

CONDENSED SUMMARY OF THE MEMORANDUM OF

CHARLES S. HAMLIN, DATED MAY 1st,

SO FAR AS RELATES TO PROPOSED AMENDMENTS TO SECTION 16,
OF THE FEDERAL RESERVE ACT.

1. It is necessary carefully to distinguish between: -
 - A. The issue of Federal reserve notes by the Federal Reserve Agent to a Federal reserve bank.
 - B. The paying out of such notes by the Federal reserve bank into circulation.
2. The present law requires: -

For A, - the pledge with the Agent of 100% in commercial paper.

For B, - the impounding in the bank vaults of 40% gold reserve.
3. The proposed amendment permits: -

As to A, - the pledge with the Agent of gold as well as commercial paper.

As to B, - the pledge with the Agent of the 40% reserve fund.
4. The proposed amendment also provides that the 40% gold reserve, when pledged with the Agent, shall count as part of the 100% collateral which the Agent must have as security for all outstanding Federal reserve notes, and that it shall be counted, as if it were in the bank vaults, as the gold reserve of 40% required to be impounded in the bank's vaults.
5. The effect of the amendment is: -
 - A. Where the bank has an ample supply of commercial paper.
It permits the same issue of Federal reserve notes as under the present law, but releases commercial paper as collateral by the exact amount of gold deposited with the Agent.
 - B. When the bank can secure only a limited amount of commercial paper.'
It permits the bank to issue a larger amount of Federal reserve notes by the exact amount, dollar for dollar, of gold deposited in lieu of commercial paper.

In both A and B, however, the total notes outstanding can never exceed $2\frac{1}{2}$ times the amount of gold held by the bank, whether deposited, as in A, in the bank vaults, or deposited, as in B, with the Federal Reserve Agent. In both A and B, also, the total notes outstanding can never exceed the amount of collateral, whether commercial paper or gold, pledged with the Agent.

6. Under the present law, if the bank has $2\frac{1}{2}$ times as much commercial paper as it has free gold in its vaults it can take out as many notes as it could under the amended law, and no special benefit would be derived by the amendment, except that it would permit banks to conserve their gold by taking out Federal reserve notes, dollar for dollar, in its place.
7. If, however, the Federal reserve bank can not secure $2\frac{1}{2}$ x as much commercial paper as it has gold, some of its gold can not be utilized in the shape of Federal reserve notes for lack of commercial paper to pledge with the Agent, and the amendment permits the lack of commercial paper to be made up by the pledge of gold in its place, and thus enables all of the gold owned by the bank to be utilized by the issue of Federal reserve notes.
8. The amendment thus permits an additional issue of notes, dollar for dollar, by the amount of gold deposited by the bank with the Agent, but the total issue can never be (a) more than $2\frac{1}{2}$ x the gold held in the bank's vaults (excluding that held as reserve against deposits,) plus the gold pledged with the Agent; (b) more than 100% of the total collateral, paper and gold held by the Agent.
9. Thus the amendment operates to reduce the gold and paper required to be impounded from a minimum of 140% (40% reserve plus 100% commercial paper) under the present law, to a minimum of 100% (40% reserve and 60% commercial paper) under the amendment.

10. The 40% gold reserve, under the present law, when held in the bank's vaults serves as a reserve for $2\frac{1}{2}$ x that amount of notes covered by $2\frac{1}{2}$ x the same amount of commercial paper; when, however, this reserve, when available as a basis for further note issues, is deposited with the Agent, under the amendment, it serves as part collateral, dollar for dollar, for all outstanding Federal reserve notes, and also as the required cash (gold) reserve.
11. The amendment is, in effect, a legal recognition of the fact that the 40% cash (gold) reserve requirement when kept in the bank's vaults is not a trust fund, but merely a cash (gold) requirement; when, however, this cash (gold) reserve is pledged with the Federal Reserve Agent, it becomes a part of his collateral, that is to say, a part of his trust fund.
12. The amendment, therefore, provides that where 40% of the Agent's trust fund consists of cash (gold), that cash (gold) must be held to satisfy the requirement of a 40% cash (gold) reserve.
13. The amendment, while permitting an increase of notes to the extent that gold is permitted to serve as collateral, produces no inflation, for the reason that all notes issued are covered by 100%, either in commercial paper or gold, or both, as a trust fund.
14. As a matter of fact, a contraction necessarily results from the substitution of Federal reserve notes for the outstanding National bank notes, both under the present law and under the amendment, because of the 40% gold reserve required for Federal reserve notes as compared with only a 5% reserve for National Bank notes. If such substitution could immediately take place it would more than absorb the 250 millions of net imports of gold into the United States since January 1, 1914.
15. The amendment is predicated upon two principles; (a) That, if

Federal reserve notes can be safely issued by the Government against the pledge of 100% of commercial paper, it does not impair their safety if they can be issued against 60% commercial paper and 40% gold, or against 100% of gold; (b) That the cash (gold) reserve requirement is satisfied by permitting it to be deposited with the Agent and thus constitute a part of his trust fund.

16. Assuming that the Federal reserve banks must keep a 40% gold reserve, it makes no difference whether it is kept in the bank's vaults or with the Federal Reserve Agent, for, as shown in the memorandum, it is as instantly available to the reserve bank in the latter case as in the former.
17. The real effect of the amendment is, therefore, to prevent unnecessary duplication of collateral whether considered as reserve or as a trust fund, recognizing that, if in the shape of gold, it is as available for reserve as for collateral, or as available for collateral as for reserve. It can never be actually used for both purposes at the same time. Its service is an alternative one, and its use for either purpose discharges it from liability for the other.
18. Concrete results of the amendment as to note issuing power.

A

Present Law

Assume that the bank holds 400 millions of free gold which, for convenience, we will call capital.

Under the present law it can not directly take out Federal reserve notes against this gold unless it has $2\frac{1}{2}$ times this amount in paper.

This is to say, while 400 millions of gold held as reserve in the bank's vaults would sustain an issue of $2\frac{1}{2}$ times 400 millions in notes, i. e., 1000 millions, yet notes to that amount could not be taken out except by the pledge of 1000 millions of paper.

Only, therefore, in the event that it could rediscount 1000 millions of paper for member banks, could it use its 400 millions of gold as a reserve for 1000 millions of Federal reserve notes.

B

Present Law

If the member banks, instead of offering 1000 millions of paper for rediscount, should offer 1000 millions of gold as an excess deposit provided the Reserve banks gave them Federal reserve notes, the Reserve banks could not accept the gold for, although such deposit would give them a total of 1400 millions in gold, not a single Federal reserve note could be taken out from the Agent by depositing it, or any part of it.

C

Amended Law

Under the amendment, however, the banks in A could take out 400 millions in Federal reserve notes by depositing with the Agent 400 millions in gold; and in B they could take out 1400 millions in Federal reserve notes, paying 1000 millions to the member banks, and retaining 400 millions in their cash, thus conserving 1400 millions in all of gold.

D

Let us suppose that in A above, the Reserve banks can not secure $2\frac{1}{2}$ times as much paper as they have in free gold, but can secure, e. g., only 600 millions. In such a case, under the present law the banks could take out only 600 millions of Federal reserve notes directly against the pledge of 600 millions of paper.

This would leave the bank with its 400 millions of gold, of which 240 millions is held as reserve for the 600 millions of Federal

reserve notes already taken out, and 160 millions would remain free in its vaults, not capable of being used for further Federal reserve note issues because of lack of commercial paper to pledge for them.

E

The bank could, however, - under the circuitous process permitted by the present law, - pay this 160 millions of free gold to the Agent, taking down 160 millions of paper, and then by repledging the paper obtain 160 millions of additional notes, making the total outstanding notes 760 millions.

F

The maximum note issuing power, therefore, under the present law, assuming 400 millions of free gold and 600 millions of paper, - is 760 millions.

G

Under the amendment, however, the bank could not only pledge the 160 millions referred to above in E with the Agent, thus receiving 160 millions in notes, but it could also pledge with the Agent the 240 millions of gold held in its vaults as a reserve against the 600 millions of Federal reserve notes secured by pledged commercial paper, and by thus pledging this 240 millions of gold, could take out 240 millions additional of Federal reserve notes.

The total notes which could be taken out under the amended law, is therefore, 1000 millions. The Agent would then hold as collateral 600 millions of paper and 400 millions of gold, - i. e., 100% of all notes issued by him.

The required reserve of 1000 millions of notes is 400 millions, Inasmuch as the Agent holds 400 millions of gold this, under the amendment, satisfies the cash (gold) reserve requirement.

H

In conclusion: -

1. Under the present law, the reserve banks can only utilize their free vault gold as a reserve against $2\frac{1}{2}$ times that amount in notes secured by $2\frac{1}{2}$ times that amount of commercial paper.
2. Any excess of gold in their vaults over what is used as reserves, as in A, supra, must lie idle so far as Federal reserve note issues are concerned.
3. Under the circuitous method permitted under the present law, however, this excess gold can be used, dollar for dollar, for new issues of Federal reserve notes.
4. Under the amendment, the gold used as a reserve under A, supra, can also be used, by pledging it with the Agent as part collateral, thus permitting the issue of additional notes in amount equal to the gold thus pledged, that is, dollar for dollar; Provided, however, that the total notes issued by the Agent can never exceed the amount of the collateral, - whether paper, gold, or both, - pledged.
5. The 40% gold reserve requirement is satisfied provided the collateral held by the Agent consists of gold to the amount of 40% of the total notes outstanding.

5/5/16.