

RECOMMENDATIONS OF THE  
FEDERAL ADVISORY COUNCIL  
TO THE  
FEDERAL RESERVE BOARD  
FEBRUARY 22, 1921.

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TOPIC NO. 1. Should the Board exercise the authority given it in Section 16 of the Federal Reserve Act and impose an interest charge against Federal Reserve Banks on the amount of their Federal Reserve notes outstanding, less the amount of gold or gold certificates held by the Federal Reserve Agents as collateral security, and if so, what should the rate of interest be?

Recommendation:

The Council voted unanimously in the negative. The Council is of opinion that the argument of excessive earnings should not impel the Board to exercise its authority to impose an interest charge against Federal Reserve Banks on the amount of Federal Reserve notes outstanding. The Council believes that if an educational campaign is carried on stating that the earnings of the Federal Reserve Banks are used for the purpose of reducing the amount of government bonds outstanding particularly the Liberty Loan and Victory notes, it would dissipate any unwarranted criticism concerning excessive earnings made by Federal Reserve Banks, and that it would not be difficult to convince the people that the earnings of the banks could not be used to any better purpose.

In this connection, and with the same point in view, the Council expressed itself unanimously against the proposition to permit the payment of interest on member banks reserve balances with Federal Reserve Banks. The high profits of the Federal Reserve Banks should not, in the opinion of the Council, lead to the payment of interest on balances which in the best interest of the system should be kept uninvested as far as may be practicable. If interest were paid it would act as a stimulant towards keeping the funds of the Federal Reserve Banks invested and it might

therefore interfere with the proper conception on the part of those in charge of the Federal Reserve Banks, concerning their first duty to keep the Federal Reserve Banks in a condition of maximum strength.

TOPIC NO. 2. Should the Board establish for the year 1921 a tentative limit for each Federal Reserve Bank on the amount which it may rediscount with other Federal Reserve Banks?

Recommendation:

The vote of the Council was unanimously in the negative. The Council's opinion is that no limit should be placed on the amount which one Federal Reserve Bank may rediscount with other Federal Reserve Banks. The Federal Reserve System is one and indivisible and not twelve independent districts. The Council holds the view that the Board should exercise its own discretion and should not limit its own power of action by binding itself to definite rules, which, with conditions varying in the several districts and strongly fluctuating at this time, might fit one condition and one period but might prove embarrassing in others. The Council believes, however, that where Federal Reserve Banks are fairly regular rediscounters with other Federal Reserve Banks their discount rates should not be permitted to be lower than those prevailing with the Federal Reserve Banks granting the rediscounts.

TOPIC NO. 3. Should existing preferential rates on notes secured by Liberty Bonds and Victory notes be continued?

- (a) With respect to customers' paper rediscounted.
- (b) With respect to member banks' 15 day collateral notes?

Recommendation:

The Council is of opinion that for the time being it may be opportune to continue preferential rates on notes secured by Liberty Bonds and Victory notes, both (a) in respect to customers' paper discounted, and

(b) in respect to member banks' 15 day collateral notes, but such preferential rates should be discontinued as soon as it can be done advantageously and without injustice.

TOPIC NO. 4. Section 14 permits any Federal Reserve Bank under rules and regulations to be prescribed by the Federal Reserve Board to purchase and sell in the open market cable transfers and bankers acceptances and bills of exchange of the kinds and maturities by this Act made eligible for rediscount with or without the endorsement of a member bank. Section 13 provides that "any Federal reserve bank may discount acceptances of the kinds hereinafter described, which have a maturity at the time of discount of not more than three months' sight, exclusive of days of grace, and which are indorsed by at least one member bank".

Counsel is of opinion that the words "of the kinds and maturities by this Act made eligible for rediscount", in Section 14, apply only to bills of exchange which therefore cannot be bought where they have a maturity of more than three months, but that they do not apply to bankers acceptances and that consequently the Federal Reserve Board might legally issue regulations permitting the purchase by Federal Reserve Banks of bankers acceptances of six months' maturity. As a matter of sound banking policy does the Council advise the Board to issue such a regulation?

Recommendation:

The Council voted unanimously to advise the Board that in its opinion it should permit Federal Reserve Banks to purchase bankers acceptances drawn for the purpose of financing the importation and exportation of goods having a maturity up to six months. The Council understands that the Board has expressed its preference by ruling to have accepting banks, in cases where the transactions extend over a period in excess of three months, grant acceptance credits in the form of acceptances running as nearly as may be possible over the whole period involved in the liquidation of such transactions not to exceed six months, rather than favoring the granting of acceptance credits extending over ninety days with the privilege of one renewal. This ruling will force the accepting banks to issue their acceptances for periods in excess of three months, and it is most important that these acceptances when offered in foreign markets

or in the United States should find a ready market and should not be penalized by being offered as ineligible bills. It is claimed that the open market might absorb these bills, but the rate for them in that case would be so unfavorable, and moreover the confidence in their ready salability would be so much weakened by the mere fact that the Federal Reserve Banks would not be regular purchasers of this class of paper, that it would seriously impair the ability of American Banks to establish themselves in foreign markets as acceptance bankers able to compete with England. In our opinion it is no more than logical and right for the Board to follow up its ruling with the granting of the power to Federal Reserve Banks to purchase eligible acceptances financing the importation and exportation of goods and having a maturity of from three to six months.

TOPIC NO. 5. Under authority given in Section 13 of the Federal Reserve Act the Board has authorized member banks to accept drafts or bills of exchange having not more than three months sight to run, drawn by banks or bankers in Central American and South American countries for the purpose of furnishing dollar exchange as required by the "usages of trade" in those countries. Within the past few days the Board has authorized member banks to accept drafts in the same manner for banks of bankers in Australia, New Zealand and other Australasian dependencies, having received assurance that there is now a "usage of trade" in these dependencies which requires dollar exchange. Will the "usages of trade" in European countries likely lead to requests for the extension of these privileges to those countries, and if so, what should the policy of the Board be regarding such applications?

Recommendation:

The Council expressed itself unanimously in favor of endorsing the Board's action in authorizing member banks to accept dollar exchange drafts for banks in Australasia in addition to the authority already granted them to accept in like manner for banks in Central and South American countries. With respect to the question asked by the Board whether such power should be extended to banks in European countries the

Council is of opinion that this should not be done. The Council does not favor the granting of this power to countries where there exists a system of a large number of highly developed banks of great financial strength which could easily issue drafts for the purpose of furnishing exchange to an extent which might become embarrassing to the Federal Reserve System, and moreover it would appear impossible in these countries, where stock exchange and financial transactions are highly developed, to provide for safeguards which would prevent the abuse of facilities so offered by financing stock exchange loans and other financial transactions not directly involved in export or import operations; nor does it appear that in the exportations of Europe to the United States there are regular seasonal movements which would warrant the drawing of finance drafts in anticipation of exportations such as exist in the United States with respect to cotton or similar crops. The Council feels that the power to accept for the furnishing of dollar exchange should be restricted to such Colonial countries and dependencies and countries on this hemisphere as, after proper investigation, may seem entitled to the granting of the privilege.

#### ADDITIONAL RECOMMENDATIONS

##### TOPIC No. 6

##### Recommendation:

Resolved that in view of the grave economic conditions abroad and the influence they will exercise upon the future trend of American commerce and trade it is the sense of this Council that it might be advisable for the Federal Reserve Board to appoint a suitable representative to visit European countries for the purpose of making a thorough first hand

investigation and report of the social, economic and financial situation of those countries.

TOPIC NO. 7.

The Council wishes to go on record again that in their opinion the office of the Comptroller of the Currency should be abolished and the duties pertaining to this office should be taken over by the Federal Reserve Board and that the number of appointive members of the Board be increased from five to six.

The Council favors the creation of the office of an Under-Secretary of the Treasury in charge of financial matters who would take the place of the Secretary of the Treasury as an ex-officio member of the Federal Reserve Board, the Governor of the Federal Reserve Board, who would act as its chairman, to be chosen by the Board itself from its appointive members.

Resolved that the Executive Committee, or a subcommittee, not exceeding four, of which the President and Vice President shall be members, to be appointed by the President, communicate these views of the Council to the incoming Secretary of the Treasury and to the chairmen of the proper committees of Congress and that it point out the importance pending the proposed legislation, of appointing a comptroller of the currency who could qualify as a member of the Board in case amendments on lines as proposed should be enacted.

Resolved Further That the executive committee or said subcommittee be hereby authorized and instructed to take such further steps to aid in the attainment of the aims above outlined as it may deem proper.

## TOPIC NO. 8.

With respect to discount rates it was Resolved that the Council does not favor at this time the reduction of any discount rates.

## TOPIC NO. 9.

The Council suggested to the Board the cancellation of the rediscount rate for bankers acceptances. Rediscount rates for bankers acceptances now in force appear inoperative and anomalous in their relation to one another and to the open market rates for bankers acceptances. A rediscount rate for bankers acceptances, if established at all, should logically be higher than the open market rate for such paper.

## TOPIC NO. 10.

The Council urges upon Congress the necessity of the immediate enactment of legislation authorizing the Treasury to pay over to the railroads the sums due them, obviating the delay in those payments which at present seriously hampers the entire banking situation.