FEDERAL RESERVE BOARD

WASHINGTON

December 3,1920.
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Subject. Letter from Senator R.L. Owen, criticising certain policies of the Federal Reserve System.

Dear Sir:

In order that you may better understand the basis upon which my letter to Senator Owen, copy of which was forwarded to you yesterday, was written, I am enclosing herewith for your files a copy of the Senator's letter to me, dated November 18th, the substance of which appeared in yesterday afternoon's papers.

Very truly yours,

Enclosure.

Governor.

To Chairmen and Governors of all F.R. Banks.

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UNITED STATES SENATE
Washington

COPY

November 18, 1920.

Honorable W.P.G. Harding,
Federal Reserve Board,
Washington, D.C.

My dear Governor:

I wish to again appeal to you and to the Federal Reserve Board to lower the rates of interest charged by the Federal Reserve Banks, and expand the loans of the Federal Reserve Banks to the extent which may be required for purposes of legitimate production and distribution.

American banks are justified in charging six and seven per cent, because they pay two and three per cent for deposits, and they are entitled to make a profit of two and three per cent above their overhead charges on the deposits which they handle as merchants of credit.

Three per cent profit on the total loans of all the banks of the United States, which amounted on June 30th, 1920, to $30,891,693,000.00 would make $926,000,000.00 profit on $5,953,983,000.00 of capital, surplus and undivided profits.

The Federal Reserve Banks earned last year over one hundred per cent and are earning now at a rate in excess of one hundred and fifty per cent per annum on its capital, contrary to a sound public policy. This excess profit is all the more reprehensible because it goes to the Treasury, is made by a Governmental instrumentality and puts the Government in the position of profiteering, and setting a national bad example.

The Federal Reserve Banks under these high interest rates are measurably destabilizing credits and promoting industrial depression under the arbitrary high interest rates which the Reserve Banks are charging.

If the Reserve Banks would be content with the same margin of profit in interest rates which the average bank of the country obtains, it would be charging a rate of between three and four per cent, because the Reserve Banks pay no interest on deposits, and a three or four per cent rate for the Reserve Banks would correspond with the interest a member bank would earn which charged six per cent.

Nevertheless, the Federal Reserve Board is approving a six per cent rate on loans secured by Treasury certificates of indebtedness, and a seven per cent rate on trade acceptances and on agriculture and live stock paper.

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The Federal Reserve Board and the Federal Reserve Banks are setting a standard of interest that justifies the member banks and all other banks in raising the rates on all their loans and discounts, probably an average of three per cent which would amount to an additional tax on the productive and distributive processes of America to the extent of a billion dollars per annum.

Of course, this tax goes into the pockets of the stockholders of the banks, but it is at the expense of the whole country, and contrary to a sound public policy. As a stockholder of the banks, I am benefited. As a consumer, as a producer, as a citizen, I am injured. The country as a whole is injured by the industrial depression far beyond the billion of unearned profits.

I fully agree with the Board in its policy of advising restrictions of loans employed in stock speculations, in commodity speculations, in hoarding and in profiteering. This advice of the Board is wise. It can be only applied advantageously by the individual banks exercising an individual discrimination against loans for such purposes. Such credits when released, however, should be extended to those who are engaged in legitimate production and distribution.

It seems to be the policy of the Board to raise the rates of interest for the purpose of <u>broadly</u> deflating credits. It has been pursuing this policy for a year with the result of this policy of high interest charges being extended generally throughout the country, which has thus brought on a condition of industrial depression resulting in checking, and in some cases absolutely stopping, legitimate production and legitimate distribution. This is the evil of usury.

I heartily approve the checking of speculation, hoarding and profiteering, but I very vigorously disapprove and protest against the breaking down of legitimate production and distribution by this course. It is discrediting the Federal Reserve System, and if you will pardon me for saying so, I believe, it is impairing in the public mind the confidence of the wisdom of the Federal Reserve Board and the Federal Reserve bank management.

The error of the policy of <u>indiscriminate</u> deflation is largely due, in my opinion, to the lack of vision of the big New York City banks. Beginning a year ago, the men who control the policy of the big banks dealing in stock exchange loans, began to put the interest rates up from ten to thirty per cent, instead of requiring such loans to be gradually liquidated on some reasonable basis.

On these high interest charges they probably made $100,000,000.00 of profit. "Incidentally the individual deposits of New York City banks which were November 12, 1919, $6,313,998,000.00 were reduced on November 10, 1920, to $4,916,375,000.00, a net loss of deposits in New York City of about $1,400,000,000.00, and a net reduction of loans amounting to a similar amount.

Is it any wonder that New York City is complaining of the credit situation?

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But while the individual deposits and loans of New York City banks were coming down, the total deposits of all the banks of the country, including bank deposits, increased according to the Comptroller's letter of October 13, 1920, $4,045,164,000.00, and loans increased $5,805,736,000.00 (including overdrafts and discounts) for the fiscal year ending June 30, 1920, so that this disparity of reduced deposits and loans in New York City is all the more conspicuous.

The New York City banks have above all others pursued the policy of indiscriminate deflation, and have deflated their own deposits accordingly. The balance of the country's banks therefore, increased their deposits exclusive of New York about $5,000,000,000.00.

The total resources of the banks of the United States increased $4,045,164,000.00 for the fiscal year ending June 30,1920, reaching the gigantic total of $53,079,108,000.00.

The balance of the country has shown its normal increase in spite of the high rates. New York City under the control of those favoring the policy of deflation shows a great loss in deposits and in loans. The stock market has been broken. The price of Government bonds has been seriously depressed because the American market of stocks and bonds is located in New York City, where this policy of deflation is peculiarly in evidence.

Incidentally, many of the export houses in New York City are going into bankruptcy. Many of the great commodities like leather, wool, silk, rubber, oats, corn, etc., are already down below the cost of production.

The deposits of the nation June 30, 1920, were over forty-one billion dollars, and the deposits of New York City were less than one-eighth of the other banks' deposits of the country, but New York is the financial heart of the country, and powerfully affects the whole nation.

My dear Governor, I am protesting to the Reserve Board against the policy of indiscriminate deflation, and am praying the Board to reconsider its attitude, and to withdraw from supporting the policy of indiscriminate deflation by high interest rates, and by refusal of credits to legitimate industry, which the Reserve banks can well afford to make to whatever extent actually required by the country.

I have been distressed by the propaganda being carried on to impress the country with the idea that the Federal Reserve Banks were in a condition of instability.

A day or two since, Mr. M. L. Requa, 120 Broadway, sent me a letter inclosing a Roger Babson circular, stating that many of Babson's clients have asked --

> "Why the Federal Reserve Banks should be alarmed over a ratio of forty per cent when England is getting along on a ratio of about fifteen per cent."

This circular then stated in large black face type --

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"The truth is that the United States reserves are quite as low as those of England. The seeming difference is only the methods by which they are calculated."

In the first place the Federal Reserve Banks are not alarmed, and have not the slightest reason in the world to be alarmed.

It is true that the Bank of England is getting along very well with a ratio of currency against deposits of less than fifteen per cent (ten per cent August 4, 1920,), and nobody in England is at all alarmed about the Bank of England, and have no need to be. The British Government is behind the Bank of England in fact, if not in law.

But the statement that the United States reserves are quite as low as those of England is entirely and utterly untrue.

The statement of the Bank of England which Babson quotes shows 136,000,000,000 pounds of deposits with little over 13,000,000 pounds of Bank of England notes (now irredeemable), and less than 2,000,000 pounds in gold. The cash reserves, therefore, of the Banking Department of the Bank of England against its deposits was only a little over ten per cent, but there was no reason why the depositors should have any fear whatever, and they had none.

But against the deposits of the Federal Reserve Banks are reserves of 35 per cent in gold (over $600,000,000) and over 65 per cent first class securities, when as a matter of fact, the deposits in the Reserve Banks cannot be withdrawn under the statute, and no reserve of any kind is really necessary for the mere purpose of protecting such fixed deposits.

Reserves Against Note Issues.

The currency of Great Britain consists of British treasury one pound notes and ten shilling notes and certificates, ordinarily known as the "Bradbury notes", because issued under John Bradbury's administration.

These notes amount to 352,796,058 pounds sterling, secured by 28,500,000 pounds in gold, (equal to 8 per cent of gold) in the treasury, and 18,750,000 pounds sterling in Bank of England notes (equal to 5.3 per cent), a total cover of 13.3 per cent against these treasury notes which correspond closely with the treasury notes issued by the United States Treasury to the Federal Reserve banks, and called "Federal Reserve notes."

But the Bradbury notes (now irredeemable) have a gold cover only of 13.3 per cent (counting the Bank of England notes as gold), while the Federal Reserve notes amounting on November 12, 1920, to $3,328,985,000.00 had an actual gold cover of $2,180,000,000.00 (equal to 65 per cent), besides an excess of thirty-five per cent of other first class securities behind these Federal Reserve notes amounting to good security of over one hundred per cent.

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The Bradbury notes are good if the British Government is solvent, as everybody believes it is, but the Bradbury notes have only 13 per cent gold cover, while the Federal Reserve notes have 65 per cent of gold cover, and are otherwise secured by sound securities, making a total security exceeding one hundred per cent, and in addition has the full taxing power of the United States behind them.

The Bank of England has outstanding 139,920,000 pounds sterling in Bank of England notes secured by 121,420,010 pounds of gold held in trust by the Issue Department of the Bank of England for the benefit of the noteholders, together with 18,500,000 pounds of Government debt, and other securities so that the Bank of England notes, though not underwritten by the British Government, are secured up to one hundred per cent. However, under the need for the economical use of gold, public opinion and the Government of Great Britain sustains the Bank of England in refusing to redeem its notes in gold just as the Bradbury notes are not redeemed in gold. England is not on a gold basis. Last Saturday gold was selling in London per ounce at 121 shillings and 11 pence (par value 85 shillings per ounce). In other words, gold was at a premium of forty-five per cent in London, while selling at par in New York. This explains why the paper pound sterling in New York is selling on the Exchange around $3.35 per pound.

The currency of the United States is on a gold basis, and the Federal Reserve notes are being daily redeemed in gold by law.

Babson's statement --

> "That the United States reserves are quite as low as those of England. The seeming difference is only in the methods by which they are calculated."

is quite unpardonable coming from a respectable publication.

The Editor was unaware apparently of the existence of the Bradbury notes amounting to $1,750,000,000.00. In the next place, in theory, he takes the trust gold held by the Issue Department of the Bank of England and adds it to the gold in the banking department, and then adds together the outstanding notes of the Bank of England and the deposits of the Bank of England, and establishes a ratio between the sums thus obtained (omitting the Bradbury notes).

There is no justification in law or in morals to thus assume to use the trust gold held by the Issue Department of the Bank of England. This gold is held in trust for the noteholders of the Bank of England, and cannot be used for any other purpose. Nobody in Great Britain ever dreamed of using this trust gold to pay depositors with. It would be unlawful and a felony to do so.

The treasury notes of the British Government issued for currency have behind them thirteen per cent of gold, and are not redeemable in gold.

The Bank of England notes are not redeemable in gold, as a matter of fact.

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The deposits of the Bank of England have a cash reserve running from ten to fourteen per cent in Bank of England notes, including about one per cent of actual gold. The Bank of England can command gold nevertheless, and is not alarmed.

The deposits and acceptances of the twelve joint banks of Great Britain in their last report (these banks do the great commercial business of the British Isles) amounted to 1,955,200,000 pounds, against which they had 300,000,000 pounds in so-called cash, the cash consisting of Bradbury notes secured by thirteen per cent gold, and their deposits with the bank of England secured by a like percentage of Bank of England notes, so that if the actual gold reserves were estimated against their deposits and acceptances it would amount to less than five per cent gold, and this need cause, and does cause, no alarm. These banks are abundantly protected by public opinion and by the support of the British Government behind the Bradbury notes, and behind the Bank of England.

The truth is the English people are using gold very economically, and the United States is using gold very uneconomically.

The Federal Reserve Banks have in gold, including a small amount of legal tender, $2,180,000,000.00. The banks of the United States had in cash in their vaults $626,000,000.00 on June 30th, 1920. There is in the United States treasury over $300,000,000.00 of free gold and silver, and there is outstanding outside of the Federal Reserve Banks and outside of the Treasury $670,000,000.00 in gold and $414,000,000.00 of silver, making a total of over $3,000,000,000.00, or about $30.00 per capita, while the total amount of gold in the British Isles is about $800,000,000.00 or seventeen and a fraction dollars per capita. The world owes the United States $15,000,000,000 and we can command the gold of the world.

The Bank of England acting as the Reserve Agent of all the banks of Great Britain is safeguarding a world wide business, probably equal to that of the United States, with a cash supply on hand of only $75,000,000.00, consisting of the Bank of England notes (irredeemable at this time) and including less than $10,000,000.00 actual gold, while the Federal Reserve Banks serving a similar office for American banks have $2,180,000,000.00 of gold, so that the Reserve Banks have over twenty-five times as much gold as the Banking Department of the Bank of England.

To talk about the Reserve Banks being alarmed under the circumstances is stupid. To state that the reserves of the United States are quite as low as those of England does a serious injustice to the Federal Reserve Banks and Federal Reserve notes, whose reserves are many times stronger than the Reserves of the Banking Department of the Bank of England. If the Federal Reserve notes were issued up to the 13 per cent reserve of the Bradbury notes the $2,100,000,000.00 of gold would sustain Federal Reserve notes equal to $16,155,000,000.00, or an expansion of credit equal to over $12,000,000,000.00.

The Federal Reserve Act contemplated the reserves against the Federal notes going below forty per cent, and made provision for it by a moderate and small penalty. The Federal Reserve Board has refused to allow the reserves to go down when the very purpose of the reserve as contemplated

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by the Act is that it should be used when the national welfare requires it.

I respectfully pray the Board to now give consideration to the question of reducing the rate of interest and of extending the powers of the Federal Reserve Banks to the full accommodation of our legitimate commerce and industry in order that the gigantic strides of America along the road to prosperity may continue unimpaired.

Respectfully yours,

(Signed) ROBERT L. OWEN.

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