.

(2) Inasmuch as the interest rate on these bonds cannot be higher than 2 per cent, the Federal reserve banks would not be able to dispose of them in the market. Our minimum portfolio of U. S. securities, consequently, would be in the neighborhood of $2,500,000,000 for the next thirty years at least and the reserve banks would not be in a position to control any inflation that might start as a result of superfluous excess reserves.

(3) Under these circumstances, the chances are that gold would flow out of the country in a flight of capital.

H. R. 7726--Representative Patman

This bill directs that the bonus be paid in U. S. Treasury notes and authorizes the Secretary of the Treasury to issue such notes in an amount sufficient to pay the bonus. It contemplates, consequently, printing $2,500,000,000 of greenbacks. As this currency, because of hoarding at the present time, is now larger than is needed by business, these greenbacks would not increase the total volume of currency. Instead, they would be deposited in banks and be returned to the reserve banks, where they would swell the item "reserves other than gold." These are not real reserves since they cannot be used to settle international balances, and the reserve banks would hold $2,500,000,000 of printed paper called reserves which in fact would be utterly unproductive, yielding no income to the reserve banks, and furnishing no buffer against an adverse balance of payments. In all other respects the effects of this bill would not differ from the Brookhart and Thomas bills; its effects as a relief measure would be inequitable and costly; it would give the member banks more reserves than were needed to finance industry in the boom conditions of 1929, it would retire all existing reserve bank credit and thus render the Federal reserve system powerless to exert any restraining influence whatever on the situation, and, finally, it might lead to a flight of capital from the country involving heavy withdrawals of gold.

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date November 20, 1931

To Mr. Harrison.

Subject:

From Mr. Riefler

WWR.

GPO 2—8495

Attached is a draft summary of the report of the Committee on Bank Reserves, as requested by the Federal Reserve Board.

For release morning papers, Nov — 1931

SUMMARY OF REPORT OF ~~FEDERAL RESERVE SYSTEM~~ the COMMITTEE ON member BANK RESERVES of the Federal Reserve System.

A committee of the Federal Reserve System on member bank reserve requirements, which included representatives of the Federal Reserve Board and the Federal reserve banks, has recently made its report to the system. This report has been released for publication with the consent of the Federal Reserve Board pending its consideration by the Board and the Federal reserve authorities banks.

The ~~report~~ Committee recommends a number of fundamental changes in existing ~~reserve~~ requirements as to reserves of member banks, with ~~a~~ the view ~~to~~ of eliminating ~~inequitable features in~~ inequalities that have arisen under the existing law, but ~~does not recommend any change in~~ points out that its proposals would not change the total volume of required reserves under existing conditions. It ~~provides for~~ suggests a system of reserves which would treat all member banks in the country alike regardless of their location. It would also simplify reserve requirements by eliminating the classification of deposits into demand and time deposits and the classification of banks in accordance with their location in different cities. At the present time, all member banks must carry a 3 per cent reserve against time deposits and reserves against demand deposits of 13 per cent at central reserve city banks, 10 per cent at reserve city banks, and 7 per cent at so-called country banks. The new proposal drops these distinctions and recommends as a substitute that all member banks carry a reserve of 5 per cent against their net deposits and, in addition, a reserve equal to 50 per cent of the average daily turnover of deposits, with a maximum of 15%. This formula, the Committee states, automatically make~~s~~ demand deposits carry a higher reserve than time deposits, and also ~~makes~~ causes more active demand deposits, such as are likely to be found in central reserve cities, carry a higher reserve than less active demand deposits, such as are held by a majority of country banks.

Treatment of ~~time~~ deposits

~~Under this formula~~ NoP the problem of properly defining time deposits, which has given rise to a great deal of confusion and ~~evasion is elimi-nated.~~ difficulty also would be ~~The Committee has found that time deposits in many cases do not represent genuine savings, but deposits classified as time deposits merely for the purpose of permitting banks to carry lower reserves against them. The Committee reached the conclusion that it was impossible to define time deposits so as to avoid evasions of this type and, therefore, proposes a plan by which~~ as the difference between demand and time deposits ~~will~~ would be taken care of automatically under the Committee's proposal.

Deductions from gross deposits ~~New method of determining reserves~~

~~The Committee found that under existing reserve requirements changes in the volume of reserves have not corresponded with changes in the volume of business activity. Since 1914 there has been a very rapid growth of member bank credit and of the activity of member bank deposits, but reserve requirements have not shown a corresponding growth. In order to correct this condition,~~ The Committee recommends a new method of determining required reserves and a change in the definition of what constitutes reserves. Under its ~~According to the~~ proposal, reserves ~~shall~~ would be ~~held~~ required against ~~total debits or charges to deposit accounts and against~~ total net deposits, that is, against the total deposit liabilities of the member banks, less their items in process of collection and their balances with member banks. This method of determining net deposits differs from the existing requirements in that it proposes to allow~~s~~ deductions, which are more carefully defined, to be made from total deposits rather than from amounts due to banks. Present requirements, the Committee points out, have operated in favor of banks in financial

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centers having large amounts of bankers' balances from which deductions are permitted and against banks in country districts and elsewhere that do not have such balances.

Vault cash ~~to count~~ as part of reserves

The Committee~~'s~~ propos~~al~~es to define~~s~~ reserves as balances with the Federal reserve banks and cash carried by the banks in their own vaults. Prior to 1917 the cash which member banks held in their vaults was counted as part of their required reserves, but in 1917 the provisions of the Federal Reserve act with respect to member bank ~~legal definition of reserves~~ were ~~was~~ changed so as to exclude cash held in vault and include only deposit balances with the reserve banks. At the same time reserve requirements were reduced by 5 per cent on demand deposits and by 2 per cent on time deposits ~~at all classes of banks~~ on the theory that banks would continue to carry about an equal amount of ~~that much~~ cash in vault ~~in order to be in a position to meet the daily withdrawals of their customers.~~ according to the Committee. Actual experience has shown this not to be true, as few cities because ~~member banks~~ ~~have greatly reduced their cash in vault since 1917 and thus in substance have diminished substantially the proportion of reserves, including vault cash, which they hold against their deposits. This reduction has occurred chiefly at~~ banks located in Federal reserve bank and branch cities, ~~which are~~ have quick access to the Federal Reserve banks and are able to replenish their cash quickly ~~by sending a messengers to the reserve bank. Country banks, on the other hand, have not been able to reduce their cash holdings to the same extent. In the aggregate, the result has been that total member bank reserves, including vault cash, are now about $700,000,000 less than they would have been if the reserve act had not been amended in 1917. The 1917 amendment,~~ consequently, has had the effect of gradually reducing the effective reserves of member banks. It has also neutralized to a considerable extent the effectiveness of differentials in reserve requirements at different types of banks since the city banks by cutting down their vault cash have been able to reduce their effective reserves to the level held by country banks. By allowing vault cash to count as reserves, within certain limitations, the Committee's proposal would put~~s~~ banks that are not located conveniently near a reserve bank or branch more nearly on an equality with banks that are in Federal reserve bank or branch cities. Insert B The proposal, furthermore, would make it impossible for future economies in the use of vault cash to reduce total reserves, because any ~~further reduction~~ in vault cash below the prescribed limits would ~~involve the necessity of~~ require a corresponding increase in member bank reserve balances with the reserve banks.

transfer from page 2

~~More equitable distribution of reserves~~ Increased reserves in periods of activity.

The Committee's proposal, ~~while not changing the total amount of required reserves, would change considerably their~~ would provide a more equitable distribution of required reserves as between different member banks and groups of member banks, but, as already indicated, would not change the total volume under existing conditions. ~~These changes would operate mainly to increase reserves at city banks, which have benefitted most from the 1917 amendment, and to decrease reserves at country banks, which, because of their location, have not been able to reduce their vault cash to the same extent.~~

To ~~promote sounder~~ credit conditions

~~The proposed formula would also promote sounder~~ credit conditions ~~since~~ The volume, however, the Committee points out, ~~of required reserves~~ would increase as the volume of the banks' business increased, the business being measured not only by it states,

the amount of deposits, but by their activity. Reserves thus would be larger in periods of activity and in periods of speculative booms, and, therefore, ~~and smaller in periods of business depression. The change proposed by the Committee, therefore,~~ would work in ~~make reserve requirements work with Federal reserve policy in~~ the direction of sounder credit conditions. ~~This does not occur under existing requirements which experience shows actually permitted a reduction in member bank reserves during the speculative boom that culminated in 1929 and then operated to bring about an increase in reserves when the boom was over.~~ Under the formula proposed by the Committee, the aggregate reserve requirements of member banks would have increased sharply ~~by about $400,000,000~~ during the speculative period in 1928 and 1929, and would have decreased by approximately an equal amount ~~between $400,000,000 and $500,000,000~~ in the following two years of business recession. The increase, according to the Committee, would have been concentrated largely at banks whose customers were trading heavily in securities and consequently would have had a restraining influence on ~~acted consequently to restrain the~~ speculative movement ~~at its source~~. The subsequent decrease in reserve requirements when the boom was over would have helped, the Committee states, to ease credit conditions throughout the country.

~~Reserves to increase at right time and place~~

~~The Committee's proposal, therefore, would increase reserves not only at the time but also at the individual banks which show an actual growth in activity.~~

During the farm real estate boom of 1919-1920, the Committee's proposal ~~it~~ would have considerably increased reserves at the country banks in the interior of the country. During the speculative boom in Florida real estate, it would have increased reserves of the Florida banks, and during the stock exchange boom of 1928-1929, it would have increased the reserves of eastern city banks. During a period like the present, it would result in a total volume of reserves about equal to the ~~present~~ existing volume ~~but much smaller than two years ago~~.

Purpose of reserves

The Committee considers that the two principal purposes of reserve requirements under our present banking structure are to promote sound credit conditions by exerting an influence on changes in the volume of bank credit, and to provide the Federal reserve banks with ~~sufficient~~ adequate resources ~~to enable them to pursue an effective banking~~ and credit policy. The application of these principles should be such, ~~furthermore~~ the Committee states, that reserves are equitably distributed among the member banks and also are simple to calculate and to enforce. ~~The Committee recommends changes in the present method of administering reserve requirements which will enable member banks to know definitely in advance their requirements for reserves including those against the turnover of their deposit accounts.~~

The Committee's report includes ~~a draft of an amendment to Section 19 of the Federal Reserve Act~~ recommendations as to legislative and administrative changes which would be necessary in order to carry out ~~to put~~ its proposals ~~into effect~~

Insert B

Under the committee's proposal, member banks located in the vicinity of Federal reserve banks or branches could maintain not more than one-fifth of their required reserves in vault cash and allother banks could maintain not more than three-fifths in vault cash. With these limitations, further reductions in vault cash would not result in decreases in total reserves since corresponding increases in reserve balances with the Federal reserve banks would be required.

Riefler's draft

SUMMARY OF REPORT OF FEDERAL RESERVE SYSTEM COMMITTEE ON BANK RESERVES

A committee of the Federal Reserve System on member bank reserve requirements which included representatives of the Federal Reserve Board and the Federal reserve banks has recently made its report to the system. This report has been released for publication pending its consideration by the Federal reserve authorities.

The report recommends a number of fundamental changes in existing reserve requirements, with a view to eliminating inequitable features in the existing law, but does not recommend any change in the total volume of required reserves. It provides for a system of reserves which would treat all member banks in the country alike regardless of their location. It would also simplify reserve requirements by eliminating the classification of deposits into demand and time deposits and the classification of banks in accordance with their location in different cities. At the present time all member banks must carry a 3 per cent reserve against time deposits and reserves against demand deposits of 13 per cent at central reserve city banks, 10 per cent at reserve city banks, and 7 per cent at so-called country banks. The new proposal drops these distinctions and recommends as a substitute that all member banks carry a reserve of 5 per cent against their net deposits and in addition a reserve equal to 50 per cent of the average daily turnover of deposits. This formula automatically makes demand deposits carry a higher reserve than time deposits, and also makes more active demand deposits, such as are likely to be found in central reserve cities, carry a higher reserve than less active demand deposits, such as are held by a majority of country banks.

Treatment of time deposits

Under this formula the problem of properly defining time deposits which has given rise to a great deal of confusion and evasion is eliminated. The Committee has found that time deposits in many cases do not represent genuine savings, but deposits classified as time deposits merely for the purpose of permitting banks to carry lower reserves against them. The Committee reached the conclusion that it was impossible to define time deposits so as to avoid evasions of this type and, therefore, proposes a plan by which the difference between demand and time deposits will be taken care of automatically.

Deductions from gross deposits

The Committee found that under existing reserve requirements changes in the volume of reserves have not corresponded with changes in the volume of business activity. Since 1914 there has been a very rapid growth of member bank credit and of the activity of member bank deposits, but reserve requirements have not shown a corresponding growth. In order to correct this condition, the Committee recommends a new method of determining required reserves and a change in the definition of what constitutes reserves. According to the proposal, reserves shall be held against total debits or charges to deposit accounts and against total net deposits, that is, against the total deposit liabilities of the member banks, less their items in process of collection and their balances with member banks. This method of determining net deposits differs from the existing requirements in that it allows deductions, which are more carefully defined, to be made from total deposits rather than from amounts due to banks. Present requirements have operated in favor of banks in financial centers having large amounts of bankers' balances from which deductions are permitted and against banks in country districts and elsewhere that do not have such balances.

Vault cash to count as part of reserves

The Committee's proposal defines reserves as balances with the Federal reserve banks and cash carried by the banks in their own vaults. Prior to 1917 the cash which banks held in their vaults was counted as part of their required reserves, but in 1917 the legal definition of reserves was changed so as to exclude cash held in vault and include only deposit balances with the reserve banks. At the same time reserve requirements were reduced by 5 per cent on demand deposits and 2 per cent on time deposits at all classes of banks on the theory that banks would continue to carry about that much cash in vault in order to be in a position to meet the daily withdrawals of their customers. Actual experience has shown this not to be true, as member banks have greatly reduced their cash in vault since 1917 and thus in substance have diminished substantially the proportion of reserves, including vault cash, which they hold against their deposits. This reduction has occurred chiefly at banks in Federal reserve bank and branch cities, which are able to replenish their cash quickly by sending a messenger to the reserve bank. Country banks, on the other hand, have not been able to reduce their cash holdings to the same extent. In the aggregate, the result has been that total member bank reserves including vault cash are now about $700,000,000 less than they would have been if the reserve act had not been amended in 1917. The 1917 amendment, consequently, has had the effect of gradually reducing the effective reserves of member banks. It has also neutralized to a considerable extent the effectiveness of differentials in reserve requirements at different types of banks since the city banks by cutting down their vault cash have been able to reduce their effective reserves to the level held by country banks. By allowing vault cash to count as reserves, within certain limitations, the Committee's proposal puts banks that are not located conveniently near a reserve bank or branch on an equality with banks that are in Federal reserve bank or branch cities. The proposal, furthermore, would make it impossible for future economies in the use of vault cash to reduce total reserves, because any further reduction in vault cash would involve the necessity of a corresponding increase in member bank reserve balances with the reserve banks.

More equitable distribution of reserves

The Committee's proposal, while not changing the total amount of required reserves, would change considerably their distribution as between different member banks and groups of member banks. These changes would operate mainly to increase reserves at city banks, which have benefitted most from the 1917 amendment, and to decrease reserves at country banks, which, because of their location, have not been able to reduce their vault cash to the same extent.

To promote sounder credit conditions

The proposed formula would also promote sounder credit conditions since the volume of required reserves would increase as the volume of the banks' business increased, the business being measured not only by the amount of deposits, but by their activity. Reserves would be larger in periods of activity and in periods of speculative booms and smaller in periods of business depression. The change proposed by the Committee, therefore, would make reserve requirements work with Federal reserve policy in the direction of sound credit conditions. This does not occur under existing requirements which experience shows actually permitted a reduction in member bank reserves during the speculative boom that culminated in 1929 and then operated to bring about an increase in reserves when the boom was over. Under the formula proposed by the Committee, the aggregate reserve requirements of member banks would have increased sharply by about $400,000,000 during the speculative period in 1928 and 1929, and would have decreased by between $400,000,000 and $500,000,000 in the following two years of business recession. The increase would have been concentrated largely at banks whose customers were trading heavily in securities and would have acted consequently to restrain the speculative movement at its source. The subsequent decrease in reserve requirements when the boom was over would have helped to ease credit conditions throughout the country.

Reserves to increase at right time and place

The Committee's proposal, therefore, would increase reserves not only at the time but also at the individual banks which show an actual growth in activity. During the farm real estate boom of 1919-1920, it would have considerably increased reserves at the country banks in the interior of the country. During the speculative boom in Florida real estate, it would have increased reserves of the Florida banks, and during the stock exchange boom of 1928-1929, it would have increased the reserves of eastern city

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date April 26, 1932

To Governor Meyer

Subject: Currency Demand, April 21-23.

From Miss Joy

a.J.

In the last three days of last week the increase in currency demand was about $15,000,000 smaller than usual for the week-end, chiefly because of relatively small demand in New York and Chicago. In the San Francisco district there was a continued return of currency, and on April 23 demand was at about the level prevailing before bank suspensions on April 14 and 15. In the Dallas and Philadelphia districts demand increased somewhat more than usual over the week end, but the increases were small; while at Boston there was little change, and circulation continued slightly above the levels prevailing ten days earlier.

COPY FOR GOVERNOR MEYER

April 26, 1932

Mr. Joslin

Mr. Goldenweiser EAG

During the week ending April 20 there was an increase of $77,000,000 in net demand deposits at reporting member banks in leading cities and an increase of $26,000,000 in time deposits. These increases, although they were accompanied by a decline in Government deposits, were significant because there was an increase of $61,000,000 in the banks' loans and investments. This increase reflected a growth of $148,000,000 at reporting banks in New York City, offset in part by a decrease of $87,000,000 at other banks in leading cities.

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date July 1, 1932

To Governor Meyer

Subject:

From Mr. Goldenweiser

George W. Christian

2—8495

Mr. Christian came to me with a letter of introduction from C. O. Hardy of the Brookings Institution and left with me a lot of literature, including a pamphlet called "This Depression" and a bill, HR-11898, introduced in the House of Representatives on May 5, 1932, by Mr. McFadden at Mr. Christian's request.

The pamphlet is largely an attack on the gold standard and the Federal Reserve Board and does not present any definite proposal. The bill, however, is very definite indeed. It proposes that the standard of value in this country be the wage of male unskilled common labor at the 1928 level of 42.62 per hour. The bill provides that the Treasury of the United States take over the Federal reserve banks and pay for the banks by an issue of bonds. The banks then become loaning agencies of the Government, the Government to issue an unlimited amount of paper money to be loaned to people at rates of interest that will vary with the price of labor. When the price of labor rises above the amount indicated the rate of interest shall also rise, and when the price of labor falls the loan rate shall decline even to the point of becoming negative. That is, he assumes circumstances when borrowers shall be paid for borrowing. In Mr. Christian's opinion this would cure all the economic and social evils that now prevail. It will present a new diversion of income from producers to lenders of money. In this diversion he sees the principal evil of the situation, and by making loans at low rates or even negative rates the whole system will be corrected.

Christian is a fanatic and I am inclined to think a lunatic. He is very calm and self-possessed and talks in an intelligent way with a very good command of the language and of terminology of several sciences. At the same time he thinks that he has the power to bring about a revolution and that the revolution is at our doors. He claims that there would have been a communist outbreak yesterday if he hadn't prevented it. He feels that he will not be justified in preventing outbreaks much longer. What he wanted me to do is to arrange for an interview with you, and I suppose the next step will be an interview with the President. He wants you to arrange that. I told him that all I could do was to make a report on his plan and that you being a very busy man would see him only in case you found that the plan was important and worthy of consideration. My suggestion is that when he gets in touch with your office you have the office tell him that you do not find that the plan offers any constructive possibilities and that you have no time to spend on it.

Noted F.L.B.

Mr. Christian's address is the Annapolis Hotel, Washington, D. C.

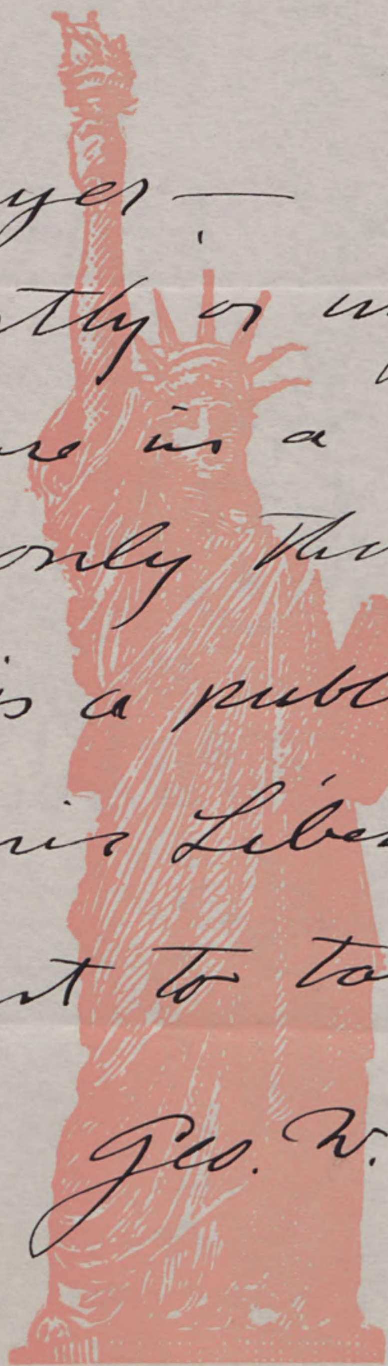
CRUSADERS FOR ECONOMIC LIBERTY

INCORPORATED

NATIONAL CAPITOL

CHATTANOOGA, TENNESSEE

CAPITALISM UNDER ECONOMIC LIBERTY ---------- OR ---------- COMMUNISM UNDER TYRANNY



Monday (July 11/32)

Eugene Meyer—

Justly or unjustly you personally are in a very tough spot. The only thing that can save you is a public announcement for Economic Liberty.

Want to talk it over?

Geo. W. Christians

RECEIVED
JUL 12 1932
OFFICE OF THE GOVERNOR
FEDERAL RESERVE BOARD

The Golden Rule Instead of the Rule of Gold

HOTEL ANNAPOLIS
ELEVENTH, TWELFTH & H STS.
WASHINGTON, D.C.

WASHINGTON, D.C. 9
JUL 12
10^30 AM
1932

NOTIFY
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UNITED STATES POSTAGE
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Eugene Meyer
Treasury

IN THE HEART OF EVERYTHING

July 6, 1932.

Memorandum

Perhaps the most suitable book for Mr. Hancock's purpose is one entitled "The Gold Standard and its Future" written by T.E. Gregory in the latter part of 1931 and published by Methuen & Company, Ltd., London. Another good book by an Englishman is R.G. Hawtrey's "The Gold Standard in Theory and Practice", second edition, 1931, published by Longmans, Green & Company. Hawtrey has rather more confidence in the power of central banks to control the course of prices than most operating bankers have, and occasionally his writing is somewhat abstract; but his book as a whole is a very lucid statement. Mr. Hancock will also undoubtedly want to read the various reports of the Gold Delegation of the Financial Committee of the League of Nations. These deal with the production of gold and the demand for it, the distribution of gold reserves, the gold legislation of various countries, and other related matters. The final conclusions of the Delegation are set forth in a report of some eighty pages, which has just been issued. A short paper by Dr. E.W. Kemmerer on "Gold and the Gold Standard", published in the Proceedings of the American Philosophical Society, 1932, is also of interest on the general question, as is a collection of papers by leading economists brought together under the title "The International Gold Problem", published by the Oxford University Press in 1931. These papers were presented before the Royal Institute of International Affairs and were followed by discussions which are recorded in the volume and are quite as well worth reading as the papers themselves. Mr. Hancock may be interested also in reading a book by Wm. Adams Brown entitled "England and the New Gold Standard, 1919-1926" (P.S. King & Son, London, 1929) and the report of the British Committee on Finance and Industry -- the so-called "Macmillan Committee" -- published in June, 1931. Brown deal with what he believes to be the entirely new foundations of the gold standard subsequent to the world war; and the Macmillan Committee undertakes to elucidate the banking mechanism in England in relation to prices and also considers the question, unsettled at the time the report was written, of whether England should or should not devaluate its currency or abandon the gold standard altogether.

On the subject of the evolution of money and the origins of various standards -- if Mr. Hancock wants to look into such questions -- I should suggest a two-volume work by L. Laurence Laughlin entitled "A New Exposition of Money, Credit, and Prices", published in 1931 by the University of Chicago Press. It is a useful book for reference purposes.

There is attached to this memorandum a paper delivered last December before the American Statistical Association by Mr. Walter R. Gardner, of the Board's staff.

FRANK HANCOCK
5TH DISTRICT
NORTH CAROLINA

PAUL DOYLE
SECRETARY

COMMITTEE:
BANKING AND CURRENCY

Congress of the United States
House of Representatives
Washington, D. C.

20 June 1932

Hon. Floyd G. Harrison
Treasury Department
Washington, D. C.

Dear Mr. Harrison:

In view of the fact that there is considerable loose talk going the rounds in reference to the advisability of our nation going off the gold standard, I have an anxiety to thoroughly inform myself about this question. I am very desirous of securing reliable, accurate and clear-stated information regarding the history of the gold standard, its relation to money and economics, and why it is desirable that we should maintain the standard. Within the past week I have received several invitations to speak before various Civic Clubs on the subject of the Gold Standard.

At your convenience I will appreciate your advising me where I can get such publications regarding this subject as will enable me to become informed, or if you can conveniently do so I will appreciate your having this information sent to me.

With personal regards and best wishes,

Sincerely yours,

F. Hancock Jr.

Frank Hancock

- Personal -

8

July 19-32
Dr Goldenweiser

CURRENCY EXPANSION UNDER THE HOME LOAN BILL

Analysis of the amendment to the Home Loan Bill extending the circulation privilege to all Government bonds having an interest rate of 3 3/8 per cent or less indicates:

(1) That the bill would not do anything to help business recovery at the present time. While the banks would be authorized to issue about $1,000,000,000 of additional currency, those banks that have excess reserves would obviously not want to use this authority. They have funds now that are lying idle and are not going to go to the expense, amounting to about 1 per cent, of acquiring additional currency. Neither can banks that are in a frozen condition avail themselves of this authority. Banks that are indebted to the Federal reserve bank or elsewhere on paper other than Government securities will have no means of issuing notes under the new proviso, because they will find it difficult to finance themselves for the purpose, and because they would have to use the notes acquired to pay for the bonds, on which they are based, and would then be 5 per cent short because of the redemption fund requirement. Banks that are in debt at the Federal reserve banks on Government securities, on the other hand, could use the new authority to pay off their indebtedness, but such banks could accomplish the same result without this authority by selling their Governments, so that the only thing that this would mean to them will be the ability to pay off their indebtedness without disposing of their Governments and taking such losses as the depreciation in the Governments may involve. Since there is only about $200,000,000 borrowed from the reserve banks on Governments altogether, and a large part of it is in large cities, this group of banks will not avail itself of the privilege in any large amount. The

only group of banks which may use this authority are the banks which have no excess reserves, are out of debt, and have a certain amount of Government securities. Such banks may decdde to issue notes for the purpose of buying additional Government securities, or making loans or investments purely as a matter of taking advantage of the profit involved.

Since there is nothing in the measure to cause an increase in the demand for currency, the notes issued under the new authority would return to the Federal reserve banks and retire an equivalent amount of Federal reserve currency. The net effect would be that the banks that would be helped are banks that do not require help, while the Federal reserve banks would find themselves holding large excess reserves for member banks. The effect on credit conditions would be the same as though the reserve banks had bought an additional amount of Government securities, with this difference, however, that the reserve banks would not have the securities to sell in case a change in the situation made it desirable.

(2) While, therefore, the additional circulation would do little, if any, good at the present time and would do some harm, it would become seriously dangerous to the country's credit and monetary system at a later period. When business recovers and the banks find it profitable to expand their operations, it may be confidently expected that all of the banks will avail themselves of the note issue privilege, and in that way there would be something like $1,000,000,000 of currency issued, which would promptly return to the Federal reserve banks and retire that much of Federal reserve notes. This process would create reserve balances at the reserve banks, and since there will be a relatively small amount of discounts, it would remain

as excess reserve balances, unless the Federal reserve banks sold Government securities to absorb the excess. At a time like that there would probably also be a large return flow of currency from hoarding, which would also back up at the Federal reserve banks and still further increase the member banks' reserves. With a billion of potential additional currency and a billion and one-half of potential return flow from hoarding, the Federal reserve banks might find themselves entirely without earning assets, and consequently entirely out of touch with credit conditions, to say nothing of inability to meet expenses. At such a time, however, heavy pressure would be exerted to prevent the reserve banks from selling all their United States Government securities and there would, therefore, be a likelihood of a large volume of excess reserves, which would enable banks to expand credit without resorting to the Federal reserve banks. This, in turn, would lead to an inflationary situation in this country that would bring about a gold outflow, with a subsequent contraction of credit, or if gold did not leave the country, then the usual course of an inflationary movement would carry on for a longer time and would ultimately lead to a more serious collapse.

The effects of the proposal may be summed up as being a mandate to the Federal reserve banks to engage in a large-scale open-market operation, not at the present time, when its results might be beneficial, but a time in the future when the results will be contrary to the public interest. It would also increase and perpetuate the currency confusion in this country and make it more difficult to maintain currency elasticity, since the inelastic element will be greatly increased.

It may be expected that, if the banks find opportunity to make any considerable use of the privilege before the expiration of the three-year limitation, the pressure for continuing the note-issue privilege will be very great ~~slow~~. It will then be pointed out, among other things, that to withdraw the privilege would force member banks to borrow heavily at the reserve banks and thus create tight credit conditions and hamper business activity, and that to convert the National bank notes into Federal reserve notes would require a large amount of gold as reserves which the Federal reserve system could not spare.

The introduction of an element into our currency that would transfer to the National banks the privilege of issuing additional notes in a volume equal to what in ordinary years has been the entire amount of Federal reserve credit outstanding constitutes an abandonment of the progress made in the last twenty years toward the establishment of a more efficient currency and banking system; an abandonment of elastic currency and of regulation of uncontrolled banking expansion. Though in form it is a temporary measure intended to help in an emergency, this bill offers no promise of helping business recovery and creates not only a danger ~~dnager~~ but almost a certainty of currency difficulties and of unhealthy credit expansion and contraction in the not distant future.

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date July 21, 1932.

To Governor Meyer.

From Mr. Wyatt.

Subject: Revised circular re discounts for individuals, partnerships and corporations.

Gee

URGENT

2—8495

Suggestions and comments have now been received from all of the Federal reserve banks regarding the tentative draft of a circular on the above subject which was sent to them on July 16; and there is attached for your information a revised draft of the circular and alternative drafts of Sections II and III thereof. The Board may wish to consider this matter at its meeting tomorrow, in view of the fact that the President signed the Bill containing this amendment today.

The most important question to be determined is whether this business ahll be confined to discounting for individuals, partnerships, and corporations eligible paper of their customers actually owned by them or whether the Federal reserve banks should be permitted to make advances direct to individuals, partnerships and corporations on their promissory notes indorsed and otherwise secured to the satisfaction of the Federal reserve banks.

Another question upon which there is considerable difference of opinion is whether Federal reserve banks should be forbidden to discount paper for individuals, partnerships, and corporations if the proceeds are to be used to pay off existing indebtedness to other banking institutions. The revised regulations provide that this may not be done "except with the permission of.the Federal Reserve Board."

Especial attention is also invited to Section VI of the circular letter which deals with the rate of discount.

A summary of the suggestions received from the various Federal reserve banks is being prepared and I hope to have it ready for distribution early tomorrow morning.

Respectfully,

Walter Wyatt

Walter Wyatt
General Counsel

July 21, 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.

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 13(a)) of the Federal Reserve Act. (Such paper must 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; and

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

II. PERMISSION OF THE FEDERAL RESERVE BOARD.

1. The Federal Reserve Board will not pass upon specific applications for discounts by individuals, partnerships or corporations; but will consider applications by Federal Reserve Banks for general permission to discount eligible paper for individuals, partnerships and corporations, and will base its decisions on the question whether in its judgment there are unusual and exigent circumstances which justify the granting of such permission.

2. Permission of the Federal Reserve Board to discount eligible notes, drafts, and bills of exchange for individuals, partnerships and corporations must be applied for by a Federal reserve bank in writing or by telegram, and the application must contain a full statement of the unusual and exigent circumstances which, in the judgment of the Board of Directors of the applying Federal reserve bank, justify such action.

3. Such permission, when granted, will be for periods specified by the Federal Reserve Board, not exceeding six months.

4. Requests for renewals or extensions of such permission must be made in the same manner as an original application.

III. FOR WHOM PAPER MAY BE DISCOUNTED.

When authorized by the Federal Reserve Board, the Federal reserve banks may discount for individuals, partnerships or corporations, eligible commercial, industrial and agricultural paper actually owned by such individuals, partnerships or corporations and bearing their indorsement.

The term "corporation", as used in this circular, includes live stock loan companies, agricultural credit corporations, finance companies and similar corporations; and eligible paper owned by such corporations may be discounted with their indorsement. No paper may be discounted for nonmember banks under the terms of this circular.

A Federal reserve bank should not discount paper for individuals, partnerships or corporations 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 purpose. 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.

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 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. 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 application for such credit accommodations has been made, the dates upon which such applications were made, whether such applications have been definitely

refused and the reasons, if any, given for such refusal;

3. A list of all banks 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;

4. Financial statements of the applicant and the principal debtors on the paper offered for discount;

5. 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;

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

7. An agreement by the applicant, in form satisfactory to the Federal reserve bank, (a) to furnish to the Federal reserve bank, when requested, additional financial statements, copies of recent auditors reports, or other credit information, (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; and

8. Any additional information or assurances which the Federal reserve bank, in its discretion, may require.

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

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 institutions with which the applicant ordinarily transacts his banking business or any other bank to which the applicant ordinarily would have access is willing to grant such credit accommodations.

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. RATES OF DISCOUNT.

When authorized by the Federal Reserve Board to discount eligible paper for individuals, partnerships and corporations, a Federal reserve bank, subject to the review and determination of the Federal Reserve Board, shall establish special rates for such discounts. Ordinarily such rates should be slightly higher than the rates charged on similar classes of paper by commercial banks to which applicants ordinarily would have access.

VII. 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.

VIII. ADDITIONAL REQUIREMENTS.

Any Federal reserve bank which obtains permission from the Federal Reserve Board to discount eligible paper for individuals, partnerships and corporations may prescribe such additional requirements and procedure respecting such transactions as it may deem necessary or advisable; provided that such requirements and procedure are not inconsistent with the provisions of the law and the Board's regulations and with the terms of this letter.

By order of the Federal Reserve Board.

Chester Morrill,
Secretary.

III FOR WHOM PAPER MAY BE DISCOUNTED.

When authorized by the Federal Reserve Board, a Federal reserve bank may discount for individuals, partnerships or corporations:

(a) Eligible commercial, industrial and agricultural paper actually owned by such individuals, partnerships or corporations, bearing their indorsement, and otherwise secured to the satisfaction of the Federal reserve bank; or

(b) The promissory notes of such individuals, partnerships or corporations bearing satisfactory indorsements by parties other than the makers and otherwise secured to the satisfaction of the Federal reserve bank; provided, that the Federal reserve bank is given satisfactory assurances that the proceeds will be used by the makers in their own business for commercial, agricultural or industrial purposes within the meaning of the Federal Reserve Act and Regulation A of the Federal Reserve Board.

The term "corporation", as used in this circular, includes live stock loan companies, agricultural credit corporations, finance companies and similar corporations; but it does not include either member or nonmember banks. The promissory notes of live stock loan companies, agricultural credit corporations, finance companies and similar corporations would not ordinarily be eligible for discount, because the proceeds ordinarily would be used in the first instance for finance purposes and not for commercial, agricultural, or industrial purposes within the meaning of the Federal Reserve Act and the Board's Regulations; but eligible paper owned by such corporations may be discounted with their indorsement.

A Federal reserve bank should not discount for individuals, partnerships or corporations either their own promissory notes or paper owned by them, 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 purpose. 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.

(NOTE: If the Board decides to permit Federal reserve banks to make direct advances to individuals, partnerships and corporations, another alternative would be to omit Section III of the circular altogether and allow the circular to remain silent on this point. This would have the advantage of not inviting applications for direct advances, but it probably would increase materially the number of inquiries which the Federal Reserve Board and the Federal reserve banks would have to answer.)

(Alternative for Section II
of Circular Letter)

II. AUTHORIZATION BY THE FEDERAL RESERVE BOARD

The Federal Reserve Board, being satisfied that there are in all Federal reserve districts unusual and exigent circumstances which justify such action, hereby authorizes all Federal reserve banks for a period of six months from the date of this letter 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.

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date July 21, 1932

To Governor Meyer

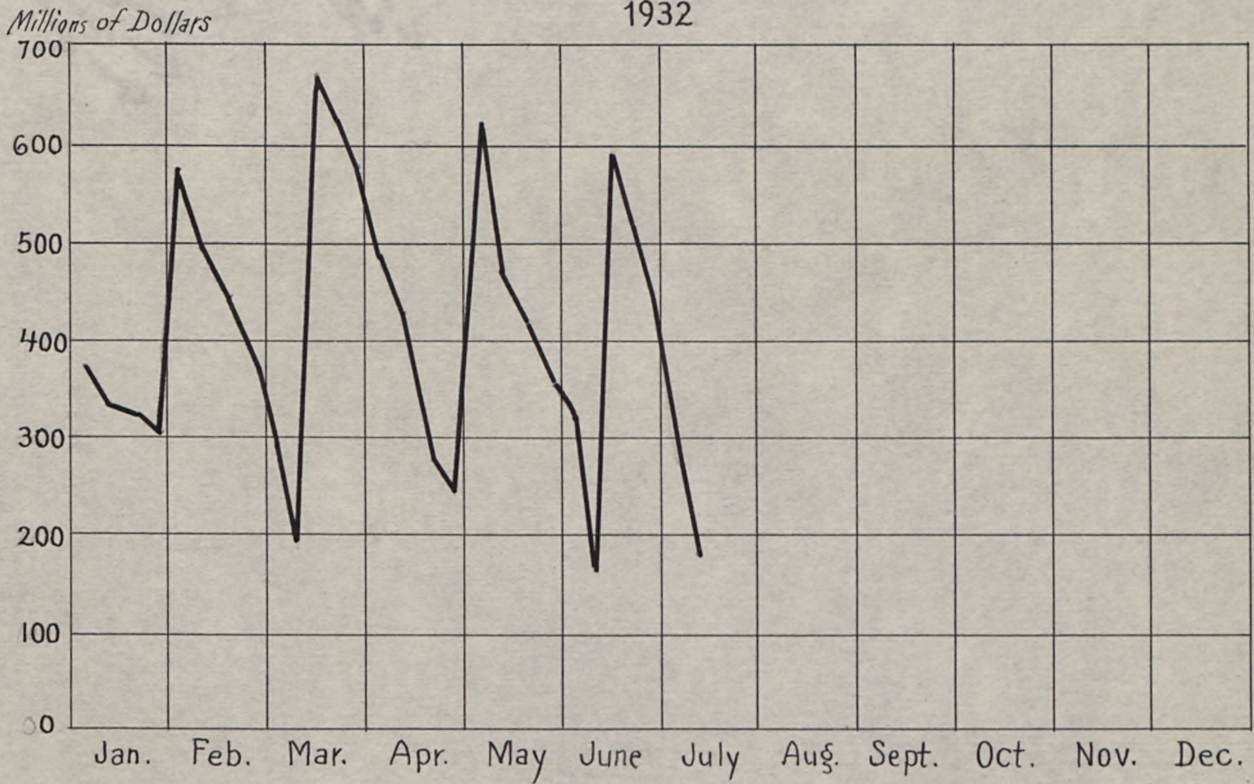
Subject:

From Mr. Goldenweiser

GPO 2—8495

In accordance with your request by telephone, I attach a chart showing Government deposits in special depositaries, by weeks, for the year 1932 to date.

U. S. GOVERNMENT DEPOSITS
IN SPECIAL DEPOSITARIES
1932



Mr. Harrison

RUSH

+

M E M O R A N D U M

July 22, 1932

To: The Federal Reserve Board

From: Walter Wyatt, General Counsel.

Subject: Comments of Chairman and Governors of Federal reserve banks on July 16 Draft of Circular re Discounts for Individuals, Partnerships and Corporations.

Six of the Federal reserve banks (Cleveland, Atlanta, Chicago, St. Louis, Dallas and San Francisco) and Deputy Governor Hutt of the Federal Reserve Bank of Philadelphia either stated that they were satisfied with the draft of the circular regarding discounts for individuals, partnerships or corporations sent to them on July 16, 1932 (X-7201a) or suggested no material changes therein.

Five of the Federal reserve banks (Boston, New York, Richmond, Minneapolis and Kansas City) and Chairman Austin of the Federal Reserve Bank of Philadelphia suggested material changes.

The important questions about which differences of opinion developed and the views expressed by the various banks will be summarized below. In summarizing their views on these questions, those banks which stated generally that they were satisfied with the circular and those which made no specific comment on the particular question being discussed will be treated as favoring the position taken in the draft of July 16.

DIRECT LOANS.

Section III of the draft of July 16 provided that Federal reserve banks could discount for individuals, partnerships or corporations eligible commercial, industrial and agricultural paper actually owned by such individuals, partnerships or corporations and bearing their indorsement. It left open the question whether Federal reserve banks could make direct loans to individuals, partnerships or corporations; but the Federal reserve banks apparently interpreted it as not permitting them to do so.

On this point, eight of the banks (Cleveland, Richmond, Atlanta, Chicago, St. Louis, Dallas and San Francisco) and Deputy Governor Hutt (Philadelphia) favored the circular as drawn;

Four of the banks (Boston, New York, Minneapolis and Kansas City) and Chairman Austin (Philadelphia) feared that the benefits of the amendment would be restricted too severely if the Federal reserve banks were not permitted to make direct loans.

The views of those who commented specifically on this point are summarized below:

BOSTON: We approve of letter except the words in Sec. XXI, "actually owned by such individuals, partnerships or corporations and bearing their indorsement". Believe this should be eliminated because cattle loan companies are about the only corporations that we can recall at the moment that would be able to function. We believe if we are to function in making loans direct that it will be necessary for borrowers to set up corporations with capital whose main business will be indorsing.

NEW YORK: Section three, paragraph one, would operate to limit eligible paper to the notes receivable of the borrower. While this will probably be desirable in most cases, it would appear to be unnecessary and perhaps unwise to so limit paper which can be accepted.

RICHMOND: Section I. Legal Requirements.-- Subsection 2 states that the Federal Reserve Banks 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, etc. In this case, under the present Act member banks' own notes are eligible for discount, whereas under Section III, subsection 1 of the Board's memorandum, "Eligibility", the direct obligations of individuals, partnerships or corporations, even if endorsed or secured, are not made eligible, but only the business paper actually owned by such individuals, partnerships or corporations bearing their endorsement and secured is made eligible. Frankly, we should prefer to have the Board's memorandum remain as it is because capital loans are under Section V of the Board's memorandum, subsection 5, prohibited, and it would not be possible for any individual, firm or corporation to obtain a capital loan, directly or indirectly under Section III, which makes eligible only paper actually owned by applicants; nevertheless, this comment seems called for.

CHICAGO: After careful consideration and consulting with counsel it is out understanding <u>from both the act and regulations</u> that we may rediscount for individuals, partnerships and corporations only such eligible paper of others which they may own and endorse the same as we now rediscount for member banks their own paper endorsed by them this would preclude our taking direct from them their notes signed by themselves as their commercial banks would do. We also understand eligible paper does not include type of loans provided by Glass-Steagall Bill and that paper which we can rediscount as above may be available to secure currency issues. If our understanding as outlined above is correct we think proposed regulations are in satisfactory form.

MINNEAPOLIS: Section 3 regarding eligibility says paper must be actually owned by the individual, partnership or corporation offering it, which would seem to limit offerings to concerns like agricultural credit corporation and livestock loan companies. There might be a situation where a canning factory in a small town might be unable to get the necessary credit to pack and carry their peas and corn. They could however, offer us their note with the endorsement of the directors and secured by warehouse receipts for canned goods in storage, which would seem to come under the terms of the act and yet would not be paper actually owned by the endorses who might offer it.

KANSAS CITY: It is the opinion our counsel that tentative draft proposed circular X-7201a correctly interprets GlassAmendment providing for discounts for individuals partnerships and corporations under strict construction of the amendment in the light of the provisions of the Federal Reserve Act which are amended and the Act of which it is a part,but that standing alone the act would permit of construction authorizing advances direct to borrowers of the classes mentioned. Debates in Congress and proceedings before committees on the amendment not yet available here but it is our understanding that Congress intended to authorize direct loans where credit not available through commercial banks or other credit channels. The provision of the act which reads "When such notes, drafts and bills of exchange are endorsed <u>and</u> otherwise secured to the satisfaction of the Federal Reserve Bank" should be interpreted to mean, in our opinion, if the same is at all permissable, "When such notes, drafts and bills of exchange are endorsed <u>or</u> otherwise secured to the satisfaction of the Federal Reserve Bank". Otherwise ordinary commercial and industrial loans as a practical matter cannot be rediscounted at the Federal Reserve Banks for the reason that industrial and commercial corporations in the main have no security to pledge even though their financial statements may entitle them to credit. Such concerns could probably furnish accommodation endorsers and we consider the final test should be whether such notes are eligible and are good and collectible. We believe the tentative draft of the circular would make the act almost wholly inoperative in this district except possible for livestock and agricultural loans through cattle loan companies or other such organizations. With funds available through the intermediate credit banks and the RFC it should be possible for the latter class of loans to be handled as satisfactorily as could be done under the protisions of this act. The suggested construction of the words "and otherwise secured" might be justified on the theory that the loan is otherwise secured if in addition to bearing an endorsement it is accompanied by a satisfactory financial statement. In short we believe that as an aid to commerce, industry and agriculture this act is a mere gesture unless there can be read into it an intent on the part of Congress that loans may be made direct when the paper is endorsed even though by an accommodation endorser and further in any event that a construction of the words "and otherwise secured" which requires a pledge of or a lien on property will largely deprive commerce and industry of the benefits of the act.

(See alternative substitute for Section III)

REQUIRING BOTH INDORSEMENT AND SECURITY

See Governor Hamilton's telegram which is quoted in full above. No one else objected to this requirement, which is contained in the law itself. This is not one of the rare cases where "and" can properly be construed as meaning "or".

USING PROCEEDS TO PAY OFF INDEBTEDNESS.

The Federal Reserve Bank of Minneapolis, Chairman Austin (Philadelphia) and Messrs. Goldenweiser and Smead question the advisability of the provision in Section V (p.6) of the draft of July 16, which forbade Federal reserve banks to discount paper for individuals, partnerships or corporations if the proceeds are to be used to pay off existing indebtedness to other banking institutions; and the revised draft (Sec. III, p. 4) modifies this prohibition by inserting the words, "Except with the permission of the Federal Reserve Board".

The comments were as follows:

DR. GOLDENWEISER: I am inclined to question the absolute prohibition of borrowing under this proviso for the purpose of paying off existing indebtedness. While ordinarily such loans should not be granted, circumstances might arise where a bank is pressing a firm for repayment of a loan, and this is threatening failure to the firm. I should think that if all other circumstances are all right, the Federal reserve bank might very well be permitted to grant a loan to such a firm.

MR. SMEAD: In the paragraph on page 6 relating to the purposes for which the proceeds of the discounts are to be used, it is stated that they must not be used for the purpose of paying off existing indebtedness to other banking institutions. While this in general is no doubt a good provision, I am wondering whether it is wise to close the door against all such loans. Might there not be instances where the granting of such loans may be in the best interests of the community?

MINNEAPOLIS: We feel too that the provision that loans cannot be made to pay off existing indebtedness is too drastic. Cases might arise where it would be advisable to make a loan to pay off a receiver of a closed bank who would otherwise sell the debtor out.

Mr. AUSTIN: As the paper we might discount would be what is so-called "self-liquidating paper" that is, such paper would be obligations of other parties and form a part of the capital of the borrower, he would not have to provide for its payment, and we do not see why there would be any objection to allowing the proceeds of such paper to be used for fixed investment or other capital purposes, or even liquidating indebtedness to other banks, which banks might be pressing the borrower for payment. The intended purpose of the Act is to provide means for stimulating business, starting up factories, etc. and in such cases it probably would be necessary to make some expenditures for capital purposes or other fixed investments, and we cannot see any objection to so using some of the proceeds of such discounts.

RATE OF DISCOUNT.

The following are the only comments on this subject, except a comment by Governor Seay regarding a matter of procedure:

GOVERNOR McDOUGAL: In respect to interest rates to be charged on discounts it is important that consideration be given to the fact that the average borrower from a commercial bank is expected to maintain a deposit balance. Under these circumstances the minimum rate charged by Federal Reserve Banks should be kept at least a fraction higher than prevailing counter rates otherwise borrower would have a preferential rate here.

SAN FRANCISCO: In connection with section VI may we assume in view of wide variation in twelfth district in interest rates for same class of paper board would approve a 2% spread between minimum and maximum discount rates.

DR. GOLDENWEISER: I am inclined to think that the rate of interest should always be somewhat higher than the prevailing rate on the same class of paper.

PERMISSION OF FEDERAL RESERVE BOARD.

There were some helpful suggestions regarding the phraseology of Section II, but the following are the only comments on matters of substance:

GOVERNOR SEAY: Sub-section 1 states that permission to a Federal Reserve Bank can only be granted upon written or telegraphic application of a Federal Reserve Bank, containing a full statement of the unusual and exigent circumstances which in the judgment of the Board of Directors of the Federal Reserve Bank justifies such action. In the case of this bank, and of some other Federal Reserve Banks, directors' meetings occur only once a month, and unless a special meeting of the directors of this bank is called (their monthly meeting having just been held), this bank would not be able to act in the matter for a month from this date, and in the meantime will therefore not be able to issue any circular, as provided for in Section VIII of the Board's memorandum.

Inasmuch as this amendment to the Act is a permanent provision, and inasmuch as the exigencies of the current situation are well known and understood, also inasmuch as all Federal Reserve Banks in good faith are called upon to act under this amendment, it would seem that under existing circumstances no particular statement as to the unusual and exigent conditions would now be needed and that the application of a Federal Reserve Bank, through its officers or Executive Committee, might be adequate at this time.

MINNEAPOLIS: Paragraph 1 requires a full statement of the unusual and exigent circumstances, while paragraph 2 says the Board will not undertake to consider individual cases. It seems to us that the unusual and exigent circumstances are almost always in connection with individual cases rather than with the general conditions.

(See alternative draft of Section II.)

FORMS.

A suggested set of forms for use in connection with such discounts has been prepared by this office; but it is not believed to be necessary for the Board to consider or approve them, as they are intended only as suggestions and it is contemplated that the Federal reserve banks will be at liberty to make such changes as they deem advisable in the light of local laws, conditions, and practices.

Respectfully,

Walter Wyatt,
General Counsel.

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date August 24, 1932

To Governor Meyer

Subject:

From Mr. Parry

GPO 2—8495

The memorandum by Mr. Gardner on British prices, which Mr. Goldenweiser mentioned to you recently as being in course of preparation, has now been finished, and a copy is attached.

W.R.G.

ESP

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 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 <u>relative</u> 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.

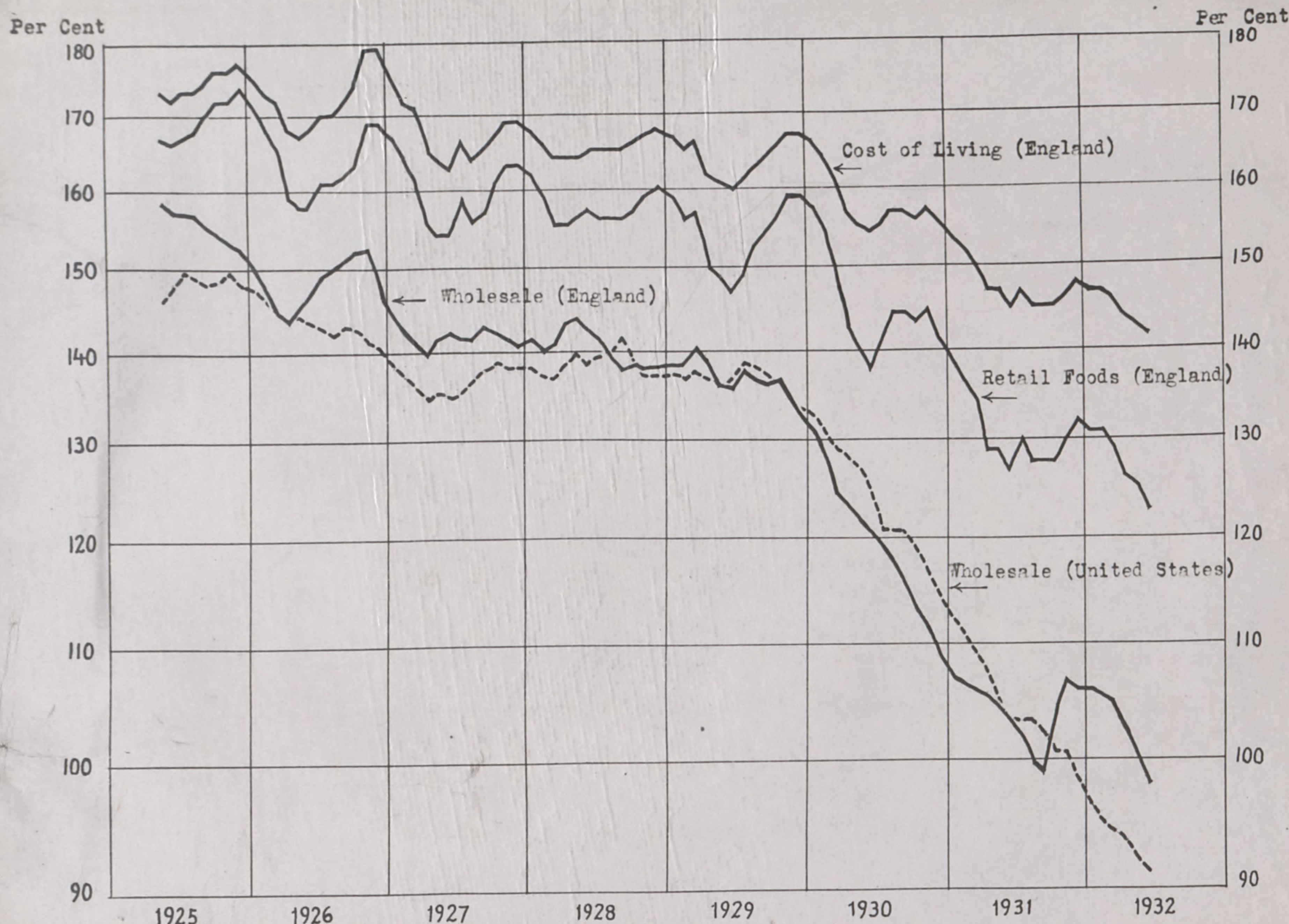
This complex of factors has led to a considerable degree of isolation of markets. Within broad limits price movements in coal, butter, or meat may occur in the United States quite without relation to price movements in the same commodities in England. Where this is the case, there is no reason to expect 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.

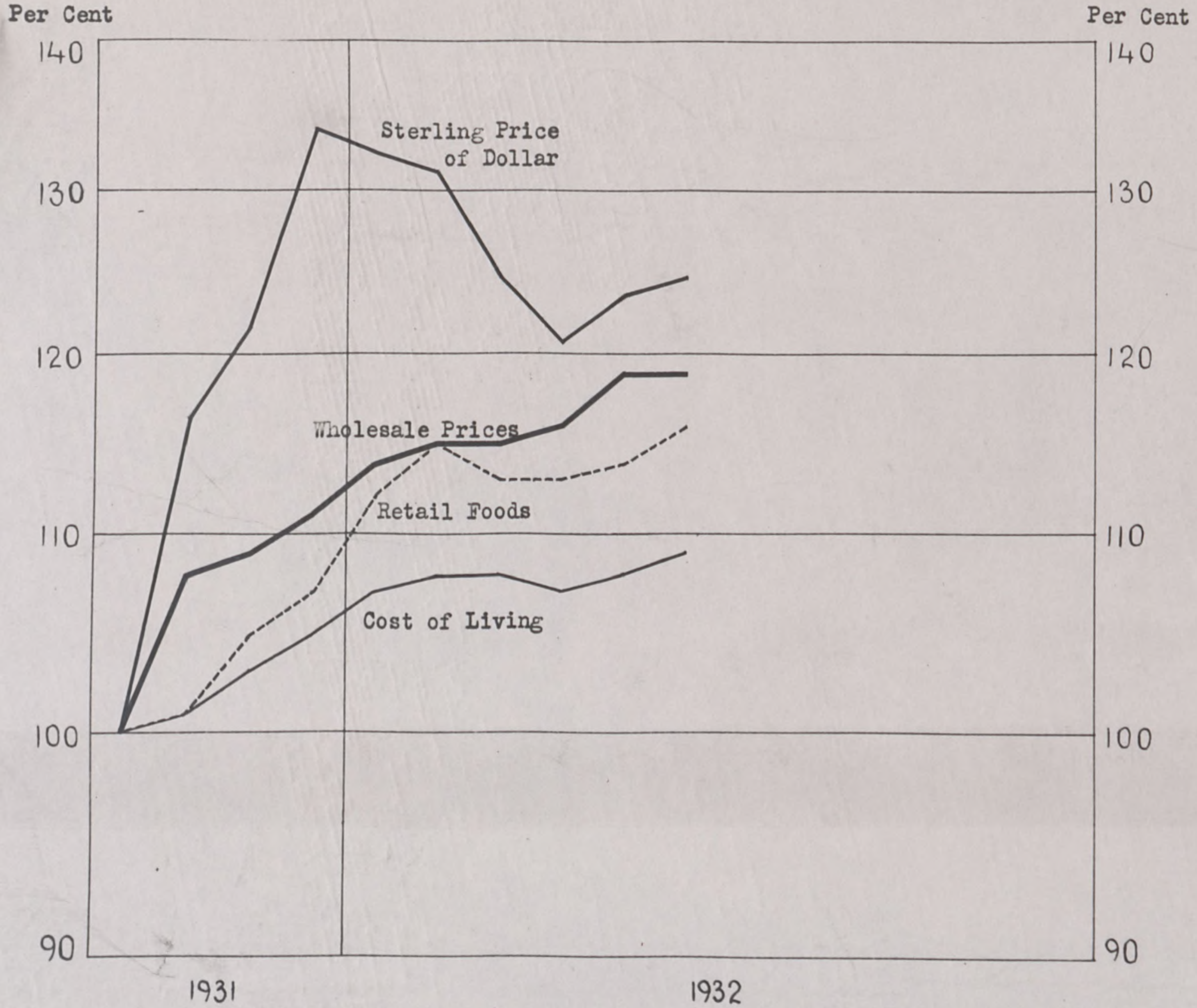
This is true even though, as shown in Chart 2, both retail foods and cost of living in England have risen in price relative to similar groups in the United States. Particularly is this noticeable in the case of retail foods; but there is no direct connection between retail prices in England and the United 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 wholesale 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 commodities 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.

<u>Note on British trade.</u> - 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.

Governor Meyer

CONFIDENTIAL

September 17, 1932

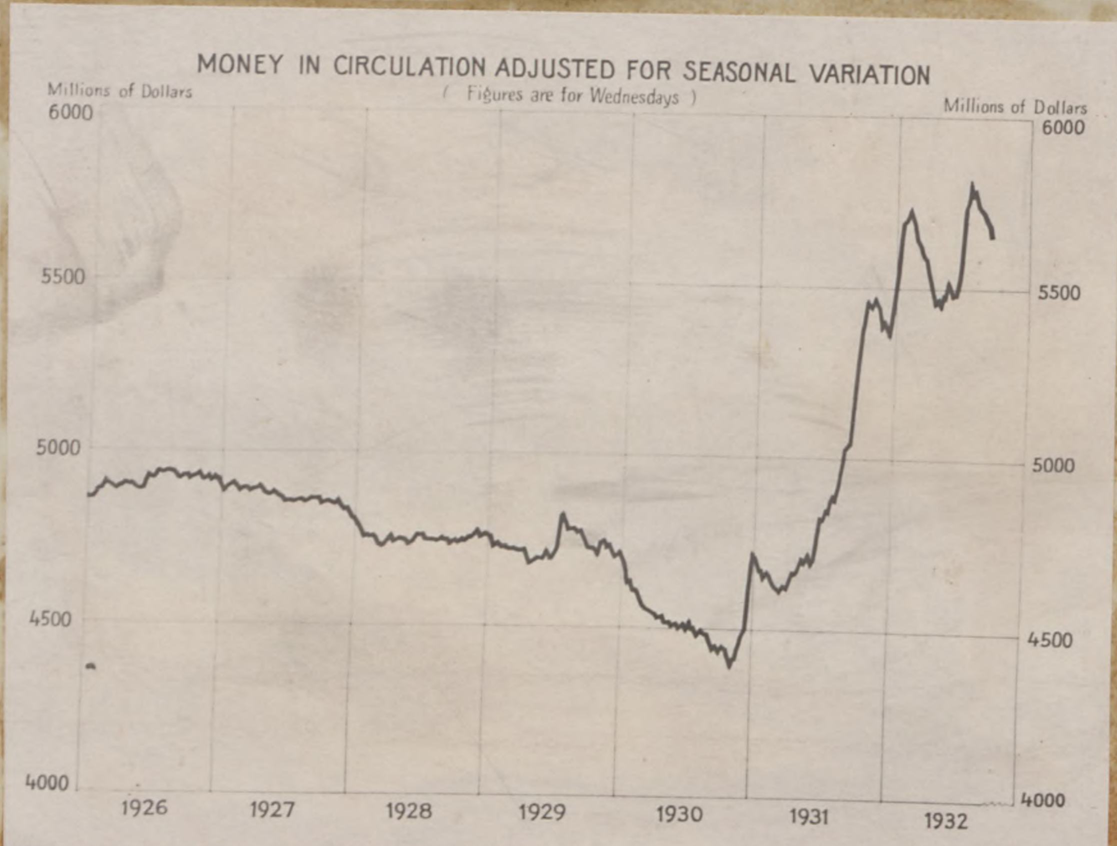
To: Federal Reserve Board

From: Mr. Goldenweiser

SUBJECT: New Issues of National Bank Notes

Since the Federal Home Loan Bank Act went into effect on July 22, national banks have taken out $77,000,000 in new notes. Issues did not begin in any volume until after the first of August, but since that time have been made at the average rate of about $2,000,000 on each business day. Up to the present time about 60 per cent of these notes have been issued for the account of 19 large banks.

The distribution of the issues by Federal reserve districts, together with their potential power to issue new notes is shown on the chart. Of the total of $77,000,000, $28,000,000 has been issued to national banks in the San Francisco district--using up over one-fourth of their available new note issue. Banks in the New York district have taken $13,000,000



out of a potential issue of about $330,000,000. An addition of about $75,000,000 to the potential maximum issue will arise from the grant of a national charter to the Continential-Illinois of Chicago, making the total for the country as a whole nearly $1,000,000,000 and increasing the issue power of national banks in the Chicago Federal reserve district to $170,000,000.

The effect of the issue of additional national bank notes has been to retire a corresponding amount of other forms of currency, and since the increased issues have come at a time when circulation has been declining, there has been a considerable retirement of other forms of money, in particular Federal reserve notes. The latest complete figures are for August 31. At that time $53,000,000 in new notes had been issued to national banks but not all of them had yet gone into circulation. The effect on circulation of different kinds of currency is shown in the table below:

	July 31 1932	August 31 1932	Change
	(In millions of dollars)		
Total money in circulation	5,726	5,692	- 34
National bank notes	700	744	+ 44
Federal reserve notes	2,838	2,793	- 45
Gold certificates	694	669	- 25
Other currency	1,494	1,486	- 8

Holdings of national bank notes by Federal reserve banks have increased by about $7,000,000 since the passage of the new law to a total of about $29,000,000.

Extension of the circulation privilege has had some effect on the prices of different classes of U. S. Government securities. Prices of the 2 per cent bonds, which had a monopoly of the circulation privilege prior to the passage of the Federal Home Loan Bank Act, declined substantially after the act was passed, while prices of 3 3/8 per cent bonds and other bonds to which the privilege was extended gained substantially-- more rapidly than prices of other Government issues. After the ruling of the Attorney General on August 12 to the effect that at the end of three years notes issued against bonds that had recently been granted the circulation privilege will have to be retired, the 2 per cent bonds, having regained a part of their monopoly position, advanced rapidly in price, and are now at par, though still below their level prior to the passage of the Glass-Borah bill.

Different phases of the problems arising out of the new legislation regarding national bank notes were discussed in the review of the month and in a special article in the August issue of the Federal Reserve Bulletin.

September 17, 1932

To: Governor Meyer

From: Mr. Goldenweiser

CONFIDENTIAL

THE CREDIT SITUATION

Demand and supply of reserve funds

During the past year this country lost $900,000,000 of gold that went abroad and in addition $630,000,000 of currency was withdrawn, largely for hoarding. Both the demand for gold from abroad and for additional currency at home constituted demands on the member banks for reserve bank funds. These demands were met by the use of funds derived from the following sources: $1,100,000,000 from an increase in Federal reserve credit, all of which was supplied through the purchase of Government securities by the reserve banks; $200,000,000 from a decrease in deposits of foreign central banks with the reserve banks;[1/] and $150,000,000 from a decrease in member bank reserve balances. These figures indicate that the increase in reserve bank credit during the year restored to the member banks somewhat less than the total amount of reserve funds employed in meeting the gold and currency drains, and that the difference was met by the member banks by drawing on their reserve balances to the extent of $150,000,000. Notwithstanding this decrease in reserve balances, however, the member banks on September 7 had excess reserves of over $300,000,000, because their reserve requirements had diminished much more than their reserves, owing to the great reduction in deposits. Decrease in net demand plus time deposits of member banks for

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1/ Last autumn foreign central banks had $207,000,000 on deposit with the reserve banks; this year the amount is $11,000,000. When the deposits were built up here during the summer of 1931, the effect was similar to that of gold exports, while the subsequent release of these funds was an offset to gold exports, similar in effect to a release of earmarked gold.

the past year approximated $6,000,000,000 and required reserves diminished sufficiently to enable member banks to reduce their reserves by $150,000,000 and still have over $300,000,000 of excess reserves.

A table follows showing factors of demand for reserve bank credit both for the last year and for the three-year period of the depression. If the entire three-year period be considered, the decrease in the monetary gold stock was only $250,000,000, since during the first two years of the depression there was a growth in the stock of gold that was exceeded by the loss during the

RESERVE BANK CREDIT AND PRINCIPAL FACTORS IN CHANGES
(In millions of dollars)

	Sept. 7, 1932	Change from --	
		A year ago	Three years ago
Reserve bank credit	2,319	+ 1,103	+ 905
Monetary gold stock	4,105	- 895	- 259
Money in circulation	5,725	+ 633	+ 934
Foreign deposits at reserve banks	11	- 196	+ 4
Member bank reserve balances	2,142	- 148	- 218
Excess reserves	323	+ 253	+ 288

past year by this amount. When this three-year period is considered as a whole, the growth in reserve bank credit of about $900,000,000 has been approximately equal to the growth in money in circulation, which represents primarily hoarding, while the decrease in member bank reserves has been approximately equal to the decline in the stock of gold. During this period member bank indebtedness diminished by $550,000,000 and the reserve banks' holdings of bills by $190,000,000, while security holdings of the reserve banks increased by $1,700,000,000. It would appear, therefore, that funds arising from security purchases of the reserve banks since the depression began have been used to the extent of $750,000,000 in the reduction of the reserve banks' holdings of discounted and purchased bills and to the extent of $950,000,000 in meeting the increased demand for currency.

From the point of view of appraising the effects of Federal reserve credit policy since the autumn of 1929, the significant fact is that at a time of abnormal demands for gold from abroad and for currency at home open-market purchases by the reserve banks have enabled the member banks to meet these demands and at the same time to reduce their indebtedness to the reserve banks from the high level prevailing in the autumn of 1929, as well as to build up a considerable volume of excess reserves. All of these developments have been in the direction of easing credit conditions and, therefore, of facilitating for the member banks the financing of business recovery.

Change in direction of gold flow

Improvement in financial conditions has become pronounced in recent months. Since the middle of June, when the large outflow of gold came to an end, there has been a return of gold amounting to about $200,000,000, shown by countries below:

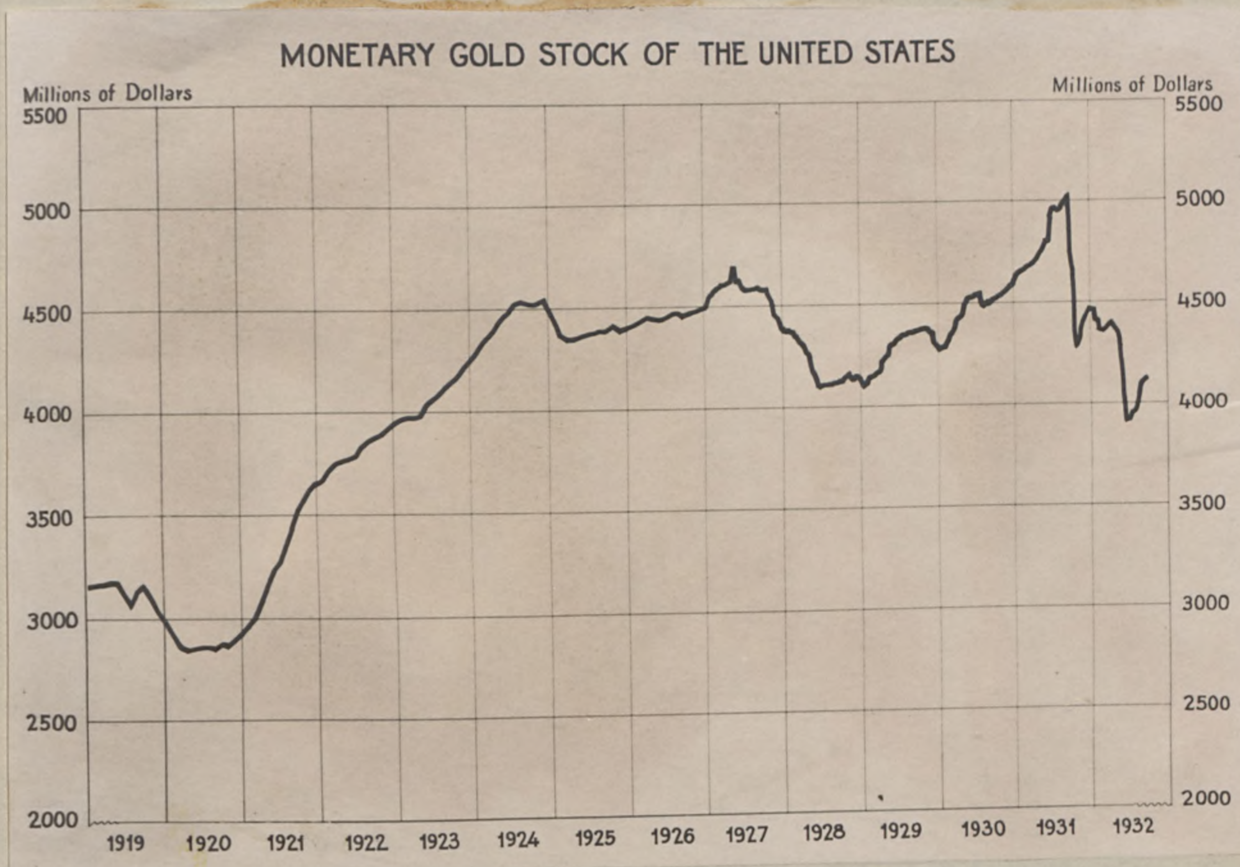
ADDITIONS TO UNITED STATES GOLD STOCK:
JUNE 16 TO SEPTEMBER 14, 1932 1/

(In thousands of dollars)

	Total	$ 219,250
From:	France	108,854
	Czechoslovakia	22,519
	China	14,110
	Canada	14,013
	Belgium	10,021
	Mexico	4,451
	Japan	4,197
	England	3,948
	Australia	2,947
	Switzerland	2,032
All other		32,158

1/ Including net imports and releases from earmark.

The accompanying chart shows the stock of gold in the United States since the removal of the war embargo. The course of gold holdings indicates that whenever there were losses of gold to this country they were followed by an import movement which not only restored the amount lost but



continued for some time beyond that point. That was true of the loss of gold in 1919-1920, which represented accumulations of balances by the Orient and South America during the period of the gold embargo; of the loss in 1925, which represented chiefly takings by the Reichsbank of a part of the proceeds of the Dawes loan in gold; of the loss of $600,000,000 in 1927-1928, following upon an extremely easy money policy in this country and a large volume of foreign loans. The recent inflow of about $200,000,000 of gold, after a loss of about $1,100,000,000, indicates that the forces that tend to bring gold to this country are still at work. Withdrawals from this country have represented repatriation of funds by a few special interests, chiefly central banks, while at other times commercial and financial transactions of this country with the outside world have steadily resulted in an inflow of gold. This inflow is due to the fact that on balance of both visible and invisible items this country receives more from abroad than it pays out; and that as a safe place for keeping funds and as a place to invest funds with a chance of an increase in value this country offers greater opportunities than any other. Confidence in the dollar was temporarily shaken last September and October and again last June, but this lack of confidence has not survived for long the certainty that the financial position of this country is stronger than that of others. It is probable that gold will continue to come to this country, and with the reduction of foreign balances to a level probably below actual needs, there is nothing on the horizon to indicate a possibility of large-scale gold exports.

Decrease of hoarding

Another item of improvement has been the return flow of currency from hoarding. A chart showing the amount of money in circulation, adjusted for seasonal variation, is attached. The rise in money in circulation from the autumn of 1930 to this summer, with seasonal influences eliminated, amounted to something like $1,500,000,000, notwithstanding a decrease in the volume of business and in the level of prices. Much of this currency went into hoards, although an indeterminable amount represents increased need for cash by communities that are deprived of banking services, and an increased use of cash resulting from charges for small accounts and from the tax on checks. The increase in hoarding has not been continuous. There was an improvement in the early part of 1931 and again in the late part of that year after the President's program of reconstruction was announced. A large return flow, amounting to about $250,000,000, began last February when the Reconstruction Finance Corporation got under way. But this summer the heavy loss of gold and banking disturbances in Chicago and elsewhere once more led to a crisis of confidence, so that hoarding increased again and reached a maximum in the third week in July. Since that time there has been a decrease of about $175,000,000 in the estimated amount of hoarded money.

<u>Decrease of bank failures</u>

The recent return flow from hoards has accompanied a definite decline in the number of bank failures. From an average of 36 a week during the first three weeks of July the number of bank failures has gradually declined, and for the last week for which figures are available the number of banks that failed was 12. The decrease in bank failures from about 75 per week last January represents the effects of the work of the Reconstruction Finance Corporation, as well as of agreements in numerous localities between banks and depositors to refrain from rapid withdrawals. Liberal policies pursued by the Comptroller of the Currency and State banking authorities in permitting banks to carry their portfolios at better prices than current market quotations also have been a factor. The decline in bank failures, therefore, is in part based on conditions that are temporary in nature. Whether the decline will be permanent depends on whether a genuine improvement in underlying conditions will develop. The rise in bond values is one such condition which has already occurred. The advance in commodity prices, scattered widely over different classes of commodities, is another such element. The banks are not yet out of the woods, but there appears to be the possibility of consolidating the gains that have been achieved and of substituting permanent elements for the temporary devices that have been keeping the banks afloat.

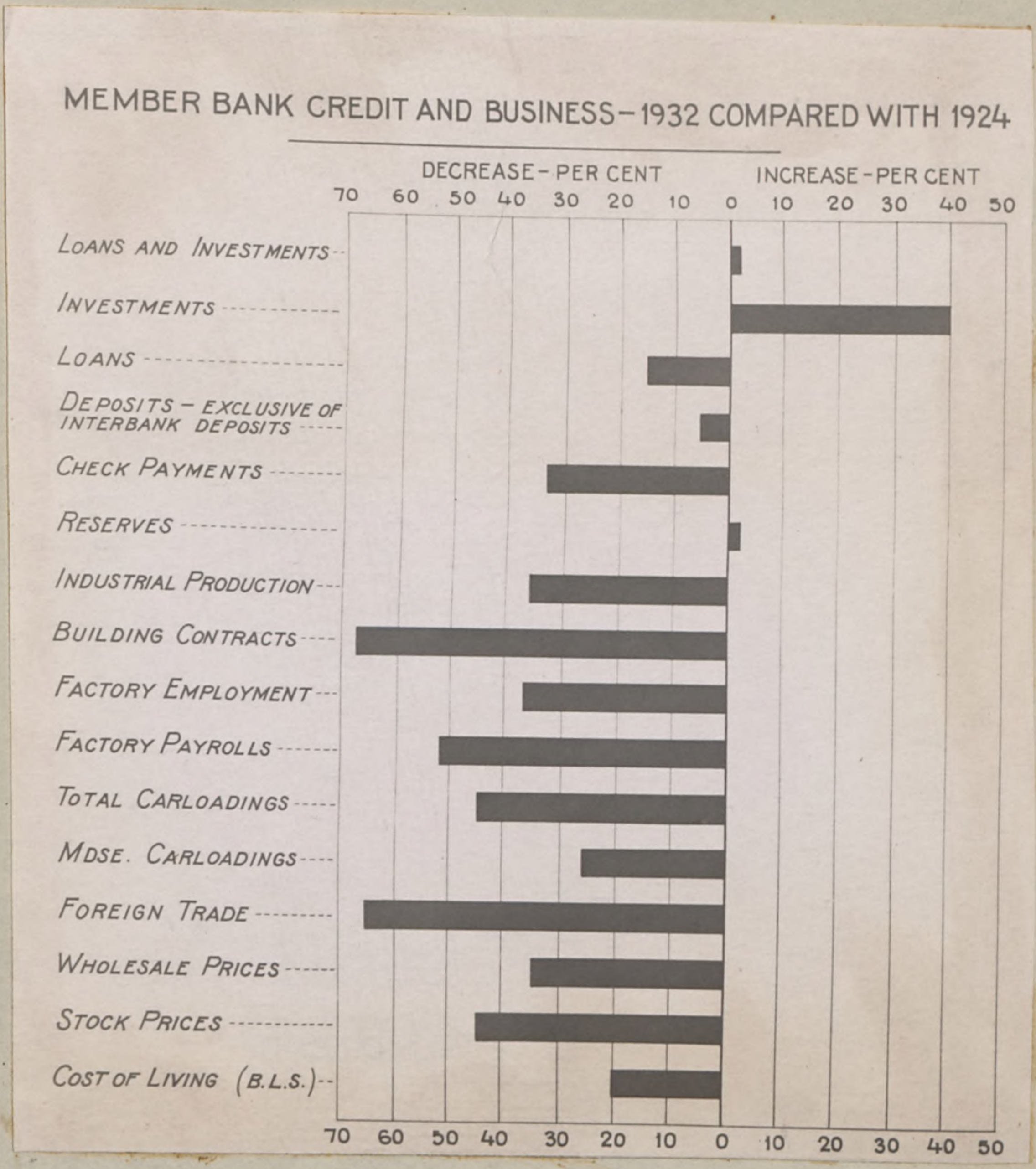
Lag in business and volume of credit

There are, however, a number of elements in the business and credit situation which so far have not shown marked improvement. Industrial activity, after the largest decline in the history of the country--from 125 per cent of the 1923-1925 average in June, 1929 to 58 per cent in July, 1932--advanced by about 2 points in August, reflecting chiefly substantial increases in the textile industries. Sales of textile products to distributors increased sharply in July and August, accompanying price increases for raw materials, and production in the woolen, silk, cotton, and rayon industries increased considerably from the unusually low levels prevailing in the spring. Reports indicate that there was an upswing in shoe production in August, but that it was only of a seasonal character. In the automobile industry a further decline in output was reported and in the steel and lumber industries output in August showed none of the usual seasonal increase. In the first half of September activity at steel mills increased slightly. In the building industry changes in the total value of contracts have been largely of a seasonal character since early in the year, reflecting some further decline in residential building offset by an increase in public works. During August the volume of freight traffic handled by the railroads showed a seasonal increase, which is in contrast to this period last year. In July the number of employees at factories, coal mines, and on the railroads was smaller than in earlier months of the year. Figures on employment in August are not yet available for the United States as a whole, but reports on factory employment in New York State show a greater than seasonal increase in that state during the month.

Indecisive progress in business activity has been paralleled by a lack of marked growth in bank credit. Bank loans have continued to decline, though there has been some increase in bank investments. Total loans and investments of banks in leading cities show a rise from the low point reached on July 20, the increase being entirely at banks in New York City. The decline of bank deposits has been arrested and of late there has been some increase in deposits, reflecting chiefly an increase in balances held by banks with other banks and, therefore, not reflecting a growth in loans and investments.

Comparison with 1924

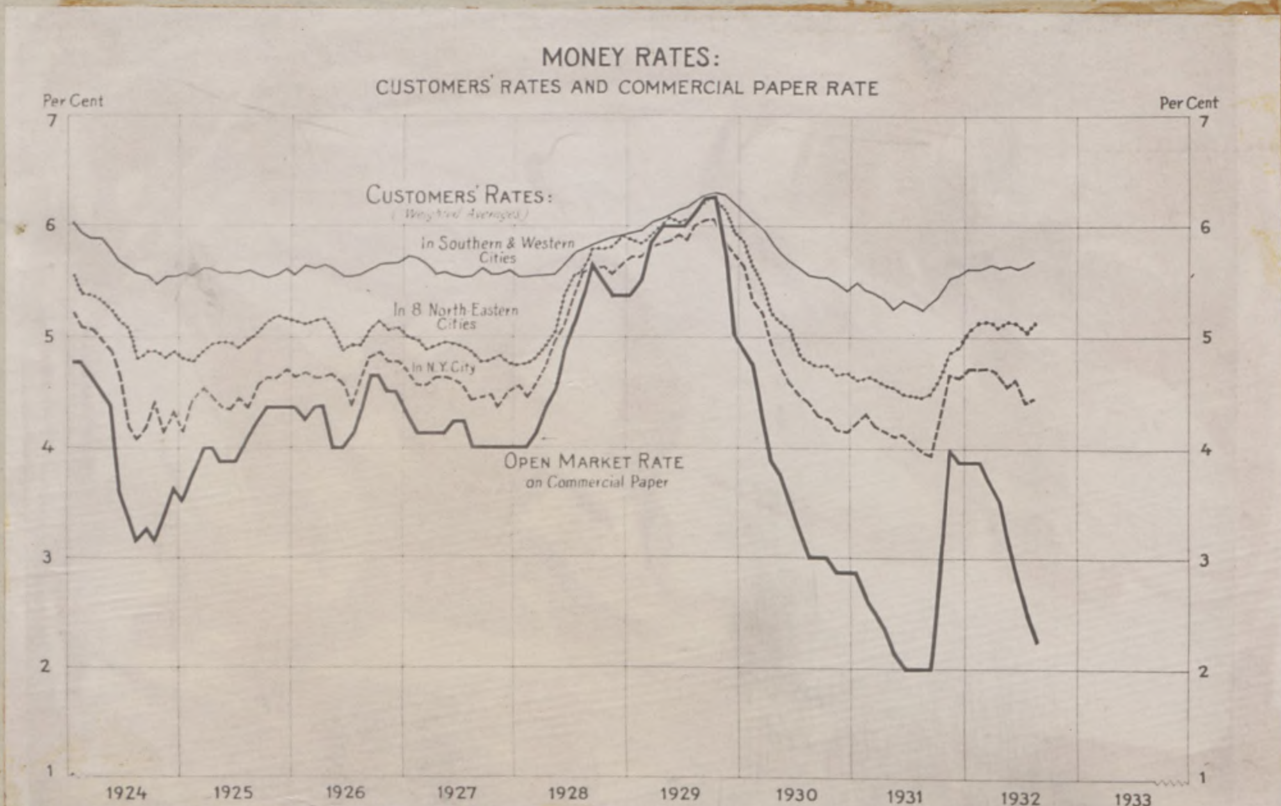
Notwithstanding the great decline in bank credit during the past two years, the volume of member bank loans and investments at this time is about the same as eight years ago in 1924, while practically all the other elements in the economic picture show a drastic reduction since that time. This is brought out by the following chart:



It is apparent from this comparison that the total outstanding volume of bank credit is adequate for the present needs of business and for financing a considerable recovery. It is the inactivity of credit, as shown by low velocity of turnover, that reflects the extreme low level of business activity and the unsatisfactory functioning of the credit machinery.

Money rates

Member banks in the financial centers have been out of debt to the Federal reserve banks for a number of months and indebtedness of banks in other leading cities and outside has been declining in recent weeks. In addition, member banks have had a large volume of excess reserves. The reserve position of member banks, therefore, has been such as to offer no obstacles to business recovery. Money rates have been low, particularly in the open market. Rates charged to customers have also shown some decline in New York City, but outside New York these rates have been sustained at what at



the present time appears to be a high level--above 5 per cent in eight cities in the North and East, and above 5 1/2 per cent in the Southern and Western cities. These high levels of customer rates should be viewed in connection with the many reports received by the reserve system indicating inability of many business enterprises to obtain credit for legitimate needs. A chart on customer rates compared with open-market rates is attached.

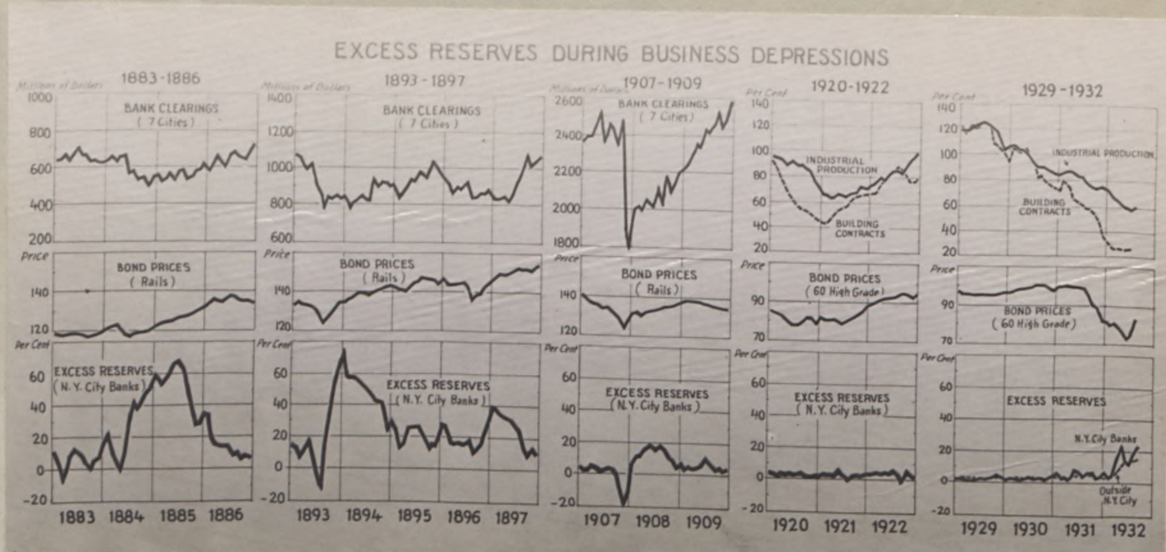
Sources of reserve funds

Viewing the situation from the point of view of immediate developments that are likely to affect member bank reserves, there are at present three sources of reserve bank funds available to member banks independent of additional use of Federal reserve credit. These sources are: gold imports, return flow of currency from circulation, and issue of national bank notes. From these three sources member banks have derived more than $300,000,000 of reserves since the beginning of July. Gold imports are likely to continue, the issuance of additional national bank notes is also likely to continue on a moderate scale, and it is to be hoped that the flow of currency from hoards will not be interrupted. It is possible, however, that the seasonal demand for currency between now and the end of the year will absorb a large part of the money released from hoards. The situation, therefore, is one in which in the immediate future the reserves of member banks are likely to be fed by moderate amounts of gold imported from abroad and by issues of national bank notes. These reserves are likely at first to accumulate as excess reserves, although some diminution of member bank indebtedness, which is about $400,000,000, may also be expected. It would seem probable from the evidence at hand that in the absence of any action by the Federal reserve banks member banks in the next few months will have excess reserves of not less than $350,000,000, tending to increase from week to week.

Excess reserves in times of depression

Accumulation of excess reserves by commercial banks, particularly in New York City, has been usual during periods of business depression in the United States, with the exception of the depression of 1920-21, when liquidation of indebtedness to the reserve banks absorbed the funds derived from the return flow of currency and from gold imports.

A chart is inserted showing the relation of excess reserves to the course of business in times of depression. It shows for the pre-war depressions of 1884-85, 1893-94, and 1908, excess reserves of clearing house banks in New York City, the course of bond prices, and the course of bank clearings in seven cities outside New York. For the post-war depressions of 1920-21 and 1930-32 the chart shows excess reserves, bond prices, industrial production, and building contracts.



In the depression of 1884-85 and again in 1893-94 banks in New York City accumulated reserves that were 60 per cent above requirements and in 1908 the excess amounted to 20 per cent for several months. The excess reserves of 22 per cent held by New York City banks at the present time and of 15 per cent held by banks outside New York City are not unusually large in comparison with reserves held during pre-war depressions.

Before the establishment of the reserve system, however, bank reserves functioned in a different way. In the depression years at that time New York banks, which performed the functions of central banks for the country, could not obtain funds in any considerable amount from outside sources, and when the panic was over they had no indebtedness to repay. Consequently, imports of gold and the return of currency as business activity declined both went to increase the banks' reserves. They accumulated very large excess reserves for brief periods, and as financial markets and business became more active, these reserves were quickly drawn down. With the reserve system in operation the periods of expansion that have preceded depressions have caused a growth in member bank indebtedness, so that when funds began to flow to the banks because of diminished demand, as was the case in 1921, they were absorbed in the reduction of indebtedness to the reserve banks. In the present depression there was no return flow of funds, however, because of gold exports and hoarding. In these circumstances the funds both for the reduction of indebtedness and for the accumulation of excess reserves were made available to the member banks through open-market purchases by the reserve banks.

Division of Research and Statistics 97 September 28, 1932

ISSUES OF NEW NATIONAL BANK NOTES

Z Up to the close of business on September 27 $100,000,000 in new national bank notes had been issued, of which $30,000,000 were taken by banks in the San Francisco district, $17,000,000 by banks in the Chicago district, and $15,000,000 by banks in the New York district. The remainder has been distributed in small amounts among the other districts as shown in the first table attached to this memorandum.

The issue of national bank notes did not begin in any volume until the first week in August and since that time has been at an average rate of about $2,000,000 per business day. The daily record of shipments by the Treasury is shown in the second table. There is considerable variation from day to day, as might be expected, but on the whole there has apparently been no particular tendency to increase the rate of issue during recent weeks. In the past week, in fact, the shipments to banks in the San Francisco district have been very small--less than $50,000,000 a day as compared with daily shipments ranging from $100,000 to $6,000,000 a day in previous weeks. National banks in other areas, however, have taken a larger volume, Chicago in particular.

The third table shows the record of shipments by 2-week periods since July 22 to the 20 large banks that have taken 59 per cent of the total new issue.

The recent increase in the Chicago district is largely because of shipments aggregating $5,000,000 since September 15 to the Guardian National Bank of Commerce of Detroit; while the recent decline at San Francisco is due chiefly to smaller shipments to the Bank of America (the largest single taker of notes--$15,500,000), and no shipments to the Anglo-California of San Francisco, the First National of Seattle, and the U. S. National of Portland.

Six of these 20 banks have already used up their available issue power, as shown in the last table--the First National of New York City, the First National of Jersey City, the Second National of Saginaw, Michigan, the Colorado National, and the Denver National of Denver, and the U. S. National of Portland, Oregon.

The banks which have taken the largest amounts of notes still have large potential issue power--the Bank of America, the Security First National of Los Angeles, and the Guardian National, which has taken $5,000,000, and the First Wisconsin of Milwaukee, which has taken $3,300,000, both have $5,000,000 unused. These 20 banks together can issue $329,000,000 more notes--of which more than two-thirds is in the hands of Chase National and National City.

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NEW NATIONAL BANK NOTES ISSUED AGAINST BONDS
Since July 22, 1932, and up to the close of business on September 27, 1932

(In thousands of dollars)

Federal Reserve District	Amount
Boston	$ 2,269
New York	14,866
Philadelphia	5,966
Cleveland	4,718
Richmond	3,123
Atlanta	3,963
Chicago	17,411
St. Louis	3,254
Minneapolis	1,749
Kansas City	9,084
Dallas	3,380
San Francisco	30,990
Total	$100,770

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NEW NATIONAL BANK NOTES ISSUED AGAINST BONDS
(In millions of dollars)

Date (1932)	Total	New York District	Chicago District	San Francisco District	Other districts
July 22-30	1.1	0.2	*	...	0.9
August 1	1.0	...	...	0.8	0.2
2	0.1	*	...	...	0.1
3	0.4	*	*	0.1	0.3
4	0.3	0.1	*	...	0.2
5	0.9	0.4	0.1	...	0.4
6	3.1	2.0	0.1	0.5	0.5
8	1.3	0.1	...	1.0	0.2
9	1.0	0.4	0.1	0.3	0.2
10	0.8	*	...	0.7	0.1
11	2.4	0.1	*	1.7	0.6
12	1.1	*	0.1	0.7	0.3
13	1.3	...	1.0	...	0.3
15	2.6	1.1	*	0.1	1.4
16	2.3	1.0	0.2	0.5	0.6
17	2.3	0.3	0.5	1.0	0.5
18	1.0	...	*	0.6	0.4
19	6.9	*	...	6.6	0.3
20	0.9	0.1	*	0.1	0.7
22	1.4	...	0.1	...	1.3
23	0.4	...	0.2	*	0.2
24	0.4	...	0.2	...	0.2
25	2.6	1.0	0.3	0.7	0.6
26	6.7	...	0.3	5.6	0.8
27	2.6	0.2	0.5	0.3	1.6
29	4.0	1.9	0.7	1.1	0.3
30	2.0	*	0.2	0.8	1.0
31	2.3	0.4	0.1	1.0	0.8
September 1	3.5	0.2	0.7	0.1	2.5
2	0.9	0.1	*	...	0.8
3	0.7	...	0.1	...	0.6
6	2.2	*	1.4	...	0.8
7	2.3	1.0	0.5	0.1	0.7
8	4.6	*	1.5	0.3	2.8
9	2.7	0.1	0.2	1.5	0.9
10	0.7	0.1	...	0.2	0.4
12	1.5	0.5	*	0.4	0.6
13	3.8	1.5	0.3	1.6	0.4
14	1.2	...	0.3	*	0.9
15	1.8	0.6	0.4	...	0.8
16	0.8	0.2	0.1	*	0.5
17	1.2	0.2	0.1	0.2	0.7
19	1.3	0.2	0.5	0.2	0.4
20	3.3	0.4	0.1	2.0	0.8
21	3.5	...	2.3	*	1.2
22	1.4	*	0.6	...	0.8
23	3.8	0.1	0.7	*	3.0
24	0.9	0.3	*	*	0.6
26	2.4	0.1	0.5	*	1.8
27	3.0	*	2.0	*	1.0

* Issues of less than $50,000.

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NEW NATIONAL BANK NOTES ISSUED TO 20 BANKS THAT HAVE TAKEN 59 PER CENT OF TOTAL NEW ISSUES SINCE PASSAGE OF THE FEDERAL HOME LOAN BANK BILL

(In thousands of dollars)

	July 22 — Aug. 17	Aug. 18 — Aug. 31	Sept. 1 — Sept. 14	Sept. 15 — Sept. 27	Total: July 22- Sept. 27
First National, New York, NY	1,508	...		...	1,508
Chase National, New York, NY	1,000	2,000	2,000		5,000
National City, New York, NY	1,877	...	...	...	1,877
First National, Jersey City, NJ	...	...	500	700	1,200
First National, Scranton, Pa	...	800	1,200	...	2,000
First Wayne, Detroit, Mich	1,050	...	2,202	298	3,550
Guardian National Bk Commerce, Detroit, Mich	...	...	...	5,000	5,000
Second National, Saginaw, Mich	...	...	900	...	900
First Wisconsin, Milwaukee, Wis	436	1,360	1,517	...	3,313
Colorado National, Denver, Col	...	...		1,000	1,000
Denver National, Denver, Col	...	...	1,500	...	1,500
U. S. National, Omaha, Neb	...	...		938	938
First National & Trust, Okla City, Okla	...	...	1,500	239	1,739
First National, Dallas, Texas	...	...	1,055	...	1,055
Anglo-California, San Francisco, Cal	...	1,673	423	...	2,096
Bank America, Nat Tr & Savings, San Francisco, Cal	500	10,000	3,000	2,000	15,500
Citizens Nat Tr & Savings, Los Angeles, Cal	1,000	...	...	...	1,000
Security First National, Los Angeles, Cal	4,466	3,534	...	...	8,000
First National, Seattle, Wash	263	601	264	...	1,128
U. S. National, Portland, Oregon	560	54	86	...	700
Total 20 banks	12,660	20,022	16,147	10,175	59,004

CONFIDENTIAL

ISSUING POWER AND NOTE ISSUES OF 20 NATIONAL BANKS THAT HAVE TAKEN 59 PER CENT OF THE NEW NOTES ISSUED SINCE PASSAGE OF FEDERAL HOME LOAN BANK BILL

(In thousands of dollars)

	Paid-up capital, June 30, 1932	Liability for national bank notes outstanding June 30, 1932	Unused issuing power June 30, 1932	New notes issued July 22-Sept. 27, 1932	Unused issuing power at opening of business, Sept. 28, 1932
First National, New York City..	10,000	8,492	1,508	1,508	...
Chase National, New York City..	148,000	15,942	132,058	5,000	127,058
National City, New York City...	124,000	...	124,000	1,877	122,123
First National, Jersey City, New Jersey..................	1,600	400	1,200	1,200	...
First National, Scranton, Pennsylvania................	5,000	2,983	2,017	2,000	17
First Wayne, Detroit, Michigan.	25,000	6,182	18,818	3,550	15,268
Guardian National Bank of Commerce, Detroit, Michigan....	10,000	...	10,000	5,000	5,000
Second National, Saginaw, Michigan....................	1,250	350	900	900	...
First Wisconsin, Milwaukee, Wisconsin..................	10,000	1,680	8,320	3,313	5,007
Colorado National, Denver, Colorado....................	1,000	...	1,000	1,000	...
Denver National, Denver, Colorado....................	1,500	...	1,500	1,500	...
United States National, Omaha, Nebraska..................	1,100	50	1,050	938	112
First National and Trust, Oklahoma City, Oklahoma.........	5,000	...	5,000	1,739	3,261
First National, Dallas, Texas..	8,000	2,945	5,055	1,055	4,000
Anglo-California, San Francisco, California..........	10,400	7,000	3,400	2,096	1,304
Bank America National Trust and Savings, San Francisco, California.................	50,000	15,000	35,000	15,500	19,500
Citizens National Trust and Savings, Los Angeles, California.....................	5,000	750	4,250	1,000	3,250
Security First National, Los Angeles, California.........	30,000	2,001	27,999	8,000	19,999
First National, Seattle, Washington....................	8,000	3,872	4,128	1,128	3,000
United States National, Portland, Oregon...............	4,000	3,300	700	700	...
Total 20 banks.................	458,850	70,947	387,903	59,004	328,899

Note. - The figures shown are based on the banks' liability for notes outstanding as reported by the banks instead of total amount outstanding as recorded by the Comptroller of the Currency. The difference for all national banks amounted to $20,000,000 on June 30, 1932.