The Papers of Eugene Meyer (mss52019)

119_05_001-	Subject File, Federal Reserve Board, Office Correspondence, Oct.-Dec. 1932

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

EUGENE MEYER

SUBJECT FILE

FEDERAL RESERVE BOARD
OFFICE CORRESPONDENCE
Oct.-Dec. 1932

Goldenweiser, E.A.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

FEDERAL RESERVE BOARD

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

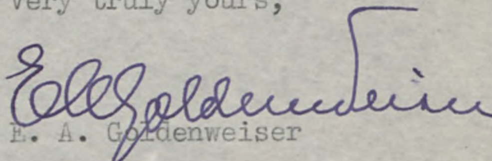
October 15, 1932

Dear Governor Meyer:

I am sending you a memorandum from Garfield on the current business situation, which I thought you might find of interest. I hope you will excuse the corrections in ink.

I also enclose two photostatic copies of the chart on reserves of Federal reserve banks, which you saw before. I think it brings out the point very forcibly. We must remember, however, that the amount of additional gold needed as collateral could have been reduced by about $250,000,000 by reducing the amount of Federal reserve notes held in the vaults of the Federal reserve banks.

Very truly yours,



E. A. Goldenweiser

Governor Eugene Meyer
c/o Federal Reserve Bank
New York City

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date October 15, 1932

To Mr. Goldenweiser

Subject: Current business situation

From Mr. Garfield F.R.G.

GPO 2—8495

Production

Figures on domestic cotton consumption came in yesterday and showed a larger increase than I had anticipated. The figure for September was 492,-000 bales, an increase of ~~26~~ 30 per cent in the daily average. This is considerably more than the usual increase of 8 per cent and the seasonally adjusted index advanced from 82 in August to 99 in September. This is the highest figure since January 1930. As a result of this advance, in addition to increases in the seasonally adjusted indexes for steel, coal, meatpacking, and silk--offset only in very small part by further reductions in automobiles and lumber--the Board's adjusted index of industrial production for September will show an increase from 60 to at least 64, and there is a strong possibility that the wool and shoe figures, not available until the 20th, will bring the index to 65. The low to date was 58 for July. The September level of 64 was ~~the same as~~ slightly above that of April, and higher than in succeeding months.

The salient feature of the current situation, as I see it, is the high level attained by the industries producing nondurable goods and in the case of many of these it is likely that future months will show no further increase. The high level of activity in textiles is partly the result of the extreme low production in the April to June period, and when inventories are replenished it seems likely that unless support in the way of ultimate consumption by producers of other commodities is received, output of textiles will decline. The accompanying charts show that stocks of cotton cloth in the hands of manufacturers were reduced further in September and are at extremely low levels. Unfilled orders were reduced slightly but are, nevertheless, at the level of

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

early 1929. Sales were in about the same volume in September as production, following a month in which sales were more than double production.

Employment

In New York and Pennsylvania there were large increases in factory employment from August to September and the figures for the United States, available this morning, show increases of 4½ per cent for factory employment and 5 per cent for payrolls, as computed by the Bureau of Labor Statistics. As indicated in the State reports, the textile group (United States - B.L.S. group) showed the largest increases--14 per cent in employment and 23 per cent in payrolls. There were smaller increases in many other lines, but I have not analyzed these to see in which cases the increases were larger than usual at this season. The automobile industry reported a decline of 13 per cent in working forces, and of 32 per cent in payrolls. Altogether the report is about what was expected, in view of the State reports previously received; increases reported in Pennsylvania and New York were much larger than for the United States, but this reflected the great importance of textile and clothing trades in these States.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

NO. 3114. 12 BY 20 DIVISIONS PER INCH. 120 BY 140 DIVISIONS.

CODEX BOOK COMPANY, INC. NORWOOD, MASSACHUSETTS

COTTON CLOTH - STOCKS & UNFILLED ORDERS

(Saturday nearest end of month)

Millions of yards

600
500
400
300
200
100
0

Stocks

Unfilled Orders

1928 1929 1930 1931 1932

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

NO. 3114. 12 BY 20 DIVISIONS PER INCH. 120 BY 140 DIVISIONS. CODEX BOOK COMPANY, INC. NORWOOD, MASSACHUSETTS

COTTON CLOTH - PRODUCTION & SALES

(Per Week)

Millions of Yards

Production

Sales

110
100
90
80
70
60
50
40
30
20
10
0

130
120
110

1928 1929 1930 1931 1932

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date October 17, 1932

To Governor Meyer

Subject:

From Mr. Goldenweiser

I have had a report on this morning's meeting from Professor Williams. The meeting was in the office of the Secretary of State, and there were present Secretaries of State and of the Treasury, Mr. Castle, Mr. Bundy, and Mr. Feis, in addition to Messrs. Williams and Day.

It was stated that the American position is clearly that a return to the gold standard is desirable and that methods of accomplishing this result should be studied. The American experts should make it a point to find out as much as possible about what is in the minds of the European experts on this subject.

There was a mention of silver, with the understanding that silver could never become a part of the monetary standard, but that some consideration to the return of silver coinage on the scale and of the fineness that prevailed before the war might be considered. Study might also be given to the silver policy pursued by the Indian Government. Mention was made of the Strong-Sprague testimony before the Indian Currency Commission in 1926.

Professor Williams reports that there was some discussion of inter-allied debts, as well as governmental and private debts in general, and that he was impressed by the degree of recognition of the importance of debt reduction on the part of the representatives of the Government. Of course, it was understood that the subject of debt reduction was not to be on the agenda of the international conference. I think it was Mr. Mills who talked on that subject.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

After this conference the experts called on the President. The one thought that Professor Williams carried away from that conference was that the President said that a means ought to be found to prevent financial runs on a country.

Secretary Mills asked the experts to come to his office at 2:30 this afternoon. This meeting lasted only a few minutes, as the experts were catching an afternoon train.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

+

October 19, 1932

Mr. Morrill — Direct Loans to Individuals, etc.

Mr. Van Fossen

CONFIDENTIAL

Attached hereto are statements showing the number of applications of individuals, partnerships and corporations for loans not granted by the Federal reserve banks to October 1 and to October 8, respectively, including a tabulation of the reasons for not granting the loans applied for.

It will be noted that of 482 applications refused to October 8, as shown in the second statement, 258 were because of unsatisfactory security; 210 paper not eligible; 8, loans placed with other banks; 3, present credit deemed adequate; and 3, denial of credit by other banks not shown.

Direct loans to individuals, partnerships and corporations granted by the Federal reserve banks to October 17 are as follows:

Federal Reserve Bank of New York

Amawalk Nursery Co.		$15,000
Dorman Brothers	Astoria, N. Y.	5,000
Foster and Stewart Co.	New York, N.Y.	50,000
Friedman & Sons, Neckwear Co., Inc.	New York, N.Y.	25,000
Joseph H. Meyer Brothers	New York, N. Y.	12,500
Miller-Cummings Co., Inc.	New York, N.Y.	125,000
Morris White Mfg. Co.	New York, N.Y.	19,000
New Jersey Flour Mills Co.	Clifton, N. J.	50,000
Scaramelli & Co., Inc.	New York, N.Y.	20,000
S. Shuff Sons, Inc.	New York, N.Y.	10,000
		$331,500

Federal Reserve Bank of Philadelphia

J. F. Apple & Co., Inc.	Lancaster, Pa.	400
J. B. Henkeln (Henkeln & McCoy)	Philadelphia, Pa.	3,427
		3,827

Federal Reserve Bank of Atlanta

Continental Turpentine & Rosin Corp.	Laurel, Miss.	19,750
Richmond Hosiery Company	Rossville, Ga.	50,000
Mississippi Cotton Seed Products Co.	Jackson, Miss.	48,000
		$117,750

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Federal Reserve Bank of Minneapolis

Bricelyn Canning Co.	Bricelyn, Minn.	$90,947
H. C. Ervin Co.	St. Cloud, Minn.	*7,580
Kiddie Gym Co.	Minneapolis, Minn.	7,500
		$106,027

*Revised.

Following is a summary of a letter dated October 1 from the Chairman of the Board of Directors of the Federal Reserve Bank of Chicago in regard to credit demands in the Chicago district:

Little legitimate demand for credit which cannot be satisfied through banking or other channels. An exception may be feeder loans, but this problem is thought to be in a fair way to being taken care of. The worst condition to be contended with is the agricultural one, particularly with relation to maturing farm mortgages. Low prices for farm products in many instances make it absolutely impossible for the farmers to meet these obligations. The problem is very serious, particularly so in Iowa, where the farmers through mass meetings, resolutions, and strikes are approaching a state of revolt. Resolutions are being passed in some counties protesting against anyone bidding for farm lands being sold under foreclosure. Protest is also being made against exhorbitant taxes and in some cases a moratorium on the payment of taxes and mortgage charges has been proposed.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

APPLICATIONS OF INDIVIDUALS, PARTNERSHIPS AND CORPORATIONS FOR LOANS NOT GRANTED BY THE FEDERAL RESERVE BANKS - TO OCTOBER 1, 1932

	Number		Reasons for not granting loans applied for					Amount of loans declined#
	Week ending Oct. 1	Total to Oct. 1	Loans placed with other banks	Present credit deemed adequate	Paper not eligible	Paper not satisfactorily secured	Denial of credit not shown	
Boston	--	7	--	--	3	4	--	$19,240
New York	3	98	2	3	17	76	--	2,890,400
Philadelphia	2	41	--	--	26	15	--	851,600
Cleveland	2	7	--	--	1	6	--	26,000
Richmond	2	42	--	--	30	12	--	857,295
Atlanta	2	102	1	--	55	46	--	1,670,828
Chicago	4	87	--	--	47	40	--	1,088,750
St. Louis	2	30	1	--	6	23	--	259,800
Minneapolis	2	13	1	--	6	6	--	172,000
Kansas City	--	17	--	--	11	3	3	41,172
Dallas	2	9	--	--	1	8	--	68,200
San Francisco	2	8	1	--	--	7	--	143,250
Total	23	461	6	3	203	246	3	8,088,535

#Approximate; amounts sometimes not stated.

DIVISION OF BANK OPERATIONS
OCTOBER 19, 1932.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

APPLICATIONS OF INDIVIDUALS, PARTNERSHIPS AND CORPORATIONS FOR LOANS NOT GRANTED BY THE FEDERAL RESERVE BANKS - TO OCTOBER 8, 1932

	Number		Reasons for not granting loans applied for					Amount of loans declined#
	Week ending Oct. 8	Total to Oct. 8	Loans placed with other banks	Present credit deemed adequate	Paper not eligible	Paper not satisfactorily secured	Denial of credit not shown	
Boston	--	7	--	--	3	4	--	$19,240
New York	9	107	4	3	17	83	--	3,002,050
Philadelphia	--	41	--	--	26	15	--	851,600
Cleveland	--	7	--	--	1	6	--	26,000
Richmond	3	45	--	--	33	12	--	869,884
Atlanta	3	105	1	--	56	48	--	1,677,065
Chicago	4	91	--	--	49	42	--	1,289,650
St. Louis	--	30	1	--	6	23	--	259,800
Minneapolis	1	14	1	--	7	6	--	232,000
Kansas City	--	17	--	--	11	3	3	41,172
Dallas	--	9	--	--	1	8	--	68,200
San Francisco	1	9	1	--	--	8	--	163,250
Total	21	482	8	3	210	258	3	8,499,911

#Approximate; amounts sometimes not stated.

DIVISION OF BANK OPERATIONS
OCTOBER 19, 1932.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

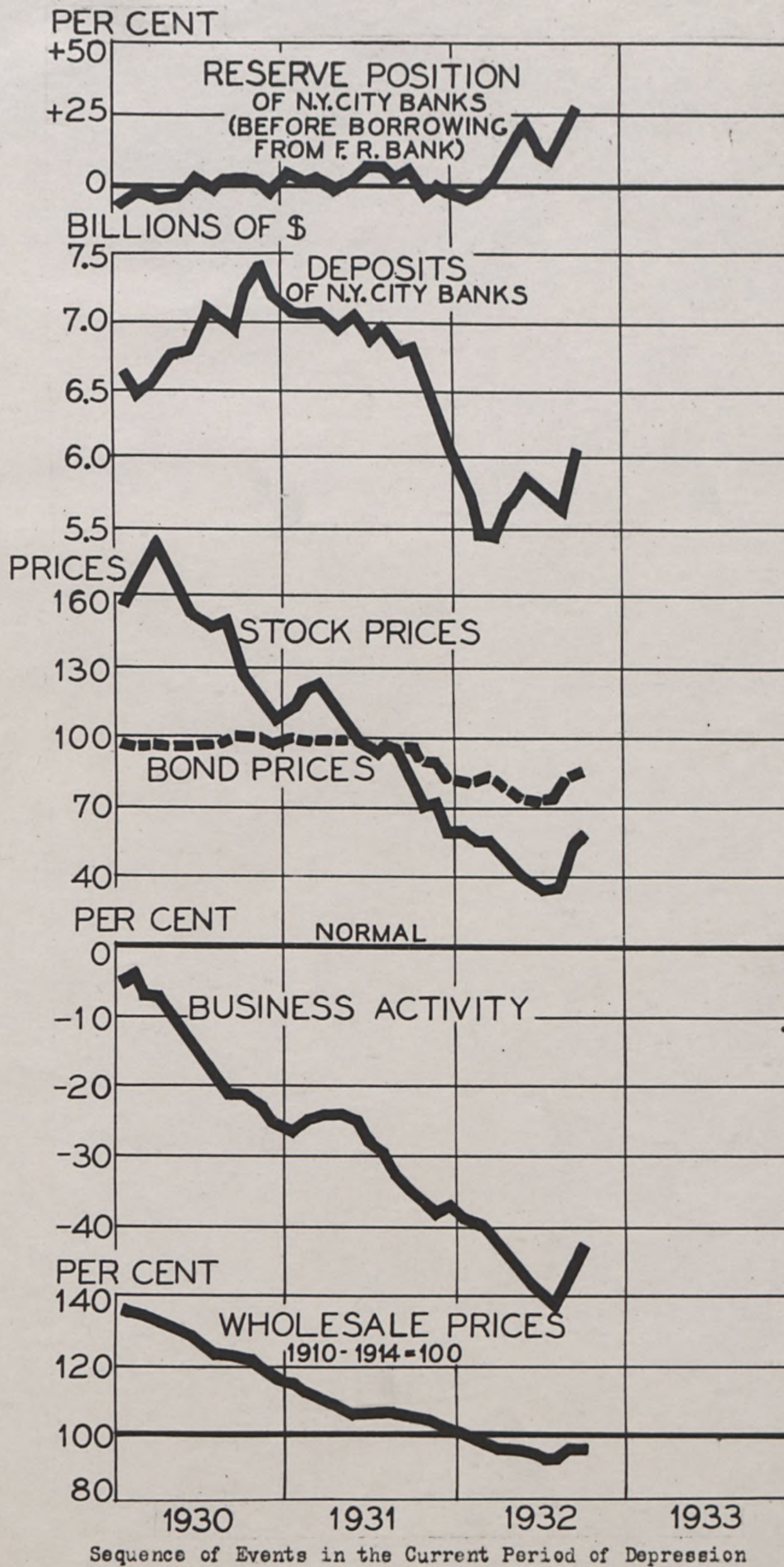
To Governor Meyer
From W. R. Burgess

You may be interested in the attached charts. I think you have seen the second one, but the first one is new. The figures are monthly averages so they do not show the latest weekly movements. A comparison of this diagram with those for preceding depressions indicates that things are working out about as would be expected, and shows the importance of the excess reserves.

NOV 1932

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

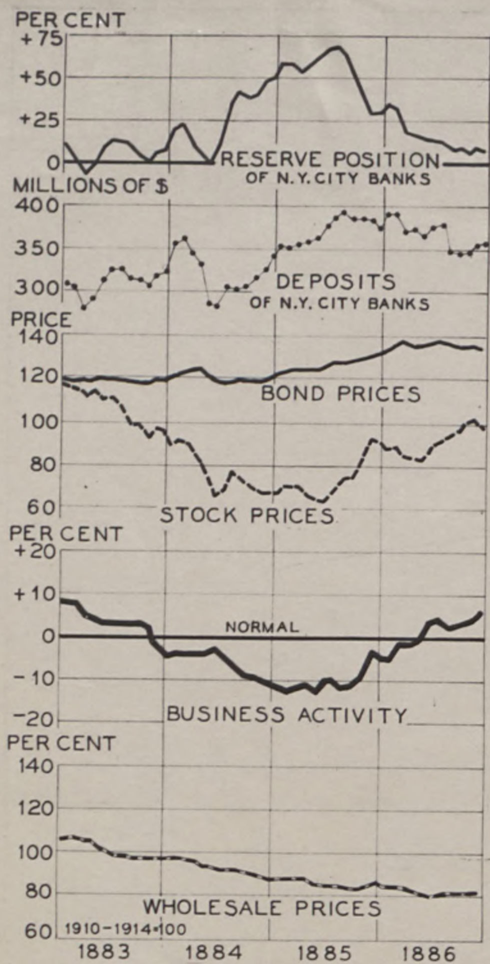
Federal Reserve Bank
of New York
Reports Department
Oct 28, 1932.
2388

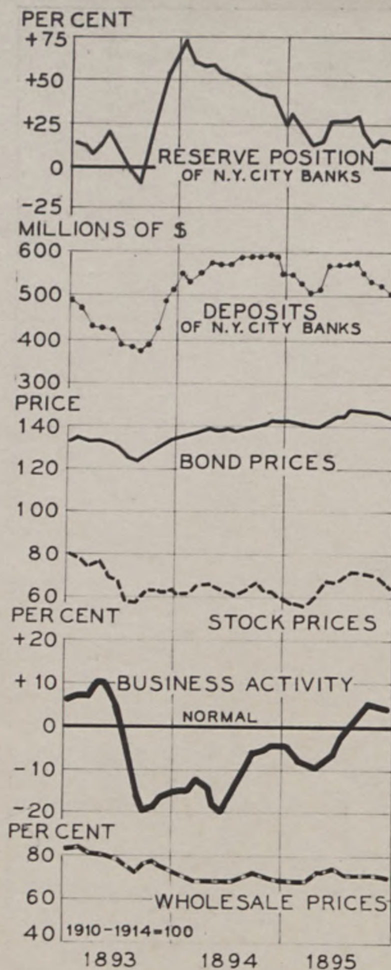


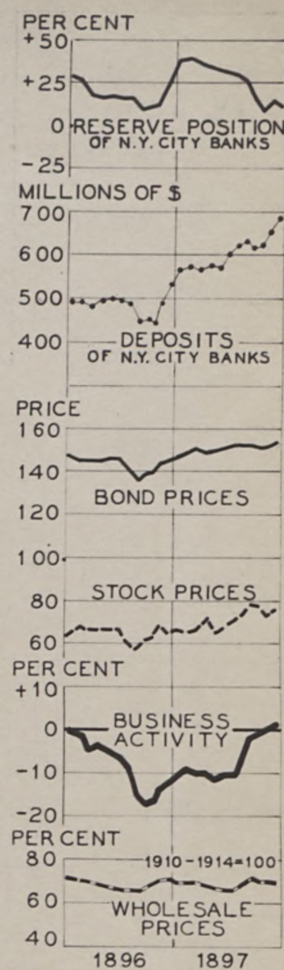
Sequence of Events in the Current Period of Depression

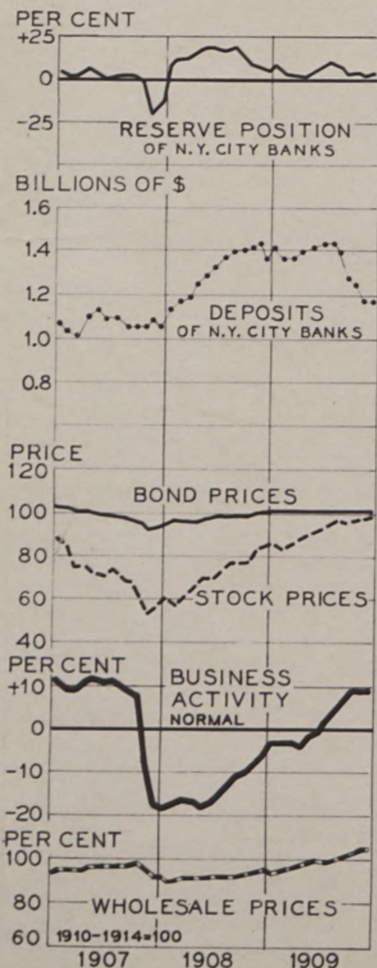
Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

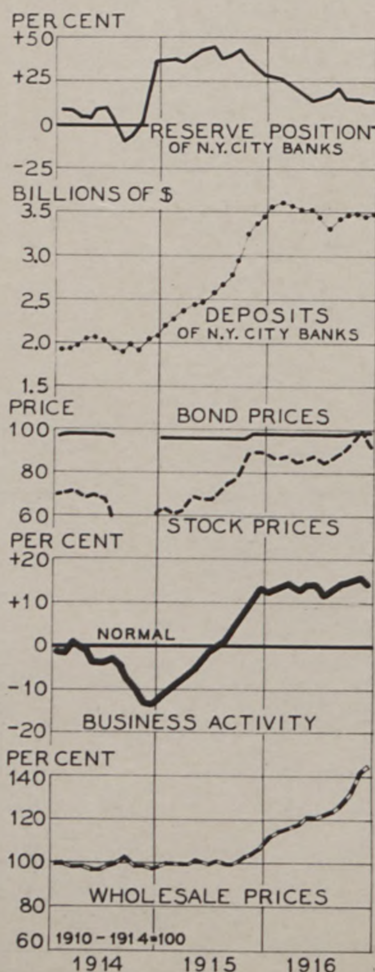
Federal Reserve Bank
of New York
Reports Department
JUNE 20, 1932
2321

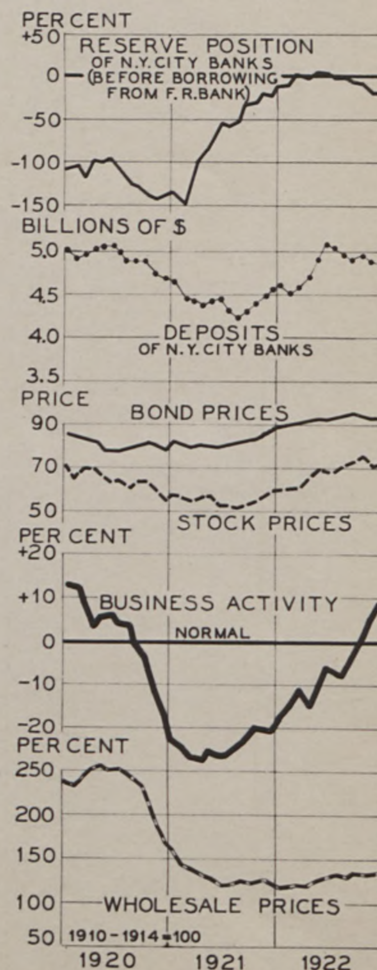












Sequence of Events in Previous Periods of Depression

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

C O N F I D E N T I A L

X-7278-a

October 21, 1932.

TO Federal Reserve Board

FROM Mr. Wyatt, General Counsel.

SUBJECT: Questions of law and policy arising in the administration of Section 8 of the Clayton Act.

It is contemplated that, during their meeting in Washington commencing on November 14, 1932, the Board will discuss with the Federal Reserve Agents the policy and procedure which govern in granting permits under the provisions of the Clayton Act relating to interlocking bank directorates; and it is the purpose of this memorandum and the attached memorandum by Mr. Chase to review this subject in the light of questions which have arisen during the past year or two, in order to furnish a convenient and helpful basis for discussion.

HISTORY OF THE LEGISLATION.

It is believed that it would be conducive to a more thorough understanding of the subject if the history and purpose of the Clayton Act as a whole are reviewed briefly before entering upon a discussion of the specific problems confronting the Board.

The Sherman Anti-Trust Act dealt generally with monopolies and restraints of trade and was construed originally by the Supreme Court of the United States as making unlawful all contracts, combinations, etc., which restrained trade.

Later decisions, however, established what is known as the "rule of reason", which was to the effect that only those contracts, combinations, etc., were unlawful which operated to the prejudice of the public interest by obstructing and restraining trade unduly and unreasonably.

Under both interpretations, the Sherman Act dealt only with the past, i.e., it attempted to prevent contracts and combinations in

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

restraint of trade by penalizing those <u>which actually had restrained trade</u>.

As a result of the adoption of the rule of reason by the Supreme Court in interpreting the Sherman Act, there was much public agitation; and, in an effort to abolish the rule of reason, Congress enacted the Clayton Act, supplementing the Sherman Act and other existing laws relating to monopolies and combinations in restraint of trade.

The Clayton Act sought to prevent restraints of trade in their incipiency by prohibiting certain types of agreements, relationships and transactions which may result in a substantial lessening of competition.

The Clayton Act, therefore, unlike the Sherman Act, looks to the future and deals with results which <u>may arise</u> from the contracts, relationships and transactions with which it deals rather than with results which <u>have been</u> accomplished.

This is an important distinction which must be borne in mind constantly in administering and applying the provisions of the Clayton Act.

Following the panic of 1907, there was also an extended investigation of the so-called "Money Trust". This investigation was made by a special committee of Congress known as the Pujo Committee, which recommended a number of different legislative measures to prevent a restriction of credit and the stifling of competition between banks.

One of the committee's recommendations was that interlocking directorates between banks be restricted; and it was in response to this

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

recommendation that there was inserted in Section 8 of the Clayton Act a provision forbidding all interlocking directorates between banks of certain classes.

As originally enacted on October 15, 1914, therefore, Section 8 of the Clayton Act forbade all interlocking directorates between banks of certain classes; and there was no authority anywhere to permit interlocking directorates between banks within the prohibited classes.

The Kern Amendment of May 15, 1916, made an exception to Section 8 of the Clayton Act, authorizing the Federal Reserve Board, in its discretion, to permit interlocking directorates between not more than three banks in the prohibited classes, <u>if such banks were not in substantial competition</u>.

The other provisions of the Clayton Act had dealt with transactions which may result in a substantial lessening of competition, and it is obvious that the Kern Amendment was based upon the same policy, the theory being that, if certain banks were not in substantial competition, then no substantial lessening of competition could result from an interlocking directorate between them.

It was found that the Kern Amendment operated illogically and in some cases unjustly. Thus, it sometimes happened that a person would serve for years as a director of three banks which were not within the provisions of the Clayton Act because of their size. One of the banks would grow until its resources exceeded $5,000,000, thus bringing the interlocking directorate within the prohibitions of the Clayton Act and making it unlawful for the director to continue to serve all three banks without first obtaining the Board's permission. When the director applied

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

for the Board's permission, it would be found that, notwithstanding the interlocking directorate, the banks were then in substantial competition. The Board would have to deny the permit and the director would have to resign either as a director of the $5,000,000 bank or as a director of both of the other banks. He was thus penalized for having permitted the banks to compete.

In order to cure this situation and to prevent this and similar injustices, the Federal Reserve Board recommended that the Kern Amendment be further amended so as to authorize the Board to permit interlocking directorates between not more than three banks in the prohibited classes if, in the Board's judgment, such interlocking directorates "will not result in a restriction of credit or lessening of competition" between the banks involved.

Congress, however, amended the Clayton Act so as to authorize the Board to permit interlocking directorates between not more than three banks in the prohibited classes, "if in its judgment it is not incompatible with the public interest."

As pointed out by Mr. Chase in the attached memorandum, Congress probably had in mind only such interlocking directorates as might result in a restriction of credit or a lessening of competition when it used the phrase "incompatible with the public interest"; but the language has a much broader meaning and can be applied to any interlocking directorate which may for any reason whatsoever be incompatible with the public interest.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

MAJOR QUESTIONS ARISING UNDER THE AMENDMENT.

This gives rise to the question whether, in passing upon applications for permits under the Kern Amendment, as amended, the Board should, (a) consider only the question whether the proposed interlocking directorates may result in a restriction of credit or a substantial lessening of competition, or (b) should consider also whether they will be incompatible with the public interest for any other reason.

Regardless of whether the Board must consider the second question, there also arises a question whether, as a matter of policy, it would be advisable for the Board to exercise the power conferred upon it by the amendment in such a way as to promote the public interest generally--for example, by limiting the sphere of influence of bank directors whose services in this capacity may be harmful to the banks, because of either their malfeasance or their nonfeasance.

It could be argued that the language of the law is so clear that there is no justification for referring to its legislative history and that, therefore, in passing upon applications for permits under the Clayton Act, the Board must take into consideration every factor having any bearing upon the question whether the proposed interlocking directorate would be compatible with the public interest.

On the other hand, it could be argued that the language is so general that the Board is justified in considering the legislative history in determining the scope of its duty in the premises; that the Clayton Act deals only with the relationships between two or more banks; and that, in the light of the history of the Clayton Act, the Board is not required to

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

consider anything except the question whether the interlocking directorate may result in a restriction of credit or a substantial lessening of competition between the banks involved.

Even if the Board decides that it is not required to consider anything except the question whether the proposed interlocking directorate will result in a restriction of credit or a substantial lessening of competition between the banks involved, however, there would seem to be nothing to preclude the Board from considering other questions. The question whether it is incompatible with the public interest to permit an interlocking directorate is left to the Board's judgment; and the Board is not required to issue permits but is merely authorized to do so. The courts are very reluctant to review actions taken by administrative officers under statutes vesting them with judgment or discretion and, when they review such actions, they do not overrule the administrative authority unless it appears that there was no reasonable foundation for the action taken and that it necessarily must have been based upon prejudice, whim or caprice. Even if it should appear unlikely that an interlocking directorate between two banks would result in a restriction of credit or a substantial lessening of competition, therefore, the courts would not be likely to hold that the Board exceeded its authority in refusing such a permit, if the Board should base its action upon some other ground having a reasonable relation to the public interest.

A DIRECTOR'S QUALIFICATIONS AND RECORD.

While it cannot be said in the light of its legislative history that the Clayton Act imposes a positive duty upon the Board to consider any question other than whether interlocking directorates probably would result in a restriction of credit or a substantial lessening of competition, yet it

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

would seem that the Board has ample authority, if it desires to do so, to refuse to grant permits for interlocking directorates when for any other reason the granting of such permits would, in the Board's judgment, be incompatible with the public interest.

The question arises, therefore, whether, as a matter of policy, the Board should consider only the question whether interlocking directors probably will result in a restriction of credit or a substantial lessening of competition or whether the Board should consider other questions affecting the public interest and especially the possibility of limiting the influence of individual directors whose activities have been positively harmful to the banks which they have served previously.

Where it appears that a director has had a bad influence upon a bank, that he has been guilty of abusing his position as a director, that he has grossly neglected his duties as a director, or that for any other reason he is an undesirable bank director, the Board cannot, under existing law, prevent him from serving a single member bank; but, through the exercise of the powers conferred upon it by Section 8 of the Clayton Act, the Board can limit the sphere of influence of such a director by withholding its permission for him to serve more than one bank within the classes affected by that Act.

It is well known that the principal cause of bank failures is bad or careless management; the Board has formally approved a section of the Glass Bill which would authorize it to remove bank officers and directors who have been guilty of repeated violations of law or continued bad management; and the question arises whether the Board should not take such factors into consideration in passing upon applications for its permission to serve two or more banks within the classes affected by the Clayton Act.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

There are many cases in which the courts have held bank directors liable in their individual capacities for losses sustained by their banks as a result of the directors' misconduct or negligence; and in some of these cases the courts have criticized the directors severely.

Suppose that, in such a case, the defendant should show the court that, with full knowledge of the course of conduct upon which the suit is founded, the Federal Reserve Board had issued a permit authorizing him to serve as a director of the bank in question and also two other banks.

Or, suppose that it has been clearly established that a particular individual completely dominated the affairs of a certain bank and that his mismanagement and wrongdoing resulted in the bank's ruin. Suppose that such a director should subsequently apply to the Board for permission to serve three banks which obviously are not in substantial competition. Would it be good policy for the Board to grant such a director its affirmative permission to serve the three banks?

On the other hand, if the Board decides to consider questions of this kind in its administration of the Clayton Act, problems will arise as to how far the Board should go in investigating the records of applicants, how far afield such investigations will lead the Board, and how large a burden of responsibility the Board must assume in this connection?

Three possible alternatives are suggested:

1. The Board could consider in this connection only such information as is contained in records of which it has actual or constructive notice--i.e., information in the records of the Board, the Federal Reserve Agents and the Federal reserve banks; or

2. The Board could supplement information already in such records

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

by requiring the applicant (and possibly the Federal Reserve Agent and the Chief National Bank Examiner) to answer a series of questions designed to disclose the character of the director's influence as such and whether his record as a director is good or bad; or

3. The Board could cause an independent and searching investigation to be made regarding the character, qualifications and record of each person who applies to it for a permit under the Clayton Act.

If the Board decides to go into this phase of the subject, it will be necessary to consider which of these three course of action or what other course of action it will pursue.

THE QUESTION OF COMPETITION.

Applications involving banks which clearly are not in substantial competition usually present no difficulties, because it can safely be assumed that an interlocking directorate between them will not result in a substantial lessening of competition; and such applications clearly should be granted, unless it is incompatible with the public interest for some other reason.

When the Board receives an application for a permit to serve two banks which clearly are in substantial competition, however, a number of administrative questions arise.

If such banks have no common directors, it could be argued that the mere fact that they are in substantial competition is not alone sufficient evidence that a single interlocking directorate between them probably will result in a substantial lessening of competition and that, therefore, the application should not be denied unless there is some other evidence tending to show that a substantial lessening of competition probably will result.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

If this view is adopted, however, then the question will arise whether, under similar circumstances, the Board should grant permits for a second, a third, a fourth, a fifth, interlocking directorate, and so on. In other words, how many interlocking directorates between such banks should the Board permit? Should it permit a third of the directors of the one bank to be directors of the other? or half of them? or three-fourths of them? or all of them?

It could hardly be denied that to permit all of the directors of one bank to serve also as directors of a competing bank probably would result in a substantial lessening of competition; and it would seem exceedingly difficult to establish anything but an arbitrary rule as to the number of common directors which should be permitted between such banks.

In this connection, it must be remembered that the Clayton Act establishes a basic rule that no interlocking directorates shall be permitted between banks in the prohibited classes and that, when a director applies to the Federal Reserve Board for permission to serve two or three banks in the prohibited classes, he is asking the Board to take action which will bring him within one of the exceptions to the Clayton Act. He is asking the Board to make a special exception in his case; and, in order to grant his request, the Board must find that it is not incompatible with the public interest to do so.

In these circumstances, it would seem that, if the banks are in substantial competition, the Federal Reserve Board, for its own protection, ought to have in its records some affirmative evidence that such an interlocking directorate will not result in a substantial lessening of competition;

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

and it would seem logical to place the burden of furnishing such information upon the applicant who is asking the Board to grant him a special privilege. It would also seem that the evidence justifying the Board's action should be something more than a mere expression of opinion by the applicant or the Federal Reserve Agent.

In other words, the fact that the banks are in substantial competition could be considered as creating a presumption that an interlocking directorate between them will tend to lessen competition; and the burden could be placed on the applicant to furnish some affirmative ground for granting the permit.

It would seem entirely reasonable, therefore, to adopt the policy of refusing to grant any new permits for interlocking directorates between banks <u>which are in substantial competition</u>, unless the applicant is able to show the Board that there are exceptional circumstances which afford some affirmative basis for such action.

It would be difficult, if not impossible, for the applicant to show affirmatively that his service as a director of both banks will not result in a substantial lessening of competition (unless he can show that they are not in substantial competition); but a justification for the granting of the permit could often be furnished in the form of some affirmative reason why it would be in the public interest for him to serve both banks.

Thus, the Board might feel justified in granting the application if it could be shown that one of the banks has been in serious difficulties; that the applicant and his friends are willing to put large sums of money in the bank to save it, if the applicant can become a director of such

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

bank in order to protect their interests as well as the interests of the public.

Likewise, the Board might feel justified in granting a permit for an interlocking directorate between competing banks, if it should appear that the applicant has contributed materially to the good management of one of the banks and that the management of the other bank would be materially strengthened by obtaining his services as a director.

Another reason for placing upon the applicant the burden of showing some affirmative reason why his application should be granted is that normally there is no one who will object to the granting of such applications. The information submitted by the applicant naturally is submitted in such a way as to make out the strongest possible case for him consistent with honesty and truthfulness, and he cannot reasonably be expected to point out reasons why his application should not be granted. Experience has shown that Federal Reserve Agents seldom recommend that Clayton Act applications be refused and seldom produce facts not contained in the applications and accompanying exhibits which tend to show that they should not be granted. It is exceedingly difficult, if not impossible, for the Federal Reserve Board to discover and produce such information.

MISCELLANEOUS QUESTIONS.

Other questions arising from time to time in the administration of the Clayton Act may be indicated very briefly as follows:

1. Whether additional permits for interlocking directorates should be granted when the banks involved are already closely knit with numerous other banks in the same city by a spider web of interlocking directorates.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

2. Whether it is in the public interest for the Board to facilitate the organization of a chain or group of banks by permitting the parent bank to have interlocking directorates with the other banks in the group or chain.

3. Whether under any circumstances it is proper to permit interlocking directorates between a rapidly expanding branch banking system and independent unit banks located in cities in which the parent bank has branches.

REVOCATION OF EXISTING PERMITS.

Section 8 of the Clayton Act, as amended, also authorizes the Federal Reserve Board to revoke any permit for an interlocking directorate issued thereunder "whenever it finds, after reasonable notice and an opportunity to be heard, that the public interest requires its revocation".

The question arises, therefore, whether the Board has a duty to review existing permits from time to time and, if so, on what grounds existing permits should be revoked.

Since the purpose of the Clayton Act, as amended, is not to penalize competition between banks but to preserve and foster such competition, it would seem obvious that:

1. A permit for an interlocking directorate should not be revoked merely because competition between the banks has increased since the permit was issued; and

2. A permit should be revoked if it appears that the existence of the interlocking directorate has reduced competition between the banks or has prevented the growth of competition between them.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

If the Board decides that, in granting Clayton Act permits, it will go into the question whether the influence of the applicant on the banks involved might be detrimental, it would also be proper to consider the same questions in determining whether or not to revoke existing permits; and all of the problems suggested above should be considered in this connection.

It would seem that the possession of the power to revoke existing permits whenever in its judgment the public interest so requires imposes a duty upon the Federal Reserve Board to exercise this power in such a way as to promote the public interest. Therefore, it would seem that all existing Clayton Act permits should be reviewed at reasonable intervals with view of determining whether they should be revoked. In deciding whether to revoke existing permits, however, the Board could properly take into consideration the question whether it would be in the public interest to do so in the light of all circumstances existing at the time, including the unsettled banking situation; and it would not seem necessary to review existing permits unless and until the Board is prepared to revoke them and thereby disrupt existing relationships, in cases where the facts seem to warrant such action.

RECOMMENDATION.

I respectfully recommend that copies of this memorandum and of the attached memorandum by Mr. Chase be sent to all Federal Reserve Agents for their information in advance of their conference with the Board and also that I be authorized to send copies to Counsel for all of the Federal reserve banks, in order that they may be prepared to discuss the subject with the Federal Reserve Agents.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

I discussed the subject orally with Counsel for the Federal reserve banks during their recent conference here; but I think it would be helpful for them to have copies of these memoranda.

Respectfully,

Walter Wyatt,
General Counsel.

WW:mw

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

CONFIDENTIAL X-7278-b

Oct. 3, 1932.

To: Federal Reserve Board

From: Mr. Chase, Assistant Counsel.

Subject: Administration of Section 8 of the Clayton Act.

In this memorandum are considered various questions arising in connection with the administering of section 8 of the Clayton Act, as amended (U.S.Code, Title 15, section 19). The questions arise with regard to the scope of the Board's authority under the standard prescribed by that section, namely, compatibility with the public interest.

As originally enacted, section 8 of the Clayton Act absolutely prohibited interlocking directorates between banks of certain classes. The provision of that section dealing with banks was amended, first, by the Kern amendment in 1916 which authorized the Board to grant permits to serve not more than three banks provided such banks were not in substantial competition. Since the forbidding of interlocking directorates in all cases where competition existed sometimes actually stifled competition and produced other unsought results, the provision was again amended in 1928 so as to authorize the Board to grant such permits if in its judgment such action "is not incompatible with the public interest".

The three principal questions to be considered in this memorandum are:

(1) In dealing with the question of competition, if substantial competition is found to exist between the banks, should the Board deny the application in all cases unless the applicant is able to show a valid reason why it should be granted, or should the Board adopt a policy of granting each application unless it feels that there is more than a remote possibility that a substantial lessening of competition will result?

(2) Is the question of competition in its various aspects the only question to be considered by the Board in passing upon an application?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

(3) If that is not the only question, what other matters should be considered?

There are no court decisions which answer these questions specifically, and it will therefore be necessary to examine, first, certain decisions of the Supreme Court relating to the general purpose of the Clayton Act, second, the legislative history of the particular provision of section 8, and, lastly, certain legal principles and matters of policy involved in the third question stated above.

I. SUPREME COURT DECISIONS RELATING TO THE GENERAL PURPOSE OF THE CLAYTON ACT.

The Clayton Act was enacted with the purpose of changing and supplementing the existing statute dealing generally with monopolies and restraints of trade, the Sherman Act. The Sherman Act at first had been interpreted by the United States Supreme Court as making unlawful all contracts, combinations, etc., which restrained trade. Later decisions, however, (see particularly Standard Oil Co. v. United States, 221 U.S. 1; 31 S.Ct., 502, 516-518) established what is known as the "rule of reason", which was that only those contracts, combinations, etc., were unlawful which operated to the prejudice of the "public interest" by obstructing and restraining trade unduly and unreasonably.

After considerable political agitation, and after the decision of the Standard Oil case, the Clayton Act was enacted. Two leading cases were subsequently decided by the Supreme Court involving the meaning of the phrase "substantially lessen competition" as used in the basic sections of the Clayton Act dealing with subjects other than banks. The first, Standard Fashion Company v. Magrane-Houston Co., 258 U.S. 346, 42 S.Ct. 360 held that:

1. Although much was said in the briefs concerning the reports of committees, "the words of the Act are plain and their meaning is apparent

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

without the necessity of resorting to the * * * often unsatisfactory aid of such reports."

2. "The Clayton Act sought to reach the agreements embraced within its sphere in their incipiency, and in the section under consideration to determine their legality by specific tests of its own. * * * ". In other words, under sections 2 and 3 of the Clayton Act it is not necessary to show that the acts have actually resulted in a restraint of competition: it forbids acts which "may" lessen competition, thus reaching the evil in its incipiency.

3. The use of the words "may" and "substantially" shows that the statute was intended to reach not all the acts described but only those which would "probably lessen competition or create an actual tendency to monopoly. That it was not intended to reach every remote lessening of competition is shown in the requirement that such lessening must be substantial."

The second case, United Shoe Machinery Corp. v. United States, 258 U.S. 451; 42 S. Ct. 363, illustrates point 2, above. It involved a group of transactions which had previously been held not to violate the Sherman Act. They were held to be in violation of the Clayton Act (or rather, certain facts which were immaterial in the Sherman Act case were held to amount to a violation of the Clayton Act). The Court held that the first decision did not make the question res judicata under the Clayton Act, saying:

> "Under the Sherman Act, as interpreted by this court before the passage of the Clayton Act contracts were prohibited which unduly restrained the natural flow of interstate commerce, or which materially interrupt the free exercise of competition in the channels of interstate trade. In the second section monopolization or attempts to monopolize interstate trade were condemned. The Clayton Act (section 3) prohibits contracts of sale, or leases made upon the condition, agreement, or understanding that the purchaser or lessee

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

> shall not deal in or use the goods of a competitor of the seller or lessor where the effect of such lease, sale, or contract, or such condition, agreement, or understanding 'may' be to substantially lessen competition or tend to create monopoly. The cause of action is therefore not the same."

To summarize:

1. The phrase "the public interest" was used by the Supreme Court in the leading Standard Oil Case in describing the purpose of the Sherman Act, and in laying down the "rule of reason" for interpreting the prohibitions contained in that Act.

2. The Clayton Act was enacted to amend the existing law as interpreted by the courts. It sought to prevent the evils in question by reaching them in their incipiency, and provides a standard of its own to be applied to the specific acts with which it deals. The standard is: Whether the acts are such that they "may" "substantially" lessen competition, or tend to create a monopoly, -- which means, in the words of the Supreme Court, such as will "probably" lessen competition "substantially"; that is, by amending the law, Congress did not intend to make unlawful acts which only had a remote and possible tendency to lessen competition.

3. The two Acts, as interpreted by the Supreme Court, both obey the legal maxim that the law will not concern itself with matters of trifling importance, -- the Sherman Act, by not condemning contracts unless they restrain commerce unreasonably to the detriment of the public interest; the Clayton Act,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

by forbidding certain actions only when they probably will result in a substantial lessening of competition, the test in Section 8 of the latter Act being compatibility with the "public interest".

LEGISLATIVE HISTORY

The first part of the legislative history of the present provision is completely summarized in the Annual Reports of the Federal Reserve Board.

1921 Report, pp. 87-89:

> "As originally enacted section 8 of the act approved October 15, 1914, known as the Clayton Antitrust Act, absolutely prohibited interlocking directorates between certain classes of banks. The act of May 15, 1916, known as the Kern amendment, modified the provisions of that section so as to allow a person who first obtains the permission of the Federal Reserve Board to serve not more than three banks in the prohibited classes, if such banks are not in substantial competition. " * * * "When the work done in connection with the review of the interlocking directorates revealed to the Board how many instances there were in which a strict enforcement of the terms of section 8 of the Clayton Act would operate inequitably, the Board decided to consider the question of a further amendment to the Clayton Act to carry out more effectually the intention of Congress to promote and encourage competition. The matter was referred to the Board's committee on the Clayton Act, which, after making a careful study of the problem, with the assistance of counsel, rendered a report in which it recommended an amendment which would authorize the Federal Reserve to permit a person to serve not more than three competing banks, when the Board is satisfied that such interlocking directorates will not result in a restriction of credit or lessening of competition between the banks involved, the Board, however, to continue to have full power to revoke such permits at any time. * * * The Board adopted the recommendations of its committee on the Clayton Act and a bill amending the Clayton Act in this manner was drafted and submitted to the Senate and House Committees on Banking and Currency." (H.R. 4826).

The recommendation that the Kern amendment be further amended was renewed in every annual report up to and including the Report for 1926. The

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

recommendation was omitted from the 1927 Report perhaps for the reason that an amendment was then actually in the process of being enacted.

1923 Report, p. 52:

> "* * *The Board directed its 12 Federal reserve agents to make a comprehensive review * *. This investigation disclosed that in a few cases banks with common directors have become substantial competitors since the time when permits for such directorates were granted, either through the natural growth of competitive business or through the acquisition of competitive business incident to a consolidation."

and the Board accordingly renewed the recommendation contained in its 1921 Report.

In the interval between the Report for 1923 and the Report for 1924 a bill was introduced in the Senate known as S. 3299 which contained the phrase "lessening of competition". A bill was introduced in the House by Representative McFadden known as H.R. 9344 which contained the phrase which has subsequently been enacted, "not incompatible with the public interest". It does not appear from the Board's files that the Board suggested to any member of Congress the broader language of the latter bill, but the Board approved the language, as is shown by its Report for 1924. In discussing these two pending bills, the Board said:

1924 Report, p. 29:

> "In its present form section 8 of the Clayton Act in operation often defeats the purpose for which it was enacted; it discriminates against national banks, and in many cases its enforcement results in unnecessary hardship to individuals and to the disadvantage of the banking and credit situation in certain communities. The board has repeatedly recommended the enactment of an amendment to the Clayton Act to overcome these defects. * * * The fundamental purpose of both bills, however, was to give the board more latitude in the matter of permitting interlocking directorates and thus enable it to administer the Clayton Act more effectively and

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

more nearly in harmony with the apparent purpose and intent of Congress in regulating interlocking directorates. The Senate bill was introduced at the board's request and the House bill with the board's approval."

1928 Report:

After the enactment of the present provision, the Board made note of the fact in its Annual Report, but did not undertake to answer the question discussed herein. It said, p. 37:

"* * Under the amendment the board is authorized to grant such permits if in the judgment of the board the issuance of such a permit is not incompatible with the public interest, and such permits may be granted even though no member bank of the Federal reserve system is involved."

The letters and memoranda sent by the Board to various members of Congress in connection with the various bills referred to above relate only to the question of competition in its various aspects, and as indicated in the 1924 Report of the Board, its approval of the language of H.R. 9344, which was the language ultimately enacted into law, was based on those considerations.

In view of the length of time which elapsed between the original enactment of the Clayton Act, - - and even between the enactment of the Kern amendment, - - and the subsequent enactment of the present provision, there is little logical justification for assuming that the thoughts of the members of Congress which were not actually put into legislation persisted unaltered until the time of the enactment of the present provision in 1928. Little help can therefore be expected from the debates and other parts of the legislative history of the earlier provisions. Three reports of committees

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

concerning bills containing the language which was finally enacted into law in 1928 should, however, furnish as reliable a guide as committee reports are apt to furnish in any case.

The Senate Committee inserted an amendment containing the phrase "not incompatible with the public interest" in H.R. 2 (a bill containing numerous amendments to the Federal banking laws, which, after enactment with changes, became known as the McFadden Act of Feb. 25, 1927) and this amendment was passed by the Senate but rejected by the House. Two bills were introduced in the 60th Congress containing similar provisions, H.R. 9098 and S. 3007. The bill which was ultimately enacted on March 9, 1928, was known as H.R. 6491.

None of the bills which contained the language which has since been enacted, except the proposed Senate amendment to H.R. 2 (which was rejected by the House) and H.R. 6491, was ever made the subject of a report by a committee of Congress. The report on H.R. 2 (Senate Report 473, 69th Cong.) contains the following (at p. 13):

> "* * *By the passage of the Kern amendment Congress recognized the fact that it is not objectionable per se for the same person to serve as director of a limited number of banks. Interlocking directorates become objectionable when by reason of the common domination of several banking institutions competition is unduly restricted and concentration of the control of credit results. Presumably Congress intended to vest a discretion in the board to determine, within the limits prescribed by it, when it became incompatible with the public interest for the same director to serve on the boards of two or three banking institutions. The test applied, however, namely, the degree of competition existing as between such institutions, has proven impracticable and unworkable." * * *

> "This amendment retains the limit on the number of banks that may have common directors, but vests in the board a discretion to determine when interlocking directorates within the limits imposed by Congress are inconsistent with the purpose of the Clayton Act. This is

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

> a question which must be determined by consideration of all the facts in a given case and which can not be determined by the application of any formula."

The Senate report on H. R. 6491 (Sen. Rep. 439, 70th Cong., 1st Sess.) contains no original comment but merely quotes in full the report of the House committee. The latter report is explicit.

The House report on H. R. 6491, (House Rep. 487, 70th Cong. 1st Sess.) the language and substance of which is derived largely from letters and memoranda from the offices of the Board, begins with a brief statement of the original provision and of the Kern amendment. The report then states that the experience of the Board has been "that the Kern Amendment in its present form does not work out in the way in which it was intended". Illustrations are given. Competition has grown up between banks in spite of common directorates, showing that they had not prevented the existence of competition. In some cases requiring a director to resign might precipitate a crisis in the affairs of the bank by undermining public confidence in it. The report then sums up the situation as follows:

> "To sum up briefly, the Kern amendment was designed to permit limited interlocking directorates, but only in cases where the public interest would not be prejudiced, as by the lessening of competition between banks or the restriction of credit. * * * <u>It is not particularly important whether banks which wish common directors are or are not in substantial competition -- that has little to do with the question -- but it is important what effect the interlocking directorates will have on the banking and credit situation in the community</u>. Consequently the test for permitting interlocking directorates should be

whether or not such directorates will injuriously affect the public interest by discouraging interbank competition or restricting credit or otherwise, and not the present test as to the existence of substantial competition."

* * * ** * * * * * *

"The above discussion should demonstrate clearly that the Kern amendment in its present form operates in an illogical way and often defeats the very purpose for which it was enacted. It follows that the law should be further amended in such a way as to enable the Federal Reserve Board to administer it more effectively and more nearly in harmony with the apparent purpose and intent of Congress in regulating interlocking directorates."

The debate in Congress was very meagre. In the House, Mr. MdFadden's statement explaining the bill is merely a summary of the Committee's report. In response to questions from the floor, he explained that competition was the "principal" factor to be considered by the Board, but did not name any other factors. (Cong. Rec. Vol. 69, p. 2335). Mr. Goldsborough and Mr. LaGuardia opposed the bill on the ground that interlocking directorates should be forbidden absolutely. In the Senate there was virtually no debate. An extract from a letter from the Board was read, saying that the amendment "will enable us to function more in accordance with the original intent of the law."

The conclusion which I reach upon the first two questions are, therefore -

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

1(a) The Board must, as a matter of law, deny an application if in its judgment the granting of it would probably result in a substantial lessening of competition between the banks involved.

(b) The Board is "authorized" to grant an application if in its judgment no substantial lessening of competition will probably result, and provided no other reason exists which in its judgment would make the granting of the application incompatible with the public interest.

2. Section 8, as amended, provides that the Board is "authorized" to issue a permit if in its "judgment" it would not be incompatible with the "public interest". The words "competition" and "monopoly" are not used in this provision. It follows, therefore, that although Congress had in mind only the question of competition, or restriction of credit, the language of the act clearly vests the Board with discretion to deny an application if in its judgment it would be incompatible with the public interest to grant it; and the Board is vested with a wide discretion in deciding upon the matter.

Moreover, under well-established legal principles, the courts will not disturb an exercise of discretion thus vested by statute unless the discretion has been plainly abused and exceeded.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

However, the fact that the Board is "authorized" to grant the permit in its discretion, also means that the permit must not be denied arbitrarily or capriciously.

III. MATTERS OTHER THAN COMPETITION.

In the event that the Board should decide to consider matters other than competition, a number of questions are raised:

Should the Board grant a permit, even if the banks are not in competition, if it knows that the applicant -- taking the extreme case as an illustration -- has ruined a bank by his unlawful acts?

Should it, on the other hand, attempt to improve the quality of directors generally, by exercising its limited right to deny an application involving more than one bank within the prohibited classes, -- in spite of the fact that its decision, even when adverse, can only affect the <u>number</u> of banks which the applicant can serve without being able to prevent him from serving any bank, even though it is a member of the Federal Reserve System?

Should it undertake to pass upon the qualifications of directors although it is not in a position to make an informed decision in a great many cases?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

From what sources and in what manner would the Board seek information with regard to his qualifications :

(a) Should the Board grant the permit unless there is information in its files or those of the Federal Reserve Agent which indicates that it would be incompatible with the public interest to grant the permit:

(b) Should the Board require the applicant to answer a series of questions regarding his experience, training and other qualifications, his attendance at directors' meetings, etc; or

(c) Should the Board cause a special investigation to be made of the applicant's qualifications and record as a bank director or officer.

These are questions of policy which are not within the scope of this memorandum. It will be assumed, however, for the purpose of discussion, that the Board may avoid the extremes indicated above, and take a middle ground, denying an application, regardless of competition, when information readily available to it indicates that the applicant has some positive disqualification.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

In order to ascertain the facts with regard to such matters, the Federal Reserve Agent could be requested to give his comments at the time of forwarding the application to the Board, and, in addition, such means could be adopted as the Board may determine for ascertaining whether the reports of examination and similar sources of information either show definitely an objection to the applicant along the lines referred to or give an indication sufficient to make further inquiries advisable.

In that event, it would seem that the questions to be considered, aside from competition, should include:

1. Whether the applicant is dishonest or incompetent, -- the character of the management of the banks with which he is associated and the extent of his responsibility therefor, being considered pertinent to this inquiry.

2. Whether the applicant discharges the duties and responsibilities of his office by attending directors' meetings, etc., -- the geographical location of the banks being one of the factors considered in this connection.

3. Whether he abuses his borrowing privilege, -- or, more specifically, whether the examiner has criticized loans to the applicant, his family or his interests, as being excessive, or for any other reason.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The questions outlined above are necessarily general in character since it would not be possible to predict except in a general way what facts might be developed which would make the granting of the application undesirable from the standpoint of the public interest in the less restricted meaning of that phrase.

Matters such as dishonesty, incompetence and knowingly directing the bank's affairs in violation of statutory provisions, require no illustration or description.

The abuse of the borrowing privilege may, of course, be indirect and consist of excessive borrowing not only by the director but by members of his family and his or their interests.

The character of the bank's investments may be found to be highly speculative, and the applicant be found to be responsible therefor.

The undesirability of a director who serves merely as a figure-head also requires no extended comment. The point is aptly summarized by the Supreme Court of the United States in the case of Martin v. Webb, 110 U. S. 7, 3 S. Ct. 428, 433:

> "* * Directors cannot, in justice to those who deal with the bank, shut their eyes to what is going on around them. It is their duty to use ordinary diligence in ascertaining the condition of its business, and to exercise reasonable control and supervision of its officers. They have something more to do than, from time to time, to elect the officers of the bank, and to make declarations of dividends. That which they ought, by proper diligence, to have known as to the general course of business in the bank, they may be presumed to have known in any contest between the corporation and those who are justified by the circumstances in dealing with its officers upon the basis of that course of business."

As was stated by the Supreme Court in another case, however,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

(Briggs v. Spaulding, 141 U. S. 132, 11 S. Ct. Rep. 924) it is not possible to define with precision the degree of care and attention which a director should give to the affairs of the bank. That must depend upon all the facts of the particular case. The Court concluded, however:

> "* * Without reviewing the various decisions on the subject, we hold that directors must exercise ordinary care and prudence in the administration of the affairs of a bank, and that this includes something more than officiating as figure-heads. They are entitled under the law to commit the banking business, as defined, to their duly-authorized officers, but this does not absolve them from the duty of reasonable supervision, nor ought they to be permitted to be shielded from liability because of want of knowledge of wrong-doing, if that ignorance is the result of gross inattention; but in this case we do not think these defendants fairly liable for not preventing loss by putting the bank into liquidation within 90 days after they became directors, and it is really to that the case becomes reduced at last."

In Bowerman v. Hamner, 250 U. S. 504, 39 S. Ct. 549, a decree against Bowerman as director for losses sustained by the bank as the result of unlawful and negligent management of its affairs was affirmed. Bowerman lived 200 miles from the bank and had not attended a single meeting of the board.

> "* * He was a man of such importance and reputation that the use of his name must have contributed to securing the confidence of the community and of depositors for the bank, and it would be a reproach to the law to permit his residence at a distance from the location of the bank, a condition which existed from the time he first assumed the office of director, to serve as an excuse for his utter abdication of his common-law responsibility for the conduct of its affairs and for the flagrant violation of his oath of office when it resulted in loss to others."

Respectfully submitted,

G. Howland Chase,
Assistant Counsel.

GHC:mw

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date October 21, 1932

To Mr. Harrison

Subject:

From Mr. Goldenweiser

GPO 2—8495

Attached is a copy of a statement on inflation.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

October 21, 1932

When Europeans speak of inflation in this country they base their statements on memories of currency inflation which occurred throughout Europe during the war and post-war period. This kind of inflation rests on two fundamental conditions: (1) the use of currency by the public for a considerable proportion of its payments, and (2) long-continued inability of the Government to meet expenses through taxation, and a consequent issuance of paper money in unlimited amount either directly by the Government or by the central bank on the basis of direct borrowing from it by the Government.

These conditions do not exist in this country. Currency in the United States is distinctly a minor element in the total volume of payments. Probably no more than one-twentieth of all payments are made by the use of cash. The volume of currency in the country fluctuates in normal times entirely in response to the demand of the public for cash to be used in retail trade and for payroll purposes. Since the autumn of 1930 a considerable amount of cash has also been withdrawn for hoarding. The only way through which the inflationary process could get under way is through retail purchases, and before that took place there would have to be a fundamental change in the habits of the people. People will not carry more cash in their pockets than is their habit. Storekeepers will deposit with banks the cash they do not currently require, and the banks will turn in cash in excess of till money requirements to the reserve banks and thus retire it. The first condition for currency inflation, therefore, the cash-using habit of the people, is absent in this country.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

In the second place, there has been no attempt by the Government to issue currency for the purpose of meeting a deficit. In fact, currency has been issued by the reserve banks in response to applications from commercial banks, which in turn have merely transmitted to the reserve banks the demands of their customers for cash either for trade purposes or for hoarding.

Currency issues by national banks under the recent extension of the circulation privilege to a large volume of Government bonds have amounted to something over $100,000,000 of notes, but these new issues have merely displaced other kinds of currency in circulation and have not increased the total. The total volume of currency, in fact, has been declining rapidly since the privilege was granted to the national banks, largely in response to improvement in banking conditions, increased confidence in banks, and the consequent return flow of currency from hoards. The Government itself has issued no currency over and above the amounts which have been constant for many years, and the Federal reserve banks have issued Federal reserve notes only in response to the demands already discussed.

The passage of the Glass-Steagall Act, which for one year permitted the use of Government securities as collateral for Federal reserve notes, has no doubt appeared to foreigners as a means by which currency can be issued for the purpose of meeting Government deficits. Theoretically this power does exist. The Government could sell securities to the reserve banks and the reserve banks could pay for them with Federal reserve notes so long as they had 40 per cent in gold as reserves. But in the first

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

place, as outlined above, currency is not the means used in this country to make large payments and the Treasury pays its bills by check and not in cash. And in the second place, as a matter of fact, the Federal reserve banks have not issued any additional notes since the passage of the Glass-Steagall Act, except during the period when currency was being demanded for hoarding purposes. The Glass-Steagall Act, whatever its theoretical implications may be, has in practice been a means by which the Federal reserve banks were able to transfer assets to the Federal reserve agent and thereby release gold which thus became available for other purposes.

The record is conclusive that there is no currency inflation in this country. Currency expanded to meet demands for hoarding and has contracted since confidence in the banks has been restored. During a currency inflation currency remains in circulation and does not go into hoards. An invariable characteristic of currency inflation, in fact, is a rapid turnover of currency. In this country the turnover of currency has been extraordinarily slow as the result of business inactivity and hoarding.

Inflation in the United States, when it occurs, is credit inflation and is characterized by a rapid growth of bank credit and a rapid turnover of this credit. There certainly has been no evidence of such a development during the past year. Bank credit declined rapidly from the autumn of 1930 to mid-summer of 1932 and has shown only a moderate advance since that time. The turnover of credit has declined radically from 1929. In that year turnover at reporting member banks was at the rate of 45 times per year, and in the first nine months of 1932 it was at the rate of 19 times per year. There has obviously been no credit inflation.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Perhaps apprehensions about inflation are based on the open-market operations of the Federal reserve banks. It is true that a purchase of a billion dollars of Government securities by the Federal reserve banks might have been highly inflationary in other circumstances, because it would have placed at the disposal of member banks a billion of reserves on the basis of which they could have erected an additional credit structure of ten to fifteen billion dollars. But in existing circumstances the purchases by the reserve banks have been absorbed by gold exports and currency hoarding, so that they have merely enabled the banks to meet these drains without accelerating the liquidation of their own credit. In addition, the purchases have enabled the banks to pay off a considerable volume of their indebtedness to the reserve banks. Member bank reserve balances, which are the foundation of credit expansion in this country, were at a low point at the beginning of July, 1932, showing clearly that security purchases by the reserve banks had not up to that time enlarged the credit base. Since then there have been few securities bought, but member bank balances have increased through gold imports and through return flow of currency.

At the present time member banks have $400,000,000 of excess reserves which could become a basis of credit inflation. But if such inflation developed the Federal reserve banks are in a position quickly to reduce the credit base by the sale of Government securities. This reflects an important difference between direct borrowing by the Government from the central bank and purchases by the bank of Government securities previously issued in the open market. The reserve banks are in a position to sell their Government securities, whereas central banks which make loans to the Government are not in a position to liquidate those loans when they so desire.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Some observers have seen danger of inflation in the activities of the Reconstruction Finance Corporation. The corporation, however, does not create new funds and, therefore, does not expand the credit base. It simply directs funds into channels where they would be most serviceable. To be sure it has been financed by the Treasury, but that in itself does not change the situation, as the Treasury had to obtain its funds through the flotation of securities.

One final observation. Inflation does not start in a depression. It makes its appearance when a boom is under way and its danger lies in the fact that it contributes to the rapidity of expansion and to the volume of speculative activity.

To summarize, therefore, currency inflation does not develop in this country because of the minor place that currency occupies in the aggregate of our payments. The volume of currency has fluctuated in response to economic conditions and to the changes in the demand for hoarding. No currency has been forced on the people and under our currency machinery cannot be so forced. The provision authorizing the reserve banks to use Government securities as collateral for Federal reserve notes is a technical device freeing the system's gold above the 40 per cent requirement, and not a device by which to finance a Treasury deficit through the issue of currency. Neither is there evidence of credit inflation, as bank credit has expanded little in volume and continues to have a low rate of turnover. Open-market operations of the reserve banks until three months ago merely helped the banks to meet gold and currency drains without accelerating the rate of credit liquidation. During the last three months excess reserves have been built up by increases

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

in gold stock and return flow of currency. Inflation on the basis of these reserves would be possible, but the reserve banks are in a position to absorb the excess reserves at any time through the sale of securities. And finally, inflation does not begin at the trough of a depression, but develops during a boom which becomes accelerated as a result.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

October 21, 1932

When Europeans speak of inflation in this country they base their statements on memories of currency inflation which occurred throughout Europe during the war and post-war period. This kind of inflation rests on two fundamental conditions: (1) the use of currency by the public for a considerable proportion of its payments, and (2) long-continued inability of the Government to meet expenses through taxation, and a consequent issuance of paper money in unlimited amount either directly by the Government or by the central bank on the basis of direct borrowing from it by the Government.

These conditions do not exist in this country. Currency in the United States is distinctly a minor element in the total volume of payments. Probably no more than one-twentieth of all payments are made by the use of cash. The volume of currency in the country fluctuates in normal times entirely in response to the demand of the public for cash to be used in retail trade and for payroll purposes. Since the autumn of 1930 a considerable amount of cash has also been withdrawn for hoarding. The only way through which the inflationary process could get under way is through retail purchases, and before that took place there would have to be a fundamental change in the habits of the people. People will not carry more cash in their pockets than is their habit. Storekeepers will deposit with banks the cash they do not currently require, and the banks will turn in cash in excess of till money requirements to the reserve banks and thus retire it. The first condition for currency inflation, therefore, the cash-using habit of the people, is absent in this country.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Inflation

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date October 21, 1932

To Governor Meyer

Subject:

From Mr. Goldenweiser

GPO 2—8495

Attached is a draft of a statement on inflation.

OCT 21 1932

OFFICE OF THE GOVERNOR
FEDERAL RESERVE BOARD

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

October 21, 1932

When Europeans speak of inflation in this country they base their statements on memories of currency inflation which occurred throughout Europe during the war and post-war period. This kind of inflation rests on two fundamental conditions: (1) the use of currency by the public for a considerable proportion of its payments, and (2) long-continued inability of the Government to meet expenses through taxation, and a consequent issuance of paper money in unlimited amount either directly by the Government or by the central bank on the basis of direct borrowing from it by the Government.

These conditions do not exist in this country. Currency in the United States is distinctly a minor element in the total volume of payments. Probably no more than one-twentieth of all payments are made by the use of cash. The volume of currency in the country fluctuates in normal times entirely in response to the demand of the public for cash to be used in retail trade and for payroll purposes. Since the autumn of 1930 a considerable amount of cash has also been withdrawn for hoarding. The only way through which the inflationary process could get under way is through retail purchases, and before that took place there would have to be a fundamental change in the habits of the people. People will not carry more cash in their pockets than is their habit. Storekeepers will deposit with banks the cash they do not currently require, and the banks will turn in cash in excess of till money requirements to the reserve banks and thus retire it. The first condition for currency inflation, therefore, the cash-using habit of the people, is absent in this country.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

In the second place, there has been no attempt by the Government to issue currency for the purpose of meeting a deficit. In fact, currency has been issued by the reserve banks in response to applications from commercial banks, which in turn have merely transmitted to the reserve banks the demands of their customers for cash either for trade purposes or for hoarding.

Currency issues by national banks under the recent extension of the circulation privilege to a large volume of Government bonds have amounted to something over $100,000,000 of notes, but these new issues have merely displaced other kinds of currency in circulation and have not increased the total. The total volume of currency, in fact, has been declining rapidly since the privilege was granted to the national banks, largely in response to improvement in banking conditions, increased confidence in banks, and the consequent return flow of currency from hoards. The Government itself has issued no currency over and above the amounts which have been constant for many years, and the Federal reserve banks have issued Federal reserve notes only in response to the demands already discussed.

The passage of the Glass-Steagall Act, which for one year permitted the use of Government securities as collateral for Federal reserve notes, has no doubt appeared to foreigners as a means by which currency can be issued for the purpose of meeting Government deficits. Theoretically this power does exist. The Government could sell securities to the reserve banks and the reserve banks could pay for them with Federal reserve notes so long as they had 40 per cent in gold as reserves. But in the first

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

place, as outlined above, currency is not the means used in this country to make large payments and the Treasury pays its bills by check and not in cash. And in the second place, as a matter of fact, the Federal reserve banks have not issued any additional notes since the passage of the Glass-Steagall Act, except during the period when currency was being demanded for hoarding purposes. The Glass-Steagall Act, whatever its theoretical implications may be, has in practice been a means by which the Federal reserve banks were able to transfer assets to the Federal reserve agent and thereby release gold which thus became available for other purposes.

The record is conclusive that there is no currency inflation in this country. Currency expanded to meet demands for hoarding and has contracted since confidence in the banks has been restored. During a currency inflation currency remains in circulation and does not go into hoards. An invariable characteristic of currency inflation, in fact, is a rapid turnover of currency. In this country the turnover of currency has been extraordinarily slow as the result of business inactivity and hoarding.

Inflation in the United States, when it occurs, is credit inflation and is characterized by a rapid growth of bank credit and a rapid turnover of this credit. There certainly has been no evidence of such a development during the past year. Bank credit declined rapidly from the autumn of 1930 to mid-summer of 1932 and has shown only a moderate advance since that time. The turnover of credit has declined radically from 1929. In that year turnover at reporting member banks was at the rate of 45 times per year, and in the first nine months of 1932 it was at the rate of 19 times per year. There has obviously been no credit inflation.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Perhaps apprehensions about inflation are based on the open-market operations of the Federal reserve banks. It is true that a purchase of a billion dollars of Government securities by the Federal reserve banks might have been highly inflationary in other circumstances, because it would have placed at the disposal of member banks a billion of reserves on the basis of which they could have erected an additional credit structure of ten to fifteen billion dollars. But in existing circumstances the purchases by the reserve banks have been absorbed by gold exports and currency hoarding, so that they have merely enabled the banks to meet these drains without accelerating the liquidation of their own credit. In addition, the purchases have enabled the banks to pay off a considerable volume of their indebtedness to the reserve banks. Member bank reserve balances, which are the foundation of credit expansion in this country, were at a low point at the beginning of July, 1932, showing clearly that security purchases by the reserve banks had not up to that time enlarged the credit base. Since then there have been few securities bought, but member bank balances have increased through gold imports and through return flow of currency.

At the present time member banks have $400,000,000 of excess reserves which could become a basis of credit inflation. But if such inflation developed the Federal reserve banks are in a position quickly to reduce the credit base by the sale of Government securities. This reflects an important difference between direct borrowing by the Government from the central bank and purchases by the bank of Government securities previously issued in the open market. The reserve banks are in a position to sell their Government securities, whereas central banks which make loans to the Government are not in a position to liquidate those loans when they so desire.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Some observers have seen danger of inflation in the activities of the Reconstruction Finance Corporation. The corporation, however, does not create new funds and, therefore, does not expand the credit base. It simply directs funds into channels where they would be most serviceable. To be sure it has been financed by the Treasury, but that in itself does not change the situation, as the Treasury had to obtain its funds through the flotation of securities.

One final observation. Inflation does not start in a depression. It makes its appearance when a boom is under way and its danger lies in the fact that it contributes to the rapidity of expansion and to the volume of speculative activity.

To summarize, therefore, currency inflation does not develop in this country because of the minor place that currency occupies in the aggregate of our payments. The volume of currency has fluctuated in response to economic conditions and to the changes in the demand for hoarding. No currency has been forced on the people and under our currency machinery cannot be so forced. The provision authorizing the reserve banks to use Government securities as collateral for Federal reserve notes is a technical device freeing the system's gold above the 40 per cent requirement, and not a device by which to finance a Treasury deficit through the issue of currency. Neither is there evidence of credit inflation, as bank credit has expanded little in volume and continues to have a low rate of turnover. Open-market operations of the reserve banks until three months ago merely helped the banks to meet gold and currency drains without accelerating the rate of credit liquidation. During the last three months excess reserves have been built up by increases

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

in gold stock and return flow of currency. Inflation on the basis of these reserves would be possible, but the reserve banks are in a position to absorb the excess reserves at any time through the sale of securities. And finally, inflation does not begin at the trough of a depression, but develops during a boom which becomes accelerated as a result.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Winfield Riefler

MEMBER BANK RESERVE REQUIREMENTS

An Examination of the Criticisms made by Dr. Benjamin Anderson

on the Report of the Committee on Bank Reserves

October 1932

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

October 1932

MEMBER BANK RESERVE REQUIREMENTS

An Examination of the Criticisms made by Dr. Benjamin Anderson on the Report of the Committee on Bank Reserves

In November 1931, the Federal Reserve Board released for publication a series of recommendations looking toward thoroughgoing revision in the legal reserve requirements of member banks. These recommendations were formulated by a committee composed of officials of the Federal reserve banks and the Federal Reserve Board, known as the Committee on Bank Reserves of the Federal Reserve System, and were adopted by that committee after a searching investigation into the functioning of present reserve requirements and the relation of these requirements to the overexpansion of credit in the securities markets which facilitated the stock market boom that culminated in 1929. At the time these recommendations were released to the public in the late fall of 1931, the Federal Reserve Board took no position on the advisability of the reserve requirements proposed. Subsequently, however, the Federal Reserve Board unanimously recommended to the Banking and Currency Committee of the Senate that the proposals advanced by the Federal Reserve System Committee on Bank Reserves be enacted into law with certain minor modifications.

Summary of Committee recommendations

The recommendations of the Committee on Bank Reserves are summarized in its report as follows:

"In the opinion of the Committee, our present system of legal requirements for member bank reserves has never functioned effectively since its inception

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

in 1914. It has not operated to relate the expansion of member bank credit to the needs of trade and industry, nor has it adequately reflected changes in the volume and activity of member bank credit. Furthermore, the Committee also finds that present requirements for reserves are inequitable and unfair as between individual member banks and groups of member banks and do not adequately take into account genuine differences in the character of banking in which a member bank may be engaged.

"The Committee takes the position that it is no longer the primary function of legal reserve requirements to assure or preserve the liquidity of the individual member bank. The maintenance of liquidity is necessarily the responsibility of bank management and is achieved by the individual bank when an adequate proportion of its portfolio consists of assets that can be readily converted into cash. Since the establishment of the Federal reserve system, the liquidity of an individual bank is more adequately safeguarded by the presence of the Federal reserve banks, which were organized for the purpose, among others, of increasing the liquidity of member banks by providing for the rediscount of their eligible paper, than by the possession of legal reserves. The two main functions of legal requirements for member bank reserves under our present banking structure are, first, to operate in the direction of sound credit conditions by exerting an influence on changes in the volume of bank credit, and, secondly, to provide the Federal reserve banks with sufficient resources to enable them to pursue an effective banking and credit policy. Since the volume of member bank credit needed to meet the legitimate needs of trade and industry depends on the rate at which credit is being used as well as on its aggregate amount, it is essential for the exercise of a sound control that legal requirements differentiate in operation between highly active deposits and deposits of a less active character. Requirements for reserves should also be equitable in their incidence, simple in administration, and, so far as possible, not susceptible of abuse.

"Similar principles underlie the present reserve law, which in requiring lower reserves against time deposits than against demand deposits, and lower reserves against the demand deposits of country banks than against the demand deposits of reserve and central reserve city banks may have been expected to impose higher reserves on more active deposits than on less

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

active deposits. Notwithstanding the fact, however, that existing requirements would appear to be so arranged as to make reserve requirements vary with the volume and activity of deposits, experience shows that since 1914 and especially since 1922 the proportion of primary reserves held by member banks has steadily declined in relation to the volume of member bank deposits and to their activity.

"This outcome has been the result of defects in the definition of reserves, in the method of determining liabilities against which reserves must be carried, and in the classification of banks and of deposits for reserve purposes. The exclusion of vault cash from required reserves of member banks in 1917 has been followed by a reduction in the vault cash holdings of some city banks to a minimum; the rule that amounts due from banks may be deducted only from amounts due to banks has tended to decrease reserves in times of business activity and to increase reserves in times of depression, and the establishment of a low reserve against time deposits in 1914 has facilitated the growth of bank credit without a corresponding growth in reserves. Even if these particular defects in the present system of reserves had not existed, however, the rapid increase in the turnover of demand deposits which has occurred in recent years would still have tended to prevent reserve requirements from increasing in proportion to the growth in the effective use of credit by the customers of member banks.

"Before deciding to recommend fundamental changes looking toward the establishment of a new basis for calculating required reserves, the Committee made every effort to frame provisions designed to correct the existing situation through modifications in the classification of cities for reserve purposes and in the classification of deposits subject to reserve, including a more stringent definition of time deposits. As these proposals were studied, however, it became more and more evident that they would not be effective and that an entirely new approach to the reserve problem was necessary.

"The Committee proposes, consequently, to abolish completely the classification of deposits into time and demand deposits, and the classification of member banks according to their location, into central reserve city banks, reserve city banks, and country banks. Instead, the Committee recommends that all member banks and all deposits be treated alike for reserve purposes, and that the formula used in calculating reserve requirements

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

take into account directly, instead of indirectly as in the existing law, the activity as well as the volume of the deposits held by each individual member bank, without regard to the location of the bank or the terms of withdrawal on which the deposits are technically held. To accomplish this, the Committee proposes that each member bank be required to hold a reserve equivalent to (a) 5 per cent of its total net deposits, plus (b) 50 per cent of the average daily withdrawals actually made from all of its deposit accounts. These withdrawals, which are shown by debit entries on the books of member banks, are the only real test of the activity of a deposit account and furnish the only basis by which that activity can be equitably and effectively reflected in requirements for reserves. Under this proposal, therefore, each deposit will carry a total reserve based on its activity as well as on its amount. A totally inactive deposit will carry a total reserve of only 5 per cent, while a deposit balance which is checked out on the average once a week will carry a total reserve equivalent to 12 per cent of its amount. For the average member bank the total reserve under the proposed formula will be equivalent to about 8 per cent of its deposits. To prevent this formula from imposing too great a burden in extreme cases, the recommendations of the Committee also provide that in no case shall the aggregate reserve required of a bank exceed 15 per cent of its gross deposits.

"The Committee proposes to include in legal reserves, in addition to the funds which member banks have on deposit with their Federal reserve banks, their vault cash, with certain limitations, as both classes of funds contribute to the strength of the reserve banks and have a direct effect on the reserve system's control of changes in member bank credit. It proposes also to place country member banks on a parity with city banks with respect to deductions from deposit accounts by permitting banks in calculating net deposits subject to reserve to deduct balances due from member banks and items in process of collection from total deposits instead of from balances due to banks alone, as is the practice at present.

"The Committee feels that the existing volume of reserves is sufficient at the present time to provide the reserve banks with the funds they require to perform their functions. Its proposals, consequently, do not contemplate a change in the total amount of reserves. They are intended rather to change the nature of fluctuations in the volume of reserves and to iron out inequitable features in their distribution among the member banks."

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Reception of plan

Dr. Benjamin Anderson, economist of the Chase National Bank of New York City, has characterized the plan in the Chase Economic Bulletin for May 1932 as a thoroughly unsound and dangerous proposal, and has stated that it rests "on an unsound and arbitrary theory, and a very inadequate examination of the facts," and "that it is a dangerous and radical innovation." To support these charges Dr. Anderson formulated nine specific indictments of the plan proposed by the Committee on Bank Reserves, and in addition advanced his own plan for curing defects in member bank reserve requirements.

The Anderson plan for member bank reserves

According to the plan advocated by Dr. Anderson for correcting existing abuses in the functioning of member bank reserve requirements, each individual member bank would be permitted to maintain indefinitely a volume of time deposits equal to its existing time deposits and to hold a 3 per cent reserve against these deposits. All future increases in its deposits, however, would carry a demand deposit reserve of 7, 10, or 13 per cent according to the classification of the bank as a country, reserve city, or central reserve city member bank. Should a member bank's time deposits decline in the future, the level to which they decreased would constitute a new maximum of the volume of time deposits on which it could claim a 3 per cent reserve.

The chief advantage of this suggestion is that it would prevent further weakening in the reserve position of member banks arising out of the classification as time deposits, of deposits which are

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

essentially demand in character. It would be unsound, however, since it would use deposits as of an arbitrary date to determine the amount of reserves required. It would give some banks a low reserve on a large proportion of their deposits and other banks a high reserve on most of their deposits without reference to their actual future composition. At the same time, it would not correct in any way the present reserve advantages of those banks which have been most actively concerned with the abuses which have developed in connection with time deposits. In fact, those banks which are benefitting competitively today as a result of a false classification of deposits for reserve purposes would retain these competitive advantages indefinitely under the Anderson proposal.

In advancing this proposal, Dr. Anderson accepts the view of the Committee on Bank Reserves which associates the overexpansion of bank credit prior to 1929 with the progressive decline in the ratio of reserves to bank credit outstanding. His proposal for correcting the situation confines itself, however, solely to that phase of the problem which is related to the overexpansion of time deposits and does not touch in any way the decline in vault cash reserves which followed the 1917 amendment to the Federal Reserve Act, which eliminated member bank vault cash from required reserves. Following the enactment of this amendment, member banks have progressively decreased their holdings of vault cash. This decrease, the Committee on Bank Reserves showed, was fully as important in the overexpansion of bank credit prior to 1929 as the overexpansion which may be attributed to the 3

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

per cent reserve against time deposits. It was particularly marked, moreover, at the larger metropolitan banks which can obtain additional currency supplies quickly because they are located close to the Federal reserve banks, and thus tended to establish serious inequalities in the relative proportion of aggregate reserves carried by different individual banks. Nor does the Anderson plan correct in any way the other major defects in the existing system of reserves which were outlined in the report of the Committee on Bank Reserves, namely, the technical problem of defining what deposits are subject to reserve and what deductions may be permitted in arriving at the volume of net deposits subject to reserve requirements. The Committee showed that the present definitions of the items had operated not only against sound credit conditions by tending to increase required reserves when business is inactive and to decrease reserves in times of increasing business activity, but also to the advantage of the large city correspondent banks which competed actively for the balances of other banks. In short, the merit in the Anderson proposal arises solely out of the fact that it would prevent future overexpansion of bank credit arising out of a false classification of time deposits. In accomplishing this end, however, it would preserve all the competitive advantages which individual member banks have achieved in the past by permitting deposits of a demand character to be classified as time deposits. It would not correct the tendency for effective reserves to be further reduced by further economies in vault cash nor would it eliminate the tendency for reserve requirements insofar as they are affected by the definition of net deposits subject to reserve, to fluctuate in an

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

opposite direction to that required for the maintenance of sound credit conditions. Finally, it would not disturb in any way those conditions which since 1914 have gradually had the effect of creating an inequitable distribution in the volume of reserves carried in favor of the large metropolitan city banks and against the smaller outlying banks located at a considerable distance from the reserve banks.

NINE SPECIFIC CRITICISMS OF PLAN PROPOSED BY THE COMMITTEE ON BANK RESERVES

I Effect of Committee's proposal prior to 1928

In commenting on the plan proposed by the Committee on Bank Reserves under which all member banks would be required to carry reserves in cash or with the Federal reserve banks equivalent to 5 per cent of their net deposits and 50 per cent of their average daily debits to deposit accounts, Dr. Anderson makes the following criticism:

> "It is clear that the proposal would have imposed little restraint until 1928, by which time the vast expansion of net deposits was practically completed, and the substitution of real estate mortgages and stock market assets for commercial assets in the portfolio of banks was practically completed. Thus the plan would facilitate rather than retard bank expansion, up to the point where a dangerous boom was already under way."

In making this criticism, Dr. Anderson was misled by the fact that the chart published in the report of the Committee on Bank Reserves, which compared present requirements with those recommended by the Committee, showed that required reserves under the Committee's plan would have been higher than present requirements since 1928 and lower than present requirements prior to that time. From this fact, Dr. Anderson drew two erroneous conclusions: (1) that the Committee's plan would

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

not have exercised restraint prior to 1928, and, (2) that it would have facilitated bank credit expansion prior to that time. The fact is that in formulating its recommendations the Committee sought to impose requirements which at the time they were adopted would neither increase nor decrease greatly the existing aggregate volume of member bank reserves. This is on the same theory of letting bygones be bygones as that adopted by Dr. Anderson when he proposed that each bank be permitted to carry a 3 per cent reserve on its existing time deposits and that the higher reserve requirement be applied only to future increases in time deposits. Under conditions prevailing in 1931 a smooth transition was achieved in the Committee's plan by recommending a reserve of 5 per cent of total net deposits and 50 per cent of average daily debits to deposit accounts. Under conditions prevailing in 1924, on the other hand, it would have been necessary, in order to carry out this same principle, to recommend higher rates, say, 6 per cent of total net deposits and 60 per cent of average daily debits to deposit accounts, since between 1924 and 1931 the various defects in our present system of reserve requirements have in the aggregate permitted a material reduction in the ratio of member bank reserves to member bank liabilities. In view of this reduction, any comprehensive plan for the reform of reserve requirements which carried out this principle and did not, as in Dr. Anderson's plan, permit individual member banks to retain competitive advantages which arose out of loopholes in present reserve requirements, would be bound to show lower requirements on the basis of 1924 figures than actual requirements at that time. In other words, if the proposed requirements were such that they would increase more rapidly between

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

1924 and 1931 than present requirements and if they were applied with percentages that would bring about no material change in 1931 at the time of transition, the percentages recommended would of necessity show a smaller volume of reserves on the basis of 1924 figures than present requirements. For the very same reason, however, had the proposed plan been adopted in 1924 with percentages which would have involved no change in the aggregate volume of required reserves in that year, total reserves under that plan would have increased more rapidly thereafter than reserves under present requirements.

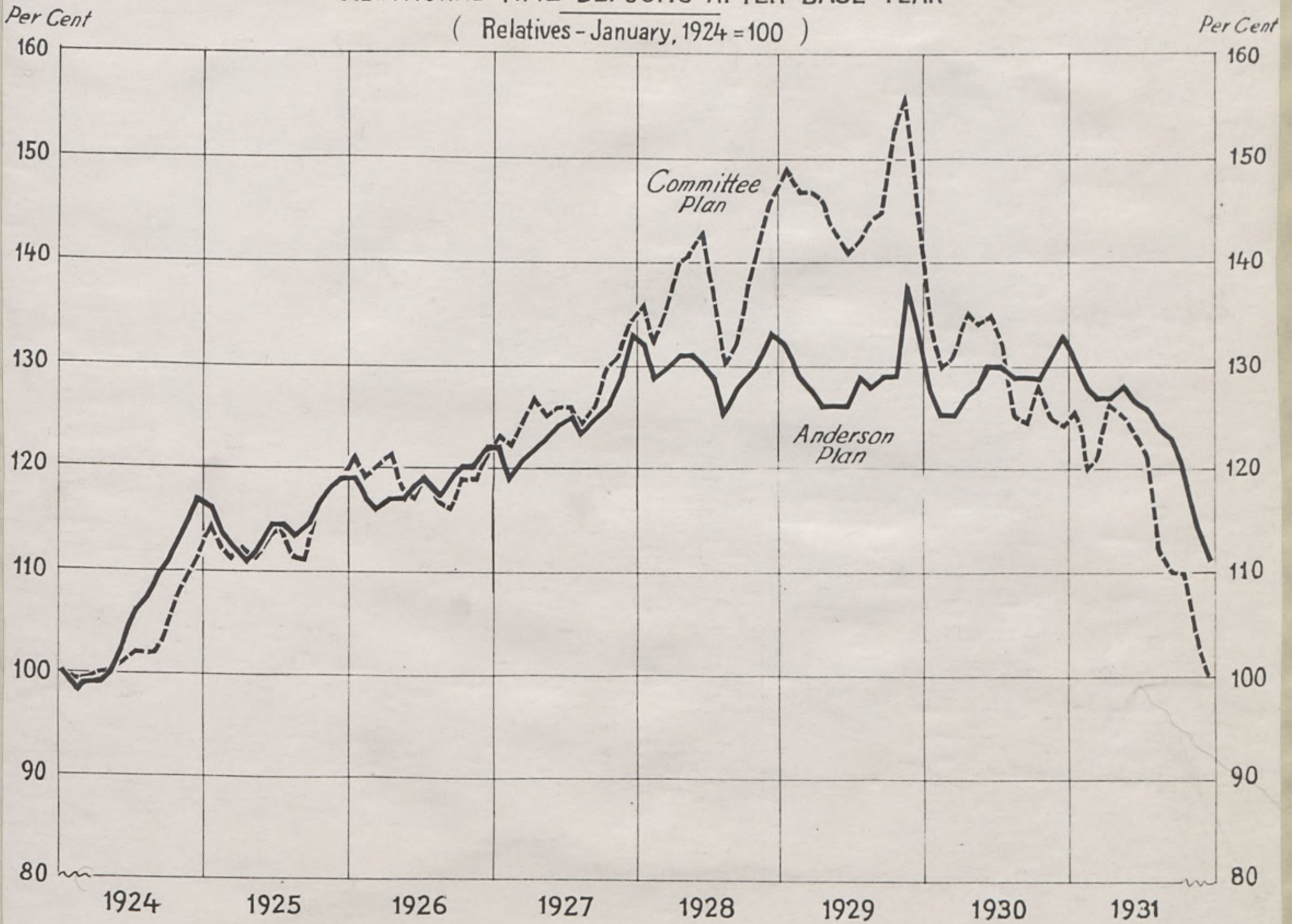
The extent of this increase is indicated on the attached chart where the plan of reserve requirements proposed by the Committee on Bank Reserves is compared with that proposed by Dr. Anderson.[1/] It is assumed in this comparison that both plans were placed in operation on a parity in January 1924, and both lines on the chart, consequently, are drawn in relatives with January 1924 equal to 100. This chart shows that required reserves under the Anderson plan would have increased more rapidly than under the plan proposed by the Committee on Bank Reserves during 1924 only, when there was a business recession and restraint was not needed, but that in 1925, 1926, and 1927, the Committee's proposal would have acted just as effectively to check overexpansion of credit as that proposed by Dr. Anderson. In 1928 and 1929, during the worst phases of the boom, the Anderson proposal would have exerted no additional pressure

---

1/ In this computation of Dr. Anderson's plan, funds deposited with member banks as time deposits in January 1924 are permitted to retain a 3 per cent reserve but all additional time deposits are required to maintain the same reserve as demand deposits.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

CHART I



Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

while that of the Committee on Bank Reserves would have applied increasing pressure on the credit situation until the boom was checked.

II Irregularity vs. activity as the true basis of reserves

The second criticism of Dr. Anderson attacks a major premise underlying the Committee's recommendations, namely, that the activity of a deposit account as well as its volume should be taken into consideration in determining the amount of reserve which it should carry, as follows:

> "Activity of accounts is not a sound criterion for bank reserves; irregularity is much more significant. The country bank with a large time deposit from a corporation in another city may be subject to a constant menace, even though the deposit remains inactive for months or years. A city bank with high daily activity, with well understood accounts of customers who regularly balance their books at the end of the day, and whose income and outgo match within a few hundred dollars on a daily volume which may run into millions, does not need to keep a large reserve against this turnover. Inactive deposits of state, county and other public money have again and again made difficulties for small banks. Furthermore, when activity waxes and wanes, both as to incoming and outgoing funds, keeping a close balance between them, it imposes no justification for increased reserves. The true theory of reserves relates them to (a) liquidity of other assets, and (b) irregularity in net demand liabilities, and (c) to variability in customers' borrowing demands. It may be added that activity of deposits is usually a concomitant of liquidity of assets. To the extent that assets other than reserves are liquid, a bank needs less reserves."

In this criticism of the Committee's recommendations, Dr. Anderson has failed to distinguish between primary and secondary reserves. In the paragraph cited, Dr. Anderson states admirably and concisely the principles that should govern a bank in determining the volume of its secondary reserves, i.e. the volume of funds it has invested in assets that may be readily converted into cash to meet withdrawals. This

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

volume must be determined by each bank on the basis of an analysis of its accounts in terms of their irregularity, i.é. their likelihood of withdrawal, and is naturally affected by the liquidity of its other assets. Secondary reserves, however, are not primary reserves and failure to distinguish properly between the two may become a menace to the preservation of sound credit conditions.

Secondary reserves are invested funds and place no limit on the potential capacity of bank credit as a whole to expand indefinitely. It is the function of primary reserves, on the other hand, to safeguard the credit structure against such overexpansion of its liabilities. Primary reserves consist of cash or balances with the Federal reserve banks, both of which are closely related to gold in that they are covered to a considerable percentage of their face value by gold. If primary reserves are maintained in proportion to the volume and use of credit instruments that are substitutes for cash, they limit the tendency of banks to overexpand these instruments in periods of boom conditions and tend to ease credit in periods of depression.

Confusion between these two types of reserves inevitably leads to banking disorders. A banking system which held no primary reserves but invested all its assets in secondary reserves instead would not thereby assure its ability to meet withdrawals on demand, since this very process would remove all reserve limitations on the potential capacity of credit to expand and would tend to inflate the credit structure to the point where even the soundest secondary reserves would become unliquid when attempts were made to realize upon them.

Conversely, primary reserves alone cannot perform the function of

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

secondary reserves in the maintenance of bank liquidity or in assuring the ability of a bank to meet withdrawals arising out of irregularity in its deposits. In the first place, primary reserves are not sufficiently large to perform this function. They constitute considerably less than ten per cent of the liabilities of our banks, the greater number of which normally experience much larger fluctuations than this in their accounts. No plan for primary reserves which established requirements sufficient to protect a bank against irregularity of withdrawals could be seriously proposed if the amount of primary reserves involved in such a proposal were once computed. Dr. Anderson, himself, in company with other students of the problem, has condemned the reserve provision in the original Glass bill, which added $660,000,000 to the primary reserves of member banks in the course of the next five years, on the ground that it would force far too great a liquidation of member bank credit. A primary reserve requirement, however, which protected individual banks against irregularity in their deposits, and which enabled them to meet the constant shifting of deposits from bank to bank that accompanies the normal processes of trade and industry, would involve an increase in primary reserves by a far greater amount than $660,000,000, and would exert an influence toward liquidation of far greater magnitude.

In the second place, the attempt to substitute primary for secondary reserves has always had serious repercussions when it has been tried in this country. Prior to the establishment of the Federal reserve system, national banks outside the central reserve cities were required to hold a certain proportion of their reserves in cash, i.e. as primary reserves, while, for the remainder of their requirements, they were permitted to

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

utilize either cash or secondary reserves in the form of balances with their city correspondent banks. When, in times of strained credit conditions, these banks exercised their legal right to hold the whole of their legally required reserves in cash, the ensuing drain of cash from correspondent banks to interior banks tended always to create a money panic.

Irregularity of deposits constitutes a major factor in the determination of a bank's policy with regard to secondary reserves, but is not, and cannot be made, a determining factor with regard to primary reserves. To adopt the principle that legal requirements for primary reserves should be based upon irregularity of withdrawals would not only involve drastic credit liquidation because of the huge amount of primary reserves required. It would at the same time unduly favor large banking units and ultimately open the door for a wider and more far-reaching decline in the future ratio of primary reserves to credit in use than that which accompanied and facilitated the disastrous boom which culminated in 1929. This would come about, because irregularity of deposit accounts reflects in part the unit size of business organizations. It is not possible for the isolated small industrial organization to achieve the same regularity in its accounts as the huge vertical combine which exercises control over the fabrication process from the extraction of its raw materials to their final sale to the consumer. Similarly, the small independent unit bank experiences greater irregularity in net withdrawals or outpayments than large unit banks or the huge consolidated branch banking system in which a large proportion of checks drawn are paid over to other customers of the same institution and involve no net outpayment

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

of funds by the bank. Theoretically, if a single bank with its branches conducted the banking business of the entire country, there would be no net bank withdrawals arising out of internal trade. While such a condition is conceivable only in theory, nevertheless, there has taken place in recent years a marked trend toward the integration and consolidation of both industrial and banking units in this country and this trend may continue to characterize the future. Should Dr. Anderson's principle of irregularity be adopted as the basis for determining legal requirements for bank reserves, it would favor large institutions as compared with small and a continuation of the present trend toward banking integration would in and of itself act as a generative force toward a tremendous credit inflation since a decrease in irregularity arising out of integration of corporate units would constitute an apparently valid reason for a reduction in primary reserve requirements.

To adopt the principle of irregularity, furthermore, would, as Dr. Anderson implies, justify higher required reserves against savings deposits which though inactive may occasionally be withdrawn in substantial amounts, than against highly active accounts which maintain a stable net balance, no matter how large the volume of business transacted through such accounts might be. This would divorce variations in reserve even further from variations in business conditions. It would even lead to the conclusion that no reserves should be required against brokers' balances, for brokers' accounts typify probably as well as any those deposit balances described by Dr. Anderson as accounts of customers "who regularly balance their books at the end of the day, and whose income and outgo match within a few hundred dollars on a daily volume which may run into

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

millions." Finally, irregularity cannot be objectively determined. There is no workable formula by which variations in the regularity of deposits can be legislated into corresponding and adequate variations in reserves.

Irregularity as a criterion for reserves, therefore, relates to sound banking procedure with respect to secondary reserves but cannot be used as a guiding principle in the formulation of legal requirements for primary reserves. Dr. Anderson's own plan for reserve requirements, namely, that each member bank should maintain existing reserves on its existing deposits but that future increases in all deposits, both demand and time, should carry a primary reserve equivalent to 13, 10, or 7 per cent according to its location in member banks classified as central reserve city banks, reserve city banks, or country banks does not contain any specific proposal that applies the principle that "the true theory of reserves relates them to (a) liquidity of other assets, (b) irregularity in net demand liabilities, and (c) variability in customers' borrowing demands."

III Reserve requirements in relation to credit policy

In his third criticism, Dr. Anderson admits there may be some merit in the Committee's proposal, but objects that reserve requirements cannot be relied upon to replace discount and open-market operations in restraining a boom.

> "It is sometimes, not always, true that reserve requirements based on activity would constitute a brake in the final stages of a period of speculation. But the traditional method of increasing discount rates and selling securities would be a safer brake, and one that could be applied much earlier. The reserve requirement plan would not be subject to the use of judgment, and might easily be too drastic. It might, on the other hand, be inadequate, through the markets finding ways to reduce turnover."

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

This paragraph reads into the report of the Committee on Bank Reserves implications which are not there. The Committee advanced no proposals for abolishing or limiting the freedom of action of the reserve banks with respect either to discount rate changes or to open-market operations. The Committee did point out that present reserve requirements frequently work to neutralize the effectiveness of discount and open-market operations. It also took the position that a correct system of reserve requirements should act in the same direction as an effective open-market and discount rate policy. There is nothing in the Committee's recommendations to imply, however, that the Committee regarded its plan as a substitute for changes in discount rates or for open-market operations.

IV Effect of Committee plan during a panic

The fourth criticism of Dr. Anderson's relates to the effect of the Committee's plan on bank reserves during the culminating period of a boom and the commencement of a business decline:

> ". . . . . activity of deposits usually reaches its very peak in a panic. When speculation has once collapsed, it becomes definitely dangerous that reserve requirements should be suddenly and sharply raised in a period of panic and liquidation. The chart on page 19 of the Federal reserve memorandum shows that its requirements would have been highest in the midst of the panic of 1929, when every effort was being made by the Federal reserve system to relax the tension."

It is true that the activity of deposits increased very sharply to peak levels during the initial stages of the decline in 1929 and that this activity would have tended to increase reserve requirements under

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

the Committee's plan at that time. Dr. Anderson neglects to state, however, that the same chart to which he refers shows that bank reserves under present requirements also increased sharply, due to the sudden depositing with banks of a huge volume of funds which had previously been loaned by others than banks in the call loan market. This increase in deposits as well as the increase in activity was an import factor in the increase in reserves under the Committee plan shown on the chart and the same increase would have occurred under the plan of reserve requirements which he, himself, advocates. (See Chart I) The increase under the Committee's plan during this period would have differed in only one important respect from present requirements or from requirements under the Anderson plan. Under present requirements and under the Anderson plan, the increase in reserve requirements during the market break at the end of October 1929 came suddenly, almost overnight, and the Federal Reserve Bank of New York was forced to buy open-market securities hurriedly in order to prevent tension in the money market. Had the Committee's plan for member bank reserves been in operation, however, the increase in requirements due to increased activity would have been averaged over the following eight weeks, and part, at least, of these same open-market operations could have been planned for in advance. One of the merits of the Committee's plan is that it would permit the Federal reserve system to prepare itself to offset the effect of sudden and drastic shifts in credit conditions such as those which occurred during the autumn of 1929.

V Effect of Committee's proposal at year-end settlements

Dr. Anderson next criticizes the effect of the Committee's plan on year-end settlements:

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

"The new plan, furthermore, would increase the tension in the money market at the year-end settlement periods. The curve on page 19 of the Federal reserve memorandum shows how reserve requirements under the new plan rise more sharply at the year-end than under the existing law, and how the new plan would prolong the tension by carrying it over into the new year."

In making this criticism, Dr. Anderson misreads the chart to which he refers and neglects to take into account the importance of seasonal changes in currency demand at the year-end. The following table compares the increase in member bank reserves between November and December of each year under present requirements and under the Committee's plan, as shown by the figures from which the chart to which he refers was prepared. It indicates that the year-end increase in reserves shown on the chart was usually smaller under the Committee plan than under the present plan.

ESTIMATED CHANGES IN MEMBER BANK RESERVES (INCLUDING VAULT CASH)
BETWEEN NOVEMBER AND DECEMBER 1924-1930

(Millions of dollars)

	1924	1925	1926	1927	1928	1929	1930
Under present requirements	+ 61	+ 33	+ 37	+ 82	+ 75	- 89	+ 63
Under the Committee plan	+ 57	+ 13	+ 43	+ 66	+ 86	-257	- 26

Tension in the money market, however, during December reflects only in minor part the effect of year-end settlements, the major factor being the high seasonal level of currency demand which accompanies the holiday season. Currency normally goes out from the banks into circulation in huge volume from Thanksgiving to Christmas, and brings heavy pressure on

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

the money market in the process. Between Christmas and New Year's Day some of this currency returns but is offset in its effect upon the money market by a sharp increase in bank reserves due to year-end settlements, window dressing for the year-end call of the Comptroller, etc. During January the whole situation changes; open-market money rates decline and tension is followed by seasonal slack in the money market as currency returns from circulation and the year-end pressure on bank reserves is relieved.

The Committee on Bank Reserves consciously and definitely took this succession of factors into consideration in framing the technical phases of its recommendations. By recommending that the reserve against activity of deposit accounts be calculated on the basis of average daily debits during the preceding eight weeks, it provided a plan in which the high activity of deposit accounts during December would not be reflected wholly in December requirements for bank reserves, when currency pressure was also high, but would be passed on in part into January when the return flow of currency from circulation normally creates a short period of "sloppy" money conditions. The fact, therefore, that member bank reserve requirements would be somewhat higher in January than in December under the Committee plan does not mean, as Dr. Anderson states, that the year-end tension would be prolonged into January. Instead, it means that the Committee devised a plan by which some of the effect of the year-end pressure from bank reserves would be removed from December when the banks are also under pressure to provide currency for circulation, and shifted to January when the return of currency is more than ample to offset its effects.

VI Effect of Committee plan on agricultural banks during marketing season

In his sixth criticism, Dr. Anderson analyzes the effect of the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Committee's proposal on agricultural banks during the period of agricultural marketing:

> "More important are the longer settlement periods in agricultural regions. Banks there show little activity through the greater part of the year, with sudden spurts when crops are being sold and farmers are paying their debts. This period ought not to be complicated by a sharp increase in reserve requirements. The fact that the Federal reserve plan proposes to base reserve requirements on an eight weeks' average of activity might soften the difficulties regarding year-end settlements and very short and sharp periods of panic security liquidation, but not those of slower commercial crises, or of agricultural settlement periods. These periods often run for four months, and sometimes five months."

The implication of this paragraph that agricultural banks would find it difficult to meet increased reserve requirements during the summer and fall marketing season is quite contrary to the facts. Reserve requirements of typically agricultural banks would not fluctuate greatly because of activity under the Committee plan for the reason that the activity of country bank deposits is relatively low. To the extent that turnover increases required reserves would also increase, of course, but the total reserves required of these banks would fluctuate more with changes in their deposits than with changes in activity.

The period in which most agricultural banks are under greatest pressure is that which precedes the marketing season. It is during the spring that farmers are drawing down their cash and borrowing most heavily in order to purchase seed, fertilizer, and meet other expenses incidental to the production of crops. These demands put the agricultural banks under pressure at that time and cause them to liquidate secondary reserves and to borrow both at city correspondents and at the Federal reserve banks.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

During this period deposits decline and activity is low, and reserves under the Committee plan would be reduced. When crops are harvested and the marketing season arrives this pressure usually changes to one of increasing ease because farmers use the cash received from marketing their crops to pay off their loans and build up their deposits. The agricultural bank in turn uses these funds to retire its own borrowing and to increase its secondary reserves in the open market. In short, the period of crop marketing is customarily the period when an agricultural bank is in a favored position to hold increased reserves.

VII Effect of Committee plan on general credit conditions in 1919-1920

Dr. Anderson next criticizes the manner in which the Committee plan of bank reserves would have operated in 1919 and 1920, as follows:

> "Had the figures for 1919-20 been studied, I do not believe that the proposal would have been made. These figures show that velocity of bank deposits for the whole country outside New York City stood virtually as high in the seven-month crisis and liquidation period, June to December 1920, as they stood in the boom period preceding, August 1919 to May 1920, and well above the velocity of the more tranquil period that preceded the boom. The velocity index, obtained by dividing individual debits by deposits of reporting member banks, was as follows: February-April 1919, 191; August 1919-May 1920, 217; June 1920-December 1920, 213. Similar results are obtained by dividing clearings by deposits, the figures showing: February-April 1919, 170; August 1919-May 1920, 195; June 1920-December 1920, 189. Had the Federal reserve 'velocity' plan been in operation in the crisis, 1920, the difficulties of the banks outside New York City would have been greater than they actually were."

It is true that the activity of deposits at reporting member banks outside New York City decreased only slightly on the average during the months June-December 1920, as compared with the months August 1919-May

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

1920. It is equally true, however, that average net demand plus time deposits of these same banks for the same periods did not decrease at all. In fact, they increased by five per cent. It follows that required reserves under the Committee plan which takes into account the activity as well as the volume of deposits, would have been reduced somewhat after May 1920 because the activity of deposits decreased, while required reserves under the Anderson plan, which takes into account only the volume of deposits, would have been increased. In the following table, total reserves (including vault cash) of reporting member banks outside New York City are compared during 1919 and 1920 by semiannual periods, in terms of relatives with January-June 1919 equal to 100.

RESERVES INCLUDING VAULT CASH OF REPORTING MEMBER BANKS
OUTSIDE NEW YORK CITY

(Relatives for semiannual periods with January-June 1919 - 100)

	Present plan	Anderson plan	Committee plan
1919			
January-June	100	100	100
July-December	108	110	114
1920			
January-June	115	120	124
July-December	114	120	123

Of the three plans for reserves compared on this table, the one which is advocated by Dr. Anderson, himself, is the only one which would have failed completely to reduce reserve requirements at banks in leading cities outside New York after the culmination of the boom in 1920. Requirements under the present plan and under the Committee plan, on the other hand, both showed a slight reduction during this period, reflecting in the case of the present plan a reduction in demand deposits which was partly offset

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

by a growth of time deposits, and in the case of the Committee plan, a reduction in the velocity of deposits, which was partly offset by a growth in the volume of deposits.[2/] In the accompanying chart fluctuations in reserves for this group of banks under the Committee plan are compared with fluctuations under the Anderson plan for the three years 1919, 1920, and 1921. The chart shows clearly how much more effective the Committee plan would have been both in tightening credit conditions during the boom in 1919, and also in easing conditions during the depression and liquidation of 1921.

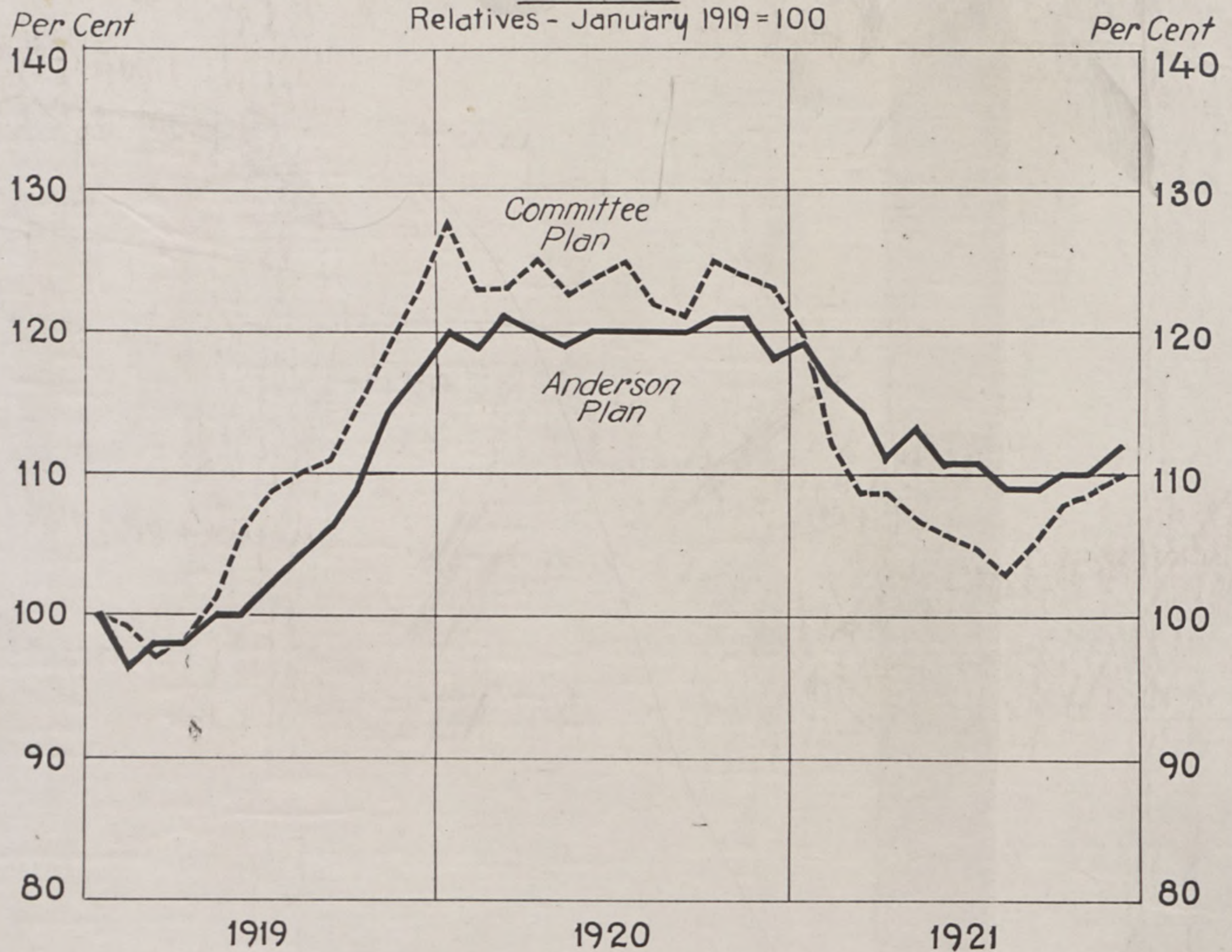
VIII Effect of Committee plan on individual cities--1919-1920

> "When individual cities and regions are studied, many are to be found where velocity during the crisis period was far higher than velocity during the preceding period of boom.
>
> "Comparing National bank deposits with debits to individual accounts, we find this to be true for Fort Worth, Texas, for Indianapolis, for Cedar Rapids, Iowa, for Wichita, Kansas, and for San Francisco. In all five of these cities, which are representative of a large number of others, reserve requirements would have been higher in the seven months of crisis and liquidation than in the preceding boom period."

2/ These figures are based on estimates of reserves required under the three plans. For these estimates, figures of net demand deposits, time deposits, U. S. Government deposits and vault cash are directly available from published figures for reporting member banks outside New York City. Average daily debits to individual account are estimated as equal to 88.7% of total reported debits outside New York City during that period, and debits to bank account of this group of banks as equal to 85% of debits to individual account. In the computation of reserves under the Anderson plan, funds deposited on time with member banks in January 1919 are permitted to retain a 3 per cent reserve but all additional time deposits are given the same reserve as demand deposits.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

CHART II



Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

"INDICES OF VELOCITY OF BANK DEPOSITS IN CERTAIN CITIES

	San Francisco	Cedar Rapids	Wichita	Fort Worth	Indianapolis
Pre-boom, March-May 1919	100	100	100	100	100
Boom, September 1919-February 1920	107.6	126.3	97.8	93.5	103.2
Crisis, June-December 1920	123.5	161.5	105.6	101.7	108.2 "

While reserves in some localities might have increased under the Committee plan, it is extremely doubtful whether the five cities cited by Dr. Anderson would have fallen into this category. Dr. Anderson computed his indices of velocity for these five cities by comparing the deposits of all national banks with debits for all clearing house banks within each city, thus introducing a strong possibility of error in the event that relative changes in deposits of national banks did not reflect changes in the deposits of all clearing house banks.

In the case of Indianapolis, Wichita, and Fort Worth, there were 27 national banks in these cities in 1919, of which four were not members of the Clearing House, according to Rand McNally. In 1920 there were 32 national banks in these cities, of which all but one were members of the Clearing House. At the same time, the number of non-national banks that were members of the clearing house in these cities increased from 11 in 1919 to 18 in 1920. The comparison in these cities is further complicated by the fact that they are all important livestock centers and the total debits which they report upon which Dr. Anderson has based his calculations include debits from stockyard banks which, as the Committee indicated in its report, are extremely high in relation to deposits. The high rate of turnover at these banks, however, would not necessarily be reflected in a

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

corresponding increase in reserves under the Committee plan since the reserve requirement of these banks might be limited by the provision recommended by the Committee fixing 15 per cent of gross deposits as the maximum reserve required of any individual bank, or by the provision subsequently recommended by the Federal Reserve Board which would permit member banks to ignore turnover on extremely active accounts provided they maintained a reserve of 50 per cent against the net balance in such accounts. In the case of San Francisco, the comparison is vitiated for the same reason. During 1920, furthermore, the Mercantile National Bank was merged with the Mercantile Trust Company, which at the same time was joined by the Savings Union Bank and Trust, a merger which had a tendency to decrease national bank deposits and to increase clearing house debits.

In the case of Cedar Rapids, Iowa, there may have been a real increase in deposit activity during 1920. In this city there were no shifts in national banks or in banks having clearing house membership to account for a very sharp increase in the volume of debits. The increase, however, is much more puzzling than is indicated by Dr. Anderson. Debits in Cedar Rapids averaged around $20,000,000 a month during the first five months of 1919, then suddenly doubled to around $40,000,000 a month, and continued to fluctuate seasonally and cyclically around this inflated level in the midst of the depression through all of 1921. During the first half of 1922, they returned to their previous level of around $20,000,000 a month and have moved in harmony with that level since that time. It is probable, consequently, that there is some special and particular reason which accounts for the sudden doubling of debits from their expected volume in Cedar Rapids from June 1919 to December 1921, and that this increase was

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

not, as is implied in the quotation, a typical aftermath of the boom.

It is one of the distinctive advantages of the Committee plan that it is highly responsive to business conditions. It is responsive moreover in a selective sense, increasing or decreasing only in those localities where the volume or activity of deposits is increasing or decreasing, and within those localities fluctuating at those banks whose customers are involved in the activity. While the ebb and flow of economic activity between boom and depression exhibits considerable similarity throughout the industrialized world, it is by no means uniform. It is a matter of common observation, for example, that during the present depression France for a long time appeared little affected, while during the depression of 1920-1921 certain important parts of South America were affected much later than the United States. It is highly probable that this same diversity might be found in some degree within the United States, that some areas might be found in which business continued to expand for a time after the peak of the boom had passed in the country as a whole, and that in these areas the activity or volume of deposits at that time were such as to require increased reserves under the Committee plan. It is one of the merits of the plan that it would act in this manner, for business and financial commitments in such a community, undertaken at a time when the rest of the world is heading into a depression, are particularly susceptible to disaster.

IX Effect of Committee plan in Florida

> "The Report of the Federal Reserve Committee on Bank Reserves (page 18) refers to the Florida real estate boom as occasioning increase in velocity of

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

deposits, in illustration of their contention that reserves based on velocity would operate as a brake on speculation. They give no figures. The fact is that the Florida figures offer a most powerful argument against their plan. The figures for Florida are as follows:

"INDEX OF VELOCITY OF BANK DEPOSITS IN FLORIDA

	Deposits (000,000)	Debits (1920-1924 = 100)	Index of velocity
1922 December 29	201.5	106	52.6
1923 April 3	238.3	110	46.2
June 30	230.8	106	45.9
September 14	216.0	89	41.2
December 31	243.8	122	50.0
1924 March 31	286.6	116	40.5
June 30	273.8	111	40.5
1925 April 18	472.2	176	37.3
June 30	530.2	197	37.2
September 28	682.4	226	33.1
December 31	788.8	293	37.1
1926 April 10	704.2	242	34.4
June 30	566.8	215	37.9
December 31	486.8	210	43.1
1927 March 23	456.3	198	43.4
June 30	425.4	159	37.4
October 10	383.3	141	36.8
December 31	385.9	160	41.5

"The Florida boom was active in 1923. It reached dangerous heights in the latter part of 1924, and fantastic heights in 1925. The frenzied buying of real estate suddenly ceased in the late autumn of 1925. The winter of 1925-1926 and the whole of 1926-1927 were a period of prostration and liquidation.

"The velocity of bank deposits, however, declined sharply from 1923 on through the whole of the boom. The point is that, while debits to deposits grew, deposits grew more rapidly than debits. The Florida banks during the boom, therefore, would have seen

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

> their required reserve percentages come down, and money would have been easier during the boom than it was. Velocity does not rise in the figures above until the period December 1926 to March 1927, something more than a year after the crash had come, at which time the surviving banks were under a cruel pressure and ought not to have been subject to any more."

To state that the Florida boom "suddenly ceased in the late autumn of 1925" and that "the winter of 1925-26 was a period of prostration and liquidation" over-simplifies a rather complex situation. The Florida boom was not concentrated in a single market such as the New York Stock Exchange where turning points can be located to the day, but extended over various parts of Florida and responded to some extent to varying local conditions. A more accurate statement would be that the pace of the boom began to slacken in the late fall of 1925 and that the episode on the whole was in process of liquidation by the spring of 1926. The full impact of Dr. Anderson's criticism, however, does not center around this point but around the figures which he presents as indicative of the velocity of deposits at Florida banks during these years.

To obtain this index of velocity, Dr. Anderson has divided an index of Florida debits compiled from debits reported by three cities only--Jacksonville, Pensacola, and Tampa--and representative of conditions, therefore, in these three cities alone, by deposits of banks, not in these three cities but in banks throughout the whole of Florida including both member and nonmember banks. The result is a series of figures having no statistical validity whatever since deposits for the State of Florida as a whole increased at a much more rapid rate up to 1926 than deposits in these three cities alone and declined thereafter at a much more rapid rate than deposits

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

in these cities.

It happens that the actual velocity of deposits for these three cities over the period cited can be computed with less probability of error than usual since practically all of the banks in these cities which report debits are member banks for which comparable deposit figures are available. In October 1931, in fact, a special study made by the Committee on Bank Reserves showed that member banks accounted for all of the debits reported in Pensacola, for 97.3 per cent of the debits reported in Jacksonville, and for 96.2 per cent of the debits reported in Tampa. If it is assumed that these banks accounted for the same proportion of total debits reported in earlier years, the turnover of individual deposits for the three cities can be computed for several dates during each year. The following table compares the actual turnover of individual bank deposits in these cities with the index computed by Dr. Anderson.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

INDEX OF VELOCITY[3/] FOR JACKSONVILLE, TAMPA, AND PENSACOLA COMBINED

(Relative average of 4 dates 1923 = 100)

Date	As computed by Dr. Anderson (converted to average 1923 basis)	As computed on basis of actual figures	Percentage of error in Dr. Anderson's figures after base period
1923 April 3	101	106	...
June 30	100	100	...
September 14	90	92	...
December 31	109	103	...
1924 March 31	88	106	- 17
June 30	88	97	- 9
1925 April 6	81	112	- 28
June 30	81	113	- 28
September 28	72	122	- 41
December 31	81	119	- 32
1926 April 2	75	106	- 29
June 30	83	99	- 16
December 31	94	103	- 9

This comparison shows (1) that the velocity of deposits in these three Florida cities did increase greatly with the boom, (2) that velocity reached its peak with the peak of the boom at the end of 1925, and (3) that velocity declined throughout 1926 as the boom subsided. It shows also that the error in Dr. Anderson's computation grew to 40 per cent at the critical period in the comparison. It is true that the Committee formula would not have caught all of this increase in velocity up to the autumn of 1925 nor all of the decrease thereafter, since debits first grew and subsequently declined so rapidly that average daily debits over an eight-week

3/ In these computations individual deposits as of call dates are divided into average daily individual debits for the four weeks preceding and the four weeks following the call date.

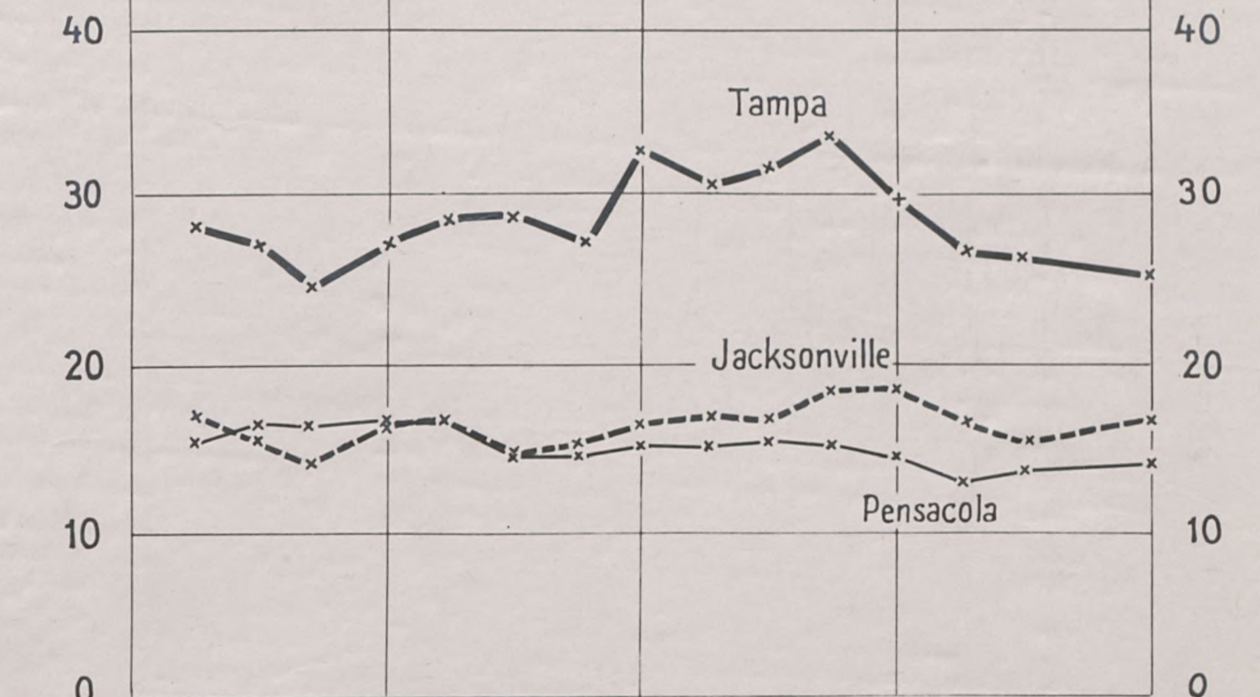
Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

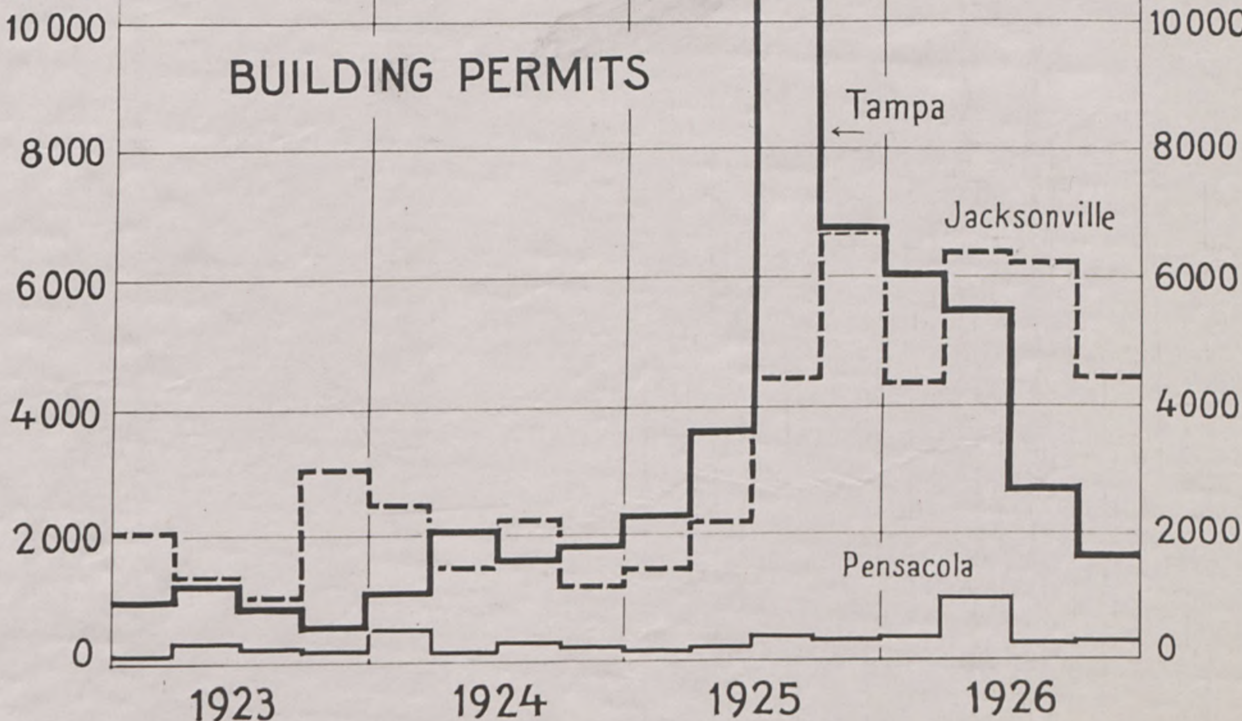
period did not adequately reflect the daily volume of debits at the end of the period. The Committee formula would have reflected a considerable part of this change, however.

These velocity figures continue to illustrate the advantages of the Committee plan when they are studied individually, by cities. The varying degree to which these cities were affected by the Florida boom is indicated roughly by the accompanying chart which compares changes in the velocity of deposits in each of these cities with changes in the dollar volume of building permits issued. The lower part of the chart indicates that of the three cities, Pensacola had only a small volume of building activity throughout the period, that Tampa was the center of the largest increase in building activity, and that the peak in building activity in Tampa fell in the latter part of 1925, whereas in Jacksonville building continued very high well into 1926. The upper part of the chart shows that these same developments were reflected in the activity of deposits, that the velocity of deposits was very much higher in Tampa where the boom was most pronounced than in Jacksonville or Pensacola, that velocity increased in Tampa through 1925 while building activity was increasing, and declined subsequently with the passing of the peak in building, that velocity fell less in 1926 in Jacksonville where building activity remained high than in Tampa where building activity declined, and that Pensacola, the city least affected by the boom, was the only city in which velocity decreased throughout the period. The different rates of turnover in the three cities also indicate the desirability of taking velocity into account. Under the Anderson plan all new deposits in Tampa, where velocity was highest, would carry a 7 per cent reserve, whereas such deposits in Jacksonville where

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

THREE FLORIDA CITIES





Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

velocity was materially lower would carry a 10 per cent reserve. Under the Committee plan average deposits in each city would carry a reserve corresponding to the average velocity in that city, and individual deposits of different customers in each bank would carry a reserve that corresponded with the velocity of the deposits.

Although Dr. Anderson's conclusion that the activity of deposits decreased sharply in Florida during the boom and increased thereafter was based upon erroneous calculations, there is no theoretical reason why this development might not have occurred. On the basis of past records, changes in the velocity of deposits have regularly corresponded with changes in business conditions, but it is not inconceivable from a theoretical point of view that a situation might arise in which credit expansion was extremely excessive and had as one result an increase in deposits that was more rapid than the increase in debits. During a depression following such a boom, deposits might decrease more rapidly than debits and there might therefore be an increase in the velocity of deposits. In the event that this should happen in the future at a time when the Committee plan of bank reserves were in operation, it would not, as Dr. Anderson suggests, place banks under "cruel pressure" at a "period of prostration and liquidation." The figures which he cites for Florida, unrepresentative as they are of the actual facts, may be used as representative of this hypothetical situation. In this table of figures both debits and deposits increased rapidly up to December 1925 and decreased rapidly thereafter. Reserves based upon deposits and debits under the Committee plan, consequently, as well as under the Anderson plan, or the present plan, would have increased up to December 1925 and have decreased thereafter during the slump which followed the boom. An increase

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

in velocity at that time, had it occurred, would not have put the banks under "cruel pressure" but merely have prevented required reserves from decreasing as rapidly as reserves based on deposits alone.

Conclusion

Discussions of the Committee plan since its publication have revealed some confusion over the extent to which credit conditions should reflect an automatic influence such as reserve requirements as compared with policy-expressing influences reflected in discount and open-market operations of the reserve banks. The fact is that credit conditions under modern banking organizations do reflect, and must reflect, both types of influence. Without reserve requirements, imposed either by law or custom, policy-expressing influences such as changes in open-market operations and in discount rates would have little or no effect upon credit conditions, for in the final analysis the efficacy of these operations depends on the extent to which they affect either the volume of reserves which member banks hold, or the cost which member banks must incur when they borrow such reserves from the reserve banks. If, under these circumstances, there were no reserve requirements, customary or legal, and member banks were indifferent to the volume of reserves which they held, the influence of open-market operations and discount rates would be correspondingly impaired.

Reserve requirements, consequently, constitute a necessary part of the machinery that makes open-market and discount operations effective. They are, furthermore, necessarily objective and automatic in their operation. They form part of the fixed legal background or framework of our credit institutions in which the volume of reserves required fluctuates in accordance with changes in the items upon which they are based. Under

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

a formula which bases required reserves solely on the volume of deposits, for example, without regard to whether they are active demand deposits or inactive time deposits, total required reserves would automatically have remained high in the Middle West following May 1920, largely because such reductions as occurred in demand deposits at that time were offset to a considerable extent by increases in time deposits.

This fact, that reserve requirements in their very nature must be automatic in their effect, constitutes the main reason why the items upon which they are based should reflect insofar as possible basic elements in the credit and business situation, for otherwise reserve requirements will fail to support credit policies, as they should, and might even work in direct opposition to policy, as has been the case on many occasions under existing reserve requirements. The Committee plan meets this test by recommending that reserve requirements be based on (1) the volume of deposits, which measure the total volume of funds involved, and (2) the total volume of debits, which measure the actual dollar use made of these funds. By defining its requirements definitely in terms of these two basic elements, the Committee plan automatically takes into consideration the distinction between time deposits and demand deposits, and also between demand deposits in different classes of cities, which form the basis of differences in reserve requirements under the existing system of reserves.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date November 9, 1932

To Mr. Parry

Subject: The Corporate Bond Market in Two Depressions

From Mr. Terborgh

G.T.

How does the present market for corporate bonds compare with the market during the depression of 1920-21? Strange as it may seem, none of the existing bond price or yield averages affords an answer to so obvious a question. With few exceptions, bond market series covering both depressions are limited to high-grade issues which constitute only a minor part of the total outstandings. Those series which include a representation of lower-grade obligations have defects and limitations too serious to permit their use as an index of the condition of the bond market as a whole.1/

In view of this statistical hiatus, I have made an original investigation of bond prices at the present time in relation to prices at the bottom of the bond market in 1920-21. I have distributed, by price ranges, all of the rail, utility, and industrial bonds for which sale or bid prices were quoted in the Bank and Quotation Record as of December 31, 1920 and September 30, 1932. The former date is fairly representative of the bond market for the year July, 1920-June, 1921, during which period the market made what was substantially a flat bottom. The latter date is satisfactorily representative of the market at the present writing (November 8).

The following table shows the number of bonds tabulated and the median price in each case.

	Rails		Utilities		Industrials	
	Number	Price	Number	Price	Number	Price
December 31, 1920	961	$74.91	807	$73.46	236	$87.04
September 30, 1932	899	72.07	1,556	80.04	593	58.56

The median prices indicate some astonishing reversals of position since the end of 1920. Industrial bonds, which at that time were much the strongest of the three classes, have by now sunk to the bottom. Utilities, weakest in 1920, are decisively at the top. Rails have held the middle position in both cases. The median price of industrials is drastically lower than in 1920, that of utilities is definitely higher, and that of rails is slightly lower.

1/ The Dow-Jones bond price averages include no second-grade issues other than rails. Moody's averages of bond yields by ratings exclude a large but indeterminable volume of outstanding bonds poorer in quality than the lowest rating (Baa) for which averages are computed; moreover, the substitutions which have to be made in a degenerating bond market in order to maintain the quality of the rating groups gives the averages computed from such groups of bonds a movement unrepresentative of movement of bonds in general.

The New York Stock Exchange averages of listed bond prices go back only to 1925 for some classifications and to 1929 for others. The Standard Statistics yield averages by ratings date from 1924.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

If we inquire into the reasons for the shifts in the market positions of the three types of bonds, we must invoke two general considerations: (1) the condition of each class of bonds at the beginning of the two depressions, (2) the duration and gravity of the depressions.

The prosperity which preceded the crash of 1920 was confined almost wholly to industrial concerns, the rails and utilities having suffered acutely from the rapid rise in prices and costs. In consequence, the investment standing of rail and utility bonds had been seriously undermined before the depression began, while industrial issues were, relatively, in good demand. The depression was of too short a duration to reverse the situation. Before the shrinkage in industrial earnings had gone far enough seriously to undermine confidence in industrial bonds conditions began to mend.

Before the beginning of the current depression all three types of bonds had built a good record and seemed to have good prospects. Had the depression lasted no longer than that of 1920-21 all three would probably have performed excellently throughout. They did in fact gain in unison for an entire year after the slump started. After that the shrinkage in earnings began to record itself in softening bond prices. Industrials as a class began to slip in the autumn of 1930. Rails held fairly well until the summer of 1931. Utilities were the last to be affected, due to their demonstrated capacity to sustain their earnings better than other types.

The disintegration of confidence, due to the attrition of a long and severe business slump has given the bond market a character quite different from that of the market of 1920-21. Then yields were high even on riskless issues, higher apparently, than at any time since 1878.1/ The spreads between yields on gilt-edged and lower grade issues underwent only a very moderate widening during the depression.2/ The bond market seemed to be affected far more by a lack of capital than by a loss of confidence. Now the reverse is the case. Riskless issues have maintained far lower yields than in 1920-21, but low grade issues have deteriorated in a manner for which the previous depression affords no precedent.

This contrast is displayed clearly in the accompanying diagrams, which show the distribution of prices of tabulated bonds on September 30, 1932 and on December 31, 1920. In all cases the percentage of bond prices falling in the lower brackets is higher now than in the earlier period, even though--as in the case of the utility bonds--the median price for the whole group may be higher. The proportion of the industrials now in the low brackets is startling. In all cases the percentage of bonds selling for $100 or over is higher at present than in 1920-21. This difference is especially notable in the case of the utilities.

1/ This is by reference to Macauley's index of yields on high-grade railroad bonds.
2/ As shown by Moody's series.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

New bond issues in the two depressions

The charts present a comparison between the present bond market and that of the year between the middle of 1920 and the middle of 1921. If I had used the bond market of last June, before the recent recovery, the picture would be far more striking than it is, but I have chosen the present level because of the significance which the comparison with 1920-21 may have in relation to the question of the possibility of new bond issues in a market such as we have now to reckon with.

One of the astonishing things about the situation in 1920-21 is the volume of new bond issues which were floated during the year in which the market was describing a flat bottom at the approximate level of December 31, 1920. During the last half of 1920 and the first half of 1921 new offerings of corporate bonds (refundings excluded) totaled $1,600,000,000, divided as follows: rails $150,000,000; utilities $330,000,000; industrials $1,120,000,000. The total for all corporations, and for each class except railroads, greatly exceeded that of the twelve months preceding the depression. These bonds were put out in the face of a tight market, at offering yields which seem in retrospect to be prohibitive. Approximate median offering yields for the year's issues (refundings included) were as follows: Rails 6.8 per cent, utilities 8.0 per cent, industrials (including real estate) 8.0 per cent. These yields show what business will pay when it really wants to borrow and cannot get money for less.

Unlike the depression of 1920-21, we had in the current depression an easy bond market in all departments for a full year after the slump started. For rails and utilities the market was good for nearly two years. This gave an opportunity for heavy flotations at favorable rates. By the time the market became bad enough to require offering yields anything like as high as those of 1920-21 borrowings had fairly well "caught up." The same loss of confidence which affected the bond market affected also the desire to borrow, except for indispensable refunding operations. The result was that after the middle of 1931 new flotations almost disappeared "without a struggle."

Only 11 railroad bond or note issues came out in the twelve months following June, 1931, and of these only 2 bore an offering yield in excess of $5\frac{1}{2}$ per cent. The situation was similar in other lines. Of 13 industrial offerings in this period only 3 yielded over $6\frac{1}{2}$ per cent. Of 58 real estate issues only 3 yielded over $6\frac{1}{2}$ per cent. Of 97 utility offerings only 32 carried a yield of over $6\frac{1}{2}$ per cent. During the entire year only 179 corporate bond and note issues came on the market, and of these, only 9 bore offering yields of more than $7\frac{1}{2}$ per cent. Contrast with this the median yields of 8 per cent for industrial and utility offerings, and 6.8 per cent for rail offerings, during the twelve months following June, 1920. 1/

1/ The volume of bonds offered (excluding refundings) in the twelve months beginning July, 1931, was only $600,000,000, contrasting with the $1,600,-000,000 put out in the twelve months beginning July, 1920, at the foregoing high median yields.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The bond market is now at a level corresponding roughly to its average for the year July, 1931-June, 1932, during which the record just cited was made. Would the present level permit a fair volume of flotations if there were a real demand for long-term money such as existed throughout the 1920-21 depression? If the issuers of bonds were willing to come across with yields comparable with those offered in 1920-21 could they find takers?

It seems to me that no categorical answer to the question can be made. It appears likely that in view of the deterioration in the standing of industrial bonds as compared with the previous depression, issues of a quality comparable to the bulk of the offerings then sold could not find a market now even at the yields then offered. On the other hand, it should be possible for a sizable volume of utility bonds to be placed at yields offered in 1920-21. The case of the rails is probably intermediate between the other two.

The striking thing about the year following June, 1931, is the apparent absence of any attempt to sell high-yield bonds. This may have been due (1) to a refusal of underwriters to handle such issues, (2) to a comparative lack of any desire to incur obligations at high cost. Unfortunately, I have not the data to permit an evaluation of the relative importance of the two influences. It seems probable that underwriters get much more cautious in a market that is weak through loss of confidence than in a market that is merely "tight" for all grades of bonds alike, as in 1920-21. It seems probable, likewise, that there is at the present time little desire to borrow at high cost, even if it could be done. My own inclination is to accord to the second factor the leading role.1/

1/ The fact that in the year beginning July, 1931, practically all the offerings yielding over 6½ per cent were issued by utilities seems to support this view, though, of course, it is subject to other interpretation.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

NO. 328. 20 DIVISIONS PER INCH BOTH WAYS. 150 BY 200 DIVISIONS.

CODEX BOOK COMPANY, INC. NORWOOD, MASSACHUSETTS

DISTRIBUTION OF RAILROAD BOND PRICES

(IN PERCENTAGES OF THE TOTAL)

December 31, 1920

September 30, 1932

PER CENT

30

20

10

0

PER CENT

30

20

10

0

Under $10

10-20

20-30

30-40

40-50

50-60

60-70

70-80

80-90

90-100

$100 and over

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

DISTRIBUTION OF UTILITY BOND PRICES

(IN PERCENTAGES OF THE TOTAL)

December 31, 1920 (black)

September 30, 1932 (red)

PERCENT

30

20

10

0

PER CENT

30

20

10

0

Under $10

10-20

20-30

30-40

40-50

50-60

60-70

70-80

80-90

90-100

$100 and over

NO. 328. 20 DIVISIONS PER INCH BOTH WAYS. 150 BY 200 DIVISIONS.
CODEX BOOK COMPANY, INC. NORWOOD, MASSACHUSETTS

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

DISTRIBUTION OF INDUSTRIAL BOND PRICES
(IN PERCENTAGES OF THE TOTAL)

NO. 328. 20 DIVISIONS PER INCH BOTH WAYS. 150 BY 200 DIVISIONS.
CODEX BOOK COMPANY, INC. NORWOOD, MASSACHUSETTS
Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

/ +

CONFIDENTIAL

November 12, 1932

To: Governor Meyer

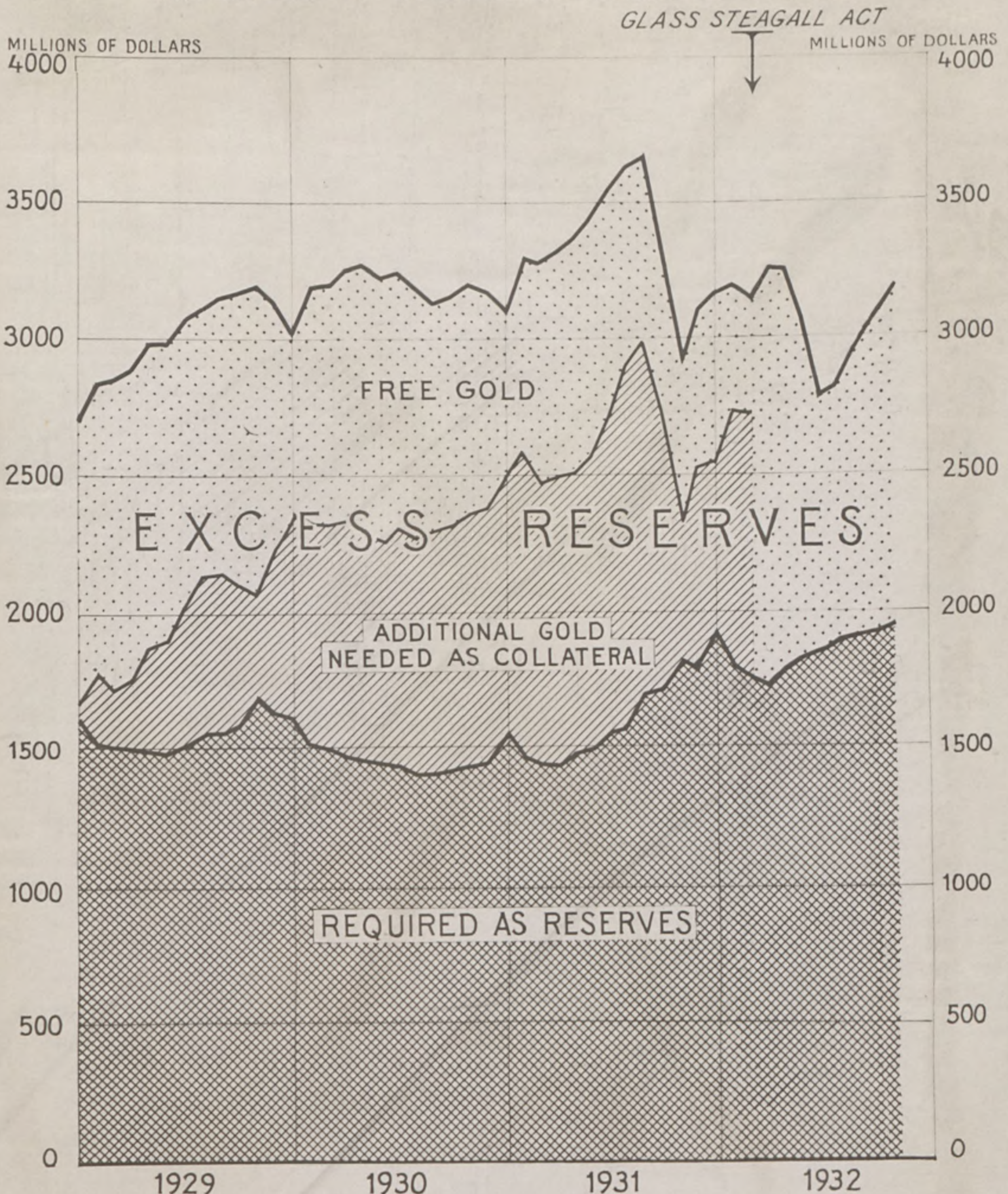
From: Mr. Goldenweiser

Subject: Section 3 of Glass-Steagall Act

Authority to pledge United States Government securities as collateral for Federal reserve notes under the terms of Section 3 of the Glass-Steagall Act expires on March 3, 1933. If the time limit is to be extended or removed, the system should make a recommendation to Congress soon after it convenes.

As a means of clarifying graphically the effects of the Glass-Steagall Act, a chart is presented which shows total reserves of the Federal reserve banks, the amount of gold required as reserves against deposits and against Federal reserve notes, and the excess reserves. It also shows the amount of these excess reserves that prior to the passage of the Glass-Steagall Act was immobilized as collateral against Federal reserve notes. By permitting the reserve banks to pledge Government securities as collateral against notes, the Glass-Steagall Act made the distinction between excess reserves and free gold meaningless.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis



The entire area below the top line represents total reserves of the Federal reserve banks; the double-hatched area at the bottom--reserves required against Federal reserve notes and deposits; the single-hatched area over it--additional gold needed as collateral for Federal reserve notes; and the dotted area--free gold, that is, gold that was not needed under the law either as reserves or as collateral. After the passage of the Glass-Steagall Act on February 27, 1932, which authorized for one year the use of United States Government securities as collateral against Federal reserve notes, the distinction between excess reserves and free gold lost its significance.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Pledging of Government securities under the Glass-Steagall Act began on May 5 and on that date amounted to $56,000,000. The maximum amount of $682,-000,000 was pledged on July 6 and since that time the amount has decreased by about $250,000,000 to $425,000,000. This decrease has been the result of the same factors that have increased the excess reserves of member banks, namely, the inflow of gold, the decrease in currency, and the issue of national bank notes. It is not impossible that, if the present movement in these items continues and becomes accelerated after the turn of the year, the necessity for pledging Government securities may disappear by the time the authority to do so expires. This is not likely, however. In any case, it is not desirable for the Federal reserve system to be deprived of the flexibility in carrying out its credit policies, which is conferred by this authority.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

CONFIDENTIAL

November 12, 1932
R.& S.
Cr. 1

BANKING AND CREDIT SITUATION

Growth of excess reserves since last summer

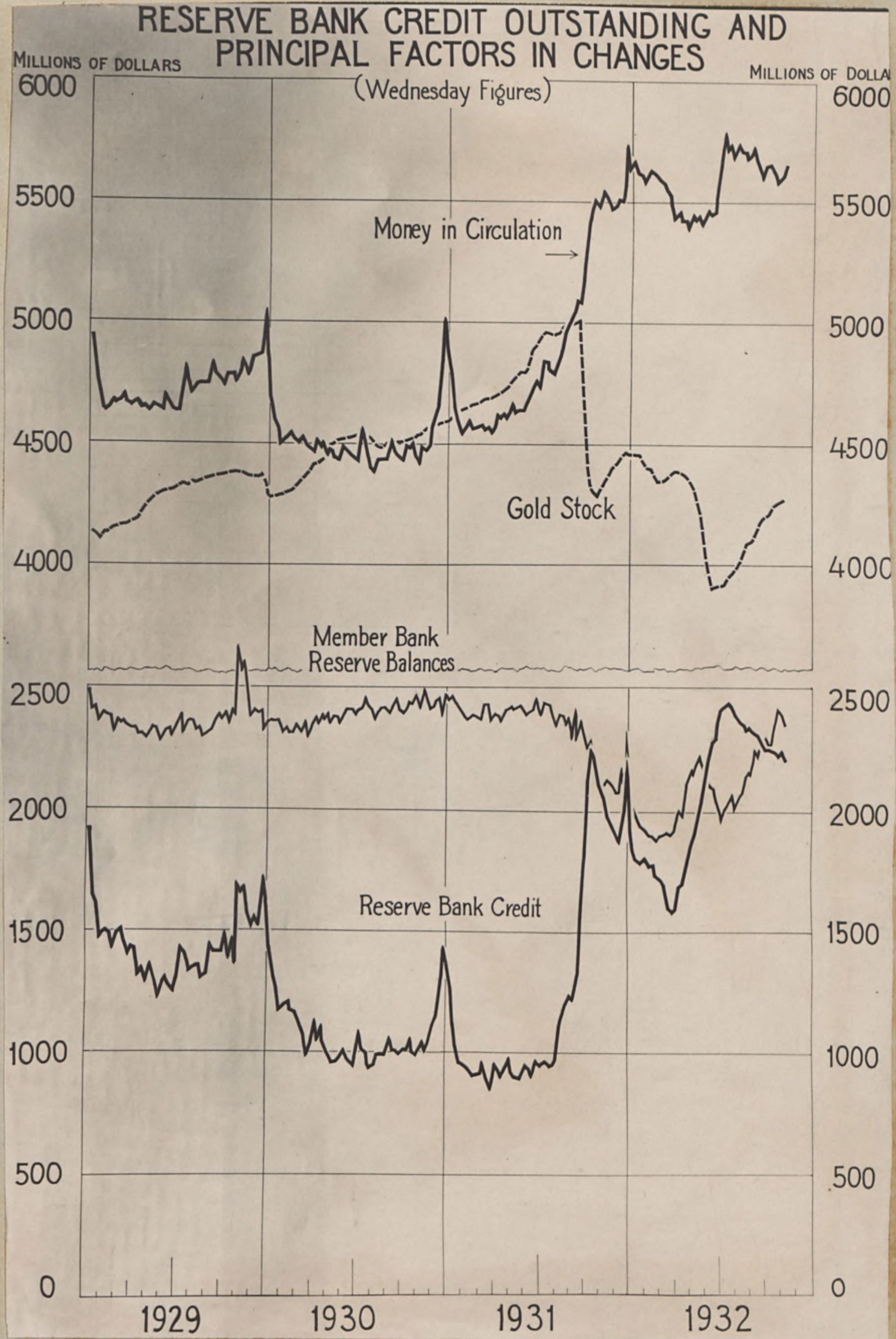
Considerable improvement in the financial situation since the middle of July is clearly indicated. The figure which epitomizes these developments and presents the background for a discussion of credit conditions and credit policies at the present time is the figure of excess reserves of member banks, which on November 9 stood at $450,000,000, and showed an increase of $200,000,000 since the middle of July.

That date marks a definite turn in financial conditions. Since that time the monetary gold stock of the country has increased by $320,000,000, both through imports and through releases from earmark. During the same period money in circulation decreased by $85,000,000 at a time when seasonally it would have been expected to increase by about $160,000,000. Broadly speaking, this amount of about $250,000,000 represents a return from hoarding. In addition, about $150,000,000 of national bank notes have been issued under the provisions of the law which increased the classes of bonds having the circulation privilege. All of these developments placed additional reserve funds at the disposal of member banks. About $230,000,000 of these funds was used to reduce further the indebtedness of member banks to the reserve banks, about $100,000,000 to meet an increase in reserve requirements resulting from a growth of member bank deposits, and about $200,000,000 remained as additional excess reserves.

The course of gold movements, money in circulation, member bank balances, and reserve bank credit for a series of years is shown on the following chart.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

2.



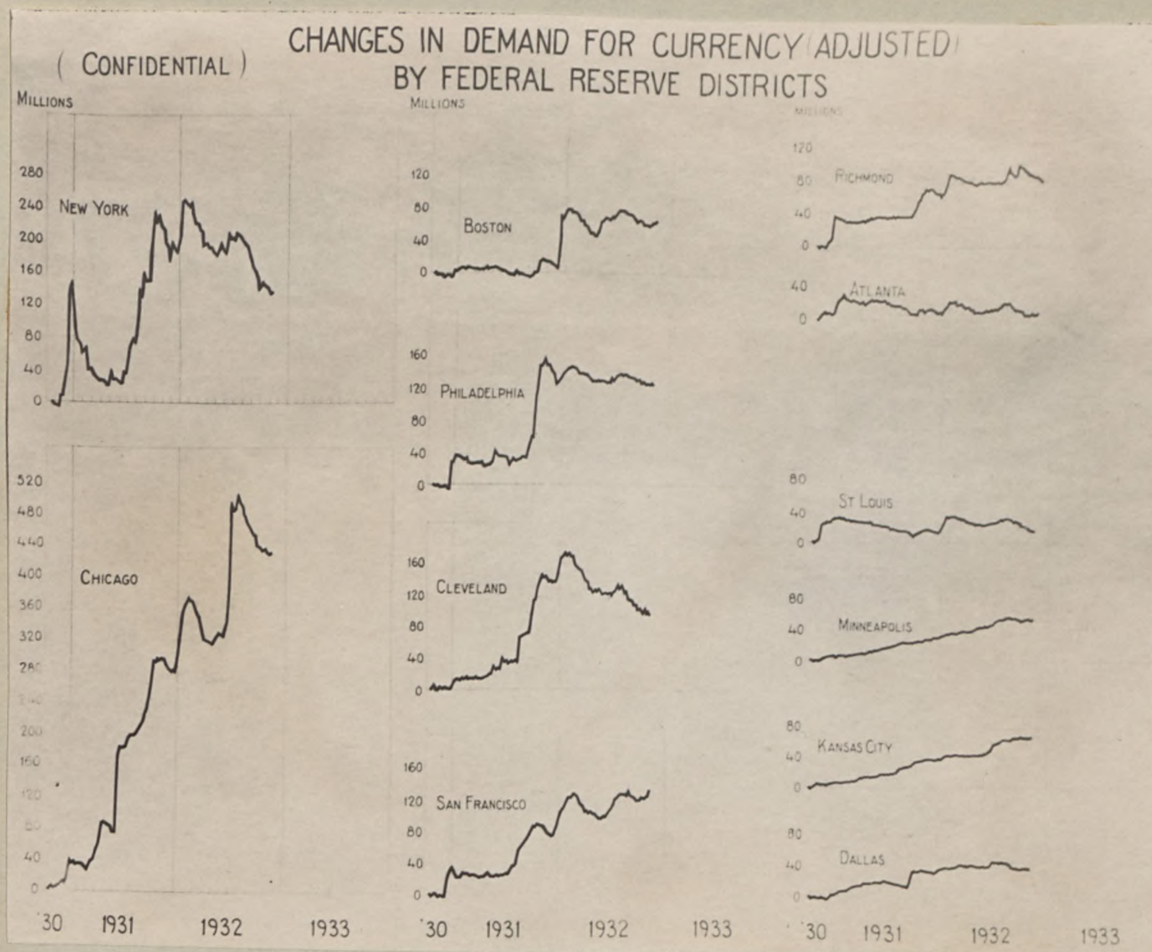
Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Decline in hoarding

Hoarding was at its maximum in mid-July. Since that time a definite decrease in bank suspensions throughout the country has been reflected in release of currency from hoards both by the public and the banks. Up to the first of October the return flow was particularly rapid, amounting to about $250,000,000. Since that time there has been comparatively little change.

The charts show estimates of demand for currency in excess of usual seasonal requirements in each Federal reserve district since October of 1930. These figures are not an accurate measure of hoarding, strictly speaking, since, on the one hand, they make no allowance for reduced use of cash for business purposes during the depression, nor, on the other hand, for larger demand as a result of the tax on checks and the imposition of service charges on small accounts, or for additions to circulation in localities where there are no longer any banking facilities.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis



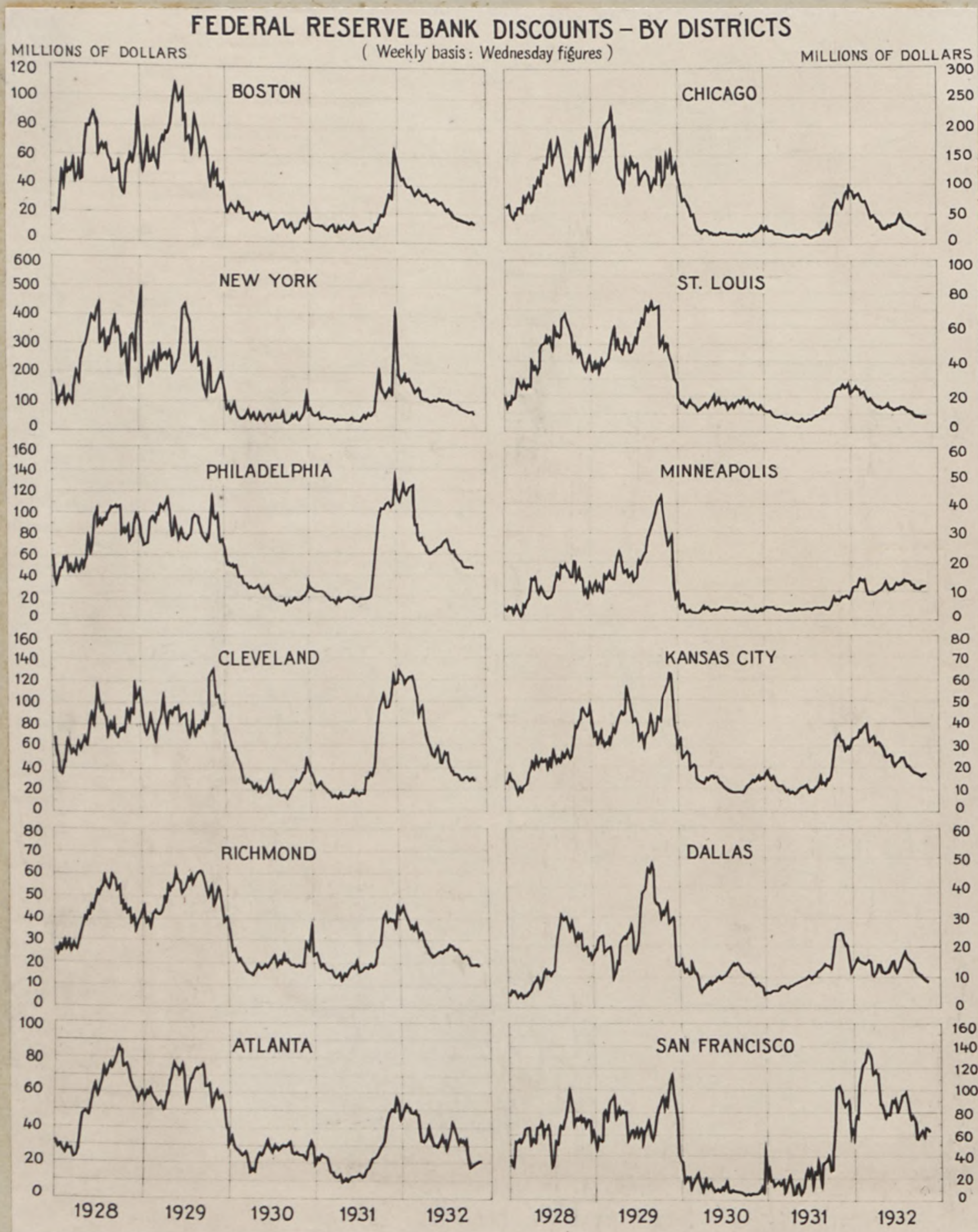
The charts indicate that, while the greater part of the nonseasonal increase in currency outstanding during the summer was in Chicago, almost all of the districts experienced some added demand. Since mid-July the decline, after allowance for seasonal factors, has been largest in Chicago and New York---where the volume of hoarded currency was largest. All districts have had some return of currency, except San Francisco where recent banking difficulties have occasioned withdrawals, and certain agricultural districts--- Minneapolis, Kansas City, and Dallas in particular---in which there has been little net change in circulation.

Decrease in member bank indebtedness

The decrease of member bank indebtedness since the middle of July has

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

brought the total for all member banks down to $311,000,000, a figure not far above the level prevailing before the outward movement of gold began last autumn. The chart shows the course of discounts by Federal reserve districts--and brings out the fact that the decline has been general throughout the country.



Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

A figure that has a bearing on the volume of member bank indebtedness is the extent of borrowing from the Reconstruction Finance Corporation, which at the end of September, the latest available date, amounted for member banks to $245,000,000. Indebtedness to the corporation, however, differs from indebtedness to the reserve banks in two respects. First, it does not represent the same degree of pressure on the member bank, even though the rate paid is higher; and, secondly, taking the banks in the aggregate, debt to the corporation can be paid off by a transfer of deposits and does not require reserve funds, as does a repayment to the reserve banks.

Prospects of demands to the end of the year

On the basis of existing information, it would seem likely that between now and Christmas there may be a seasonal demand for currency for holiday purposes of about $250,000,000, compared with $300,000,000 in ordinary years. To what extent this amount is likely to be met by further return flow from hoarding, it is impossible to estimate. During the past month there has been practically no change in the amount of hoarded money.

It is also impossible to estimate how much longer gold imports shall continue at their recent volume. The increase of $350,000,000 in the gold stock of the country, which has taken place since June, is larger than can be accounted for by ordinary remittances due this country on trade balance or ordinary invisible items in the balance of payments, and undoubtedly reflects in some part extraordinary movements such as capital investments and the fact that minimum foreign balances were reduced below working requirements during the outflow of gold in the first half of the year. If the recent large rate of gold inflow should continue for the immediate future, however, and amount to between $50,000,000 and $100,000,000 between now and the end of the year,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

a considerable part of the holiday demand for currency would be met by this movement, as well as by additional issues of national bank notes. The drain on member bank reserve balances in this case would not be large, probably not in excess of $100,000,000, which, in their present position, they would be able to meet without creating any tightness in credit conditions.

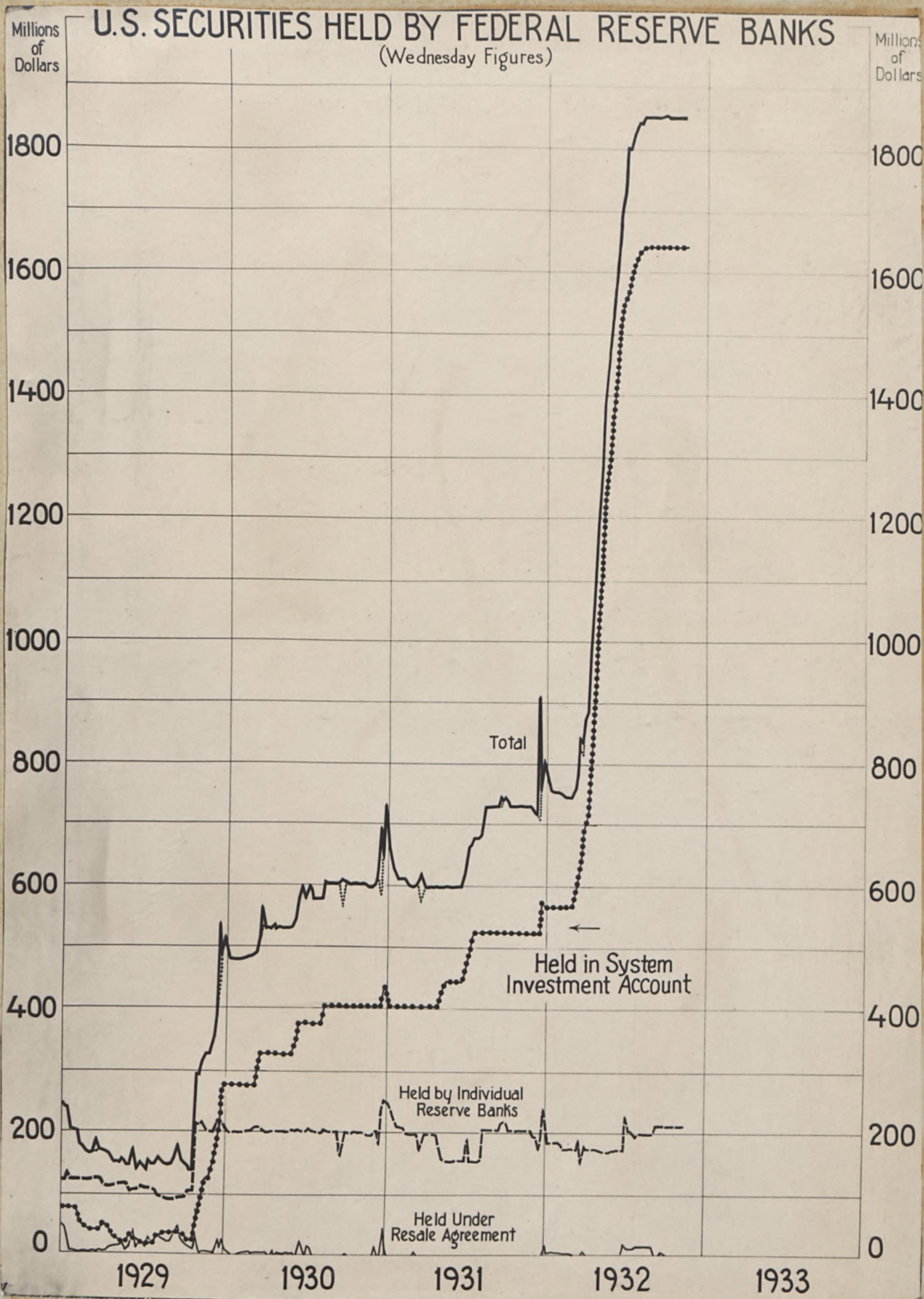
After the first of the year, when the seasonal return flow of currency begins, the volume of member bank excess reserves is likely to increase at a rapid rate.

Open-market operations since 1929

Reserve bank holdings of United States Government securities have been increasing since the autumn of 1929, when the speculative boom came to an end. The chart shows United States security holdings of the Federal reserve banks from 1929 to date, distinguishing between securities held by the individual reserve banks and those held in the system investment account. Holdings of

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

8



Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

the individual reserve banks, after an increase of $100,000,000 during the stock market panic in 1929, have remained relatively constant, while the system's holdings increased by $1,700,000,000. This increase continued until August of this year; since that time the investment account has been at a constant level.

The table below shows changes in the important factors in the credit situation between the end of September, 1929 and the middle of July, 1932, and since that time. It brings out the fact that during the period of 33 months prior to July 20 of this year the reserve banks had bought $1,684,000,000 of United States Government securities. The funds released by these purchases were

Banking Developments, 1929-1932

(In millions of dollars)

Changes in--	Sept. 25, 1929 to July 20, 1932	July 20, 1932 to Nov. 9, 1932
Reserve bank holdings of United States Government securities.....	+1,684	+15
Discounts for member banks.........	-406	-227
Gold stock.........................	-423	+318
Money in circulation...............	+991	-84
Reserve balances...................	-328	+306

largely absorbed, however, by increases of almost a billion dollars in money in circulation and by over four hundred millions of gold exports. Nevertheless, member banks, as the result of the system's security purchases and a decrease in their reserve requirements, reflecting a decline in their deposit liabilities, were able to reduce their discounts by over $400,000,000 and to accumulate by mid-July of this year about $250,000,000 of excess reserves. During this long period, therefore, open-market purchases by the reserve banks enabled the member banks to meet an external drain on their gold reserves, an internal drain of currency for hoarding, and at the same time to reduce their

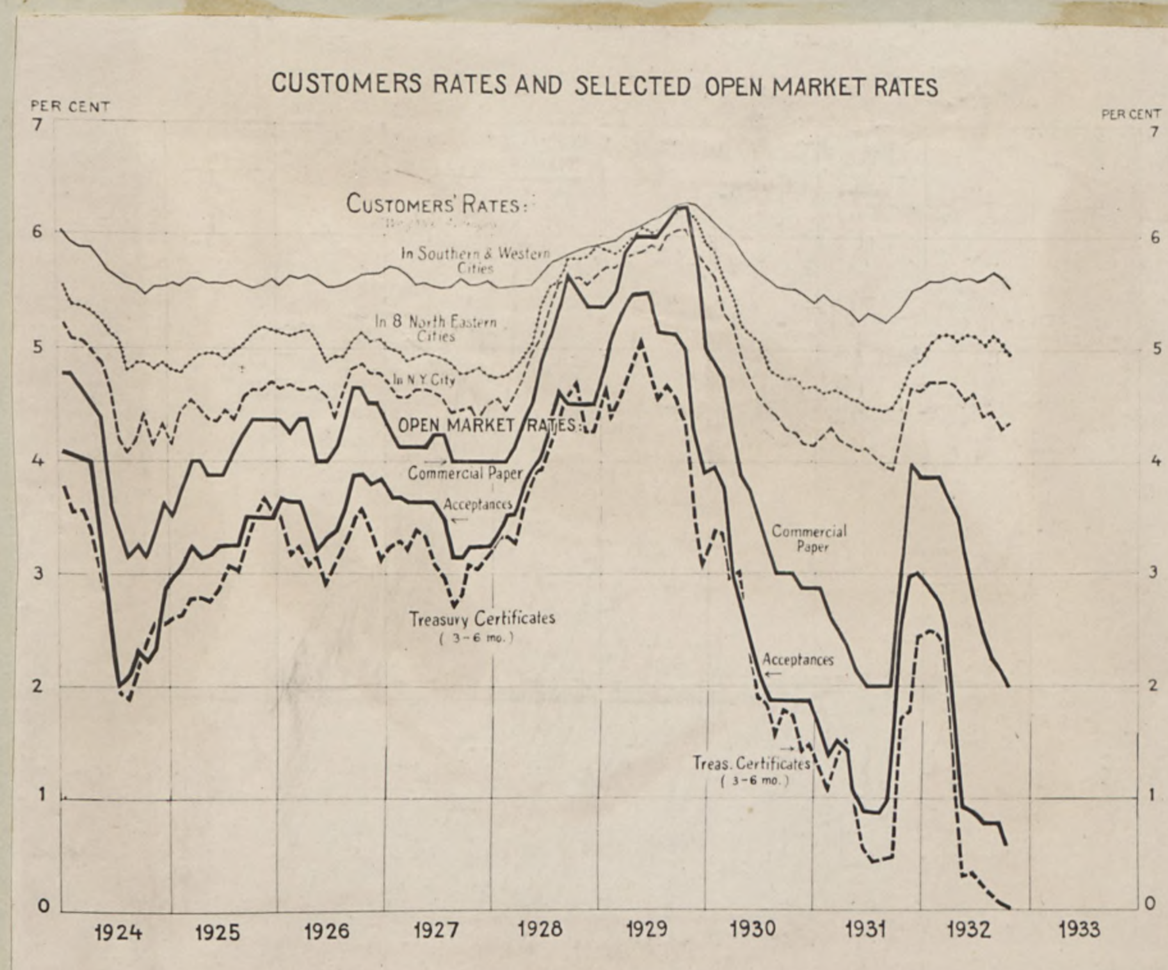
Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

indebtedness, and to increase their reserves.

Since the middle of July Federal reserve bank holdings of United States Government securities have continued at a practically constant level, but other factors, already mentioned, have been adding to members' reserves, with the consequence that member bank indebtedness has declined further and their excess reserves have advanced to a level of $450,000,000.

Money rates

Increased ease in the credit situation, as indicated both by the low volume of member bank discounts and by the increase in their excess reserves, has been reflected in easier money rates in the short-term open money market, the course of which for a period of years is shown on the chart. The rate on short-



time Governments has become nominal and the rate on acceptances and open-market commercial paper has fallen to a low level. Rates to customers, however, outside of New York have shown relatively little decline since the beginning of the year. They advanced sharply at the time of the gold export movement last autumn and have remained at a fairly high level since that time. This relatively high level of money rates reflects the fact that the monetary ease has not been distributed throughout the country, nor to all classes of borrowers.

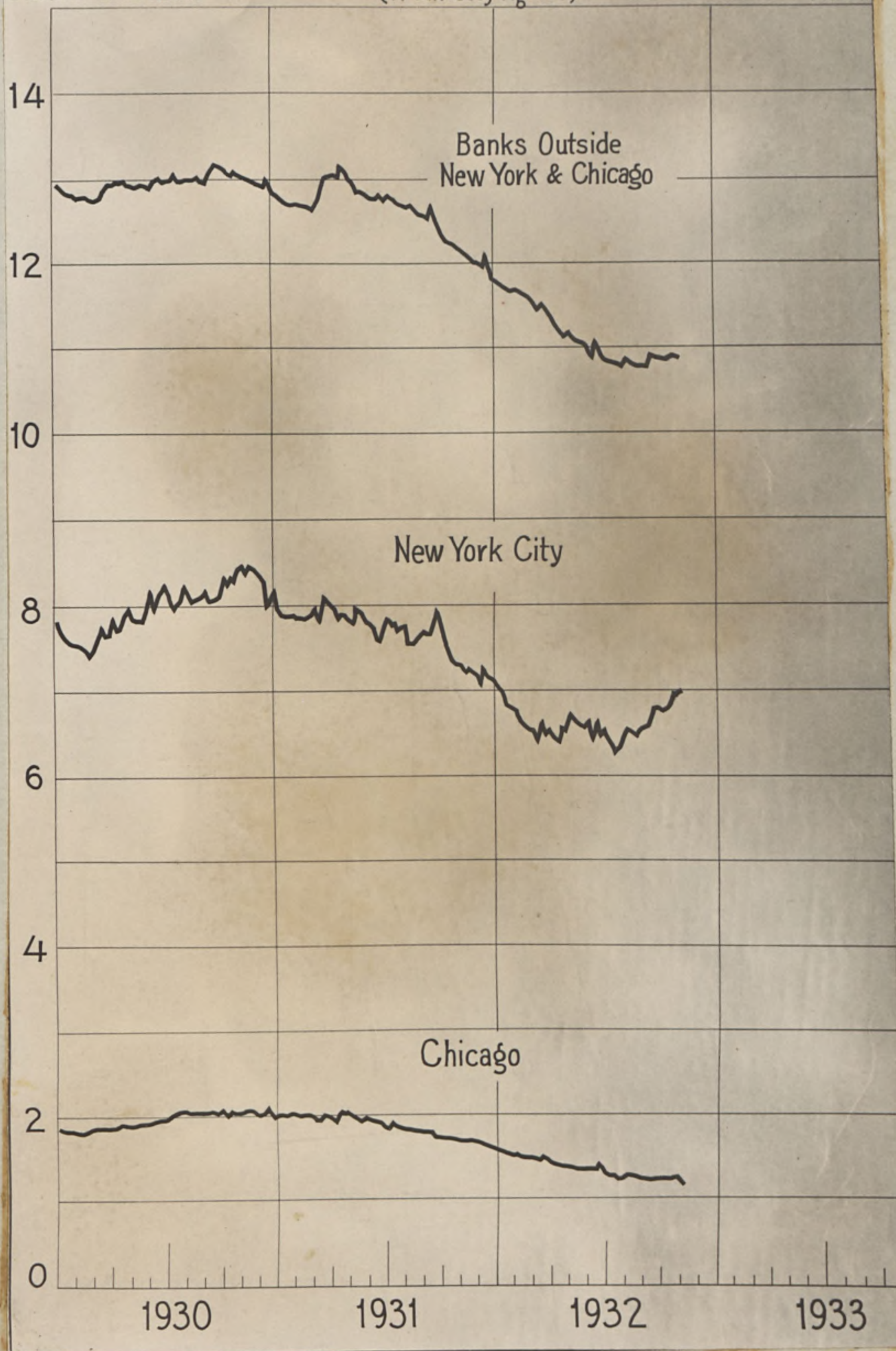
In the bond market prices are well above the low levels of the summer, but except for governmental issues there have been few flotations of new securities. So far a condition of great ease in the short-term markets has not worked its way into the long-term markets for industrial issues.

Member bank credit

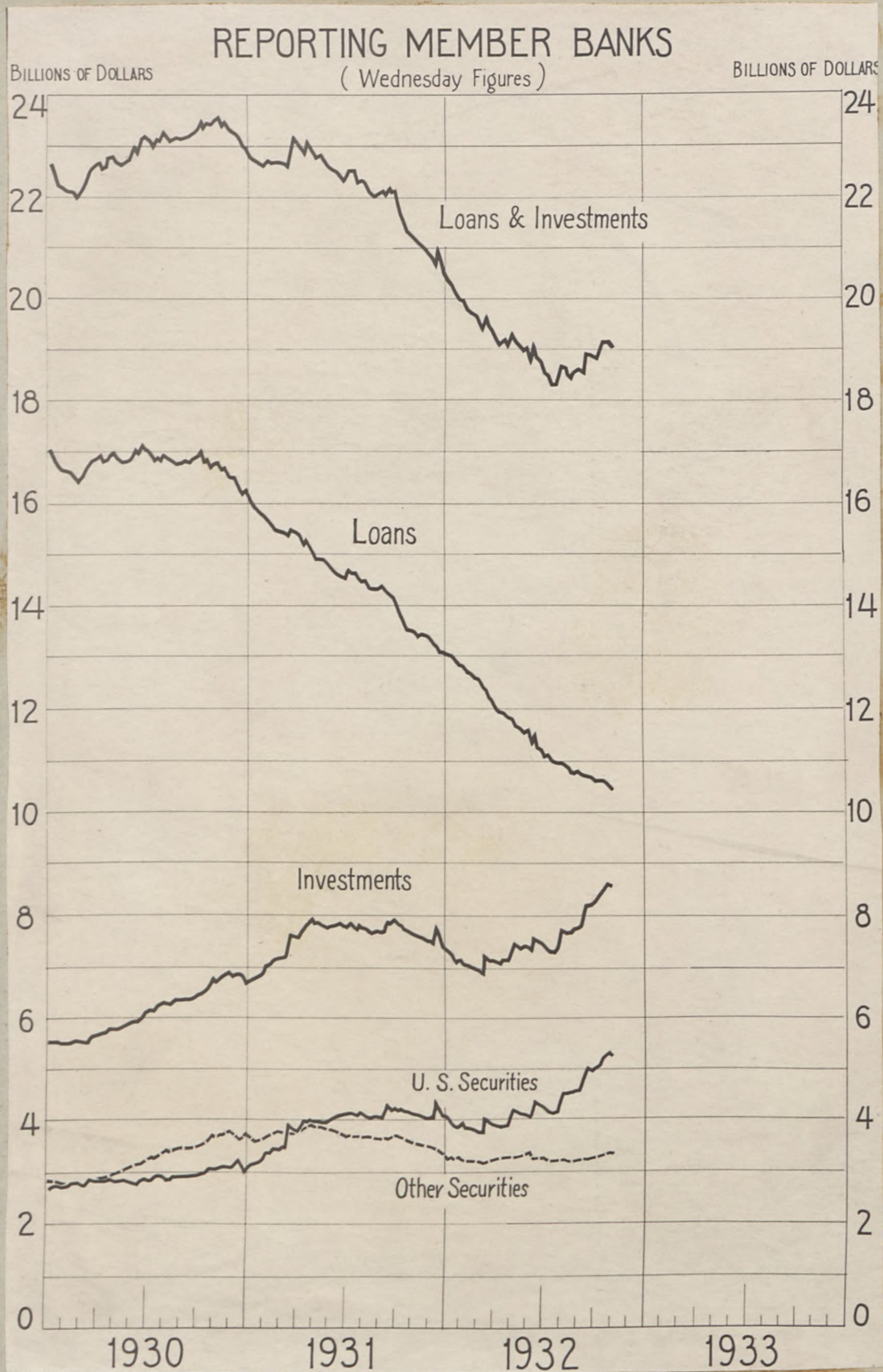
The fact that excess reserves and credit ease have not been distributed throughout the country and have not resulted in material expansion of member bank credit is reflected in the course of member bank loans and investments, which is shown in the two following charts. They indicate that the decline in total loans and investments, which was rapid from the early part of 1931 to

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

12.



Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis



Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

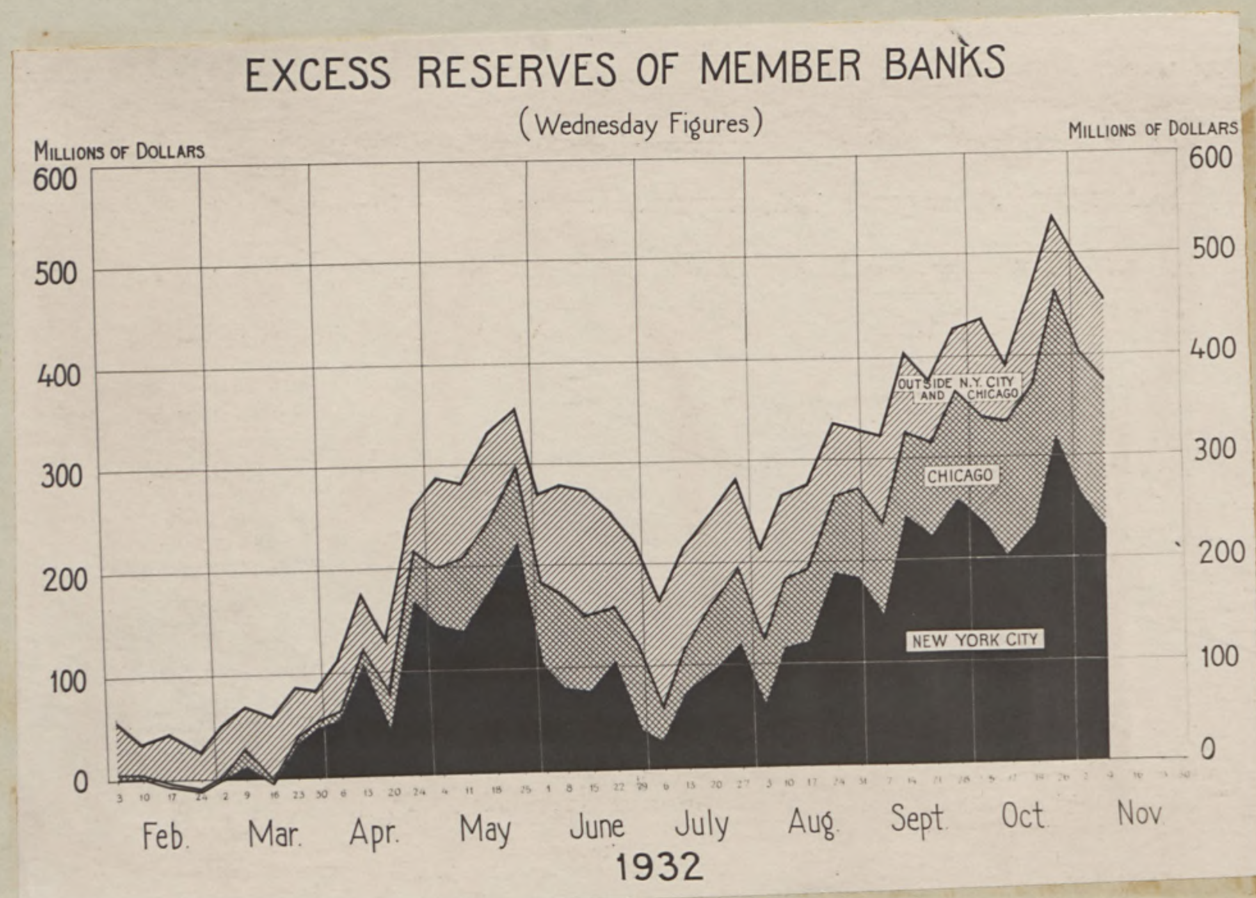
the middle of 1932, came to a stop at that time. Since then the level has been fairly well maintained at banks outside of New York, while at the New York banks there has been in the last three months a considerable increase. This increase in New York practically comprises the entire increase for the system, and, as is shown by the second chart, consists almost entirely of an increase in United States Government securities. Other securities have remained at a fairly constant level, while loans have continued to decline, although not at as rapid a rate as earlier in the year.

For all reporting member banks, the increase in total loans and investments between July 20 and November 2 amounted to $700,000,000. At the same time, the United States Government deposits of these banks increased by $450,000,000, indicating that all but $250,000,000 of the net increase in loans and investments, which took the form of increased holdings of United States Government securities, is still represented by deposit credits to the account of the United States Government on the books of these banks. The increase of $725,000,000 in net demand deposits and $175,000,000 in time deposits during the same period reflects in part the disbursement of Treasury funds, in part, a growth in inter-bank balances, and in part the deposit of currency and gold at the member banks.

Correspondent balances at reporting member banks have grown steadily since the end of February and are now back to the levels prevailing in August, 1931, before the withdrawals that accompanied and followed the credit crisis of last autumn. Interior banks as a whole, therefore, are again in possession of a large volume of liquid assets in the form of balances due from banks, although their total volume of liquid open-market assets, including also call loans, open-market commercial paper, and short-term securities, is still small as

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

compared with other years. The recent growth in correspondent balances reflects the disbursements of the Treasury and of the Reconstruction Finance Corporation which made available to interior banks reserve funds accruing to the central money markets from Federal reserve bank purchases of United States securities and from deposits of currency and gold. It also reflects in part recent issues of national bank notes. Interior banks have not used these funds to increase their customers' loans nor to any great extent to increase their open-market loans and investments, other than investments in United States Government securities, but have deposited them with correspondent banks in the money centers. This accounts for the concentration of the increase in excess reserves of the member banks at member banks in those centers. As is indicated by the chart, the accumulation of excess reserves has been chiefly in New York City, though



banks in Chicago also show some increase in excess reserves. Excess reserves outside of the two financial centers are approximately at the level that is usually maintained by country banks.

Business activity

The domestic business situation has shown some improvement since last summer. Output of manufacturing and mining industries has increased, as is indicated by a rise in the Board's seasonally adjusted index of industrial production from a low point of 58 in July to 66 in September. In October there appears to have been no further increase in activity, which was maintained at the September level. Traffic on the railroads increased more than seasonally this autumn, while changes in building activity have been largely of a seasonal character since early spring.

The improvement in manufacturing output and factory employment has been concentrated largely in the light industries, such as textiles, clothing, shoes, and some of the food products. Both production and employment in these industries increased substantially between the early summer and September. In the heavy industries, on the other hand, such as steel, machinery, automobiles, etc., there was no improvement in August and only slight improvement in September and October.

Farm income this fall is smaller than last season by a considerable amount, reflecting lower prices than a year ago for agricultural products, especially livestock and dairy products, and in addition smaller crops of cotton, winter wheat, and tobacco.

Wholesale prices in the United States, after declining steadily until the middle of June, advanced during the following three months by about 3 per cent.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Since early September, however, they have declined again to approximately the low level of June. The price of cotton, reacting after the end of August, remains above the lowest levels of the year, but cattle and hogs have recently been selling again at the low prices prevailing in early summer, and the price of wheat at Chicago, after recovery in July and August, declined in November to the lowest levels ever recorded. Prices of other commodities in general have maintained their advance since mid-summer rather better than agricultural products. This is true of certain textiles, some of the metals, particularly lead, tin, and zinc, and products which we import from abroad, such as silk, sugar, and rubber.

Recent business developments are described further in the Review of the Month in the forthcoming November issue of the Federal Reserve Bulletin.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

November 14, 1932

To: Mr. Goldenweiser

From: Mr. Rhodes and Mr. Thompson

CONFIDENTIAL

NATIONAL BANK NOTE ISSUES UNDER THE NEW AUTHORITY

From June 30 to November 9, 1932, issues of new national bank notes have amounted to approximately $150,000,000. Practically all of these notes were issued subsequent to the enactment on July 22 of the Federal Home Loan Bank Bill which contained a provision liberalizing the national bank note-issue privilege.

At the time of the passage of the Bill the unused note issue power of the national banks amounted to about $900,000,000. Less than 30 per cent of the potential issuing power was possessed by the so-called country banks; one-third was possessed by banks in New York City and Chicago, and the remainder--about 40 per cent--by banks in reserve cities.

The potential issuing power of different classes of banks on June 30, 1932, is shown in the following table:

Unused Issuing Power of National Banks, by Classes of Banks, June 30, 1932

(In thousands of dollars)

Class of bank	Paid-in capital	Liability for national bank notes 1/	Unused issuing power 2/	
			Amount	Per cent
All national banks	1,568,983	652,168	916,815	100
Central reserve city banks	336,429	32,901	303,528	33
Reserve city banks	537,686	177,267	360,419	39
Country banks 3/	694,868	442,000	252,868	28

1/ Does not include notes in own vaults or in transit from Washington, D. C., estimated at $20,000,000.
2/ Probably overstates unused issuing power by $20,000,000--see note 1/.
3/ Includes 5 national banks in Alaska and Hawaii.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

By Federal reserve districts, the privilege to issue additional notes was concentrated chiefly in the national banks of four Federal reserve districts--New York, Boston, Chicago, and San Francisco, which together had the authority to issue 69 per cent of the potential increase in notes.

Table A shows by Federal reserve districts the unused note issuing power of national banks as of June 30 and November 9, 1932 and the total issues of new national bank notes during the period.

Issues by Size of Banks

During the period from June 30, 1932 to September 30, 1932, for which detailed statistics are available, a total of 406 banks in the continental United States made use of the national bank note issue privilege to issue $140,500,000 of new national bank notes. Of this amount, $82,000,000 was issued by 79 large banks, and $9,500,000 was taken by 234 small banks.

The distribution of the note issues during the third quarter of the year by size of banks is summarized in the following table:

Issues of New National Bank Notes to National Banks
From June 30, 1932 to September 30, 1932

By Size of Bank

Paid-in Capital (In thousands of dollars)	Number of banks	Amount of notes issued	
		Thousands of dollars	Per cent of total
25 - 75	103	2,035	2
76 - 200	131	7,489	7
201 - 500	89	12,735	12
501 and over	79	81,984	79
All banks*	402	104,243	100

* Not included in these totals are 4 banks that took $260,000 of national bank notes: 1 suspended on September 30, 1932 and submitted no report; 3 were organized subsequent to June 30, 1932.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Uses of Note Issues

The issue of notes by national banks, in addition to affording them a profit, may be used by these banks to reduce their borrowings, to meet customers' demands for cash, to replenish or increase their reserves, and to build up their correspondent balances.

Of the banks making use of the privilege, twenty per cent used the notes to reduce their borrowings either directly or indirectly. Forty per cent used them to improve their cash positions. These banks were enabled by the issue of notes to avoid or reduce additional borrowing. The remaining forty per cent of the banks, taking nearly half of the issues, were not in debt, had excess reserves or ample balances with correspondents, and were not under pressure from loss of deposits during this period. With some conspicuous exceptions in the Philadelphia, Atlanta, Chicago, Kansas City, and San Francisco districts, the larger banks that took large issues of notes were not under pressure. Table B summarizes by Federal reserve districts the effect of the note issues on the banks.

Reduction of Indebtedness

On June 30, 1932 the banks that made use of the note issue privilege were borrowing $154,000,000 from Federal reserve banks and elsewhere or approximately 18 per cent of the total borrowings of all member banks of the Federal reserve system. On September 30, 1932, these national banks had reduced their borrowings to $101,000,000 a decline of $53,000,000, Of this reduction in indebtedness, $49,000,000 was in the accounts of eight banks, including two large banks in the San Francisco district which reduced their indebtedness by $34,000,000.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The amount of borrowings on June 30, 1932 and September 30, 1932 of the 402 banks issuing national bank notes is shown in the following table:

Borrowings of All Banks Issuing National Bank Notes
June 30 - September 30, 1932

(In thousands of dollars)

	June 30	September 30	Change
Total borrowings	154,357	101,254	-53,103
From Federal reserve bank	80,081	52,391	-27,690
From Reconstruction Finance Corporation	36,289	29,687	- 6,602
From National Credit Association	531	392	- 139
From others	12,843	6,466	- 6,377
Agreements to repurchase U. S. Government securities	24,615	12,316	-12,299

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

TABLE A

Unused Note Issuing Power of National Banks, by Federal Reserve Districts
June 30, 1932 and November 9, 1932

(Amounts in thousands of dollars)

District	June 30, 1932			New notes issued June 30 to Nov. 9	November 9, 1932 Unused issuing power 2/ 3/	
	Paid-in capital	Liability for national bank notes 1/	Unused issuing power 2/		Amount	Per cent of total
Boston	140,150	43,616	96,534	2,765	93,769	12
New York	419,630	91,329	328,301	17,404	310,897	40
Philadelphia	124,062	65,241	58,821	7,455	51,366	7
Cleveland	112,638	74,667	37,971	7,005	30,966	4
Richmond	70,806	45,818	24,988	4,645	20,343	3
Atlanta	75,285	45,508	29,777	6,978	22,799	3
Chicago	170,395	74,462	95,933	23,132	72,801	9
St. Louis	54,594	26,934	27,660	4,335	23,325	3
Minneapolis	57,210	26,299	30,911	5,558	25,353	3
Kansas City	81,233	30,938	50,295	14,376	35,919	5
Dallas	76,692	45,239	31,453	4,653	26,800	4
San Francisco	182,863	78,855	104,008	49,556	54,452	7
Total	1,565,558	648,906	916,652	147,862	768,790	100

1/ Does not include notes in own vaults or in transit from Washington, D. C., estimated at $20,000,000.
2/ Probably overstates unused issuing power by about $20,000,000 -- see note 1/.
3/ Makes no allowance for new banks organized, for bank suspensions, or for changes in paid-in capital since June 30, 1932.
Note:- Does not include 5 national banks in Alaska and Hawaii.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

TABLE B

New Issues of National Bank Notes, June 30, 1932 to September 30, 1932 by Federal Reserve Districts Classified According to Effect of Issue on Banks

District	Number of banks				Amount of issues (In thousands of dollars)			
	Borrowings reduced	Reserve and cash position eased	All other	Total	Borrowings reduced	Reserve and cash position eased	All other	Total
Boston	5	8	6	19	265	1,015	860	2,140
New York	19	14	15	48	1,875	2,189	10,784	14,848
Philadelphia	14	19	15	48	977	3,471	1,739	6,187
Cleveland	11	11	21	43	1,399	991	2,841	5,231
Richmond	8	7	9	24	705	664	1,855	3,224
Atlanta	...	19	8	27	...	3,078	1,469	4,547
Chicago	9	23	18	50	5,422	5,643	6,661	17,726
St. Louis	6	4	15	25	297	135	2,947	3,379
Minneapolis	1	19	4	24	25	2,265	89	2,379
Kansas City	4	16	23	43	242	4,871	4,742	9,855
Dallas	...	8	11	19	...	1,170	2,263	3,433
San Francisco	5	15	12	32	17,826	2,058	11,410	31,294
Total	82	163	157	402	29,033	27,550	47,660	104,243

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

(Report adopted by Federal Reserve Agents during their Conference, Nov. 14-16, 1932.) L-10

PERMITS FOR INTERLOCKING DIRECTORATES UNDER CLAYTON ACT

With reference to the question suggested by the Federal Reserve Board with regard to the policy and procedure in granting permits under the provisions of the Clayton Act relating to interlocking directorates, your committee has to report as follows:

We understand that under the present operation of the Kern amendment to the Clayton Act, as amended, the question of approval of permits for interlocking directorates in banks is subject to two major considerations. The first is the factor of lessening competition or restricting credit, and the second is the question of public interest involved.

We consider, therefore, that the Federal Reserve Board may properly weigh against the question of competition the factor of public interest involved, and this we believe to be recognized in the present regulations of the Federal Reserve Board.

We are of the opinion that the final determination by the Federal Reserve Board must necessarily be on the evidence presented in each individual case rather than by general rule. To this end we respectfully suggest:

One. That Section IV, sub-section (d)3 of Regulation "L" be amended to read as follows:

> "Purpose for which services are sought, nature of proposed influence and activity, relationships, competency, and any other facts having a bearing upon the interest of the public in such banks as affected by their having the same directors, officers, or employees."

Two. In order to comply with this suggested amendment to Regulation "L", it is recommended that, as a matter of procedure, the applicant for a permit and the banks which he is serving and proposing to serve, be required to furnish in writing such information and reasons as they may, in support

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

of their contention that the granting of the permit will not be against the public interest, and thereupon the application follow the usual course of review and recommendation by the Federal Reserve Agent before submission to the Federal Reserve Board.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date November 17, 1932

To Mr. Wyatt

Subject: Attitude of Mr. Glass regarding National Bank Notes.

From Mr. Seitz

2—8495

In accordance with your request, I have examined the remarks which were made by Mr. Carter Glass at the time the original Federal Reserve Act was under consideration in Congress to ascertain what his attitude was with reference to national bank currency. In this connection, I have also examined the report which the House Committee on Banking and Currency made on this measure, since Mr. Glass was also Chairman of that Committee and in that capacity submitted the report to the House. While the statements contained in the report necessarily represent the official views of the Committee, they also undoubtedly incorporate to a large degree the personal views of Mr. Glass.

From the remarks of Mr. Glass and, particularly, from the statements contained in the report of the House Banking and Currency Committee, I think it is shown pretty clearly that, briefly stated, Mr. Glass was of the opinion that national bank notes were inelastic and "absolutely unresponsive to the Nation's business needs", since they were based upon and secured by a bonded indebtedness of the United States, and that, therefore, they should be gradually retired and replaced by a system of currency which would be issued by the Government itself and which would be readily and elastically responsive to business requirements. Pertinent excerpts from these remarks and statements are as follows:

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

EXCERPTS FROM REMARKS MADE PERSONALLY BY MR. GLASS.

Congressional Record, Vol. 50, Part 5.

"I think it is pretty generally agreed that there is a pressing necessity for currency legislation in this country. * * *

"For more than a quarter of a century there have been strong symptoms of an intense dissatisfaction with the prevailing national banking and currency system; and this spirit of discontent has been accentuated as, from time to time, the utter inadequacy of the system has been made manifest in periods of financial peril. While the existing system has operated satisfactorily under ordinary business conditions, and while the administration of the system for the 50 years of its history furnishes a high tribute to the integrity and efficiency of those concerned in its operation and oversight, its very best friend is bound to admit that in time of stress and storm it has broken down utterly * * * The currency based upon the Nation's debt is absolutely unresponsive to the Nation's business needs. (p. 4642) (September 10, 1913)

*　　*　　*　　*

"The last national platform of the Democratic Party committed us to 'a systematic revision of the banking laws of the country,' and the Democratic President of the United States who was elected on that platform appeared at the Speaker's desk of this House more than two months ago and urged Congress not to wait until 'the demands of the country shall have become reproaches.' The President recommended the lines upon which we should proceed, saying:

"We must have a currency, not rigid as now, but readily, elastically responsive to sound credit, the expanding and contracting credits of everyday transactions, the normal ebb and flow of personal and corporate dealings. * * *"
(p. 4643). (September 10, 1913)

*　　*　　*　　*

"I should be inclined to estimate that through

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

"the elimination of bond security and the substitution of the new plan of issue there should be no good reason why the note loans made by banks in agricultural regions should run to a higher figure than perhaps 6 or 7 per cent as against the charge of 12 to 15 per cent that may now be found in many of the small towns of the West and South during the height of the season. (p. 4648) (September 10, 1913)

* * * *

"Retirement of the national-bank circulation, frequently redundant and never elastic, is regarded as one of the essentials of currency reform. During the 12 years that I have served as a member of the Banking and Currency Committee the universal testimony of banker and business man, text writer and political economist has favored this alteration in the existing system. All political parties are pledged to this reform, notably the Democratic Party, which has repeatedly declared for it. In its platform of 1896 it declared:

"Congress alone has the power to coin and issue money, and President Jackson declared that this power could not be delegated to corporations or individuals. We therefore denounce the issuance of notes intended to circulate as money by national banks as in derogation of the Constitution, and we demand that all paper which is made a legal tender for public and private debts, or which is receivable for dues to the United States, shall be issued by the Government of the United States and shall be redeemable in coin.

"Again, in 1900, the Democratic platform on the same subject declared that -

"A permanent national-bank currency, secured by Government bonds, must have a permanent debt to rest upon, and if the bank currency is to increase the debt must also increase. The Republican currency scheme is therefore a scheme for fastening upon the taxpayers a perpetual and growing debt. We are opposed to this private corporation paper circulated as money but without legal-tender qualities and demand the retirement of the national-bank notes as fast as Government paper or silver certificates can be substituted for them.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

"This measure provides for the gradual retirement of national bank circulation over a period of 20 years and the reversion of the right of note issue to the Government of the United States. (p. 4650). (September 10, 1913)

* * * *

"The gentleman seems ignorant of the fact that the national-bank notes which Federal reserve notes will gradually displace are redeemable in 'gold or lawful money.'" (p.4937) (September 13, 1913)

Congressional Record, Vol. 51, Part 2.

"* * * A colleague awhile ago propounded a question to the Member from Oklahoma asking the latter to point to the provision of the Senate amendment providing for the retirement of the bond-secured national-bank currency. There is no such provision. The Senate amendment provides for an interminable perpetuation of the bond-secured currency. We have complained for 50 years of the inflexibility of this currency. Bankers, business men, textbook writers, currency experts, uniformly and concurrently agree that we ought ultimately to retire, without disturbance or shock, this bond-secured currency; and yet the Senate amendment extends its existence interminably. Not only that, but it requires the regional reserve banks to purchase a given amount of United States 2 per cent bonds annually, against which, whether currency be needed for business purposes or not, notes shall be issued. No banking discretion remains. We may have a redundancy of currency; there may not be one particle of business necessity for the issuance of more, but rather a need of retirement. Yet under this Senate amendment banks are required to issue." (p. 1304) (December 20, 1913)

Congressional Record, Vol. 51, Part 17.

"The Senate radically altered the bond provision of the House bill. The pivotal point of banking and currency reform in this country around which controversy has

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

raged for a quarter of a century has been the rigid and inelastic nature of a currency based on Government bonds. The demand of the banker, the text writer, the business man, and other currency experts has been for the abrogation of the bond-secured currency system and the gradual substitution therefor of a currency based on commercial assets and immediately responsive to business requirements. That has been the universal contention of all persons who have a clear comprehension of the question. It has been the declared policy of the Democratic Party for years, the declaration having appeared in specific terms in three of its recent national platforms. Nevertheless, the Senate in its wisdom radically altered that provision of the House bill so as to make an appreciable retirement of the bond-secured currency unlikely, if not impossible. The House conferees gained a measure of advantage by so modifying the Senate amendment as to make probable the retirement of at least $300,000,000 of the bond-secured currency within a period of 20 years, and the possible retirement of $500,000,000 of that currency, based upon a gold reserve and commercial assets, expanding and contracting automatically with the business requirements of the country. (December 22, 1913)

* * * *

"The House conferees so amended the Senate bond provision as to require the retirement over a period of 20 years of about $300,000,000 of the bond-secured national-bank notes, whereas the Senate amendment did not provide for the retirement of more than $125,000,000." (pp. 562-564). (December 22, 1913)

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

EXCERPTS FROM REPORT OF HOUSE COMMITTEE ON BANKING AND CURRENCY (No. 69, 1st Session) — Submitted September 9, 1913.

One of the essential features of reform which "should be recognized and provided for in any new plan" is the

"* * *Furnishing of an elastic currency by the abolition of the existing bond-secured note issue in whole or in part, and the substitution of a freely issued and adequately protected system of bank notes * * * " (p. 11).

* * * *

"In lieu of the notes, now secured by national bonds and issued by the national banks, and, so far as necessary in addition to them, the committee recommends that there shall be an issue of 'Federal reserve Treasury notes,' * * * ." (p. 17)

* * * *

"There are several important reasons for the retirement of bond-secured currency. The most obvious is that bond-secured notes are not 'elastic'. By this is meant that the necessity of purchasing bonds to be deposited with a trustee for the protection of note issues prevents banks from issuing these notes as freely and promptly as they otherwise would, while it also prevents them from retiring or contracting the notes as freely and promptly as would otherwise be the case. There is little or no disagreement at present among students of the banking and currency problem in the United States that the retirement of the bond-secured notes is essentially necessary if success is to be had in restoring elasticity to the circulation and in making the national banking system really responsive to the needs of business. For that reason every plan of currency or banking reform that has been put forward during the past 15 years has contained as an important factor some provision for getting rid of the bond-secured notes. The basic criticism on the present system of

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

notes already indicated is reenforced by the fact that the supply of United States bonds available for use in protecting note issues is likely to be limited, as was the case in the panic of 1907. Then the national banks were not able to enlarge their issues because of their inability to obtain further bonds, until they had been aided by the action of the government in issuing additional bonds for the very purpose of furnishing a backing for currency, notwithstanding that at that moment there was a very large surplus in the Treasury. Over and above this consideration has been the fact that the formalities and technicalities connected with the issue of bank notes based upon bonds have been so great and troublesome as to preclude the easy and prompt supplying of currency, even when there were enough bonds in the market to furnish all the backing for notes that might be desired. This shows why, apart from the special and peculiar difficulties that attend anything of the sort, the substitution of bonds other than national for the national bonds now used will not help the situation. The only way to relieve the bad conditions that have developed in connection with national bank currency is, therefore, generally admitted to be the abandonment of the bond-secured plan and the introduction of something else in its place." (p. 22.)

* * * * * * * *

"After reviewing all of the different factors in the situation, the Banking and Currency Committee has reached the conclusion that the issue of national-bank notes now current should, for the reasons already surveyed, be retired despite the serious difficulties that have been sketched, and that in their place a new issue of notes put out by the Government of the United States and closely controlled by it should be authorized. This issue of notes it is proposed to entitle 'Federal reserve Treasury notes.' (p. 24.)

* * * * * * * *

"Whatever may be the ultimate earnings of the banks, however, the committee is convinced that the conversion of the bonds and the retirement of the present notes, followed by the issue of new notes, ought to be effected at all hazards and at any cost, as a fundamentally desirable reform. It believes that the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

"change should be carried through, upon a frank, open and direct basis, and that no effort should be made to mask, as was done in the Aldrich Bill, proposed by the Monetary Commission, the real nature of the process or the burden and distribution of its cost." (pp. 25, 26.)

" * * * * The distribution of earnings upon the basis of deposit balances would give to the Government a large share of the profits in any case and when the present national-bank notes shall have been replaced by Federal reserve notes it is obvious that the function of note issue will result in a large volume of earnings which the Federal reserve banks could not enjoy were they to share this power with other banking institutions." (p. 39.)

* * * * * * * * * * * * *

"Sections 18 and 19 may best be treated together, as they jointly provide for the disposal of existing national-bank notes and for the refunding of the bonds now held by the banks behind these notes. The general views entertained by the committee with respect to bank-note issues in general and the treatment of existing national-bank notes in particular have been sufficiently set forth at an earlier point in this report. It remains here to outline the exact steps that have been recommended to attain the desired end, and to indicate the probable cost and incidental problems connected with each step in the process. What has been done in the bill is as follows:

"1. Provision has been made for paying at the end of 20 years the existing outstanding 2 per cent bonds. This is a manifest matter of justice.

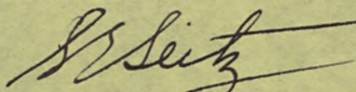
"2. Meantime banks have been permitted at their discretion to present one-twentieth of their bond holdings each year for conversion into 3 per cent bonds, and in the event they do not so present them the Secretary of the Treasury is authorized to reassign the quotas of bonds not taken up to other banks which are authorized to in that case secure a corresponding amount of additional conversions.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

"3. During the 20 year period any bank may increase or decrease its circulation at pleasure, subject to the maximum limitation prescribed by law.

"4. However, from the date of the passage of the act no national bank is to be required to hold any United States bonds as security for circulation if it chooses to retire such circulation- in other words, the compulsory bond-purchase requirement of existing law is repealed." (p. 56.)

Respectfully,



S. E. Seitz

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date November 29, 1932

To Governor Meyer

Subject:

From Mr. Goldenweiser

GPO 2—8495

I attach a copy of a memorandum on currencies linked to sterling, which was prepared at Secretary Mills' request.

RECEIVED
NOV 30 1932
OFFICE OF THE GOVERNOR
FEDERAL RESERVE BOARD

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

November 29, 1932

Secretary Mills — Currencies linked to sterling,

Mr. Goldenweiser — course of sterling, etc.

Currencies linked to sterling. - As a result of England's suspension of the gold standard in September, 1931, a number of other countries, which with England go to make up the so-called sterling group, also departed from gold and their currencies have since followed rather closely the course of sterling on the gold exchanges. In general the currencies of these countries are now maintained at parity with the pound through exchange regulations of the governments and central banks, or, in Australia, through agreements among the members of the banking community to sell exchange at a fixed rate. This linking to sterling is in some countries accomplished by law, and in others by a policy followed by the banking system. The following list gives the thirteen more important members of the sterling group, those whose membership is a matter of law being classified separately from those whose membership is a matter of banking policy.

Important Countries Whose Currencies Are Linked to Sterling

As a matter of law	As a matter of banking policy
New Zealand*	Australia
Bolivia	Sweden
British India	Norway
Straits Settlements (British Malaya)	Denmark
Irish Free State	Finland
Egypt	Portugal
	Portuguese Africa

*New Zealand legally departed from the sterling standard on June 30, 1932, but since that time its currency has in fact continued to follow the course of sterling.

The laws establishing a sterling standard in the Straits Settlements, Irish Free State, Egypt, and British India were passed prior to England's departure from the gold standard, while the laws in New Zealand and Bolivia have been passed since that time.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

In deciding to link their currencies to sterling these countries were influenced by the fact that their export trade was chiefly with Great Britain and others of the sterling group. Had these countries attempted to maintain the gold standard, they would probably have suffered a decline in their export trade and consequently an adverse balance of payments. The resulting drain upon their gold reserves would have in the end impaired their ability to maintain the gold standard. In short, these countries believed that they could maintain greater stability in their international position by linking themselves to the pound. It is not unlikely that at least most of the members of the sterling group will remain on a sterling standard until England returns to gold.

A number of other countries, not shown on the list because their currencies are not definitely linked to sterling either as a matter of law or as a matter of banking policy, have such close relations with England that they are affected in important ways by the course of sterling. Among these are certain South American countries in which British investments are on a large scale.

Course of sterling exchange since England's departure from gold. - The course of sterling exchange at New York since England's departure from gold is shown by the accompanying chart. The chart brings out the fact that during most of this period sterling has fluctuated over a considerable range.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

STERLING EXCHANGE AT NEW YORK

(Weekly averages of daily figures)

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date December 3, 1932

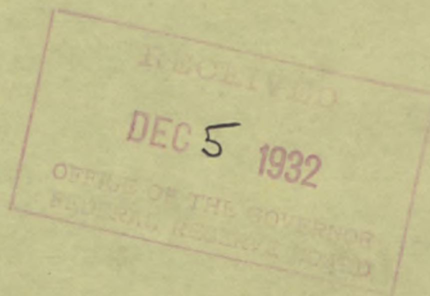
To Governor Meyer

Subject:

From Mr. Goldenweiser EAG

G P O 2—8495

I transmit herewith a memorandum prepared by Mr. Terborgh describing the currency difficulties of the 90's with special reference to silver purchases.



Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date November 29, 1932

To Mr. Goldenweiser

Subject: Currency Difficulties in the Nineties

From Mr. Terborgh

G. T.

2—8495

The purpose of this memorandum is to present a brief account and analysis of the financial developments following the passage of the Sherman Silver Purchase Act of 1890. By way of background, I have prefaced it with a short statement of the country's experience under the preceding Silver Purchase Act, that of 1878.

I. Experience under the Silver Purchase Act of 1878

The Silver Purchase Act of 1878, until its repeal by the act of 1890, added an average of about $30,000,000 yearly to the money supply of the country. It was freely predicted by economists at the time of the passage of the act and repeatedly thereafter that the continuation of silver purchases at this rate would put the country off the gold standard. The twelve years in which the act was in force failed to confirm the prophecy. During this period the country's monetary gold stock trebled in size, due largely to excess of gold imports over exports. Except for a few months in 1884 and 1885, the gold holdings of the Treasury appeared ample. The wholesale commodity price level, after rising from 1879 to 1882 and declining from 1882 to 1885, held fairly steady for the rest of the period, finishing slightly lower than it began. Our balance of trade was favorable. According to two different indexes of business activity (Cleveland Trust and American Telephone and Telegraph) business was above the computed "normal" approximately two-thirds of the time, the only severe depression being that of 1884-1886.

The reasons for the failure of events to confirm the forecasts seem fairly evident. For one thing, the silver issues, amounting altogether to

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

$370,000,000, did not exert their full expansive effect, since they were in part offset by a shrinkage of $140,000,000 in the volume of national bank notes outstanding. The net increase in silver currency and national bank notes combined for the period of the first act was therefore but $230,000,000, or an average of less than $20,000,000 a year, considerably under 2 per cent of the average quantity of all kinds of money in circulation. From 1882 to 1890 the average net increase was only $8,000,000 a year.

A second consideration is that during the twelve years 1878-1890 the country was undergoing a rapid growth in population and (excepting for 1884 and 1885) a fairly steady increase in production. An increased amount of currency was needed for circulation and to serve as bank reserves, and the new silver currency helped to supply this demand.

By the time of the repeal of the first Silver Purchase Act (July, 1890) such danger signs as may have been present in the situation did not seem conclusive. It was true that our favorable trade balance had been rather low since 1885 (actually an unfavorable balance in 1888), and that since 1887 we had had a moderate net export of gold. On the other hand, the silver issues had not prevented our wholesale commodity price level from declining, during the preceding eight or ten years, fully as much as the levels of leading European countries (England, France, and Germany). There seemed, by this test, to have been no "relative inflation" in the United States.

II. Experience under the Silver Purchase Act of 1890

Before discussing the effects of the act of 1890, which accelerated the rate of issue of silver currency, in the form of legal-tender Treasury notes, it is necessary to digress for a brief explanation of the general situation of the Treasury in relation to its silver and paper currency.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The Treasury was committed to the maintenance of gold and silver dollars at par. To do this, it had to redeem in gold, on presentation, not only greenbacks and the notes issued under the act of 1890, but silver dollars as well. Directly or indirectly, all Treasury currency constituted a potential demand for gold. Against this liability the Treasury had no segregated gold reserve; it attempted merely to maintain a part of its current cash balance in gold.

Depletion of the Treasury's cash balance (including gold) from operating deficits could be made good by borrowing. The Treasury gold stock was subject, however, to possible reduction from two other sources: gold exports and domestic "hoarding" of gold by banks and others.

Against the first of these drains, net gold exports, the Treasury had a buffer in the gold holdings of banks. To the extent that the banks were willing to see their gold reserves depleted by export the Treasury was protected. Against drain due to increased domestic gold holdings outside the banks the same limited buffer existed. If, however, the banks, themselves, through necessity or fear, chose to augment their gold holdings by converting Treasury currency into gold, the Treasury would have to part with gold and might be obliged to take extraordinary measures of protection.

The essential insecurity of the Treasury position lay, of course, in the lack of adequate measures of defense against a gold drain. Loss of gold by a central bank can be countered by various measures, such as raising discount rates and contracting credit. Loss of gold by the Treasury could not be countered in this way. The leading defensive devices available to it were the direct exchange of legal tenders for gold and the sale of bonds for gold or other currency. The first entailed no contraction of bank reserves, since the legal tenders were lawful reserve money; the second

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

tended to contract reserves only so long as the Treasury could avoid paying out the gold or other currency realized from bond sales. A net contraction of credit by this means could occur only if the Treasury augmented its cash holdings at a rate in excess of that at which it issued new currency under the Silver Purchase Act. Such contraction was so plainly contrary to the purpose of the Silver Purchase Law that the Treasury did not in fact attempt it until the act had been repealed. It found itself, consequently, in a vicious circle, paying out gold for currency, then paying out the currency, then once more paying out gold for the currency.

Increase of currency under the act of 1890. - The Silver Purchase Act of 1890 had the effect of adding about $50,000,000 a year to the monetary stock of the country in the form of legal tender notes payable in gold or silver. Passed July 14, 1890, it became operative in August and remained in effect until November 2, 1893. During this period $156,000,000 of notes were issued. During the same time, the downward movement of national bank circulation reversed itself and outstandings actually increased by $25,000,-000. The result was a growth at the rate of roughly $60,000,000 a year in the volume of Treasury currency and national bank notes combined, as compared with a rate of only $8,000,000 a year for the seven years immediately preceding 1890. This obviously was a striking development.

Effect of the act on confidence. - European financiers, and many of our own, viewed with apprehension the adoption of the expanded silver purchase program. From a legislative standpoint it was a compromise deemed necessary by conservatives to hold in check the much more extravagant demands of the silver interests and other interests demanding "easy money." Repeated pleas of Presidents and Secretaries of the Treasury, of both parties, had failed to secure the repeal of the Silver Purchase Law of 1878, and this new victory

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

of the silver interests seemed to augur still further experiment. Competent observers held that the success of the Treasury in maintaining the gold standard under the first Silver Purchase Act was partly a matter of luck, and that the length of time for which it could hold out under the augmented program would depend on business remaining favorable. That it would be submerged eventually if the program were not abandoned seemed to be fairly evident. The passage of the act, therefore, caused a considerable loss of confidence.

Loss of confidence abroad. - During the years 1891-1895, inclusive, net gold exports totaled $250,000,000, as compared with $30,000,000 in the five years 1886-1890. That this difference was due to an unfavorable shift in the invisible items of the balance of payments is clearly indicated by the fact that in the later period the excess of commodity exports over imports was $510,000,000, against $113,000,000 in the earlier period. This shift in the balance of invisible items recorded principally a diminution of foreign investment in this country and a repatriation of American securities held abroad. This radical change in capital movements, though due in part to European depression in the early nineties, was principally a reflection of alarm on the part of foreign investors in the future of our monetary standard.

Between the beginning of 1891 and the autumn of 1896, the net export loss of gold was about $270,000,000. During this period gold in circulation within the United States, including that held by the banks, fluctuated roughly within a range of $100,000,000--between $500,000,000 and $600,000,000--and showed no upward trend. Even if a part of the upward fluctua-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

tions in the domestic gold circulation is ascribed to "hoarding,"1/ it is apparent that this factor was quantitatively small in comparison with the loss of gold to foreign countries.

That this loss of gold was not due to a "relative inflation" of commodity price levels in this country as a result of the silver issues seems to be indicated by Mitchell's study (Business Cycles, 1913, p. 121). Between 1890 and 1896 the wholesale price level here declined both absolutely and relative to price levels in England, France, and Germany.

The period 1891-1896 in detail. - The following discussion traces in some detail the course of events from 1891 to 1896. The arrangement is chronological and the focus of attention is the vicissitudes of the net gold balance of the Treasury. The course of this balance is shown in the table. The accompanying charts show for the period 1891-1896 the course of the country's gold stock and the Treasury's gold balance, also the gold export and import movements.

1/ It is known that some gold was hoarded during the nineties, as well as some other money, but how much of either was "hoarded" is not known. Reported circulation figures relate only to the total amounts "outside Treasury," including holdings by banks (which then counted as reserves) and holdings of the public. National banks are known to have held more gold than usual in the first half of 1892, the last part of 1893, and during part of 1894. On the other hand, the banks repeatedly let their gold holdings run low in order to aid the Treasury.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

NET GOLD BALANCE OF TREASURY, 1891-1897

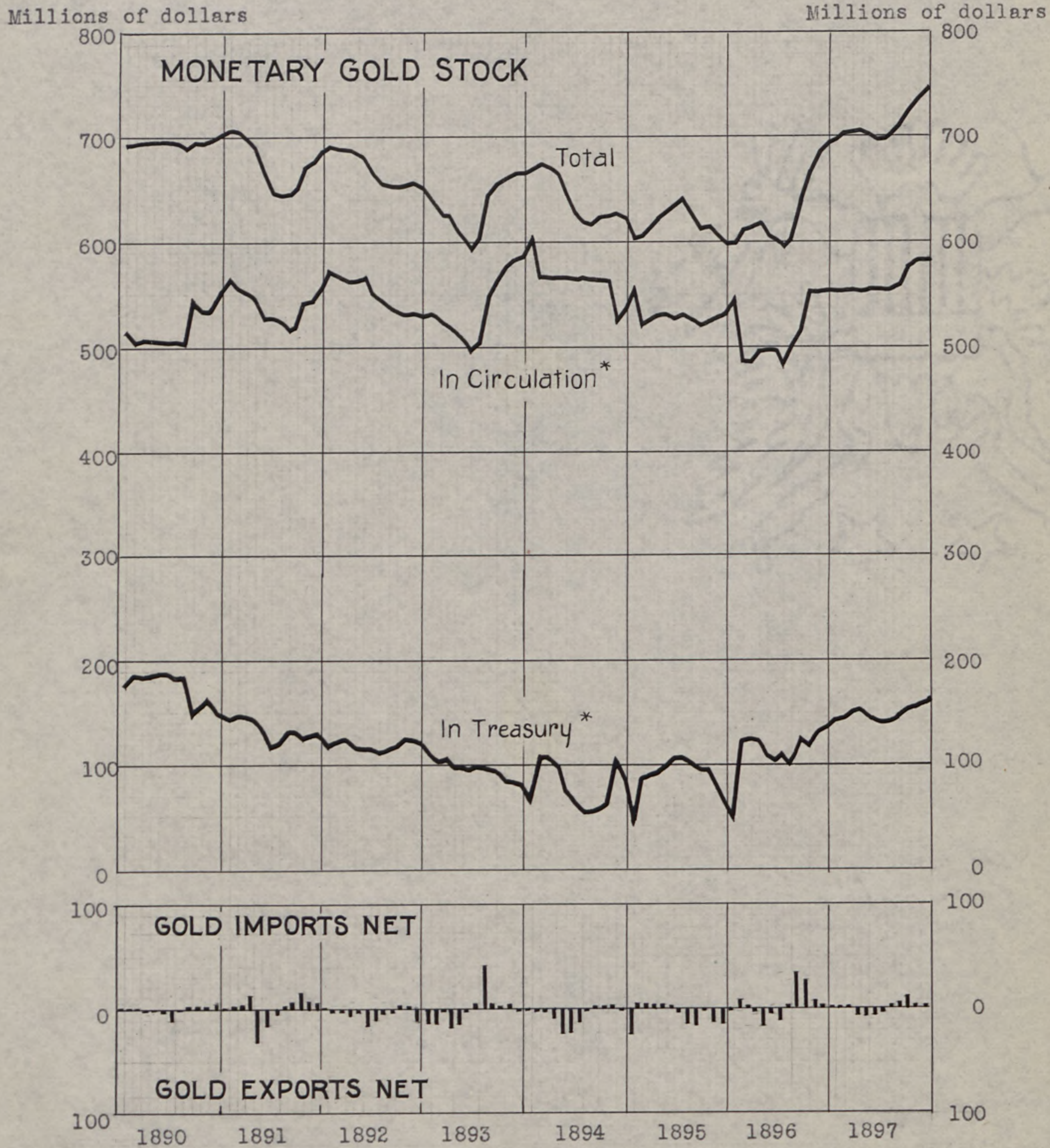
(In millions of dollars)

End of month	1891	1892	1893	1894	1895	1896	1897
January	142	120	108	66	45	50	145
February	150	122	103	107	87	124	149
March	148	126	107	106	91	129	152
April	142	120	97	100	91	125	153
May	133	114	95	79	99	108	144
June	118	114	95	65	108	102	141
July	121	110	99	55	107	111	141
August	132	114	96	55	100	101	144
September	133	119	94	59	93	124	148
October	128	124	84	61	92	117	154
November	129	124	83	105	79	132	157
December	131	121	81	86	63	137	161

Note. Figures shown are those reported as "net gold in Treasury," which is part of the Treasury's "available cash balance." They do not include gold held by Treasury in trust against gold certificates in circulation.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

7a.



* Figures shown for circulation include, and those shown for Treasury holdings exclude, gold held against gold certificates in circulation.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

1891

The act of 1890 had scarcely been passed when the great Baring failure occurred in London, bringing to an end a period of great speculative activity abroad. The first half of 1891 saw a heavy selling of American securities and a serious drain on our gold supply. Between February and July we lost $70,000,000, the Treasury net gold stock falling from $150,000,000 to $118,000,000. Practically all of the export gold was taken from the Subtreasury in New York.

The Treasury gold supply would have fallen at once to a dangerous level except for the defensive measure adopted, namely, an offer to transfer currency to distant banks, through the Subtreasury system, at virtually no cost to the bank, upon payment of gold at the point at which the transfer was initiated. By picking up some domestic exchange business in this way the Treasury reduced its net loss of gold to only a little over $30,000,000.

A bumper crop in the autumn, coupled with a crop failure abroad, gave us an extraordinarily favorable trade balance and reversed the gold movements in the second half of the year. We recovered about half of the loss of the first six months, though less than the trade balance warranted. Repatriation of American securities continued.

1892

A net export of gold reappeared early in the year and continued in every month except October and November. The total loss amounted to $59,000,000.

By July the Treasury gold reserve, which stood at $130,000,000 at the end of 1891, had shrunk to $110,000,000. The day was saved by the autumn

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

flow of money to the west. The New York banks took free advantage of the facilities offered by the Treasury for the transfer of currency to distant points in exchange for gold paid in to the Treasury at New York. By the aid of this device the Treasury was able to transfer to the banks the bulk of the loss in gold due to exports during the year, and to end the year with a gold balance of about $120,000,000.

1893

The first five months of the year saw net gold exports of about $60,-000,000. Securities continued to flow to this country in large volume, due in part to fear of a suspension of gold payments and in part to severe depression in Europe. In this country business was prosperous between the middle of 1891 and the spring of 1893, and stock prices were enjoying a boom, offering a strong inducement to Europeans, cautious after the Baring debacle, to "get out while the getting was good."

The export of gold in the first half of 1893 fell heavily on the Treasury. Its gold balance began ominously to decline. By April it was below the $100,000,000 line which tradition had fixed as the danger zone. A wave of apprehension swept the financial markets. The government made strenuous efforts to maintain its position by exchange of paper for gold with banks in different parts of the country. It was a makeshift which did little to inspire confidence. Only the cooperation of the banks saved the Treasury from a suspension of gold payments. In this atmosphere of uneasiness the panic broke.

It seems probable that the crisis was immediately precipitated by

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

anxiety over the gold situation,1/ though the business and speculative boom which had been built up in the preceding years may have been ripe for deflation in any case.

The distrust of our monetary stability, indicated by the continuous liquidation of securities from abroad, had by 1893 affected the psychology of our bankers. I quote from Taussig, who is speaking of the gold exports of the first half of that year:

> "The drain of gold now fell directly on the Treasury. This is one striking new feature of the currency situation of recent years. Before 1890 an outflow of gold did not necessarily or indeed usually fall on the Treasury. What gold had been needed for export was readily furnished by the banks from their own supplies. There was general confidence that the Treasury would redeem its legal tenders without fail in gold, and hence, no disposition to hold the specie itself rather than the right to it. After 1890, and especially after 1892, all this was changed. The new and enlarged silver issues had shaken general confidence. The use of legal tenders in place of gold, in payment by the Treasury to the New York banks, was daily proof to the financial world that the Government's gold resources were strained; and there was the ominous decline in the gold reserve.2/ The banks no longer furnished gold to anyone who asked for it. They furnished United States notes of the old issue, or Treasury notes of 1890, which could be exchanged for gold over the Government's counters."

Following the crash there was for a short time a heavy net import of gold. Over $40,000,000 entered in the month of August. This was due to several factors. The Administration had announced its intention of moving immediately for repeal of the Silver Purchase Act. This sufficiently buoyed

---

1/ There is no unanimity among authorities concerning the importance of this factor. For instance, Sprague declares that "if we inquire how far the currency situation had anything to do with the course of events up to this time (May, 1893) the answer is clear that the influence was extremely slight." On the other hand, Taussig's opinion is that "beyond question the general uneasiness as to the currency situation and its outcome was the prime occasion of the crisis."

2/ Prior to 1891, the Treasury had regularly settled its unfavorable clearing house balances in gold certificates. Thereafter, by way of protecting its gold supply, it paid all or most of such balances in legal tenders. The New York banks, in turn, furnished legal tenders instead of gold certificates to importers for customs payments to the Treasury, and obtained gold by direct redemption of legal tenders at the Treasury instead of through clearing house balances against it.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

confidence abroad to lead to sizeable purchase of securities in our markets, where they were available at bargain prices. Another influence was the currency premium which accompanied suspensions of currency payments by the banks early in August. The chief remaining factors were a heavy favorable trade balance in July and August, and some sterling loans negotiated in London before the banks resorted to suspension of payments.

1894

The revival of foreign confidence in our monetary situation following the repeal of the Silver Purchase Act was short-lived. It soon developed that the silver agitation was not over; indeed, the depression which followed the crash of August, 1893 intensified the clamor. The depression brought also a succession of heavy Treasury deficits which added to the concern over the precarious state of the gold reserve. Liquidation of American investments was resumed.

The gold imports in the autumn of 1893 were absorbed by the banks and the public. The gold balance of the Treasury continued to decline, reaching \$66,000,000 by the end of January, 1894. The situation was so acute that in February the Treasury sold a \$50,000,000 bond issue to the New York banks in exchange for gold. The relief was only temporary. Heavy gold exports began again and the year closed with a net loss of \$80,000,000, despite an exceptionally favorable trade balance. In the summer of 1894 the Treasury gold holdings were about \$55,000,000. A second bond issue of \$50,000,000 was sold to the New York banks in November.

1895

By the end of January, the Treasury gold balance stood at \$45,000,000. A loan of \$65,000,000 was arranged in February with a banker's syndicate,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

by the terms of which a part of the proceeds were to be imported in gold from abroad and measures were to be taken to assist the Treasury to protect its gold stock. This procedure had been found necessary because the previous bond issues had been paid for in part by gold withdrawn from the Treasury for the purpose.

The support of the syndicate propped up the Treasury gold balance until late in the year, when the effects of continued gold exports ($70,-000,000 net for the year) proved too much. The balance slipped off badly in November and December.

1896

By the end of January the Treasury gold reserve was down to $50,000,-000. February saw another bond issue, this time for $100,000,000. It proved to be the last for this purpose. With the generous cooperation of the banks, whose gold holdings were allowed to remain relatively low, the Treasury was able to protect its position until the results of the national elections, coupled with heavy gold imports in September and October, relieved the pressure on its reserve. For the year as a whole net gold imports amounted to $46,000,000, reflecting chiefly an exceptionally heavy favorable balance of trade.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date December 3, 1932

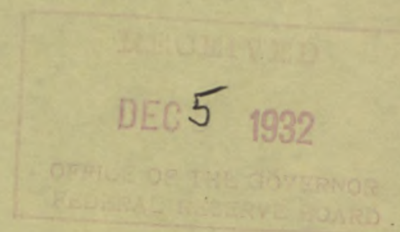
To Governor Meyer

Subject:

From Mr. Goldenweiser

2—8495

I transmit herewith an analysis of the domestic allotment plan (S. 4985, 72nd Congress, 1st session). The analysis was prepared by Mr. Riefler and Mr. Garfield. They appear to think that this plan holds more promise than any of its predecessors in this field. At the same time they feel that it has certain weaknesses, the principal among which are: (1) Cumbersome administrative machinery; (2) Subsidizing agricultural production which is already over expanded; (3) Through limitation of certain crops in this country encouragement of production abroad, particularly in the case of cotton; (4) the period 1910-1914 as a base appears to be faulty because that was a period when agricultural prices had a preferred position as compared with other prices.



Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

DOMESTIC ALLOTMENT PLAN
Analysis of S. 4985, 72nd Congress, 1st session

The object of the domestic allotment plan is to give agricultural producers of export commodities the equivalent of tariff protection on that part of their production which is domestically consumed. As this cannot be done by a tariff imposed on imports into the country, an excise tax called a "tariff adjustment charge" is imposed on the domestic user (with certain minor exceptions) of each commodity coming under the plan, and out of the proceeds an equivalent "tariff benefit" is paid to each agricultural producer who agrees to control his production in accordance with the plan, on that proportion of his total production which corresponds to domestic consumption of the commodity. In general, therefore, farm commodities would continue to be sold in the world market at a world price under this plan, but after being sold a tax would be paid by processors on that portion which is domestically consumed, the proceeds of the tax being distributed back to producers. Special provision is made against dumping abroad of any surplus resulting from the operation of the plan. The plan is not compulsory on producers and any producer not joining the plan may increase his production as he desires. Specific features of the general plan are discussed by topics below.

Commodities affected

The "tariff adjustment charge" may under certain conditions be collected from the domestic processor of any farm commodity on which a tariff now exists and also on cotton, raw silk and rayon. The charge on raw silk and rayon would be applied only in event a similar charge

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

were placed on cotton and would have as its purpose the protection of the domestic manufacturer of cotton from competition of rayon and silk manufacturers. Different charges may be placed on different grades of the same general commodity. The plan also instructs the President to raise import duties on any manufactured imports which would have been subject to a tariff adjustment charge if domestically manufactured when such action is necessary to protect the domestic processor from increased competition because of the operation of the plan.

Conditions under which plan may be invoked

The plan could be invoked by the Federal Farm Board only on commodities which fulfilled the following conditions:

A. The domestic price of the commodity would have to be lower in relation to its average price from 1910 to 1914 than was the Index of Wholesale Commodity Prices computed by the Bureau of Labor Statistics.

B. This lower price would have to be ascribable to an excess of domestic production over domestic consumption or to a volume of domestic production "otherwise unduly depressing the price." The effect of the last provision on the list of individual commodities to be included is not clear.

C. Sixty per cent of the domestic producers of the commodity, measured either in terms of number of producers or in terms of their average annual production, would have to signify by vote, or otherwise indicate to the board, their willingness to cooperate in carrying out the plan. No vote so taken would of itself impose any obligation on the producer.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Amount of "tariff adjustment charge assessed"

The charge assessed on the processor of any commodity to which the plan were applied would be determined as follows:

A. It could not exceed the import duty in effect upon that commodity at the time it was assessed, or in the case of cotton, rayon or raw silk which carry no duty, 5 cents per pound.

B. Within these limitations it should be as near as possible the amount necessary to make the average price to producers on that part of the product which is consumed domestically the same relative to the average price of all commodities as prevailed on the average from 1910 to 1914. At the same time it should not be so high as to raise the cost of the commodity to the domestic processor or manufacturer to a level higher with relation to other prices than prevailed on the average from 1910 to 1914. The Index of Wholesale Commodity Prices compiled by the Bureau of Labor Statistics would be used as an indicator of changes in the average price of all commodities.

Payment of tariff adjustment charge by processor

The tariff adjustment charge would be paid by the manufacturer, processor, or distributor, at the stage of manufacture, processing, or distribution at which, in the judgment of the Federal Farm Board, it could most conveniently be collected. Provision is made in the bill for refund of the charge on goods destined for export. The board would have the power to reduce or eliminate the charge for portions of the commodity when collection of the full amount would prevent the "use of any commodity in the manufacture of any specific low value product, and thereby reduce

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

consumption and increase the surplus." No charge would be levied against commodities used for feeding livestock or on any commodity processed or manufactured by producers "for consumption by their families, employees, or households, or by their livestock." It would be levied on all goods processed which came under the plan, imported commodities as well as those which were domestically produced. The specific charge to be paid on any commodity would ordinarily be changed only at the end of each marketing year, such year to be determined by the board.

Payment of tariff benefit to producer

The tariff benefit would be paid to producers in proportion to their previous production if they entered into and fulfilled an annual contract with the Federal Farm Board agreeing:

A. Not to increase the acreage planted to the commodity benefitted, or, in the case of livestock, not to increase either the number fed or bred, the pounds of livestock sold, nor, if required, the acreage of corn or other feed crops; and

B. To reduce the acreage or pounds of livestock sold, in any season by such amount up to 10 per cent as the board might specify, and also, if so required by the board, to put the land withheld from production into certain specified uses such as pasture, other grassland, summer fallow, crops for improving fertility or preventing erosion, etc., when in the opinion of the board such control of land released from production were necessary to control other surpluses. In the case of livestock, the contract might also restrict acreage of corn or other feed crops.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Funds collected on silk and rayon would go into the Treasury as miscellaneous receipts and would not be paid out as tariff benefits.

Administration of plan

The general administration of the plan would be vested in the Federal Farm Board, but other agencies of government, both Federal and local, would also be called upon to share actively in the work. The main duties of each of these agencies are outlined below:

A. Federal Farm Board

1. Take votes among affected producers (1) to acquaint them with the advantages of the plan, (2) to ascertain the extent to which they would cooperate in carrying out the plan, (3) to secure other information necessary to carry out the plan, (4) to find out how many producers would sign contracts limiting production under the plan, and (5) to determine the amount of reduction in production desired by the producers.

2. Determine and impose the tariff adjustment charges.

3. Determine the probable annual amount of any commodity upon which tariff adjustment charges would be paid and allot this amount among the states; in the case of livestock or livestock products in proportion to the average production for sale during the past five years; and in the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

case of crops in proportion to the average acreage planted during the past five years, multiplied by the average yield per acre planted during the past twenty-five years.

4. Enter into cooperative agreements with duly authorized State representatives for the formation of State, county, and local allotment committees. Representation on these committees would be accorded so far as is practical to producers, consumers, bankers, cooperative marketing associations, and other dealers in commodities coming under the plan, and also to different geographical regions.

5. Enter into annual contracts with each producer joining the plan. These contracts would give to the producer the right to obtain tariff benefits in return for his agreement to limit production. If at the time the individual allotment were made the marketing year had advanced too far for a full limitation agreement the board would have power to modify the contracts to conform to this situation. Producers accepting the plan would have the right to transfer or exchange allotments with other producers provided the total allotment and total acreage were not affected.

6. At the end of each marketing year determine and pay the tariff benefit to each producer fulfilling

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

his contract. The total paid any such producer could not exceed the sum of the adjustment charges on his allotment.

7. Establish an arbitration committee to pass on appeals from allotments made to individual producers; the board would pass on county appeals directly or establish an arbitration board for that purpose. The board would also be empowered to reallocate or transfer allotments when there had been a sale of the land upon which such allotment was made or a change in tenancy, etc.

8. Reallocate allotments as between States, counties, etc., when in its opinion such reallocation were necessary to obtain a more equitable distribution of benefits in view of readjustments in the geographical distribution of production, etc. Such reallocation would be made in the same manner as the original allotments, except that reductions in output already carried out by individual producers in accordance with the plan would be disregarded in making such reallotment.

9. Prescribe rules and regulations necessary to carry out various features of the plan.

B. State allotment committees would be formed to allocate the State allotment of any commodity as determined by the Federal Farm Board among counties; in the case of livestock on the basis of the average production

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

for sale during the past five years; and in the case of crops on the basis of average acreage planted during the past five years and the average yield per acre during the past ten years. They would also hear appeals from producers on allotments made.

C. County allotment committees would be formed

1. To determine the average production of producers during the past five years on the basis of information obtained (a) by questionnaire and inquiry among producers, (b) by publication of data so obtained and investigation of challenges of the accuracy thereof, and (c) by examination of elevator and gin records and other relevant data.

2. To allocate among producers the county allotment of any commodity certified to it by the State allotment committee.

3. To hold a copy of the contract entered into by producers with the Federal Farm Board.

4. To determine at the end of each marketing year which producers had fulfilled their contracts and were entitled to tariff adjustment benefits.

5. To pay such benefits upon receipt of funds from the Federal Farm Board through the State allotment committee.

D. Local allotment committees would be formed to assist county committees in examining reports, hearing complaints, etc.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

E. U. S. Treasury

1. Cooperate with the Federal Farm Board in working out the procedure by which refunds would be made for tariff adjustment charges levied on goods processed or manufactured for export, and also to establish a system by which processors and manufacturers for export might avoid original payment of fee by posting a bond.

2. Establish conversion factors for determination of refunds, etc.

F. Bureau of Internal Revenue

1. Collect and pay into the Treasury to the credit of the Federal Farm Board the tariff adjustment charges levied on domestic processors.

G. Tariff Commission

1. Investigate and report to the President the amount of tariff duties which should be imposed on articles of foreign manufacture which compete with domestic articles subject to the tariff adjustment charge.

Penalties

Manufacturers or processors who failed to pay the tariff adjustment charge would be subject to a fine not to exceed $10,000 or imprisonment not to exceed two years, or both.

Producers who failed to live up to their contract with the Federal Farm Board for control of production would lose their rights to tariff

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

benefits under their contracts that year and for as many years thereafter as the board, on recommendation of the State and local allotment committees, might decide.

Expenses of administration

Expenses of the Federal Farm Board in administering the plan would be limited to 2½ per cent of the receipts from tariff adjustment charges.

Except for expert assistants all permanent employees of the board under the bill would be subject to Civil Service and the Classification Act of 1923.

Members of county and local allotment committees would serve without compensation but would be paid travel and subsistence expenses not to exceed $5 per day. Authorization is made in the bill to pay members of State allotment committees $10 per day in addition to travel and subsistence for time actually spent in the work of the committee.

Should any part of the plan including the tariff adjustment charge be invalidated by a court decision, payments would still be made on contracts outstanding with producers out of funds authorized in the bill.

Minor stabilization operations

Whenever it should appear that the collection of the tariff adjustment charge from processors were likely to force increased quantities of the commodity into export, the Federal Farm Board would be authorized to enter the market and buy up the surplus, either diverting it to the production of products of lower value or holding it for subsequent sale. In the following year, the contracts entered into by the board with producers of such commodities would be required to specify a reduction in acreage or

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

production sufficient to permit the disposal of the surplus without loss under average conditions. In no case could such holdings be retained by the board for more than two marketing years after purchase.

Contracts as collateral

Any producer would be allowed to borrow on his contract at a bank or credit corporation up to an amount not to exceed 90 per cent of his probable tariff benefit for that year as estimated by the Federal Farm Board. The county allotment committee would have to be notified of such loans and the check for the benefit would be delivered to the producer through the creditor. No bank would be permitted to charge more than 6 per cent on such loans or to require any additional fee, and such loans would be eligible for rediscount at the Federal reserve banks.

Economics of plan

The most questionable feature of the plan is the cumbersome administrative machinery which would be necessary. Whether contracts to limit production would be fulfilled or not would depend on the honesty of county committees whose decision on whether the contract had been fulfilled would be final unless the producer objected. There would be opportunity, therefore, for collusion between local producers and their local county committees. This would apply only to future limitation and not to the benefit paid, since the benefit would be based on a fixed allotment, and added output achieved by increased acreage or by more intensive farming would sell at only the world price. The bill contains certain safeguards against large administrative costs; if the tariff adjustment charge were invalidated by a court decision, however, the loss to the Treasury that year

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

might be large. The administrative power given to the Farm Board would be great and the possibilities of discrimination numerous. The board would have the power, for example, to make effective a 5 cent tariff adjustment charge on cotton, which at the present time would almost double the price of cotton used by factories in the United States. Similarly, the price of wheat might be doubled if a 42 cent adjustment charge were imposed. Such authority is larger than that given to the Tariff Commission. Technically, it would be difficult for the board to avoid discrimination in fixing tariff adjustment charges since they would have to determine such interrelated matters as the proportion of the crop which would be domestically consumed, the effect of the charges on domestic consumption, and the effect of both of these factors in conjunction on world prices, which in themselves would reflect a wide variety of factors outside the United States. If, for example, meat consumers in this country should curtail consumption sharply as a result of advances in retail prices on account of the tariff adjustment, livestock prices at the farm might be lowered, offsetting in part at least the tariff benefit.

If administrative difficulties did not prove insurmountable, this plan would appear to furnish a more feasible procedure for increasing farm income than the recent stabilization operations of the Farm Board. Both operations attempt to increase the income of certain groups of farmers at the expense of the consumer. The domestic allotment plan, however, has three distinct advantages over the stabilization operations hitherto attempted: (1) if it fails it does not saddle the loss on the Treasury (unless the failure is the result of a legal decision against

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

the tariff adjustment charge); (2) it provides for export refunds to processors so that American manufacturers are not excluded from the export market by reason of an increased domestic price for their raw materials, and (3) it provides a machinery for limiting production so that higher prices will not defeat themselves by increasing the domestic surplus.

From a long run point of view, on the other hand, the plan has many features that are economically unsound. It would provide a subsidy for an industry which is already overgrown. This procedure may or may not be justified as relief in an emergency, but in the long run under some circumstances would operate to perpetuate an excessive potential productive capacity.

It would also fail in the long run to control production since it applies only to the United States. In the case of cotton, for example, any higher world price which resulted from restriction of acreage in America under the plan would eventually stimulate production in Egypt, India, etc. This same difficulty was one of the important factors in eventually wrecking the Brazilian attempts to control the price of coffee. Brazil for a time controlled the world price of coffee, but could not prevent the control from increasing the output of other countries.

It would work against the most efficient use of our land resources. Acreage reduction would be as large proportionately on our best and most efficient land as on our poorest, with the result that land released from production would not consist in the main of marginal or submarginal land. It would also tend to perpetuate the present use of land and operate against those shifts of farm production from poorer land to land better adapted to new conditions which usually develop from decade to decade. Against these

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

disadvantages, however, some weight should be given to the fact that it would tend to make the individual producer diversify his production by utilizing land released under the plan in the production of non-export commodities. It is possible, of course, that this might in turn create new surpluses.

It would give present claimants on farm income a vested interest in a subsidy on part of their production. These vested interests, furthermore, could be borrowed upon and transferred under certain conditions. Under these circumstances it might come about that operating producers would share less and less in the benefits of the plan. The right to cash in on the allotment, for example, might be sold or transferred in other ways to retired farmers or other non-producers, in which case the income of the actual producers would not be improved even though consumers continued to pay a heavy subsidy.

Finally, the choice of the period 1910 to 1914 as a base period seems highly questionable. The bill requires the Farm Board to raise within the limits of the tariff all individual agricultural prices that are now lower relative to other commodities than they were in that period up to that relative level. Prices of farm commodities not subject to tariff benefit, therefore, would be those which were higher than this relative level, and the net effect would be to establish a general level of agricultural prices that was higher relative to nonagricultural prices than the average level which prevailed from 1910 to 1914. To comprehend the real significance of this level it is only necessary to recall the fact that the period 1910-1914 was characterized by widespread urban

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

protest against the high cost of living. It is likely, consequently, that if the bill were successfully administered under present conditions of urban income, it would soon give rise to wide protests from urban wage earners. It makes no allowance whatever, furthermore, for the fact that the relative cost of production in the case of many agricultural commodities, notably wheat, has declined materially since the period 1910-1914. Since present prices of most agricultural commodities are extremely low on almost any basis of comparison with prices of other commodities, a strong argument can be made regarding the economic justification of measures designed to lessen this discrepancy. There is no economic justification, however, for attempting to freeze permanently the price of an individual commodity at a fixed level with reference to other commodities, especially at a level prevailing twenty years earlier. To do so ignores completely relative changes in efficiency, costs, geographical accessibility and the whole gamut of economic factors which on a stable general level of prices still require wide shifts in the prices of individual commodities.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date December 7, 1932.

To Governor Meyer.

From Mr. Wyatt.

Subject: Questions of policy arising in the administration of Section 8 of the Clayton Act.

ero 2—8495

CONFIDENTIAL

Dear Governor Meyer:

URGENT

For your convenience in connection with the consideration of the above subject as a special order of business at the Board meeting on Friday, December 9, 1932, I am handing you herewith the following documents:

1. Memorandum suggesting certain specific questions which should be decided in order to facilitate an orderly administration of the Clayton Act and suggesting for the Board's consideration certain general principles which could be adopted for this purpose.

2. Copies of memoranda addressed to the Board under date of October 3 and 21 by Mr. Chase and the undersigned discussing the above subject.

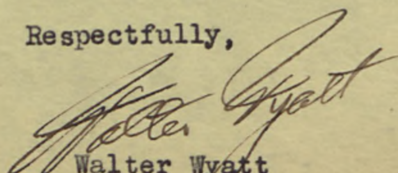
3. Report adopted by Federal Reserve Agents on this subject at their recent conference.

4. A memorandum by Mr. Chase regarding the problem of reviewing existing permits.

5. Section 8 of the Clayton Act as amended to date and the Board's Regulation regarding interlocking bank directorates.

I believe it would be very helpful if you would read these documents in advance of the Board meeting on Friday.

Respectfully,



Walter Wyatt
General Counsel

Papers attached

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

CONFIDENTIAL

Dec. 7, 1932

TO: The Federal Reserve Board

FROM: Mr. Wyatt, General Counsel.

SUBJECT: Questions of policy arising in the administration of Section 8 of the Clayton Act.

I am advised by Mr. Morrill that, at a meeting of the Executive Committee on December 2, 1932, it was decided to make the above subject a topic for discussion at a meeting of the Board to be held on December 9, 1932.

It will be recalled that this subject was placed on the program for the recent Conference of Federal Reserve Agents; this office prepared two memoranda thereon dated October 3 and 21, 1932; and copies were furnished to all Federal Reserve Agents in advance of their conference.

QUESTIONS TO BE CONSIDERED.

No rule of thumb or fixed formula can properly be adopted and regularly adhered to in the administration of the Clayton Act, since each case must necessarily depend upon its own facts; but, as indicated in the above memoranda, decisions by the Board on the following points would materially facilitate an orderly administration of the Clayton Act:

1. In passing upon applications for permission to serve two or more banks under the Clayton Act, will the Board:

(a) Consider only the question whether interlocking directorates may result in a restriction of credit or a substantial lessening of competition? or

(b) Will the Board consider other questions affect-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

ing the public interest and especially the question whether the applicant's influence on such bank is likely to be detrimental or beneficial?

2. If the Board decides to consider only the possibility of a restriction of credit or a substantial lessening of competition, or if no other question is involved in the case, but it appears that the banks which the applicant desires to serve are in substantial competition, will the Board:

(a) Grant the application in each case, unless it appears that there is more than a remote possibility that a substantial lessening of competition will result?

or

(b) Deny the application, unless the applicant furnishes evidence sufficient to overcome the presumption that an interlocking directorate between the banks will result in a lessening of competition or otherwise shows affirmatively a good reason why it would be in the public interest to grant his application?

3. If the Board decides to consider the question whether the applicant's influence on the bank is likely to be detrimental or beneficial, will the Board:

(a) Consider only such information as is contained in records of which it has actual or constructive notice -- i.e., information in the records of the Board, the Fed-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

eral Reserve Agents and the Federal reserve banks? or

(b) Require the applicant, the Federal Reserve Agent and the Chief National Bank Examiner to answer a series of questions designed to disclose the probable character of the director's influence and whether his record as a director is good or bad? or

(c) Cause an independent investigation to be made regarding the record of each person who applies to it for a permit under the Clayton Act? or

(d) Adopt some other means for obtaining such information?

4. If the conditions are otherwise satisfactory, will the Board, as a general rule, refuse to grant additional permits for interlocking directorates when the banks involved are already closely knit with numerous other banks in the same city by a spider web of interlocking directorates?

5. If the conditions are otherwise satisfactory, will the Board permit the parent bank of a chain or group of banks to have interlocking directorates with the other banks in the same group or chain?

6. Will the Board permit interlocking directorates between the parent bank of a branch banking system and independent unit banks located in cities in which the parent bank has branches?

7. Will the Board undertake to review all outstanding permits for interlocking directorates under the Clayton Act period-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

ically, in order to determine whether the public interest requires their revocation?

REPORT OF FEDERAL RESERVE AGENTS.

During their recent conference, the Federal Reserve Agents considered the memoranda which had been prepared by this office and forwarded to them for their information, and they adopted the attached report.

A careful analysis of this report fails to reveal any definite recommendation except that the Board's regulation be amended so as to provide that, in passing upon applications under the Clayton Act, the Board will consider not only whether the banks involved are natural competitors and whether having the same officers, directors or employees will tend to lessen competition or restrict credit, but also the following questions:

> "Purpose for which services are sought, nature of proposed influence and activity, relationships, competency, and any other facts having a bearing upon the interest of the public in such banks as affected by their having the same directors, officers, or employees."

GENERAL PRINCIPLES SUGGESTED FOR CONSIDERATION.

I respectfully suggest that the Board consider the adoption of the following principles for its guidance in the administration of the Clayton Act:

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

1. In passing upon applications for permission to serve two or more banks under the provisions of the Clayton Act, the Board will consider not only the question whether such interlocking relationship may result in a restriction of credit or a substantial lessening of competition, but also whether the applicant's influence upon such banks is likely to be helpful or harmful to the banks.

2. Where the banks involved are in substantial competition, this will be considered as raising a presumption that an interlocking relationship between them will result in a substantial lessening of competition; and the permit will not be granted unless the applicant furnishes evidence sufficient to overcome this presumption or to show affirmatively why it would be in the public interest to make an exception in his case and permit him to serve the banks in question.

3. If the banks are not in substantial competition, the Board will grant the application, unless it appears that the applicant's influence upon the banks may be harmful to them or that it is otherwise incompatible with the public interest for him to be permitted to serve such banks.

4. In determining whether or not the applicant's influence is likely to be helpful or harmful to the banks involved, the Board will consider the following matters:

(a) The condition and management of the banks with which he is already associated and the extent of his responsibility therefor;

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

(b) Whether the applicant discharges the duties and responsibilities of his office by attending directors' meetings or otherwise;

(c) Whether the applicant has abused the credit facilities of the banks he is already serving - e. g., whether the examiners have criticized loans to the applicant, his family or his interests as being excessive or unjustified for any other reason; and

(d) Any other factors having a bearing upon the desirability of the applicant as an officer, director or employee of two or more banks.

5. In order to pass upon these questions, the Board will require the Federal Reserve Agent to consult with the Chief National Bank Examiner or the State Banking authorities, to inspect the reports of examination of the banks which the applicant is already serving, to consider any other information in the possession of the Federal reserve bank, to answer a series of questions on this subject, to express his opinion regarding the applicant, and to give a full statement of his reasons for such opinion.

6. Where the banks involved in an application are already closely knit with numerous other banks in the same city by a spider web of interlocking directorates, the Board will refuse to grant permits for additional interlocking directorates, unless it appears that the banks are not in substantial competition or that there is some other exceptional

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

reason why it would be in the public interest to grant the permit.

7. The Board will not deny interlocking directorates between members of the same chain or group of banks solely because they are members of the same chain or group.

8. The Board will not permit interlocking directorates between independent unit banks and a branch banking system or members of a chain or group of banks, unless it is clear that such banks are not in substantial competition or that there are exceptional circumstances which make it in the public interest to permit such interlocking directorates.

9. As soon as banking conditions are sufficiently settled to remove the danger that the revocation of existing permits and the resignation of directors from banks which they are now serving may be misunderstood by the public with harmful results to the banks involved, the Board will adopt the practice of reviewing annually the outstanding Clayton Act permits, in order to determine whether the public interest requires their revocation either (a) immediately or (b) effective at the time of the next annual election of directors during the ensuing January.

ATTACHED DOCUMENTS.

For the Board's further information in this connection, there are attached hereto the following documents:

1. Copies of the two memoranda on the above subject addressed to the Board by Mr. Chase and the undersigned under date of October 3, and 21, respectively.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

2. Copy of the report on this subject adopted by the recent Conference of Federal Reserve Agents.

3. A memorandum by Mr. Chase regarding the problem of reviewing outstanding permits.

4. Copy of Section 8 of the Clayton Act as amended and the Board's Regulations regarding interlocking bank directorates under the Clayton Act.

Respectfully,

(S) Walter Wyatt
General Counsel

Papers attached

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

December 7, 1932

TO: The Federal Reserve Board

FROM: Mr. Chase - Assistant Counsel

SUBJECT: The Problem of Reviewing Outstanding Clayton Act permits.

In connection with a possible review of the Clayton Act permits which have been granted by the Board the following information is submitted for the Board's consideration.

The records of this office show that over 6200 permits have been granted by the Board. It is not possible to tell from these records what permittees have ceased to avail themselves of the permission granted them, since the Board is not usually advised of resignations, deaths, and other circumstances which terminate the permittee's service.

A review of the outstanding permits would involve the following steps, and possibly others, in connection with each permit granted by the Board:

1. To ascertain whether the permittee is still serving the banks, and in the same capacities, covered by the permit.

2. To ascertain whether the banks still come within the prohibitions of the Act.

3. If the facts ascertained under the preceding paragraphs show that a permit is still necessary, a detailed investigation of the competitive situation would be required, similar to the examination which is now made in connection with new applications to ascertain (a) whether the banks are in substantial competition, and (b) whether competition between banks involved has increased or decreased during the period when the applicant was serving them.

4. The investigation contemplated in the preceding paragraph should, of course, include current statements of the banks involved, analyses and

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

other current information showing the character of their business, the location of any branches and other facts which might affect their competitive situation with regard to other banks involved in the permit.

5. If it is found that the competition has decreased during this period, it would be necessary to make a further investigation to ascertain whether the existence of the permit had in any way contributed to the result.

6. To ascertain whether there are any other reasons why the public interest would be served, or would not be served, by revoking the outstanding permit. In this connection, it would be necessary to ascertain whether there were any facts, aside from the question of competition between the institutions involved, which would affect the judgment of the Board in deciding whether it would be in the public interest to revoke or continue the permit.

7. If, after ascertaining the above facts, the Board felt that the permit should be revoked, the applicant should then be afforded opportunity for a hearing by the Board to present any further evidence which might be relevant.

PREVIOUS REVIEWS OF CLAYTON ACT PERMITS.

Under date of November 19, 1919, (X-1728), the Board wrote to each Federal Reserve Agent requesting him to submit a list of all member banks in his district for which interlocking directorships had been authorized and which, owing to changed

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

conditions, might be regarded as having since come into competition.

In response to this letter, reports were received from the several agents listing directors and banks in their districts, but it was decided to postpone any action until the fall of 1920.

Under date of November 22, 1920, the Board wrote a letter to each Federal Reserve Agent requesting him to review all outstanding permits and report to the Board. The letter requested the Agent to make a general survey, and to report "all cases where such interlocking bank directorates have been permitted and where there is a possibility that substantial competition exists at the present time between the banks involved". It stated that the argument had been made that in cases where banks are not large enough to exercise any control over the supply of credit in their communities they cannot be regarded as within the prohibitions of the Act, but that the Board did not agree with this view. It explained that the Board did not mean to imply by this letter that, where competition was found to exist, the permit would be revoked in every instance. In conclusion, it stated that (in most cases) the report made in response to the circular letter dated November 19, 1919 (X-1728) was in satisfactory form and that the same form could be followed.

Accompanying this letter was a form letter of the same date, X-2067, containing a questionnaire to be followed in reporting on each case.

In response to this letter full reports were received from the Agents.

The matter was held under consideration, and in a circular letter dated December 21, 1922 (X-3603), the Board stated that it had decided not to revoke any permits in cases where competition had increased since the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

granting of the permit, for the reason that such cases do not appear to be a violation of the spirit and purpose of the Act.

Thereafter the question was raised whether it was consistent for the Board in such cases to permit directors to continue to serve but to refuse all further applications involving the same banks. In a circular letter dated November 28, 1923 (X-3899), all Federal Reserve Agents were accordingly asked to make a comprehensive review of all the interlocking directorates in their respective districts so as to inform the Board whether the Act was being complied with, particularly with reference to cases where competition had come into existence since the granting of the permit.

The replies to this letter which were received from the Agents were reviewed in a memorandum of Counsel dated December 12, 1923, which stated that there were relatively few cases where competition had grown up since the granting of the permit; that, after a careful investigation, the Board had previously decided (X-3603) not to revoke outstanding permits in cases where competition had grown up since they were granted, because that would be contrary to the spirit and purpose of the Act; that, on the other hand, such permits ought to be revoked where it appeared that they were resulting in the stifling of competition; and concluded by recommending that the policy expressed in X-3603 should be continued. This view was adopted by the Board.

Respectfully,

(S) G. Howland Chase,
Assistant Counsel.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

FEDERAL RESERVE BOARD

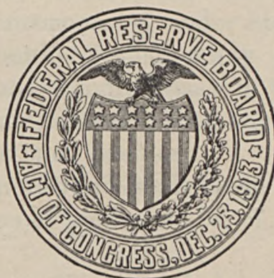
INTERLOCKING BANK DIRECTORATES UNDER THE CLAYTON ACT

SECTION 8 OF THE CLAYTON ACT

AND

REGULATION L

This Regulation as printed herewith is in the form as amended May 14, 1930



UNITED STATES
GOVERNMENT PRINTING OFFICE
WASHINGTON: 1930

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

REGULATION L, SERIES OF 1930

(Superseding Regulation L, Second Series of 1928)

INTERLOCKING BANK DIRECTORATES UNDER THE CLAYTON ACT

SECTION I. DEFINITIONS

Within the meaning of this regulation—

The term "bank" shall include any bank, banking association, or trust company organized or operating under the laws of the United States or of any State thereof.

The term "national bank" shall be construed to apply not only to national banking associations but also to banks, banking associations, and trust companies organized or operating under the laws of the United States, including all banks and trust companies doing business in the District of Columbia, regardless of the sources of their charters.

The term "resources" shall be construed to mean an amount equal to the sum of the deposits, capital, surplus, and undivided profits.

The term "State bank" shall include any bank, banking association, or trust company incorporated under State law.

The term "private banker" shall apply to any unincorporated individual engaging in one or more phases of the banking business as that term is generally understood and to any member of an unincorporated firm engaging in such business.

The term "Edge corporation" shall mean any corporation organized under the provisions of section 25 (a) of the Federal reserve act, as amended.

The term "city of over 200,000 inhabitants" includes any city, incorporated town, or village of more than 200,000 inhabitants, as shown by the last preceding decennial census of the United States. Any bank located anywhere within the corporate limits of such city is located in a city of over 200,000 inhabitants within the meaning of the Clayton Act, even though it is located in a suburb or an outlying district at some distance from the principal part of the city.

SECTION II. PROHIBITIONS OF CLAYTON ACT

Under section 8 of the Clayton Antitrust Act—

(1) No person who is a director or other officer or employee of a national bank having resources aggregating more than $5,000,000 can legally serve at the same time as director, officer, or employee of any other national bank, regardless of its location.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

(2) No person who is a director in a State bank or trust company having resources aggregating more than $5,000,000 or who is a private banker having resources aggregating more than $5,000,000 can legally serve at the same time as director of any national bank, regardless of its location.

(3) No person can legally be a director, officer, or employee of a national bank located in a city of more than 200,000 inhabitants who is at the same time a private banker in the same city or a director, officer, or employee of any other bank (State or national) located in the same city, regardless of the size of such bank.

The eligibility of a director, officer, or employee under the foregoing provisions is determined by the average amount of deposits, capital, surplus, and undivided profits as shown in the official statements of such bank, banking association, or trust company filed as provided by law during the fiscal year next preceding the date set for the annual election of directors, and when a director, officer, or employee has been elected or selected in accordance with the provisions of the Clayton Act it is lawful for him to continue as such for one year thereafter under said election or employment.

When any person elected or chosen as a director, officer, or employee of any bank is eligible at the time of his election or selection to act for such bank in such capacity his eligibility to act in such capacity is not affected by reason of any change in the affairs of such bank from whatsoever cause until the expiration of one year from the date of his election or employment.

SECTION III. EXCEPTIONS

The provisions of section 8 of the Clayton Act—

(1) Do not apply to mutual savings banks not having a capital stock represented by shares.

(2) Do not apply to joint-stock land banks organized under the provisions of the Federal farm loan act.

(3) Do not apply to banking institutions which do no commercial banking business.

(4) Do not prohibit a person from being at the same time a director, officer, or employee of a national bank and not more than one other national bank, State bank, or trust company, where the entire capital stock of one is owned by the stockholders of the other.

(5) Do not prohibit a person from being at the same time a class A director of a Federal reserve bank and also an officer or director, or both an officer and a director, in one member bank.

(6) Do not prohibit a person who is serving as director, officer, or employee of a national bank, even though it has resources aggregating over $5,000,000, from serving at the same time as director, officer, or employee of any number of State banks and trust companies, provided such State institutions are not located in the same city of over 200,000 inhabitants as the national bank and do not have resources aggregating in the case of any one bank more than $5,000,000.

(7) Do not prohibit a person from serving at the same time as director, officer, or employee of any number of national banks, provided no two of them are located in the same city of over 200,000 inhabitants and no one of them has resources aggregating over $5,000,000.

(8) Do not prohibit a person who is not a director, officer, or employee of any national bank from serving at the same time as officer, director, or employee of any number of State banks or trust companies, regardless of their locations and resources.

(9) Do not prohibit a person who is an officer or employee but not a director of a State bank from serving as director, officer, or employee of a national bank, even though either or both of such banks have resources aggregating over $5,000,000, provided both banks are not located in the same city of over 200,000 inhabitants.

(10) Do not prohibit a person who is an officer or employee but not a director of a national bank from serving at the same time as director, officer, or employee of a State bank, even though either or both of such banks have resources aggregating over $5,000,000, provided both banks are not located in the same city of over 200,000 inhabitants.

(11) Do not prohibit a private banker or an officer, director, or employee of any bank or a class A director of a Federal reserve bank from being at the same time an officer, director, or employee of not more than two other banks within the prohibitions of the Clayton Act, if there is in force a permit therefor issued by the Federal Reserve Board.

Exceptions cumulative.—The above exceptions are cumulative.

SECTION IV. PERMISSION OF THE FEDERAL RESERVE BOARD

(*a*) **In general.**—Section 8 of the Clayton Antitrust Act, as amended by the acts of May 15, 1916, May 26, 1920, and March 9, 1928, authorizes the Federal Reserve Board to permit any private banker or any officer, director, or employee of any bank, banking association, or trust company, or any class A director of a Federal reserve bank to serve as director, officer, or employee of not more than two other

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

banks, banking associations, or trust companies coming within the prohibitions of the Clayton Act, if in the judgment of the Federal Reserve Board it is not incompatible with the public interest.

(*b*) **When obtained.**—Inasmuch as this exception to the prohibitions of the Clayton Act applies only when "there is in force a permit therefor issued by the Federal Reserve Board," it is a violation of the law to serve two or more banks in the prohibited classes before such a permit has been obtained. A permit should be obtained, therefore, before becoming an officer, director, or employee of more than one bank in the prohibited classes. It may be procured before the person applying therefor has been elected as director or appointed an officer or employee of any bank in the prohibited classes.

(*c*) **Applications for permission.**—A person wishing to obtain a permit from the Federal Reserve Board to serve banks coming within the prohibitions of the Clayton Act should—

(1) Make formal application on F. R. B. Form 94, or, if a private banker, on F. R. B. Form 94d. Each of these forms is made a part of this regulation.

(2) Obtain from each of the banks involved a statement on F. R. B. Form 94a, which is made a part of this regulation, showing the character of its business, together with a copy of its last published statement of condition, and, if a private banker, make a statement on F. R. B. Form 94e showing the character of his or his firm's business.

(3) Forward all these papers to the Federal reserve agent of his district, who will attach his recommendation on F. R. B. Form 94b, which is made a part of this regulation, and forward them in due course to the Federal Reserve Board.

(*d*) **Compatibility with the public interest.**—In determining whether the issuance of such a permit would be compatible with the public interest, the Federal Reserve Board will consider—

(1) Whether the banks involved are natural competitors;

(2) Whether their having the same directors, officers, or employees would tend to lessen competition or to restrict credit; and

(3) Any other facts having a bearing upon the interest of the public in such banks as affected by their having the same directors, officers, or employees.

(*e*) **Approval or disapproval.**—As soon as an application is acted upon by the board, the applicant will be advised of the action taken.

If the board approves the application, a formal permit to serve on the banks involved will be issued to the applicant.

(*f*) **Hearing.**—If it appears to the board that it would be incompatible with the public interest to grant such permit, the board will so

notify the applicant and will afford him every opportunity to present any additional facts or arguments bearing on the subject before making any final decision in the case.

(*g*) **Effect of permits.**—A permit once granted continues in force until revoked, and need not be renewed.

(*h*) **Revocation.**—All permits, however, are subject to revocation whenever the Federal Reserve Board, after giving reasonable notice to the persons to whom they were issued and affording them an opportunity to be heard, finds that the public interest requires their revocation.

SECTION V. PERMITS UNDER SECTION 25 OF THE FEDERAL RESERVE ACT

With the approval of the Federal Reserve Board, any director, officer, or employee of a member bank which has invested in the stock of any corporation principally engaged in international or foreign banking or financial operations or banking in a dependency or insular possession of the United States, under the provisions of section 25 of the Federal reserve act, may serve as director, officer, or employee of any such foreign bank or financial corporation.

Applications for approval.—The approval of the Federal Reserve Board for such interlocking directorates may be obtained through an informal application in the form of a letter addressed to the Federal Reserve Board either by the officer, director, or employee involved, or in his behalf by one of the banks which he is serving. Such application should be sent directly to the Federal Reserve Board.

SECTION VI. PERMITS TO SERVE EDGE CORPORATIONS

With the approval of the Federal Reserve Board—

(1) Any officer, director, or employee of any member bank may serve at the same time as director, officer, or employee of any Edge corporation in whose capital stock the member bank shall have invested.

(2) Any officer, director, or employee of any Edge corporation may serve at the same time as officer, director, or employee of any other corporation in whose capital stock such Edge corporation shall have invested under the provisions of the Edge Act.

Applications for approval.—Such approval may be obtained through an informal application in the form of a letter addressed to the Federal Reserve Board either by the director, officer, or employee involved, or in his behalf by one of the banks or corporations involved. Such applications should be sent directly to the Federal Reserve Board.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

SECTION 8 OF THE CLAYTON ANTITRUST ACT, APPROVED OCTOBER 15, 1914, AS AMENDED BY THE ACTS OF MAY 15, 1916, MAY 26, 1920, MARCH 9, 1928, AND MARCH 2, 1929[1]

SEC. 8. That from and after two years from the date of the approval of this Act no person shall at the same time be a director or other officer or employee of more than one bank, banking association, or trust company organized or operating under the laws of the United States, either of which has deposits, capital, surplus, and undivided profits aggregating more than $5,000,000; and no private banker or person who is a director in any bank or trust company organized and operating under the laws of a State, having deposits, capital, surplus, and undivided profits aggregating more than $5,000,000, shall be eligible to be a director in any bank or banking association organized or operating under the laws of the United States. The eligibility of a director, officer, or employee under the foregoing provisions shall be determined by the average amount of deposits, capital, surplus, and undivided profits as shown in the official statements of such bank, banking association, or trust company filed as provided by law during the fiscal year next preceding the date set for the annual election of directors, and when a director, officer, or employee has been elected or selected in accordance with the provisions of this Act it shall be lawful for him to continue as such for one year thereafter under said election or employment.

No bank, banking association, or trust company organized or operating under the laws of the United States, in any city or incorporated town or village of more than two hundred thousand inhabitants, as shown by the last preceding decennial census of the United States, shall have as a director or other officer or employee any private banker or any director or other officer or employee of any other bank, banking association, or trust company located in the same place: *Provided*, That nothing in this section shall apply to mutual savings banks not having a capital stock represented by shares, to joint-stock land banks organized under the provisions of the Federal Farm Loan Act, or to other banking institutions which do no commercial banking business: *Provided further*, That a director or other officer or employee of such bank, banking association, or trust company may be a director or other officer or employee of not more than one other bank or

[1] Amended by sec. 25 of the Federal reserve act as amended Sept. 7, 1916, and by act approved Dec. 24, 1919, amending the Federal reserve act, as to corporations engaged in foreign banking and financial operations. See secs. 25 and 25 (a) of Federal reserve act.

trust company organized under the laws of the United States or any State where the entire capital stock of one is owned by stockholders in the other: *And provided further*, That nothing contained in this section shall forbid a director of class A of a Federal reserve bank, as defined in the Federal Reserve Act, from being an officer or director, or both an officer and director, in one member bank: *And provided further*, That nothing in this Act shall prohibit any private banker from being an officer, director, or employee of not more than two banks, banking associations, or trust companies, or prohibit any officer, director, or employee of any bank, banking association, or trust company, or any class A director of a Federal reserve bank, from being an officer, director, or employee of not more than two other banks, banking associations, or trust companies, whether organized under the laws of the United States or any State, if in any such case there is in force a permit therefor issued by the Federal Reserve Board; and the Federal Reserve Board is authorized to issue such permit if in its judgment it is not incompatible with the public interest, and to revoke any such permit whenever it finds, after reasonable notice and opportunity to be heard, that the public interest requires its revocation.

The consent of the Federal Reserve Board may be procured before the person applying therefor has been elected as a class A director of a Federal reserve bank or as a director of any member bank.

*   *   *   *   *   *   *

When any person elected or chosen as a director or officer or selected as an employee of any bank or other corporation subject to the provisions of this Act is eligible at the time of his election or selection to act for such bank or other corporation in such capacity his eligibility to act in such capacity shall not be affected and he shall not become or be deemed amenable to any of the provisions hereof by reason of any change in the affairs of such bank or other corporation from whatsoever cause, whether specifically excepted by any of the provisions hereof or not, until the expiration of one year from the date of his election or employment.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date December 20, 1932

To Governor Meyer

Subject:

From Mr. Goldenweiser

GPO 2—8495

I attach a carbon copy of "A Proposal for Mortgages Based on 'Capacity to Pay'" which was prepared for Mr. Magee by Mr. Riefler and Mr. Garfield.

RECEIVED
DEC 20 1932
OFFICE OF THE GOVERNOR
FEDERAL RESERVE BOARD

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

December 19, 1932

Mr. Magee — Payments in kind

Mr. Garfield

Preliminary investigation of payments in kind at prices above market showed that relatively little of this exists at the moment, although reports of barter are received from widely scattered localities. The seed loan plan was designed to relieve cotton farmers who had mortgaged their whole crop to obtain seed loans last spring. The arrangement was that if the farmer did not wish to pay his loan he could deliver cotton to approved warehouses or to cooperatives in an amount sufficient to cover his loan, figuring the cotton at 9 cents a pound (9½ cents in certain areas), and be allowed to do whatever he pleased with the rest of his crop. The farmer is, however, liable for the full amount of his loan. If the cotton sells for more than 9 cents (or 9½) a pound, the farmer gets the difference; if for less, he must pay the balance. The crop production loan office has agreed this year not to sell the cotton pledged before March 1, 1933; after that the decision depends on the Secretary. At the present time about 375,000 bales are held under similar arrangements prevailing before and it is anticipated that perhaps 600,000 bales of this year's crop will be held under this arrangement. This is about 5 per cent of the crop.

The International Harvester plan was essentially an extension of the practice whereby more is paid "in trade" than in cash. It applied only to a part of the payments on orders for large units of machinery. The company is reliably reported to be satisfied with the working of the plan. The Deere Company also made similar arrangements. Universities have accepted commodities in payment of tuition in certain cases.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The problems involved in tax payments and in mortgage payments, however, are somewhat different and these are discussed in the course of the accompanying memorandum relating to a proposal worked out by Mr. Riefler for mortgages based on "capacity to pay." The general situation with respect to farm income, expenditures and indebtedness is discussed in a supplementary memorandum. There is some discussion of the tax situation in that memorandum, and there is additional information on land tax delinquency in a release of the Department of Agriculture, which is attached.

Thank you for the material on the domestic allotment plan; our memorandum on what was then the current proposal went over before that material was received.

FRG:gew

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

A PROPOSAL FOR MORTGAGES BASED ON "CAPACITY TO PAY"

Farm income has shown a large decline in each of the three years since 1929, and the payment of fixed obligations of farmers has become increasingly difficult. In addition to operating costs and tax bills, which all farmers have to pay, 40 per cent of the farmers have payments to make on mortgages. At the present time a large number of farmers are not meeting these payments, as is shown by confidential figures from the Farm Loan Board. On October 31, payments on 40 per cent of the Federal Land Bank mortgages outstanding were delinquent or extended and these mortgages represented 47 per cent of the total in terms of dollar value. Since the end of 1929 the proportion has doubled each year--6.5 per cent in 1929, 11.6 per cent in 1930, 26.1 per cent in 1931, and 47.4 per cent at the end of October 1932. Special difficulties have resulted from renewals of mortgages made by other agencies in past years for short periods and without provision for amortization. These problems have been serious not only for the farmers with mortgages on their farms, but also to their creditors and to the various divisions of the Government that depend on the collection of taxes. Adjustment to the immediate pressing problem of foreclosure has been made in certain instances by creditors who were willing to compromise rather than to take over and operate farms. The capital of the Federal Land Banks has been increased, partly to permit extensions to debtors. Local taxes have been reduced. Freight rate reductions presumably under consideration by the Coolidge committee may eventually afford some relief to outlying areas. Adjustments all along the line, however, have been slow relative to the decline in income, and there is widespread demand for immediate relief, particularly from high taxes and

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

mortgage payments. A rise in prices of farm commodities would facilitate the payment of mortgage obligations for the farmers, but prices are not rising. Possible increases to be achieved through the domestic allotment plan, discussed in a recent memorandum, are in the future. In view of the current price situation, various proposals are being urged to extend relief to farm debtors through such devices as moratoria, scaling down of obligations, and payments in kind.

The "plan to relieve agriculture by the acceptence of payment in kind for obligations, debts and taxes" is a proposal to accept commodities at above their present market price in payment of obligations. Governments and mortgage holders would be asked to accept payment in non-perishable commodities at prices to be determined by the Department of Agriculture and then to hold the commodities until better prices prevailed. These holding operations, themselves, are expected to raise prices. A rise in prices for these commodities as a consequence of the operation of this plan would depend on the success of a holding movement conducted by a large number of separate governmental and private units; when these holders begin to sell, this would tend to depress prices. This plan presents a problem for local governments, which collect the bulk of the taxes, since they are obliged to make payments in cash for various services as well as for interest on outstanding indebtedness, and since they have no other source of income. While they could borrow on non-perishable products, they could do so only on the basis of market prices.

The chief purpose of this proposal for payment in kind is to prevent the loss of their farms by farmers whose income has been sharply reduced. A modification of this plan through mortgage payments based on "capacity

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

to pay" is described below. This plan would be applicable to all farmers that are unable to meet their mortgage obligations in dollars, regardless of whether their products were perishable or not, and would not involve the holding of stocks of commodities by different governmental units and other creditors.

Need for relief on mortgage payments

While the need of adjustment of mortgage payments to reduce farm incomes is apparent everywhere, the problems of some debtors are much more serious than those of others, and relief or adjustment should be in proportion to the need rather than uniform for all debtors. Such adjustments must be accepted by a wide variety of creditors who would be affected by any plan of adjustment; but creditors are showing a growing disposition to make adjustments wherever possible without foreclosure, and it may be feasible to work the problem out through mutual agreements.

"Capacity to pay" farm mortgages

The "capacity to pay" farm mortgages are designed to provide current relief to the debtor with no loss in principal to the creditor and a minimum of loss of interest over the life of the mortgage as a whole. It is not suggested that all farm mortgages be refunded into these mortgages. It is proposed to apply only to those creditors on defaulted liens who have decided that it would involve less loss to arrange a compromise with the present owners than to take possession of the property. The plan would work as follows: A "capacity to pay" refunding farm mortgage would be substituted for the present mortgage at its full face value. The new mortgage would have no definite due date, however, the contract remaining outstanding until paid off in full in accordance with the terms of the agreement. There would be no reduction in the principal of the loan, consequently, and insurance companies,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

mortgage banks, etc., would not have to take a loss on the principal if they were able to hold the loan to maturity.

The annual payment covering both interest and amortization required of the debtor would be the market value of a fixed amount of wheat or cotton or some other specified crop, so that the dollar value of these payments would fluctuate with the cash price of leading farm commodities in agreed markets. The debtor would thus be required to make an annual money payment, the amount of which would fluctuate with changes in the market price of his leading products. The payment would not exceed his capacity to pay, except under unusual climatic conditions, and the creditor would receive payments that would increase in years of farm prosperity and decline in years of depression.

One-half of the amount so paid each year would be used to reduce the principal of the loan. The other half would be considered full payment of interest on that part of the loan that was still outstanding. The amount of products to be paid could be determined in various ways on the basis of average prices of particular farm commodities in recent years. For example, on the average over the past ten years, an annual payment of $60 (for interest and amortization on a $1,000 mortgage) has been the equivalent of about 50 bushels of wheat, or 75 bushels of corn, or 300 pounds of cotton in the central markets for these commodities. The farmer, with a ten-year old Federal Land Bank mortgage which carries an annual charge of 5 per cent interest and 1 per cent amortization, consequently, has been paying on the average the equivalent of an annual delivery of these amounts of wheat, corn, or cotton in the central markets. In the earlier years when prices were high he paid

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

an amount equivalent to less than this, whereas in recent years of abnormally low prices his payments have been equivalent to a very much larger amount of products.

If this mortgage should be refunded into a "capacity to pay" mortgage, the debtor would be required annually to pay an amount equal to the cash price in specified markets of, say, 50 bushels of wheat, or 75 bushels of corn, or 300 pounds of cotton, or a certain amount of some other commodity, or a combination of commodities, for each $1,000 principal of the mortgage. If one-half of this amount were considered a full payment of interest, and the remaining half were used to reduce the dollar amount of the principal, the effect under different conditions would be as follows: If prices of the commodity chosen averaged the same in the future as in the past ten years, the mortgage would be retired as soon under the proposed plan as under the existing contract, and the average annual payment would also be the same; if farm prices remain low for a long time, the interest would be reduced and it would take longer to retire the principal; if farm prices rise materially, the interest would be increased but the period necessary for retirement of the principal would be reduced. Inasmuch as the long-time future of agriculture does not look too bright, the probabilities are that the creditor would receive less interest that under the existing contract. The principal of the loan would be repaid in full, however, and the creditor would probably average out better than he would under other plans of compromise that may be feasible at the present time.

The reason for assigning one-half of each annual payment to retirement of principal and one-half to payment of interest is partly technical and/the plan might be varied. In the present Farm Land Bank mortgages an annual payment of 6 per cent is sufficient to average 5 per cent on the principal and also to amortize

the mortgage in about 30 years. When interest and principal are both fixed in dollar amounts, it is possible to set this transaction up on a regular interest basis, most of the equal annual payments going to interest in the earlier years and most to retirement of principal in the later years. The same mortgage would be fully retired in the same number of years with the same annual payment if one-half of the annual payment were credited to the principal and one-half to interest; the only difference would be that if the books were set up that way the interest rate paid during the first years of the loan would appear to be very small while in the later years of the loan it would appear to be very large. Under the proposed capacity to pay mortgages the full amount of the principal is to be repaid and the compromise is to be confined to the payment of interest each year. In these circumstances, it would be simpler to credit one-half of the annual payment to principal and one-half to interest; if conditions in the next twenty years should be the same, on the average, as in the past ten years, this would work out in about the same manner in the end as an annual interest charge of 6 per cent on the face value of the mortgage, of which a progressively smaller part was absorbed by a 5 per cent interest charge on the principal and the remainder was credited to amortization. The proposed method would have the advantage from the debtor's point of view that in poor years, even though payments in dollar value would be small, there would still be a reduction in the principal of his debt.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

CHANGES IN FARM INCOME, EXPENDITURES, INDEBTEDNESS AND TAXES

Decline in farm income

Gross income of farms, including products consumed in farm households, is estimated by the Department of Agriculture at 5.2 billion dollars in 1932 which is less than 1/2 the amount received in the years 1924 to 1929, when income ranged from 11½ - 12 billion dollars. The course of income in postwar years is shown below:

GROSS INCOME FROM FARM PRODUCTION
(In billions of dollars)

Year	Income	Year	Income
1919	16.9	1926	11.5
1920	13.6	1927	11.6
1921	8.9	1928	11.7
1922	9.9	1929	12.0
1923	11.0	1930	9.4
1924	11.3	1931	7.0
1925	12.0	1932	p 5.2

p preliminary

The decline since 1929 has ranged from 44 per cent for producers of vegetables, fruit and nuts to 71 per cent for cotton growers, and the average reduction has been 56 per cent. Further details are shown in the accompanying table.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

GROSS INCOME FROM FARM PRODUCTION BY GROUPS OF COMMODITIES

(In millions of dollars)

	1929	1932 1/	Change (in per cent)
Cotton and cottonseed	1,389	397	- 71
Wool	99	30	- 70
Grains	1,288	391	- 70
Cattle, hogs and sheep	2,807	1,122	- 60
Total crops and livestock	11,950	5,240	- 56
Poultry and eggs	1,254	608	- 52
Dairy products	2,323	1,180	- 49
All other farm products	952	483	- 49
Vegetables	1,123	632	- 44
Fruits and nuts	715	397	- 44

1/ Preliminary

Department of Agriculture

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

These figures are totals, and do not show the full extent of declines for many products grouped under a single heading. Neither do they show the amount of reductions for individual farmers. The income of some cotton growers has undoubtedly been reduced by much more than 71 per cent, while that of some fruit growers has declined by much less than 44 per cent. An additional factor in some cases has been the cumulative effect of serious losses for several years in a row. Another consideration is the fact that freight rates have not been adjusted, so that, with prices low in central markets, some farmers distant from central markets now receive prices very low in comparison with those received by farmers nearer central markets. It is apparent that reduction in income has been far more serious for some farmers than for others, and this fact should be considered in formulating plans for relief.

Reduction in expenditures

There is ample evidence that farmers have reduced their living expenses and cost of operating farms. Wage rates for hired labor have declined by about one-half and expenditures for labor are down more than that. Outlays on fertilizers, important chiefly in the South, have been cut sharply as a consequence of reduced purchases and somewhat lower prices. Machinery purchases and repairs on farm buildings have also been curtailed. Interest and taxes, however, amounting to between 700 and 800 million dollars each per year, have remained relatively stable. In 1931 farm real estate taxes showed little decline on the whole, although in North Carolina, where the State took over some

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

of the obligations of local taxpayers with respect to roads and schools, farm taxes were reduced by about 25 per cent. This year there have been many local tax reductions and, although there have been some increases, farm taxes on the whole have probably decreased by 10 to 15 per cent. This amount, however, is small in comparison with reductions in farm income.

On about 40 per cent of the farms current cash payments must also be made on mortgages. In the cases where the mortgage is large relative to the value of the farm, current payments would prove difficult in most years and particularly so in years of low income. These instances are relatively small in number, however, according to the Department of Agriculture. Estimates made by a large group of farmers to that Department, which in previous years have checked closely with Census returns, show that the ratio of debt to value of farms at the beginning of this year was as follows:

Ratio of debt to value of farm	Per cent of mortgaged farms	Per cent of all farms
Per cent		
Over 100	5	2
75 - 100	11	4
50 - 75	21	9
25 - 50	38	15
1 - 25	25	10
0	..	60

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Probably farm values were reported above the value indicated by income last year and considerably above actual returns this season so that these figures do not afford an adequate measure of the difficulty encountered by farmers in meeting their current payments this year.

Delinquencies

The seriousness of the immediate situation is indicated by the volume of delinquencies and extensions on Federal farm loan mortgages, and by the recent increase in these items. The Federal land banks hold about 12 per cent of the mortgages outstanding; in general they are long-term loans, made on a conservative basis and amortized regularly. (Recent figures quoted below are given us by the Farm Loan Board in confidence.) At the end of 1929 delinquencies were reported ~~as~~ on 6.5 per cent of the net amount of such loans outstanding; during 1930 this increased to 11.6, by the end of 1931 to 26.1 per cent, and by October 30, 1932, to 29.8 per cent for delinquencies alone and to 47.4 per cent for delinquencies plus extensions. The number of land bank mortgages on which payments were delinquent or extended at the end of October was a somewhat smaller proportion of the total, indicating that the larger mortgages are most affected. The increase from 26 to 47 per cent for per cent in amount during the first 10 months of 1932 was almost wholly in "extensions," provided for in the Act passed last winter to increase the capital of these banks. Demand for such a large volume of extensions indicates the seriousness of the general situation, except as the demand arose out of the idea that Congress had granted a moratorium. The granting of these extensions reflects a temporary adjustment on the part of the land banks which will prevent many foreclosures in the immediate

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

future; such action by banks whose investments are all in mortgages was made possible by the Congressional appropriation. The number of these mortgages in process of foreclosure on October 31 was a relatively small proportion of delinquent and extended loans, as shown in the following table:

	Number
Loans outstanding	401,311
Delinquent or extended	159,335
In process of foreclosure	4,559

There has been, however, a large increase in the number of farms owned by the Federal land banks during the first 10 months of this year. Real estate owned outright and sheriff certificates, etc., in recent years, have been reported as follows:

	Number of farms owned
1929 December 31	6,641
1930 December 31	8,532
1931 December 31	12,529
1932 October 31	17,814

The rapid increase in holdings in 1931 and the first 10 months of 1932 has occurred in spite of some increase in the number of farms disposed of by the banks.

Holders of farm mortgages

The relative importance of various groups of creditors in any readjustment of mortgage terms is indicated roughly by the following table showing the distribution of holdings on January 1, 1928.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

HOLDINGS OF FARM MORTGAGES ON JANUARY 1, 1928,
BY PRINCIPAL CLASSES OF LENDERS

	Amount (In millions of dollars)	Per cent of total
Individuals	2,798	30
Life insurance companies	2,164	25
Federal land banks	1,146	12
Commercial banks	1,020	11
Mortgage companies	988	10
Joint stock land banks	667	7
Other agencies	685	7
TOTAL	9,468	100

From the beginning of 1928 to the end of 1931, holdings by insurance companies declined by about 150 million dollars, and those of Joint Stock Land Banks by 130 million. Outstanding loans of Federal Land Banks, after increasing by 42 million in 1928 and 1929 showed a decline of 35 million in 1930 and 1931.

The distribution by geographic areas and according to quality of loan would vary from that shown above. Also to be considered are the differences in terms of various mortgages held by the different agencies, particularly with respect to the duration of the loan and to amortization.

A factor greatly complicating the situation in many cases is the conflict of interests among various creditors. The holder of a first

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

mortgage might be willing to wait for payment but, in certain jurisdictions, may be forced to foreclose by attempts of the holder of the second mortgage to satisfy his claims. And in some cases failure of the operator to pay taxes creates difficulties for the creditors.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis