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Would it be Wise or Proper for Federal Reserve Board to Authorize Federal Reserve Banks to Pay their Member Banks, say One Percent, or Possibly Two Percent Interest on Deposits in Excess of Legal Requirements?

FIRST:

Except in Central Reserve Cities, only one-third of the reserve deposits have been paid in, and it will be six months before another instalment will come in and two and a half years before it is all paid in. Even in the end it is optional with the member banks whether they shall keep more than the required percentage of their reserves in their own vaults or in the vaults of the Federal Reserve Banks.

NOTE: At the end of 36 months the member banks will have the option of keeping the following percentages of their demand deposits in the manner indicated, depending upon their location:

	(a)	(b)	(c)	(d)	(e)
	Required Minimum In Own Vaults	Required Federal Reserve Bank Vaults	Reserve Which at Option of Member Bank may be Kept in Feder- al Reserve Bank or in Own Vaults	Total of (b) and (c)	Total Reserves
Central Reserve Cities)	6%	7%	5%	12%	18%
Reserve Cities)	5%	6%	4%	10%	15%
Country Cities) & Towns)	4%	5%	3%	8%	12%

SECOND:

It is a recognized fact that cash reserves in the hands of the Federal reserve banks can be used expansively two and one-half times for one, whereas the same reserves in the vaults of the member banks have not that potentiality.

THIRD:

The temper of the American people does not brook delay. After a thing has been widely considered the people want results. The Federal reserve banks, while endeavoring to equip themselves for full operations, find themselves handicapped by the fact that for two and one-half years they must compete actively with the banks in Central reserve and reserve cities, which are permitted to hold reserve deposits of other national banks and at the same time are permitted to pay interest on those deposits. The Federal reserve banks must therefore either expect the member banks to make sacrifices in keeping excess reserves with the Federal reserve banks or must operate only in a limited way until the remaining reserves shall have been paid in.

FOURTH:

One of the principal and very natural reasons for opposition to the introduction of a general clearing plan is the fact that country banks may now collect their city items

through their city correspondents and, while having this service rendered for them free, are given the benefit of counting as reserves the deposits in the hands of city correspondents and besides being given at least two percent interest on their balances.

City correspondents are, in many cases, giving country banks the benefit of immediate credit on items received and deferred debit for items collected. In other words, the city correspondent is in many cases carrying the "float", besides giving the country bank interest on its deposits and at the same time acting as collection agency.

FIFTH:

It must be admitted that the immediate charge against member banks' reserve deposits of items even though endorsed by the depositing member banks, involves some risk to the Federal reserve bank, because the aggregate of items so charged, as experience has already shown, sometimes considerably exceed the reserve deposit of the bank against whom drawn. The risk on this account will, however, greatly diminish when the succeeding installments of reserve deposits have been made. The difficulty is that in the next six months the risk may be considerable. The question therefore arises, how can Federal reserve banks create an insurance fund by securing excess reserves

from member banks in the face of the fact that national banks in Central reserve and reserve cities are able to offer inducements already referred to?

SIXTH:

It is likely that two or three of the Federal reserve banks will, in the next six months, be obliged to rediscount a considerable amount of commercial paper with other Federal reserve banks and will have to pay for this rediscounting privilege four percent or more. Might it not be better for the Federal reserve bank to exhaust the resources of its own District before going outside? In other words, might not the Bank of Atlanta more wisely pay one, or even two percent for balances of member banks in excess of legal reserves than to pay New York, Philadelphia or Chicago four percent?

It may be argued that these reserves will diminish the resources of the member banks, but it may be truly answered that it will not diminish those resources, for the reason that the reserves of member banks in the hands of the Federal reserve bank of the district will be more effective than if they remained in the vaults of the banks of Central reserve and reserve cities.

SEVENTH:

It may be said - and in this the writer concurs - that the practice of paying interest on checking deposits is mischievous. It will be remembered that, in its original form, the Federal Reserve Act contemplated forbidding the payment of interest on active deposits, either by the Federal Reserve Bank or by member banks; but this provision was stricken out of the Act. Why, it may be inquired, should the Federal Reserve Board authorize the Federal Reserve Banks to initiate a practice which it considers vicious, simply because the law does not prohibit it or because it does not deny member banks the privilege? The answer is that the most effective way of stopping a practice of this kind by the member banks is by authorizing the Federal Reserve Banks to do it. When the Federal Reserve Banks have been put in position to meet the competition of the member banks in this practice their bonds have been greatly strengthened, and the chances are that at the end of two or three years the Board can look forward to the likelihood of abolishing or greatly restricting this pernicious practice, although in saying this, it is admitted that the number of state banks remaining outside the system and the influence which they will have on the situation will have a very important bearing on the final outcome.